

Report



meeting

PENSIONS INVESTMENT SUB COMMITTEE

date

15 December 2006

agenda item number

REPORT OF THE STRATEGIC DIRECTOR OF RESOURCES

VOTING OF US SHAREHOLDINGS

1. Purpose

- 1.1 To present the issues involved in voting US shareholdings and to consider whether the fund should vote its US stocks.

2. Background

- 2.1 At present the fund actively votes its UK and European stocks based on advice from Pensions Investment Research Consultants (PIRC). This is in line with the Statement of Investment Principles which states that 'the fund continues to support a policy of actively voting stock it holds...[and] voting is in line with compliance on current corporate governance codes'. The fund does not currently vote its US stocks.

3. Relevant Issues

- 3.1 One of the principles of the combined code on corporate governance is that institutional shareholders have a responsibility to make considered use of their votes. According to Paul Myners 'voting is the bedrock of governance and should not be approached lightly'. Research suggests that good corporate governance enhances shareholder value.
- 3.2 Shareholder rights in the UK are enshrined in law and the combined code provides overall best practice in terms of corporate governance. The US system is governed by a variety of measures including federal and state laws, common law and stock exchange rules and differs in a number of material ways from the UK system.

- 3.3 The following issues are widely regarded as areas of concern with US corporate governance:
- plurality voting for director elections
 - staggered elections
 - poison pills
 - the status of shareholder resolutions
- 3.4 Election of directors in US companies is largely by plurality voting. Under this system a slate of directors is put to shareholders who can either vote for a director or withhold their votes – they cannot vote against. In most jurisdictions, only the “for” votes are counted, meaning that a director can be elected against the majority of votes. This system only works effectively if shareholders are able to nominate directors in competition to the management nominations but this has become prohibitively expensive.
- 3.5 In some companies not all directors are elected annually. Elections are staggered so that only a number of directors are elected each year. This can have the effect of insulating directors from a shareholder vote.
- 3.6 Poison pills are designed to protect companies from hostile takeovers, usually by issuance or allocation of disproportionate voting rights by the board of directors. These provisions are not generally submitted to shareholders and can have the effect of entrenching management and decreasing stock value.
- 3.7 In general, resolutions submitted by shareholders have advisory status only and are non-binding on the company. This means that even if a shareholder resolution is passed with an overwhelming majority, the company can simply ignore it.
- 3.8 Recent attempts by the Securities and Exchange Commission (SEC) to amend the director nomination and election process were unsuccessful due to conflicts with state laws and opposition from corporations. The State of Delaware, where the overwhelming majority of US publicly traded companies are incorporated, has plurality voting as its default system and has historically been very favourable to companies and their boards.
- 3.9 However, increased shareholder activism does seem to be making headway. A recent study by the Council of Institutional Investors shows a large increase in majority votes leading to concrete action by the company and shareholder litigation, such as in the recent News Corporation case, is being increasingly used to promote corporate governance changes.

4. Estimated Time and Cost

- 4.1 The fund's UK and European stocks are voted in-house. So far in 2006, votes have been submitted for 215 UK and 125 European meetings. Staff time committed to this varies widely according to the proxy voting seasons, but would currently average less than 2 hours per week. The fund currently holds about 390 separate US stocks with an approximate value of nearly £100 million. This would mean at least 390 additional meetings to vote, more than double the current number.
- 4.2 The overseas stocks are voted via an electronic platform (ProxyEdge) provided by Automatic Data Processing (ADP). ADP state that ProxyEdge can be amended to allow voting of US stocks and voting advice is available from the major proxy voting agencies. For 2006, PIRC offered coverage of the S&P 500 stocks for £10,000.

5. Statutory and Policy Implications

- 5.1 This report has been compiled after consideration of implications in respect of finance, equal opportunities, personnel, Crime and Disorder, Human Rights and those using the relevant service. Where such implications are material, they have been described in the text of the report.

6. Recommendations

- 6.1 It is recommended that the sub-committee considers whether the fund should vote its US stocks.

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Background Papers Available for Inspection
None