

Lancashire County Pension Fund

Pension Fund Committee Responsible Investment Report

15 September 2016
Appendix A

Title of Paper	Quarterly Report on Responsible Investment
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Appendices	Appendix 1: LAPFF Quarter 2 Engagement Report Appendix 2: Q2 2016 Litigation Monitoring Report BR&B

1. Executive Summary

This report provides members of the Pension Fund Committee of Lancashire County Pension Fund (LCPF) with a quarterly update on Responsible Investment (RI) matters.

2. Introduction

The Fund's approach to RI is set out within its Statement of Investment Principles (SIP) which confirms that the objective of RI is to decrease investor risk, improve risk-adjusted returns and assist the Fund's adherence to the UK Stewardship Code.

The Fund's approach to RI encompasses four main areas of activity:

- Voting Globally
- Engagement through Partnerships
- Shareholder Litigation
- Active Investing

Responsibility for the practical implementation of the Fund's approach to RI is devolved to LPP I as LCPF's provider of investment management services. The report which follows provides an update on RI activity in the period from 1st April to 30th June 2016.

3. Voting Globally

LCPF owns shares in listed companies across the globe. The Fund works with an external provider of proxy voting and governance services to ensure effective and consistent use of the voting rights attached to these assets. Pensions and Investment Research Consultants Ltd (PIRC) analyse and apply voting guidelines to the resolutions at every

shareholder meeting the Fund is entitled to attend and oversee the process of vote execution.

PIRC provide quarterly reports which include a summary of votes cast in the period and the outcome of voting (where known). A copy of the most recent report covering the period from 1st April to 30th June 2016 has been placed within the Members Retiring Room for reference.

During the second quarter of 2016 the Fund's interests spanned 233 shareholder meetings (10 AGM, 223 EGM) incorporating 3,360 separate resolutions. This large number reflects that Q2 spans "voting season" in which the majority of companies hold AGMs. The tables below summarise the spread of voting within Q2:

Location	Meetings Voted		Vote Categories	No. of Resolutions	
UK & BRITISH OVERSEAS	12	5%	For	2,029	60%
EUROPE & GLOBAL EU	52	22%	Abstain	126	4%
USA & CANADA	125	54%	Oppose	941	28%
ASIA	13	6%	Non-Voting	92	3%
JAPAN	21	9%	Not Supported	9	0%
AUSTRALIA & NEW ZEALAND	4	2%	Withhold	162	5%
SOUTH AMERICA	3	1%	US Frequency Vote on Pay	1	0%
REST OF THE WORLD	3	1%	TOTAL	3,360	100%
TOTAL	233	100%			

13 meetings (92 resolutions) are reported as non-voting. In each case this reflected that the Fund either held a class of shares giving no voting entitlement or acquired its holding after the applicable record date for the AGM. There were also cases where the sale of a holding shortly before the meeting cut-off date removed the entitlement to participate. There were no cases where the Fund was entitled to vote but did not submit a ballot.

On LCPF's behalf, PIRC apply a voting policy which reflects Corporate Governance best practice and oppose or abstain where resolutions are judged not to be in the long term best interests of shareholders. The Fund supported more than half (60%) of the resolutions tabled in the quarter; opposition voting concentrated upon the following matters:

- CEO and Chairman of the Board responsibilities being combined in a single role;
- the appointment of NEDs known to be fulfilling multiple other directorships;
- Non-Executive Director (NED) nominees lacking independence through their length of tenure or other conflicts of interest;
- executive remuneration arrangements lacking adequate checks on excessive pay levels or performance measures clearly aligned with shareholder interests;
- the re-appointment of auditors where long standing relationships or non-audit fee levels potentially compromise objectivity;

There were comparable Shareholder Resolutions on gender pay equality at 4 company AGMs within Quarter 2. In each case the proponents requested the Company produce a report on their policies and goals to reduce the gender pay gap defined as the difference

between male and female earnings. PIRC reviewed each resolution as an individual case and considered the performance of the company Board on gender pay issues, their formal response to the shareholder resolution and the reasonableness of the deadline given for producing the requested report. Voting on behalf of LCPF was as follows:

Company AGM	PIRC Voting Rationale Shareholder Resolutions on Gender Pay Equality	Vote
CITIGROUP INC	The Proponent's request is reasonable and would support and underpin the Company's efforts in fostering diversity, thereby enhancing its reputation	For
eBAY INC.	The Proponent's request is reasonable as, while the Company does have information on the ratio of male to female workers, it does not include anything about the gender pay ratio at the Company. However, the Proponent specifies that the report should be readily available by September 2016, which is considered too short notice for the Company to properly implement.	Oppose
ALPHABET INC (Google)	The Board has not demonstrated that the existing disclosure addresses the information requested by the Proponent, or that the information requested is not in the best interests of shareholders.	For
FACEBOOK, INC	The Board has demonstrated that the existing disclosure regarding pay parity at the Company and its ongoing efforts in this regard adequately address the concerns identified by the Proponent.	Oppose

Shareholder voting forms part of a wider continuum of active ownership through which LPP I (on behalf of LCPF) seeks to have a positive influence in favour of well-run companies whose business conduct and interests align with generating long term value for shareholders. The Fund recognises the value of engagement activities which raise specific issues of concern and reinforce the lines taken within shareholder voting.

4. Engagement through Partnerships

The Fund's approach to engagement activity reflects recognition that partnerships and collaborations offer greater potential reach and impact than acting alone. LPP I participates in a number of collaborations representing the collective interests of institutional investors which seek to make progress on issues which impact shareholder value. Key groups include the Local Authority Pensions Fund Forum (LAPFF) the Pensions and Lifetime Savings Association (PLSA) the Principles of Responsible Investment (PRI) and the Institutional Investor Group on Climate Change (IIGCC).

LCPF's principal engagement partner in the RI space is LAPFF which exists to represent the specific investment interests of local authority pension funds as asset owners. 70 of the 89 LGPS funds are now LAPFF members.

On a quarterly basis LAPFF provides member funds with a summary of the engagement activities undertaken on their behalf. A copy of LAPFF's Q2 2016 engagement report is attached at Appendix 1. Highlights from the report which covers the period from 1 April to 30 June 2016 include the following:

- Launch of All Party Parliamentary Group (APPG) on Local Authority Pension Funds**
 LAPFF's ambition to support the formation of an APPG as a forum for discussing *"the issues and concerns of local authority pension funds and the work of the Local Authority Pension Fund Forum"* came to fruition with an inaugural meeting on 18th May 2016 which was chaired by Clive Betts MP and attended by a range of interested parties. The meeting discussed the formation and objectives of the APPG and the development of a future programme. Details on the work of the APPG will feature within quarterly LAPFF business meeting papers going forward.
- LAPFF seminar on responsible investment and shareholder rights under pooling (7th June 2016)**
 This event considered the specific stewardship challenges associated with pooling investments and moving to shared ownership models including arrangements for shareholder voting and litigation. The seminar was attended by the Chair of LCPF's Pension Fund Committee.
- Strategic resilience resolutions at Rio Tinto, Glencore and Anglo American**
 Following successful resolutions at Shell and BP, LAPF has supported further strategic resilience resolutions as part of the "Aiming for A" coalition. Resolutions call for a commitment to routine annual reporting on
 - ongoing operational emissions management;
 - asset portfolio resilience;
 - low-carbon energy research and development;
 - strategic key performance indicators;
 - relevant public policy positions.
 The resilience resolutions were strongly supported by shareholders with results reflecting a 99.1% vote in favour at Rio Tinto, 96% at Anglo American and 98% at Glencore.

LCPF has no direct holdings in any of the three companies at which resilience resolutions were filed but gave support (in its capacity as a LAPFF member) to the initiative which aims to increase ongoing focus on financial risks posed by climate change.

The LAPFF Engagement Report at Appendix 1 includes detailed information on engagement activity within the quarter which included attendance at 13 AGMs to raise issues ranging from remuneration to supply chain management. Quantification of engagements across thematic topics shows that climate change and human rights were the most frequently raised issues:

Engagement Topic	Number of Engagements by LAPFF	
Climate change	18	30%
Human rights	10	17%
Employment standards	8	13%
Board composition	6	10%
Environmental risk	5	8%
Remuneration	5	8%
Campaign (general)	2	3%
Governance (general)	2	3%
Incentivising executives	2	3%
Supply chain management	2	3%
	60	100%

As its provider of investment management services, LPP I supports and represents the interests of LCPF as a member of LAPFF by attending Forum business meetings, exercising voting rights, drafting responses and feedback and identifying opportunities for participation.

In the last quarter the Fund has responded to a LAPFF questionnaire on membership requirements and proposed future services. LCPF's response stressed the importance of LAPFF evolving to support the needs of Funds both as individual administering authorities and parties within new pooling arrangements. LAPFF has subsequently contacted member funds to explain new arrangements which enable emergent pools to nominate representatives to attend LAPFF meetings in their own right as observers. LPP has responded explaining that LPP I's RI Officer will continue to routinely represent its clients at LAPFF meetings and will need to retain the ability to participate, respond, and exercise voting rights on their behalf – something which is not envisaged of the new category of pool representatives who will hold observer-only status. The LAPFF Executive will be considering the matter at their next meeting.

LAPFF's most recent quarterly Business Meeting took place on 28th June 2016. Headlines from the meeting include the following matters:

- **All Party Parliamentary Group on Local Authority Pension Funds**

The minutes of the LAPFF Executive meeting on 8 June 2016 confirm that the inaugural meeting of the APPG was well received, with civil servant attendance indicating that it was being taken seriously. Clive Betts MP was appointed chair with an SNP MP appointed as vice chair and a proposal for a Conservative representative as a second vice-chair.

A wide range of interested parties were in attendance including Lord Bob Kerslake and Michael Johnson along with Jeff Houston and representatives from the CBI, Investment Association and PLSA. The LAPFF Executive agreed that it was important to ensure RI issues feature strongly on the APPG agenda.

The APPG website at www.appglocalpensionfunds.org contains limited information at present but lists the 20 MPs who are members and confirms that the main focuses of the Group will be:

- The use of pension fund money for infrastructure, local growth and housing
- The role of pension funds in corporate governance and shareholder activism
- Reforms to the LGPS (new investment guidelines and government plans for pooling of funds)

APPG meetings will take the format of an informal round table and offer an opportunity to place issues in front of MPs from the local perspective.

- **LAPFF Guide to 'Co-filing' Shareholder Resolutions**

A new LAPFF guide has been published which explains in detail the process, requirements and timeframes involved with co-filing shareholder resolutions as an extension of existing voting and engagement activity. The question of how pooling arrangements and shared ownership may impact the ability of funds to co-file shareholder resolutions is under ongoing consideration within the LAPFF work plan.

- **Campaign on Reliable Accounts**

LAPFF has continued to engage with FTSE 350 companies, regulators and accounting standards boards on weaknesses within Financial Reporting Standards

and the guidance on these from the Financial Reporting Council (FRC). The specific matter at issue is the disclosure of distributable and non distributable reserves. LAPFF argue that a lack of adequate disclosure is hampering the ability of investors to judge the underlying financial health of companies and is a failure to comply with the Companies Act 2006 requirement for accounts which provide a true and fair view of the assets, liabilities, financial position and profit or loss as the basis for making lawful distributions including dividends.

5. Shareholder Litigation

Litigation offers a route for recovering financial losses where asset values have been diminished as a result of financial misconduct.

On LCPF's behalf, LPP I maintains an up to date understanding of prospective shareholder litigations in which the Fund potentially has an interest. Monitoring services are provided at no cost by two US law firms - Barrack, Rodos and Bacine (BR&B) and Robbins Geller Rudman and Dowd (RGRD) which ensure prospective actions are known about, the fund's interest (level of loss) is quantified and information is available as a basis for making a decision on the most appropriate course of action given the risks, costs, benefits and deadlines involved in each case.

LPP I monitors developing litigation cases to ensure the Fund is made aware of those where it has sustained losses and is appraised about opt-in, opt-out or independent legal action where this might offer a premium recovery compared with the default approach of participating collectively in class actions.

A summary from BR&B of litigation monitoring during Q2 2016 is provided at Appendix 2. The report confirms a quiet quarter in which the Fund had losses in only 2 of 54 new cases filed with Federal or State Courts in the US. Neither case warranted an active role by institutional investors meaning the Fund's interests will be best represented by monitoring the progress of each case and filing within the claims filing deadline. There were no new non-US cases in which the Fund had interests in the period and no distributions were received in respect of settled cases.

6. Active Investing

LCPF's commitment to active investing involves recognising the wider characteristics of prospective investment opportunities and ensuring both positive social characteristics and negative impacts are assessed and taken into account as part of decision-making. The commitment is fulfilled in practice by LPP I, through the consideration of relevant Environmental, Social and Governance (ESG) factors as part of investment due diligence and through continually seeking insight to enrich and evolve current knowledge on the risks and opportunities emerging from different sectors and scenarios.

As part of its commitment to the integration of ESG into investment decision-making and ongoing ownership activities, LCPF is one of several founding authorities for a new LGPS national procurement framework for Stewardship and ESG Services. The new framework which will shortly come into operation will be a means for LGPS funds to access specialist services that will support the fulfilment of fiduciary duty and help to extend stewardship and RI capabilities. Both individual funds and collective pools are eligible to use the framework to call-off services from successful suppliers.

Participation in the formulation of the new procurement framework has been ongoing for a number of months. The LPP I RI Officer has worked collaboratively with representatives from the other Founding Authorities and with officers from the National

LGPS Framework to decide the service specification and the lots, to design tender documents and participate in supplier days explaining the ethos and ambitions of the framework to prospective bidders. The latest and most detailed stages have encompassed scoring and moderating the supplier submissions received and participating in clarification interviews with suppliers to inform the final evaluation and conclude the tender process.

The insight gained from involvement in this detailed process will contribute to the ongoing development of LPP I's approach to RI and the overview it has provided of services available from the supplier marketplace will be followed up as part of the identification of information sources which may help to facilitate active investing and oversight going forward.

Further efforts within the quarter to fulfil the RI commitments of LCPF under the Stewardship Code and as a signatory to the UN –backed PRI have included:

- **Meeting with the FRC in relation to public assessment of signatory reporting against the UK Stewardship Code**

From Autumn 2016 the FRC is to introduce public assessment of the quality of signatory reporting against the UK Stewardship Code. Signatory statements will be assessed as being Tier 1 (meeting reporting expectations in relation to stewardship activities) or Tier 2 (not meeting reporting expectations). The initiative provides a whole market incentive to improve current standards of stewardship disclosure and applies to both asset owner and asset manager signatories to the Code.

Following an initial indication that LCPF's current statement is likely to be assessed as Tier 2 the LPP I RI Officer has met with the FRC to identify areas for development. Discussion indicated that the focus should be on expanding the level of disclosure on activities being undertaken by the Fund in order to provide more practical insight. A revised statement reflecting the insight gained from the FRC will be drafted for approval by the Fund. The deadline for submitting revised statements to the FRC is Friday 23rd September 2016.

- **Strengthening existing connections with the Pensions and Lifetime Savings Association (PLSA) on stewardship matters**

LPP I's Responsible Investment Officer has become a member of the PLSA Defined Benefit Scheme Stewardship Advisory Group (SAG). The Group comprises 13 representatives from UK asset managers and DB pension schemes on a 50/50 basis and meets quarterly to provide guidance and feedback on the Association's work on corporate governance and stewardship. The LGPS forms a significant sector within the UK DB pensions landscape and the new appointment has increased the LGPS presence on the SAG to 2 members which is welcomed by the PLSA.

- **Stewardship-focussed discussion as part of the LGPS Cross Pool Collaboration Group (CPPG) Responsible Investment Sub-Group**

The establishment of a specific RI Sub Group to the CPCG was detailed within the Committee's previous quarterly report on RI (10th June 2016). The RI Sub Group has met twice in the quarter (13 May 2016, 7th June 2016) with attendance from the LPP I RI Officer. Working collaboratively as RI practitioners, representatives have seized the opportunity to provide collective feedback to the

DCLG on requirements for reflecting stewardship and RI within the revised LGPS Investment Regulations and the guidance which will accompany them. The group will continue to provide a forum for encouraging consistent approaches and providing cross pool support for the practical, procedural and policy-based stewardship challenges that arise out of LGPS pooling.