Local Authority Pension Fund Forum

Shareholder engagement: the LAPFF Approach

Presentation to Notts CC Pensions Committee

Presentation by
Cllr Kieran Quinn, LAPFF chair
Chair GMPF, Leader Tameside MBC

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Shareholder engagement: what it is & why we do it

- Engagement with public companies typically seeks further clarification of or a change in behaviour.
- Shareholders that engage with companies seek to exercise ‘voice’, rather than choosing to ‘exit’.
- In that sense it is the opposite of divestment.
- Engagement involves meeting with companies on issues of interest or concern that may affect value.
- Engagement is more than voting, but voting remains a vitally important element of engagement.

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Shareholder engagement: what it is & why we do it

- The ultimate aim is to ensure companies are well-run and deliver shareholder returns that are sustainable.
- Some investors also seek to encourage companies to adhere to high standards of corporate behaviour.
- Post-crisis there is greater government pressure for shareholders to act as good stewards.
- Public policy has given shareholders more ownership rights, now there is more emphasis on responsibilities.
- Collaborative engagement is seen as an important element of improved stewardship.

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Shareholder engagement: what it is & why we do it

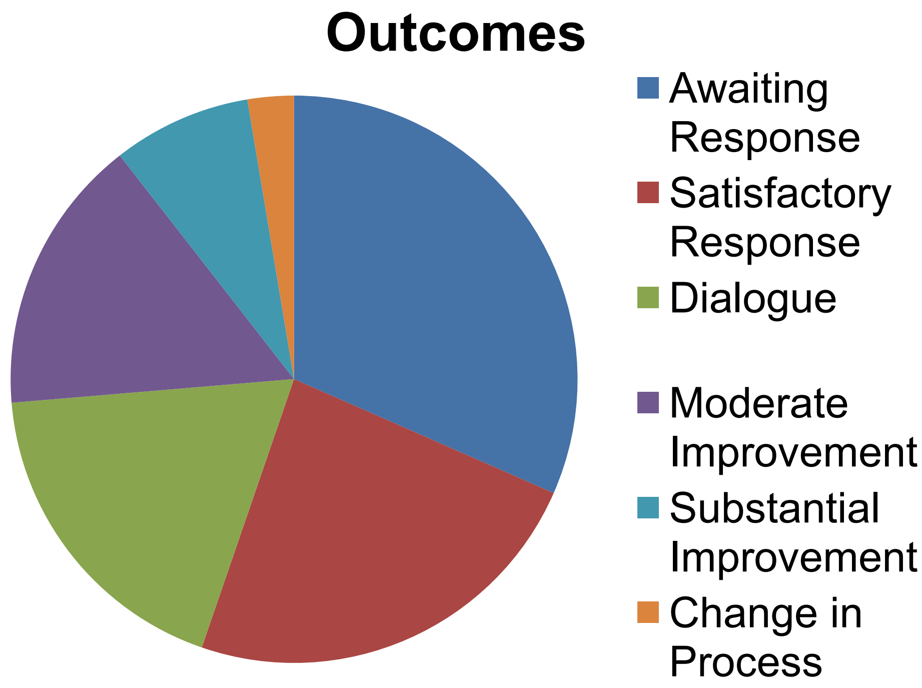
A focus on effective outcomes, c.f. Lord Myners

“*Shareholders cannot micromanage the companies in which they have holdings… but … where they identify problems, they should actively engage with the company to ensure that they are tackled* ”

“*Intervention requires persistence and a thick skin, perhaps raising issues repeatedly over a period of time with firmness until concerns are addressed. Merely meeting senior management and expressing polite reservations about strategy is not sufficient, if it is not effective.*”

Effectiveness of LAPFF engagement

- 70% of meetings are with board directors
- All engagements assessed on outcomes
- Time is a factor…
- … as is persistence



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News Corp/21st Century Fox

- Engaged 2010 over poor governance
- 2011 hacking scandal, further meetings
- Filed resolution for independent chair at News Corp in 2012, 2/3 non-Murdoch shareholders support.
- Co-filed resolution in 2013 for independent chair at 21stC Fox
- 2014 support for two non-family directors at 21stC Fox
- Separation of roles, James appointed CEO at 21st Century Fox in June 2015

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Shareholder engagement: what it is & why we do it

Reforms since the financial crisis:

- Policy reviews: Kay and Walker in the UK, plus Dodd-Frank, EC Green Papers etc
- Stewardship Code for institutional shareholders, and survey on adherence
- Annual election of directors
- Binding vote on remuneration policy
- Shareholder vote on audit committee reports (proposed by Competition Commission)
- Investor Forum – proposed by Kay, but skewed to asset managers

IFRS: LAPFF’s approach ‘Reliable accounts’

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- Attentive to specific problems with company accounts: RBS, HBOS, Coop Bank.
- Focus on auditors and accounting standards: audit problems with Royal Sun Alliance, Tesco, Betfair (defective accounts and KPMG missed illegal dividends) and latterly Wm Morrison Supermarkets (KPMG missed illegal dividends and share buybacks).
- FTSE 100 observable failure rate at around 5-10% of audits.
- Legal review, now two Bompas QC Opinions.
- Active with investor coalition, initiated engagements, with associated Voting alerts.
- Attention on the governance of the FRC.

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Carbon risk: strategic resilience resolutions

Photo Credit: alegriphotos.com

- LAPFF original member of investor group filing carbon risk resolutions
- Large international institutional group
- Uniquely Shell and BP boards advised support and cite constructive engagement
- Pre-declarations from other investors and support for resolutions which received over 98% and 99% of vote.
- Precedent that now nearly every significant institutional investor in the world has voted for disclosure of a low-carbon business strategy

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Board Diversity: FTSE 100 companies

- 30% Club Investor Group, focus on all male boards
- A wide range of perspectives is critical to effective corporate governance.
- After engagement, London Stock Exchange appointed two female directors in early 2014, Antofagasta and Glencore each also appointed a female director in 2014

GLENCORE
xstrata

Labour standards at National Express

- Cllrs Greening and Wilkinson attend the 2014 AGM to speak to a resolution co-filed by LAPFF funds on workplace rights in the US

- In 2015 LAPFF funds file shareholder proposal calling for independent review of labour issues at US school bus subsidiary

- Almost a quarter of independent shareholders fail to back the company; the highest level of support for a shareholder resolution on employee rights

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Shareholder Engagement: Accountability.

Public reporting on engagement:

- Website updates
- Quarterly engagement report
- Member newsletter
- Annual report

Audit practices, Board Composition, Employment standards, finance and accounting, Governance, remuneration, reputational risk, social risk

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LGPS Investment Regulations Reform

- LGPS funds have the power to engage with ESG issues provided activities are reasonable, proportionate and do no long term harm to financial returns or adversely impact on investment risk.
- Engagement on ESG issues can be viewed as part of the essential stewardship of pension funds' role in protecting the long term value of a fund's investment.
- The Regs require funds to state their position on ESG matters in their Statement of Investment Principles, even if they intend taking no action.
- The Law Commission's recent review of fiduciary duty concluded ESG factors could be taken into account.

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LGPS Investment Regulations Reform

- Some ESG issues may be difficult to quantify financially, but may raise reputational issues for funds or matters of public conscience where action may be appropriate, provided there is no adverse financial effect on funds' agreed risk/return objectives required to meet long term returns.
- Many with an interest in a fund want 'their money' managed to avoid or mitigate harm caused by ESG issues on individuals and communities. Some go further and wish to see 'their funds' used proactively to improve ESG outcomes from investments.
- Many funds are cautious in taking a directly active approach to ESG matters which reflects the investment briefs used; advisors used; and limited knowledge and understanding of the issues.

LGPS Investment Regulations Reform

- The approach of attempting to 'do no harm' in managing monies held in trust has also in recent times been challenged to 'ensure good is done' without financial detriment wherever practical.
- It is in the interests of communities and government to facilitate an environment in which pension funds increase their engagement with ESG issues whilst keeping to the key responsibility of not undermining their long term financial interests.
- Pension funds should not now have to opt in to considering ESG issues as presently required by regulation, but be required to address such issues as part of their normal investment processes.

LGPS Investment Regulations Reform

New LGPS Investment Regs could be drafted to:

- Require funds to have a policy concerning ESG issues and publish how this policy is applied to their investment processes.
- Require funds to understand and monitor the ESG impact arising from their investment activity.
- Demonstrate how they have been appropriately advised by relevant ESG expertise.
- Require funds to describe the action they will take to promote responsible ESG activity in their investment interests and how they will use their influence with other investors.

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Questions?

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