

QUARTERLY ENGAGEMENT REPORT

APRIL TO JUNE 2017



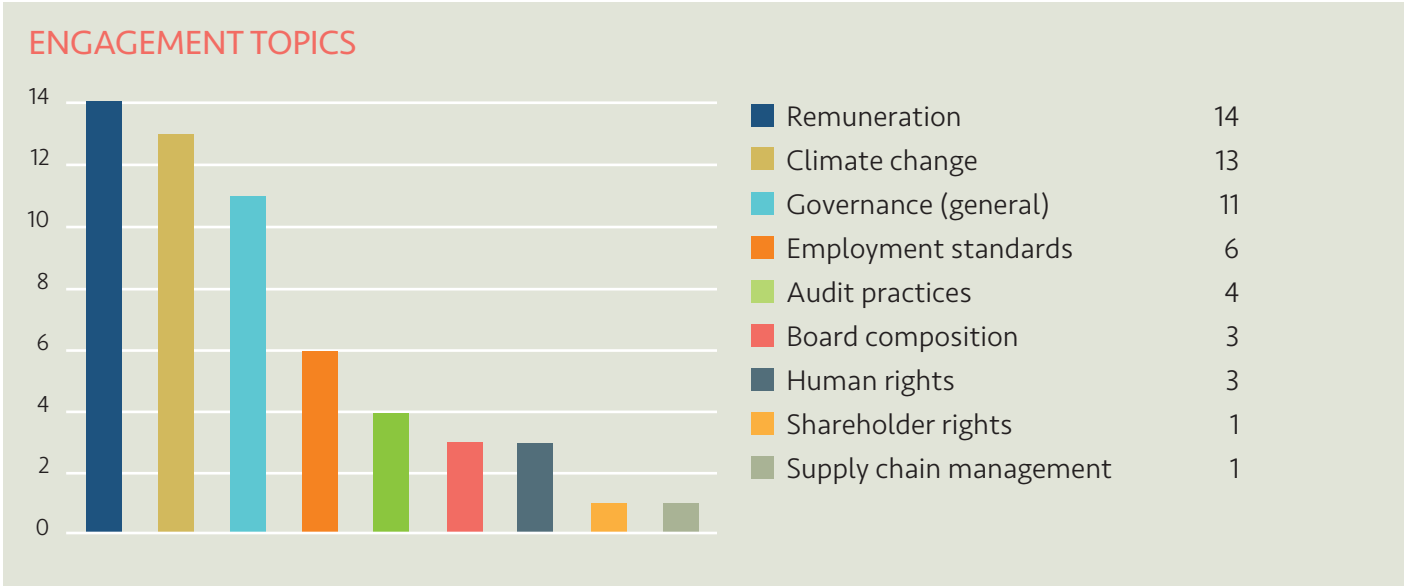
LAPFF targets executive pay during AGM season

US shareholder resolutions on climate change disclosure supported by LAPFF

The Forum engages energy and mining companies on climate change

LAPFF work on reliable accounts continues

Company Engagement



GOVERNANCE RISK

EXECUTIVE PAY

Voting alerts were issued to LAPFF members on binding pay policies at **Carillion, Smith & Nephew, GlaxoSmithKline, BP, Shell, Babcock** and **WPP**. Following the introduction of new regulations in 2014 requiring a binding vote on companies’ pay policies at least every three years, a majority of companies are holding votes on their pay policies at their 2017 AGMs. LAPFF identified the ten companies with the highest oppose votes on their remuneration reports in 2016 that are holding pay policy votes this year and is issuing associated voting recommendations on their pay policy resolutions.

In the case of Carillion, Smith & Nephew, Babcock, WPP and GlaxoSmithKline, LAPFF found that although there had been improvements, their remuneration policies did not align with the Forum’s Expectations on Executive Pay. Concerns included the strong emphasis on variable over fixed pay, the operation of upward discretion over pay awards and policy elements that allow for ‘golden hellos or parachutes’ for recruitment or on executives’ departure. Voting alerts for BP and Shell noted areas of concern, against which were balanced against positive changes in terms of strategic signalling towards an orderly, low-carbon transition, ultimately resulting in advice to vote in favour of the resolutions.

Direct engagement on executive pay, included with the Shell remuneration committee chair, where Toby Simon asked about the alignment of the pay policy with the Company’s strategy, particularly its approach to carbon management. Denise Le Gal also spoke briefly with Smith & Nephew Remuneration Chair, Joseph Papa, prior to the AGM. LAPFF’s primary concern with the Smith & Nephew



remuneration policy was its provision on discretion. The company’s use of discretion caused a shareholder revolt at the 2016 AGM. At the AGM Cllr Le Gal asked whether the Remuneration Committee had considered amending the discretion policy as part of the remuneration policy review. This discussion prompted questions about how the company had engaged investors during the remuneration policy review, and Cllr Le Gal asked about this during a follow up call with Remuneration Committee Chair, Joseph Papa. The company has promised to consult LAPFF on its remuneration policy in future.

The Forum also joined with the Council of Institutional Investors in [writing to the SEC](#) to share concerns about several provisions in the Financial Choice Act 2017. These include making it much more difficult to file shareholder resolutions and instead of the annual ‘say on pay’ vote, shareholders would only get an advisory vote on executive compensation when there is undefined ‘material’ change in CEO pay; as well as limiting clawbacks on unearned executive compensation.

BUSINESS STANDARDS

LAPFF issues voting alert backing Wells Fargo resolution

LAPFF issued a voting alert on **Wells Fargo** recommending funds support a review and report on business standards at the company. The alert follows findings from US regulators that there was an 'extensive and pervasive pattern' of abuses against customers which led the company to pay significant fines. The resolution brought by shareholders called on the company to commission a report on the root causes of the fraudulent activity and steps to improve risk management.

ENVIRONMENTAL AND CARBON RISK

LAPFF recommends backing shareholder resolutions on climate change

LAPFF issued a number of voting alerts recommending members back shareholder resolutions on climate change disclosure at US energy firms: **PPL, Chevron** and **Exxon Mobil**. The alerts follow the signing of the Paris Agreement under which countries agreed to limit the global average temperature rise to below 2 degrees Celsius. The objective of the resolutions have been that companies undertake analysis and produce publically-available reports on the impact that a 2 degree scenario is likely to have on their business and shareholder value. Some resolutions, such as that to Chevron, have also called on energy firms to report on how they can transition to a low carbon economy.

The resolutions are in line with LAPFF's policy position to press companies to use scenarios to provide forward-looking analysis, and that companies should be positioning themselves for a low carbon future by disclosing strategic business transition plans. The resolutions also follow on from LAPFF's focus on the energy sector, not least our report with Carbon Tracker: [Engaging for a low carbon transition: Why a 2°C business model is less risky than 'business-as-usual' for oil companies](#). Similar resolutions last year received the backing of a large number of shareholders. And this year, following the first climate change resolution to be passed at a US oil and gas company (Occidental), the resolutions at Exxon and PPL both received the majority backing of shareholders.

The Forum has also signed a joint [letter](#) with **200 global investors** (representing \$15 trillion AUM) urging the G7 to stand by the Paris Agreement and push ahead with its implementation.

"LAPFF will continue to press companies on aligning their business models with a 2°C scenario."

In addition to the resolutions on disclosure, LAPFF also issued a specific voting alert on the re-election of one of **NRG Energy** directors, Barry Smitherman. Mr Smitherman had made comments stating that climate change was not real and that he was 'battling' against what he described as the climate change 'hoax', positions which not just went against LAPFF's views on climate change but also the company's. In the end, a higher than usual number of votes (7.5%) were to oppose the re-election of Mr Smitherman.



LAPFF response to recommendations of the task force on climate-related financial disclosure

During the quarter, LAPFF had several meetings with companies about their strategies for the low carbon transition.

As part of collaborative engagement with the IIGCC corporate programme, a meeting with senior management at **BP**, explored the implications of scenario planning for a faster transition and how this related to the three core businesses of upstream, downstream and alternatives. LAPFF was also represented at a meeting with the chairman, Carl-Henric Svanberg, and committee chairs, where useful discussions were held over a number of topics including cybersecurity, board diversity, succession planning and remuneration as well as the low-carbon transition and climate related elements of remuneration policies.

At the BP AGM, remuneration remained a focus following the defeat of the 2016 remuneration report vote. Ian Greenwood thanked the board for responding to shareholder concern over the perceived disconnect between pay and performance, welcomed the changes that had been made, particularly the use of discretion and the clearer strategic link to rewarding progress towards a low carbon transition. He then pushed for more information on how the board would ensure an appropriate pace for its low carbon transition. Mr Svanberg answered in part by indicating that the 20% allocation for strategic targets could be raised to 30% but cautioned against the use of targets which can have unintended consequences.

At the **Rio Tinto** AGM, Rodney Barton of the LAPFF executive welcomed the company's disclosure in response to the strategic resilience resolution, indicating that the three climate change scenarios were a very positive start, and that the commitment to cover more on the use of scenarios and the business's resilience in a 2 degree scenario in future reporting was valued. He further noted that more detail could be provided on the potential impact for Rio Tinto under this scenario, with both qualitative and quantitative descriptions of the likely financial implications. These would include those for capital allocation and Research and Development, in line with the latest Financial Stability Board's Taskforce guidance.

Two meetings were held with Jean-Sébastien Jacques, the new **Rio Tinto** CEO, before and after the AGM. At these a number of areas were explored including the company's experience of internal carbon pricing, the impact of the Taskforce on Financial disclosure and progress on scenario planning.

As well as meeting with **Shell** to discuss the company's remuneration policy, LAPFF attended the Shell SRI Day. Shell is facing a number of other significant sustainability challenges, including corruption litigation and a shareholder resolution calling for targets and reporting on Scope 3 emissions. Like a number of major multinationals, Shell has adopted a 'shared value' approach as part of its strategy to deal better with sustainability challenges. The basic concept of this approach is that businesses should be able to profit from being good corporate citizens in the societies and communities in which they operate.

For the second year running, LAPFF attended the **Total** AGM in Paris. Cllr Le Gal, a fluent French speaker, represented LAPFF by thanking Total Chair and CEO, Patrick Pouyanné, for his positive response to the question posed last year by Cllr Toby Simon. This question revolved around whether Total would be willing to report its oil and gas resources in resource-neutral gigajoules in order to compare better the value of these reserves with the value of renewables for the company. Cllr Le Gal also asked how oil and gas companies could contribute to a meaningful carbon price. Total has offered LAPFF a follow up meeting to explore these issues in more detail.

50/50 Climate Change partnership announced

During the period, [the Forum announced](#) that it is partnering with the 50/50 Climate Project. The new partnership will enhance the Forum's actions to promote climate competent boards and enhance collective investor action advocating better climate strategies and decision-making at board level.

LAPFF successfully runs climate change investment framework seminar

Following member request, the Forum ran a seminar designed to help guide members' approach to the current and future investment risks and opportunities of climate change. Opened by Cllr John Clancy, Leader Birmingham City Council, speakers included representatives of LGPS

funds from around the country sharing their experiences, such as Mark Mansley from the Environment Agency Pension Fund and Cllr Richard Greening from LB Islington Pension Fund. There were also a number of external contributors including David Blood of Generation Investment Management; Nico Aspinall of the Institute of Actuaries and Tessa Tennant of NDCi.global.



From left to right: Cllr Paul Doughty (Merseyside PF), Jane Firth (South Yorkshire PF) and Cllr Richard Stogdon (East Sussex PF)

RELIABLE ACCOUNTS

LAPFF has long held that the Financial Reporting Council (FRC) has been setting accounting standards that are not aligned with the law, in particular the requirement to reflect the solvency of a company. A Freedom of Information Act request (FOI) revealed that the Government has not confirmed that LAPFF's position (based on the opinion of George Bompas QC) is wrong, nor that the FRC position (based on the opinion of Martin Moore QC) is right. That is contrary to what the FRC had said publicly, including to Parliament. Further to that LAPFF is pleased to have a letter from the relevant Minister, Margot James MP, which is consistent with what the FOI showed.

As a result LAPFF has written to the Senior Partners of the six largest accounting firms and the Chairs of their public interest committees to set the record straight. That letter includes copies of historical (2005) correspondence from the FRC that confirms that the law is what LAPFF has said it is, but that letter went on to say that the FRC was not following the law as it regarded the law as outmoded. Furthermore, LAPFF also identified extant guidance for auditors which is also setting out the law the way that LAPFF and Mr Bompas has, meaning that the FRC has itself issued self-conflicting guidance on the same issue.

LAPFF made a submission to BEIS, as a response to the consultation on the Green Paper on Corporate Governance. That response makes the recommendation that the problems with the FRC run so deep that the FRC is disbanded and that a proper competent authority is set up to replace it.

HOLDINGS-BASED ENGAGEMENT

Reliable accounts, cyber risk and Brexit discussed with BT

LAPFF executive member, Ian Greenwood met with BT Chairman, Sir Michael Rake, for the second time in a year to discuss a range of issues, including Sir Michael's views on Brexit and the British economy, BT's recent accounting scandal and cybersecurity. In respect of the accounting scandal, this has led to losses even greater than the company thought likely. As a result BT CEO, Gavin Patterson, and Finance Director, Simon Lowth, have already voluntarily forfeited their bonuses, and it remains to be seen if there are any further repercussions. Cybersecurity will continue to be a topic for discussion with BT and similar companies because of their fundamental role in the exchange of information in the British economy, the impact of this information exchange on security, and the speed with which this issue is becoming prominent on investors' agendas.



Cyber risk being addressed at Tesco

At the **Tesco** AGM, LAPFF asked the chairman, in light of the cyberattack on Tesco Bank last year, whether the board had the right competences to mitigate future attacks and whether it would benefit from having the chief technology officer on the board. The chairman stated that non-executive directors had received training on cyber risk and that the chief technology officer reported directly to the CEO. However, he thought that the chief technology officer's time was best spent addressing potential risks rather than being a board member and overseeing the overall management of the company.

Human capital and the Aberdeen AM and Standard Life merger

Ian Greenwood met with the Chairmen of **Aberdeen Asset Management**, Simon Troughton, and **Standard Life**, Sir Gerry Grimstone, on the same day to discuss the imminent merger of the two companies. The meetings both focused on the extent to which each company had considered the human capital and cultural integration of the two Scottish firms. While both companies have some similar

characteristics there were also some areas in which the cultural and human capital fit was less clear which will need to be addressed after the merger. The merger is expected to be officially completed in mid-August with the new company being listed shortly thereafter. Mr Troughton offered to stay in touch with LAPFF on this issue, and on ESG issues more generally.

Earnings, climate change and Brexit raised at meeting with EasyJet

LAPFF executive committee member, Cllr Doug McMurdo met with Charles Gurassa, the senior independent director of **easyJet** following on from his attendance at the company's AGM earlier in the year. Having originally engaged with the company in 2014 on its approach to executive pay, the meeting with Mr Gurassa as chair of the remuneration committee provided useful insights into how the company was preparing to adjust to the UK leaving the European Union. The discussions also included a detailed update on easyJet's approach to executive pay, including long-term incentive plans and the board's use of upside discretion this year. Additionally, Mr Gurassa spoke about easyJet's approach to reducing carbon emissions and its employment terms for pilots, following a well-publicised industrial dispute.

Improvements at Vodafone over audit practices

Ian Greenwood discussed a wide range of topics with **Vodafone** Chair, Gerard Kleisterlee, a couple of weeks after having met Mr Kleisterlee in his capacity as Remuneration Chair at Shell. Cybersecurity was first on the agenda in recognition of the significant interest of the LAPFF membership on this issue. The discussion proved timely as it took place just a couple of weeks before the NHS hacking. Executive pay, mergers and acquisitions, tax planning and board composition were also discussed, as well as the position of Senior Independent Director, Philip Yea. A couple of years ago, Ian Greenwood had pointed out to Mr Kleisterlee that Mr Yea's prior affiliation with Vodafone's auditor, PwC, might be perceived badly and had suggested that Mr Yea should be neither Chair of the Audit Committee nor Senior Independent Director.

SOCIAL RISK

DIVERSITY

LAPFF discusses board diversity and human rights with Carillion

LAPFF attended the **Carillion** AGM to ask about board composition. At the meeting Michael Marshall of West Midlands Pension Fund asked whether Carillion would be able to commit to appointing a director with experience in environmental matters and human rights in the supply chain to replace Ceri Powell, the departing Carillion board member who had the most experience with these issues. Mr Marshall also asked if the board could commit to producing a human rights impact assessment.

National Express AGM: a quiet affair

For the last few years, when LAPFF has attended the **National Express** AGM there has been a large contingent present from various unions concerned about the labour practices at National Express's US subsidiary, Durham School Services. However, this year only one union representative attended and he did not speak at the AGM. This might be because National Express was due to meet the US union, the Teamsters, in late May. With luck, these discussions have set the ground work for progress in what has been, so far, an intransigent situation.

Lack of gender diversity on the FTSE 350 board

LAPFF issued a voting alert on gender diversity on the board at **EnQuest**. LAPFF is a member of the 30% Club Investor Group, which encourages companies to adopt voluntary measures to increase board diversity, which can reduce the potential for groupthink. Whilst EnQuest have stated their commitment to diversity it has an all-male board, which is not representative of industry norms in the oil and gas sector or their own workforce. Given this and the lack of a plan to make the board more representative of the oil and gas industry or their workforce, the Forum recommended that member funds oppose the re-election of the chair of the nomination committee.

MEDIA COVERAGE

Executive Pay

[Executive pay is the governance target for LAPFF](#) – Room 151, 19 April 2017

[Advisory firms urge BP shareholders to back revised pay scheme](#) – Reuters, 4 May 2017

[Southern Challenged Over Executive Pay Amid Power Plant Delays](#) – Bloomberg, 25 April 2017

[Pension Funds, Foundation Criticize Southern Co. Executive Compensation](#) – Fox Business, 15 May 2017

[Sir Martin Sorrell pay packet greeted with muted response](#) – Financial Times, 7 June 2017

[More than a fifth of WPP investors reject Sorrell's £48m pay package](#) – The Guardian, 7 June 2017

[Sorrell's pay rejected by a fifth of WPP investors](#) – Research Live, 8 June 2017

Accounting Standards

[Accounting roundup: FRC sets out 2017 watchlist for shareholders](#) – IPE, 28 April 2017

[Coalition of City investors including Legal and General, Columbia Threadneedle and Hermes in bid to shake up financial reporting regime](#) – CityAm, 29 May 2017

[Asset managers call for financial reporting changes](#) – Fund Strategy, 30 May 2017



50/50 Climate Change Project Partnership

[Local authority pension funds 'ratcheting up' climate change engagement](#) – LocalGov, 6 June 2017

[LAPFF teams up with 50/50 Climate Project on carbon](#) – portfolio institutional, 5 June 2017

[US withdrawal from Paris accord no threat to ESG investing](#) – Pensions Expert, 6 June 2017

[LAPFF enters new partnership to improve engagement on climate risk](#) – Local Government Executive, 6 June 2017

[UK public sector funds eye 'new era' for climate risk engagement](#) – IPE, 6 June 2017

[Pension fund group to increase pressure over climate risks](#) – Board Agenda, 6 June 2017

[LGPS funds prepare to increase pressure over climate change risk](#) – Room 151, 8 June 2017

NETWORKS AND EVENTS

The following comprises some of the events and meetings attended by LAPFF representatives during the quarter:

The Smith School Stranded Assets Forum - Asset Level Data Initiative. This initiative is working to make accurate, comparable, comprehensive asset-level data on environmental related risk, tied to ownership information publicly available across key sectors and geographies.

The Transition Pathway Initiative's launch of research into the 20 largest electricity utility companies by market capitalisation, which analyses how companies' future carbon performance would compare to the international targets and national pledges made as part of the Paris Agreement.

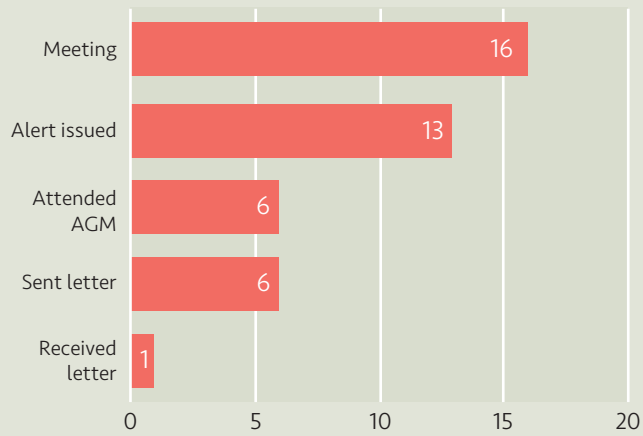
COMPANY PROGRESS REPORT

28 companies engaged over the quarter

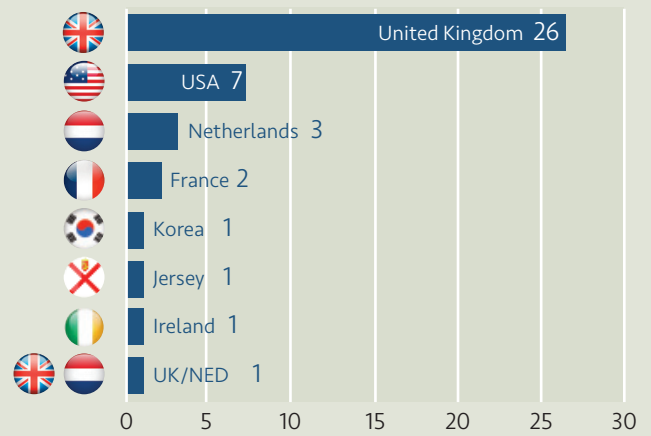
Q2 2017 ENGAGEMENT DATA				
	Company	Topics	Activity	Outcome
1	Aberdeen Asset Management Plc	Governance (General)/ Employment Standards	Meeting	Change in Process
2	Babcock International Group Plc	Remuneration	Alert Issued	Dialogue
3	BP Plc	Remuneration/Climate Change	AGM/Alert Issued/ Meeting	Moderate Improvement
4	BT Group Plc	Audit Practices/ Governance (General)	Meeting	No Improvement/ Change in Process
5	Carillion Plc	Board Composition/ Supply Chain Management/ Remuneration	Attended AGM/ Alert Issued	Dialogue
6	Chevron Corp	Climate Change	Alert Issued	Dialogue
7	EasyJet Plc	Remuneration/ Employment Standards	Meeting	Dialogue
8	EnQuest Plc	Board Composition	Alert Issued	Dialogue
9	ExxonMobil Corp	Climate Change	Alert Issued	Substantial Improvement
10	GlaxoSmithKline Plc	Remuneration	Alert Issued	Dialogue
11	Glencore	Board Composition/ Climate Change	Attended AGM	Small improvement/ Dialogue
12	Hanwha Corp	Human Rights	Sent Letter	Awaiting Response
13	Lonmin Plc	Employment Standards	Sent Letter	Dialogue
14	Motorola Solutions Inc.	Human Rights	Sent letter	Dialogue
15	National Express Group Plc	Employment Standards	Attended AGM	Dialogue
16	NRG Energy Inc	Climate Change	Alert Issued	Dialogue
17	PPL Corporation	Climate Change	Alert Issued	Substantial Improvement
18	Rio Tinto Group (GBP)	Climate Change	Meeting	Moderate Improvement
19	Royal Dutch Shell Plc	Climate change/ Remuneration	Meeting/Alert Issued/ Attended UK AGM	
20	Shire Plc	Governance (General)	Meeting	Small Improvement
21	Smith & Nephew Plc	Remuneration/ Governance	Meeting	Small Improvement/ Moderate Improvement
22	Standard Life Plc	Governance (General)/ Employment Standards	Meeting	Change in Process
23	Tesco	Governance (General)	Attended AGM	Dialogue
24	Total	Climate Change	Attended AGM	Dialogue
25	Twenty-First Century Fox Inc	Employment Standards	Sent Letter	Dialogue
26	Vodafone Group Plc	Governance (General)/ Remuneration/Audit Practice	Meeting	Moderate Improvement/ Dialogue/Substantial Improvement
27	Wells Fargo & Company	Governance (General)	Alert Issued	Dialogue
28	WPP	Remuneration	Alert Issued	Dialogue

COMPANY ENGAGEMENT ACTIVITIES

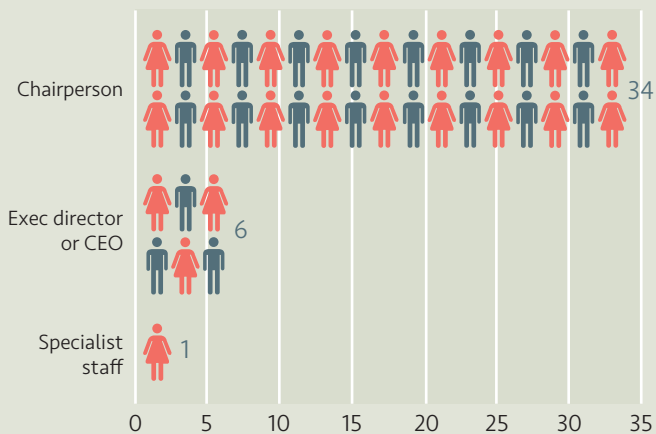
Company engagement activities



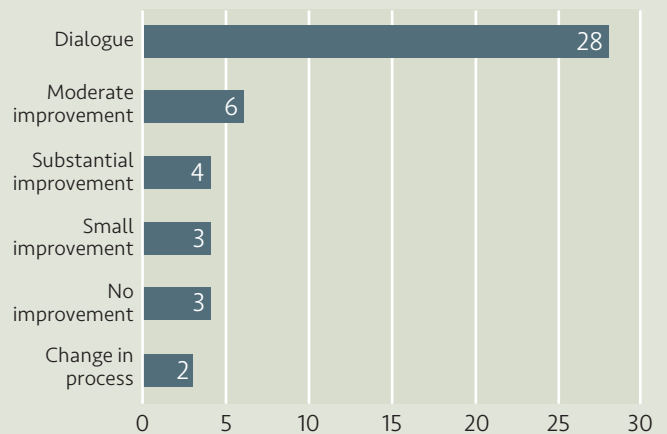
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Position engaged



Outcomes



LOCAL AUTHORITY PENSION FUND FORUM MEMBERS

- Avon Pension Fund
- Barking and Dagenham LB
- Bedfordshire Pension Fund
- Cambridgeshire Pension Fund
- Camden LB
- Cardiff and Vale of Glamorgan Pension Fund
- Cheshire Pension Fund
- City of London Corporation
- Clwyd Pension Fund
- Croydon LB
- Cumbria Pension Scheme
- Derbyshire CC
- Devon CC
- Dorset County Pension Fund
- Dyfed Pension Fund
- Ealing LB
- East Riding of Yorkshire Council
- East Sussex Pension Fund
- Enfield LB
- Falkirk Council
- Gloucestershire Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Greenwich Pension Fund RB
- Gwynedd Pension Fund
- Hackney LB
- Haringey LB
- Harrow LB
- Hertfordshire County Council Pension Fund
- Hounslow LB
- Islington LB
- Lambeth LB
- Lancashire County Pension Fund
- Lewisham LB
- Lincolnshire CC
- London Pension Fund Authority
- Lothian Pension Fund
- Merseyside Pension Fund
- Newham LB
- Norfolk Pension Fund
- North East Scotland Pension Fund
- North Yorkshire CC Pension Fund
- Northamptonshire CC
- Northumberland CC
- Nottinghamshire CC
- Powys County Council Pension Fund
- Redbridge LB
- Rhondda Cynon Taf
- Shropshire Council
- Somerset CC
- Sheffield City Region Combined Authority
- South Yorkshire Pensions Authority
- Southwark LB
- Staffordshire Pension Fund
- Strathclyde Pension Fund
- Suffolk County Council Pension Fund
- Surrey CC
- Sutton LB
- Teesside Pension Fund
- The City and County of Swansea Pension Fund
- The Environment Agency Pension Fund
- Tower Hamlets LB
- Tyne and Wear Pension Fund
- Waltham Forest LB
- Wandsworth LB
- Warwickshire Pension Fund
- West Midlands ITA Pension Fund
- West Midlands Pension Fund
- West Yorkshire Pension Fund
- Wiltshire CC
- Worcestershire CC