Avon Pension Fund

Responsible Investment Report: Policy and Activities 2014/15

Introduction

The Fund recognises that transparency and disclosure of its Responsible Investing Policy and activities is an important element of being a responsible investor.

The annual Responsible Investment report summarises the activities undertaken during the year by the Fund to meet and support its Responsible Investing policy. For the purposes of this report, Responsible Investment (RI) and Environmental, Social and Governance (ESG) are used interchangeably and have the same meaning.

The report comprises the following sections:

Section 1 and 3 of the report reaffirms the Fund's own Responsible Investment policy and the Fund's compliance with the Financial Reporting Council's Stewardship Code. The main focus of the report is Section 2 which details the RI activity of the Fund, the Fund's involvement with LAPFF (Local Authority Pension Fund Forum) and the activity of the Fund’s investment managers. Manifest Information Services Ltd have undertaken analysis of shareholder voting at the Avon Pension Fund and their report seeks to put Avon’s fund manager voting behaviour into a comparative and wider context, this report is included at the Appendix.

Executive Summary

As a responsible investor, the Fund sought to manage Responsible Investment risks through the following activity during the year:

- Embedded Environmental, Social and Governance and Responsible Investment criteria into the evaluation of the tenders for the Diversified Growth Fund mandate.
- Promoted Responsible Investment / Environmental, Social and Governance by:
    - Following through with issues identified throughout the year by the Fund's Committee and Investment Panel.
    - Holding managers to account and querying Responsible Investment / Environmental, Social and Governance factors in their investment process where appropriate.
    - Reviewing whether engagement activity of managers was in line with their stated policies.
    - Publicly supported the shareholder resolutions for greater disclosure on carbon management strategies at BP and Shell.
- The Fund continued its participation in the Local Authority Pension Fund Forum (LAPFF) recognising that their collaboration and engagement activities are important tools to manage Responsible Investment (RI) risks. Officers and committee members attended four business meetings during the year.
- The trends in voting by investors undertaken by Manifest suggests that there is a gradual improvement in governance standards. In 2014 governance concerns were lower than for previous years, although in the emerging and Far Eastern markets the standards are lower. The introduction of the vote on Remuneration Policy in the UK has had a significant impact on this year's analysis. Many investors are waiting to see this influences corporate behaviour over the next few years. As a result, all but the most controversial policy proposals received respectable levels of support. By contrast, where opposition was expressed by shareholders, it was often at a very high level, suggesting a more targeted approach on the part of investors.

Section 1 - Responsible Investment Policy

This policy was agreed by the Avon Pension Fund's Committee in June 2012. The Avon Pension Fund's (Fund's) Responsible Investment (RI) Policy is based on beliefs that express the Fund's duties as a responsible investor. These beliefs are:

- Responsible Investment issues can have a material impact on investment risk and return in the long run and therefore should be considered within the strategic investment policy
- Because Responsible Investment issues can impact underlying investments, investment managers should demonstrate a risk based approach to responsible investing issues within their investment decision-making process and where they engage with companies
- The Fund has a responsibility to carry out its stewardship duties effectively by using its influence as a long term investor to encourage responsible investment behaviour

The policy sets out how the Fund will implement these beliefs within its strategic and operational decision- making processes. It recognises that the Fund's strategic policy will develop over time and allows flexibility to manage RI issues within an evolving strategy. The policy also sets out how the Fund will monitor and disclose its activities in respect to RI issues.

Policy

- The Fund seeks to integrate a Responsible Investment approach across the entire investments portfolio, recognising the differing characteristics of asset classes. This is evidenced by evaluating the following as part of the strategic investment review process:
  - The impact of RI issues on each asset class and the materiality of RI risks within each asset class or approach to investing
  - Whether an allocation of capital to specific environmental, social and governance (ESG) opportunities would generate value.
  - Whether RI/sustainability benchmarks for investments or alternative non-traditional financial analysis could provide a more informed understanding of the RI risks within the Fund
- The Fund believes that an inclusive approach whereby it can utilise all the tools at its disposal to manage rather than avoid RI risks can often be optimal. It recognises that approaches that exclude or positively select investments could be appropriate for particular mandates.
- The Fund requires its active investment managers to provide a statement setting out the extent to which they take social, environmental and governance considerations into account in their investment processes. These statements form part of the Statement of Investment Principles (SIP).
- When appointing external investment managers, the Fund:

    - Includes in tenders an assessment of managers' process for evaluating responsible investment risks within their investment process and make use of this as an integral part of the selection process when relevant.
    - Considers whether appointing managers with specialist ESG research capability is appropriate for meeting the investment objective of the mandate.
    - Includes the adoption of UNPRI principles in the criteria for evaluating managers and, all other things being equal, it will prefer UNPRI signatories.
- The Fund actively monitors the decisions of its investment managers' regarding RI issues that have a material impact on the value of the Fund's assets.
- The Fund adopts the FRC Stewardship Code and seeks to comply with its principles for best practice when discharging its stewardship role.
- The Fund normally delegates voting and engagement to its investment managers and will monitor how investment managers vote in comparison to relevant Codes of Practice. Managers are required to vote at all company meetings where possible.
- The Fund recognises that collaboration with other investors is a powerful tool to influence corporate behaviour. The Fund takes an active role in the Local Authority Pension Fund Forum (LAPFF) to effectively exercise its influence through collaborative initiatives.
- The Fund supports the principles underlying the United Nations Principles for Responsible Investing (UNPRI). The Fund's Responsible Investment Policy seeks to improve compliance with these principles.
- The Fund encourages its external investment managers to become UNPRI signatories.
- The Fund recognises that transparency and disclosure of its Responsible Investing Policy and activities is an important element of being a responsible investor. Therefore the policy forms part of the Statement of Investment Principles and a Responsible Investing report will be published annually from 2013. This annual report will include the RI Policy, the Fund's compliance with the FRC Stewardship Code and UNPRI Principles and the voting report.
- This Policy should be reviewed as part of strategic reviews of the investment objectives and management of risk or as required in response to changing regulations or broader governance issues.

Section 2 - Responsible Investing Activity in 2014/15

The activity of the Fund is described across 4 main areas as follows:

- At the strategic level and how incorporate assessment of RI risks in strategic decisions
- Investment manager activity
- Voting analysis
- Engagement and collaboration

2.1 Investment Strategy and Change to Investment Mandates

In March 2013 the Fund adopted a new Investment Strategy. While there were no changes to the strategic allocation during the year the Fund did appoint a new Diversified Growth Fund (DGF) manager and Infrastructure manager. The Fund will also be appointing a new Fund of Hedge Fund (FoHF) manager next year. Within the existing 10% allocation to DGFs the Fund reallocated c.6.5% to Standard Life in February 2015. In addition the Fund is in the process of implementing the revised Hedge Fund Strategy which will be completed in 2015 and covered within next year's report.

The following tables summarises the Fund's evaluation of RI characteristics for the new Diversified Growth Fund Manager:

Asset Class	Can ESG Risks be Managed?	Notes
Diversified Growth Funds (DGF)	Limited	There is less scope to reflect the Fund's ESG policy through a DGF investment compared to equity mandates. DGF managers hold a variety of assets across different asset classes, so the extent to which ESG risks can be managed will be dependent on the types of assets held.
Infrastructure	Partially	An investment in infrastructure can support environmental and social projects, although whether a sufficient return is achievable for risks taken on needs to be carefully considered. The risks of disposal of assets that are no longer useful must be carefully considered, as must any environmental impact of building work, both of which could have financial implications for any investment.

In the DGF tender respondents were required to demonstrate how they incorporate ESG issues and risks into their investment decision making process which was evaluated as part of the assessment of each tender response. This enabled the Fund to understand each manager's approach to ESG risk, how it would be managed and the level of risks the Fund would be exposed to.

Although the scope for reflecting the Fund's ESG policy within the DGF search was limited, the tender questionnaire assessed the corporate approach to incorporating ESG into their investment process of each manager as follows:

- Do they have a team responsible for corporate governance and responsible investing?
- Is the organisation a signatory to UNPRI?
- To what extent are the principles of UNPRI reflected in the product offered?

2.2 Investment Managers Activity and Ongoing Monitoring

The Fund seeks to monitor, understand and where appropriate challenge investment managers' activity to gain assurance that policies and practices are being followed and to ensure they take ESG risks into account. In addition the Fund also seeks to influence investment managers where appropriate.

The Fund's investment managers provided a statement on how they take ESG factors into account in their investment decision making processes. These can be found in appendices to the SIP.

2.2.1 Investment Panel Monitoring Activity

The Panel's main focus for the year was the implementation of the new investment structure but they also met with 7 investment managers and raised the following specific RI issues.

- Schroder Equity (Global Equity mandate) – discussed the importance they place on 3 overarching global themes that informed their stock selection decisions which are climate change, demographics and super cycle.
- Jupiter (UK Equity mandate – which operates a Socially Responsible Investing approach). The Fund queried the change in the Environmental & Sustainability Strategy Team for which Jupiter responded to confirm the change had the following aims:
    - To enhance the central source of information and expertise for the benefit of the wider fund management team.
    - Designed to improve investor outcomes through knowledge and research capabilities.
    - Increased ease in sharing knowledge and insight.
    - Analysts will report to Head of Strategy.
    - The Governance research team to work in partnership with fund managers and assist them in researching, co-ordinating and conducting dialogue with companies.

  Jupiter also presented to the Panel on significant sustainability developments such as stranded assets, pharmaceutical marketing and food safety & provenance.

- TT (UK Equity mandate) – they presented their ESG framework as part of the investment process.

2.2.2 Manager Updates

Investment managers provided updates on their RI policy and activity which provides an overview of where they focused and engaged throughout the year. The key points are as follows:

- 7 of our Investment Managers were ranked within the 2015 Share Action survey. Jupiter were ranked particularly highly (3rd). The survey is an independent assessment of the managers RI performance in the UK and seeks to identify whether these firms are behaving as responsible investors and addressing ESG issues with companies.
- All of the Fund's Investment Managers are now signatories to the Principles for Responsible Investment (PRI) with the exception of the Fund's Hedge Fund managers and TT International.
- BlackRock, Genesis, Jupiter, Partners, Royal London, Schroder, SSgA, Standard Life and Unigestion all submitted a 2014/15 RI Transparency Report to the PRI.
- BlackRock, Invesco, Jupiter, Royal London, Schroder, Standard Life and Unigestion all submitted to the NAPF stewardship disclosure framework.
- BlackRock, Invesco, Jupiter, Pyrford, Royal London, Schroder, SSgA, TT and Unigestion all responded to the Department for Communities and Local Government (DCLG) consultation on 'LGPS: Opportunities for collaboration, cost savings and efficiencies'. In addition Genesis, Gottex, Record, Signet and Stenham provided feedback to the Fund with their remarks on the consultation. In summary the consultation set out evidence for reforms to the LGPS and opportunities to deliver savings, it requested respondents views on the proposals set out and how if adopted they could be implemented.

In addition manager specific updates as follows:

<u>Blackrock:</u>

- Updated their Global corporate governance and engagement principles in June 2014 in which they placed a particular focus on board directors as they are crucial to company performance and company governance. BlackRock are supportive of boards in their oversight efforts but do also vote against and abstain as a signal that they are concerned that directors or management have not acted in best interests of shareholders or responded sufficiently to shareholder concerns.
- They engaged with external bodies such as the Dutch Authority for the Financial Markets (AFM) regarding the Shareholder Rights Directive and its implications for investors. They also provided recommendations to the European Commission regarding their proposal for a revised Shareholder Rights Directive. The proposed revisions seek to improve corporate governance shortcomings and make it easier for shareholders to use their existing rights over companies and improve engagement.

- The FRC published a consultation paper on proposed changes to the UK Corporate Governance Code to take into consideration recent discussions on changes to remuneration reporting, risk management & going concern, audit committees & audit tendering and the location of corporate governance disclosures. BlackRock provided a response to the proposed revisions on remuneration reporting and corporate governance reporting.
- Updated proxy voting guidelines ahead of 2015 voting season as part of the regular annual review of guidelines. In addition the team also published a new document regarding the Corporate Governance & Responsible Investment team's approach to global executive remuneration.
- They wrote to all Italian issuers where they held an investment to lay out their concerns with the multiple voting rights legislation and to invite them to engage on the topic. They also contacted French companies on the same topic and wrote a document discussing the debate on differential voting rights (see section 2.3.2 LAPFF activity for additional comments).

<u>Invesco Perpetual:</u>

- Invesco participated in regular ESG surveys such as with the Sustainable Business Institute (SBI).
- Invesco Perpetual's engagement is carried out by EIRIS whom have increased their engagement service and now offers more in-depth engagement strategies in the areas of Bribery, Human Rights and Supply Chain Labour Standards.

<u>Jupiter:</u>

- Created the role of Head of Governance which underlines their approach to engagement and emphasises the close cooperation of stewardship and investment activities.
- Jupiter's Vice-Chairman; Edward Bonham Carter joined the Board of the Investor Forum which was formed in 2014 with the objective of making the case for long-term investment approaches, and creating an effective model for collective engagement with UK companies.
- Responded to the FRC UK Corporate Governance Code consultation, updated their Corporate Governance Policy and published their approach to the UK Stewardship Code. In addition Jupiter continued to obtain independent assurance on their stewardship code statement.

<u>Pyrford:</u>

- Pyrford became a UNPRI signatory in June 2014 through its parent company BMO Global Asset Management.
- Pyrford commissioned Sustainalytics to provide specialist ESG research to them.

<u>Royal London:</u>

- Royal London published its 2015 Responsible Investment policy and produced quarterly responsible investment bulletins.
- Participated in the 2015 Share action survey.
- Royal London responded to the FRC's Corporate Governance Code consultation.

Schroders:

- Schroder increased the resources of the ESG team and updated their ESG policy during the year.
- They participated in the UK Sustainable Investment and Finance Associations latest Analyst Committee meeting, which Schroders is now chairing. The Committee seeks to identify research and tools to add value to responsible investment analysts in the UK.
- Produced various thematic reports which Schroder believe play an important part in integrating ESG into the investment process. Such reports covered the banking sector, the environmental impact of green shipping and corporate tax avoidance.

SSgA:

- Updated their proxy voting policy which now also includes a conflicts policy.
- Participated in UNPRI, Share Action and Tower Watson ESG surveys.
- Identified their 2015 RI priorities as; targeting underperforming companies, focusing on the global pharmaceutical & fast-moving consumer goods sectors, a thematic focus on board refreshment & diversity, cybersecurity risk, climate change and proxy access in the US.

2.2.3 Trends identified by our investment managers and recent market developments

This section identifies what areas our investment managers noted during the year and their awareness of the RI/ESG risks or benefits of these trends and developments.

Best Practice:

- The Financial Reporting Council published best practice guidance in respect of the preparation of the strategic report. Although not mandatory it aims to promote clear and concise corporate reporting and encourages companies to focus on ensuring clarity of communication and disclosures that are material.
- The Financial Reporting Council updated their UK Corporate Governance Code in September 2014 following a consultation period.

Remuneration:

- The EU introduced a number of regulatory changes covering executive pay. Banks within the EU are now required to ask their shareholders to set the remuneration ratio between fixed and variable pay for risk-takers (ie; those identified whose professional activities have a material impact on the companies risk profile) to a maximum of 1-to-2.
- This year was the first in which a number of UK issuers have had to submit two remuneration-related proposals; the first being an advisory vote on the remuneration report and secondly a binding vote on future policy. This was highlighted in last year’s report.

Voting Rights:

- One manager noted a potentially concerning trend across European markets where countries are introducing or re-enforcing the existing rules on multiple voting rights (see Italian example in LAPFF activity section 2.4.2).

Board Diversity:

- The European Parliament adopted the Directive on the disclosure of non-financial and diversity information which requires large companies to provide information on their policies and practices on the diversity of their boards of directors.
- The 30% Club which has the aim of achieving a 30% female board representation by the end of 2015 launched in the UK in 2010.This year it announced its official launch in the United States and seeks to improve the representation of women across all levels of US organisations; with a short-term goal of increasing female representation in senior leadership.
- Female board directors at FTSE 100 companies represented 23.5% of all directors; up from 12.5% in 2010.
- All FTSE 100 companies now have female representation on the board

Audit Reform:

- The EU audit reform came into force in 2014. The new rules require audit reports to be more detailed and informative as well as requiring companies to retender for their auditor every 10 years and change their auditor at least every 20 years.

2.3 Voting Analysis

The Fund seeks to analyse the proxy voting activity of the Fund's investment managers to understand how managers are utilising their voting rights in conjunction with their engagement activity.

Analysis of the proxy voting activity carried out by investment managers on the Fund's behalf was undertaken by Manifest Information Services. The objective of the analysis is to provide greater understanding of:

- Voting activity undertaken on behalf of the Fund
- Wide voting issues
- Governance standards at companies
- How the Fund's investment managers use voting rights

Voting strategy should be seen as an important part of the wider investment process, by using voting rights both positively and negatively to mitigate risk in the equity portfolio.

Manifest's report is included in the Appendix. The key points from the 2014 report were as follows:

- It is the 4th annual report from Manifest (3rd year where a full year of data was available for analysis).
- Overall the Fund's managers voted in line with management marginally more than general shareholders, opposing management on 3.56% of resolutions.

- Investment managers opposed management on fewer occasions than compared to 2013 which may imply a general improvement in governance standards or increased ongoing engagement practices.
- Of the 21,880 resolutions analysed in 2014; 7,609 were resolutions where the Voting Template (best practice) highlighted potential governance concerns and where fund managers supported management. This may seem like a relatively high proportion but it should be noted that not all concerns merit a vote against management, especially where managers use engagement to voice concerns and bring about change.
- The proportion of resolutions where management was opposed without the identification of governance concerns (approximately 20% of all instances where management was opposed, compared to 10% in 2013) would suggest that investment managers are increasingly not afraid to apply their own judgement on these issues.
- The extent to which voting disagrees with management (a measure of how 'active' a voting policy is) varies depending on the managers approach and the governance characteristics of the companies in the portfolio. For example, Jupiter incorporate ESG factors into their selection criteria resulting in a relatively high governance standard amongst companies in their portfolio and therefore it should be expected that there is less reason to vote against management.
- Board balance and remuneration issues remain the most frequent concerns identified. This is in part due to the substantial number of board resolutions voted upon such as numerous director elections.
    - Committee independence related concerns were again prominent issues; although there are signs that companies in general are addressing these concerns, for example improvements in board diversity such as greater female representation on company boards.
- Remuneration related resolutions remain the most contentious resolutions proposed by management in 2014 and continue to have the lowest level of alignment with governance best practice analysis.
    - The specific concern over the absence of arrangements for the claw-back of bonuses was a key theme in 2012 and has again come back to prominence in 2014.
- Some regulatory developments in 2014 give a potential hint as to what issues may be of significance next year. These include votes on remuneration policy, gender diversity and shareholder voting rights where there is a majority owner.

2.3.1 Voting Alerts

The Fund uses LAPFF's voting alerts to help focus manager voting on issues at widely held companies. The below table provides a summary showing the 12 companies for which LAPFF issued a voting alert during the year; the table is split across 10 issue categories. Note that some companies appear across multiple categories.

Election of Chair / CEO / Directors	Approve / receive annual report / accounts	Approve remuneration report / compensation / LTIP	Greenhouse gas emissions	Eliminate dual share class structure
Barclays = ×	Trinity Mirror = ×	Barclays = ×	Exxon Mobil (SH) = ✓	News Corporation (SH) = ✓
Glencore = ×	Travis Perkins = =	Afren = =		
Betfair = ×	Betfair = ×	WPP = ×		
News Corporation = ×		Sports Direct = ×		
Twenty-First Century Fox = ×		Betfair = ×		
Twenty-First Century Fox * = ✓		News Corporation = ×		

Human capital strategy	Auditor appointment	Approve dividend	Approve share repurchases	Reduce share capital
National Express (SH) = ✓	Betfair = ×	Betfair = =	Betfair = ×	Betfair = =

Colour and symbol denotes LAPFF voting recommendation

Oppose = ×

Abstain = =

For = ✓

SH denotes Shareholder resolution

* Supportive of 2 directors for independent oversight

The Fund circulates these alerts to managers and seeks explanations from managers on how they voted on the specific resolutions.

The below table shows as an example votes cast from 4 of the Fund's equity managers:

	Resolution	LAPFF	Management Recommendation	Manager 1	Manager 2	Manager 3	Manager 4
Barclays	Approve remuneration report	OPPOSE = ×	FOR = ✓	FOR = ✓	OPPOSE = ×	OPPOSE = ×	
National Express	To develop robust and transparent oversight of human capital strategy *(shareholder proposal)*	FOR = ✓	OPPOSE = ×	OPPOSE = ×	OPPOSE = ×		
Glencore Xstrata	Re-elect Anthony Hayward, Chair and Chair of Nomination Committee	OPPOSE = ×	FOR = ✓	FOR = ✓		FOR = ✓	
ExxonMobil	Adopt quantitative greenhouse gas reduction goals *(shareholder proposal)*	FOR = ✓	OPPOSE = ×	OPPOSE = ×			FOR = ✓
WPP	Approve remuneration policy	OPPOSE = ×	FOR = ✓	FOR = ✓		OPPOSE = ×	
Sports Direct	Approve 2015 bonus share scheme	OPPOSE = ×	FOR = ✓	FOR = ✓		FOR = ✓	

Colour and symbol denotes LAPFF voting recommendation

Oppose = ×

For = ✓

The individual manager comments explaining their voting decision provides some insight into the issues they take into consideration and how managers use their voting rights.

<u>Barclays:</u>

- Manager 1 outsourced voting on this issuer to an independent fiduciary as per their conflicts management policy.
- Manager 2 commented that despite numerous engagements with Barclays to date they still consider that further progress needs to be evidenced to align

group-wide compensation with shareholder interests. They highlighted the increase in net incentive pools and compensation ratio for the year is out of line with short term performance.

- Manager 3 believed that a greater proportion of the metrics used in the remuneration calculations should be the share price of Barclays. Highlighting the need for more metrics to be added to the calculation and some of the existing ones are not stringent enough.

<u>National Express (shareholder resolution):</u>

- Manager 1 thought there was insufficient justification/rationale for the resolution to be approved with a number of unanswered questions. They also felt that the explanation of the implementation process was weak.
- Manager 2 commented that the split of responsibilities between the board and the safety & environmental committee is in line with general UK practice. They highlighted insufficient publicly available evidence to suggest that the company's current policies and practices have systematically hindered the company's business prospects. This Manager met with both the filers of the resolution and the company before voting and informed the company that they expect the board to outline its strategy to resolve these matters.

<u>Glencore Xstrata:</u>

- Manager 1 highlighted that the company had heavily engaged with investors about candidates for the chair appointment of the nomination committee. The manager thought that Tony Hayward's skills and experience was the most directly relevant to the company and the industry. Given the health & safety issues faced by the company they felt having a chair that has a strong focus on this aspect of the company's operations was also highly relevant.
- Manager 3 commented that while supporting efforts for board diversification that voting against this resolution was not in the best interests. The company stated that they were actively searching for a female non-executive director, this subsequently resulted in the appointment of Patrice Merrin. The Manager stated that they will continue to monitor the situation.

<u>ExxonMobil (shareholder resolution):</u>

- Manager 1 noted that in the company's corporate citizenship report that the company provides quantitative Greenhouse Gas (GHG) emission metrics and the company also has an energy efficiency improvement target. The company is committed to utilising its technical and management capabilities to meet growing global demand for energy efficiency and pursuing technical solutions to address GHG emissions and the risks of climate change. They therefore did not think that setting an arbitrary target on GHG emissions would be in the best interests of shareholders at this time and the decision should be left to management and the board. The company already has a number of initiatives and policies in place for their efforts to reduce GHG emissions.
- In contrast Manager 4 supported this shareholder resolution as creating and disclosing metrics and goals for GHG reduction would allow shareholders to better assess the company's related performance and management of these emissions.

WPP:

- Manager 1 highlighted that their focus is on the link between pay and performance. The company has performed very well and returns to shareholders over the recent years have been very good. However some aspects of poor disclosure were identified as an issue for further engagement with the company.
- However Manager 3 believed the remuneration for Martin Sorrell was excessive despite strong company performance and therefore voted against.

SportsDirect:

- Manager 1 highlighted that they have had a number of consultations with the company on Mike Ashley's pay. The original proposal was not supported by this Manager and under pressure from investors, the company decided not to go ahead with the proposed share award. The 2nd proposal was refined to reflect shareholders concerns and this Manager voted in favour. Mike Ashley later decided not to take the payment even after the 2nd proposal was approved by shareholders.
- Manager 3 debated this resolution at length and subsequently decided that if the EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) figures were achieved it would benefit shareholders. In the end Mike Ashley pulled out the scheme.

2.3.2 Overall Voting

The Fund's overall voting across all investment managers can be seen within the below table.

Fund	Resolutions Voted	Avon Managers Supported Management	General Shareholders Supported Management	Template For Management
BlackRock	10,550	98.6%	97.1%	69.0%
State Street	4,140	94.7%	96.4%	64.6%
Invesco	3,314	91.7%	94.7%	42.6%
Jupiter	1,234	98.2%	96.9%	69.2%
TT International	1,194	99.6%	96.4%	65.4%
Schroder	706	92.5%	95.1%	41.5%
Pyrford	457	95.2%	95.9%	72.2%
Genesis	285	86.3%	96.0%	49.8%
Total	**21,880**	**96.4%**	**96.4%**	**62.9%**

The above table highlights the following:

- In terms of overall patterns of voting behaviour, Avon's Fund managers voted with management a high proportion of the time (96.44%), marginally ahead of General Shareholders (96.36%). Both Avon's Fund managers and General Shareholders supported management less so in 2013 at 94.83% and 95.03% respectively.
- As expected the 'Template For Management' (as a proxy for compliance with corporate governance best practice expectations) identified potential governance issues on a far higher proportion of resolutions than the fund managers chose to oppose. The companies in the Pyrford, Jupiter, State Street, and TT portfolios display a comparatively higher level of compliance with governance best practice.
- Jupiter's high support for management (higher than the average of Avon's managers) and relatively high 'Template For Management' data suggests as would be expected Jupiter's practice of accommodating a company's governance characteristics in their investment decision-making as a Socially Responsible Investment mandate. Jupiter's mandate has the effect of ensuring that the companies in which they are invested tend to have higher standards of governance to begin with. In addition, the degree to which it is possible to positively engage with portfolio companies in the UK market lends Jupiter to being in a position to continue to support management even where technical concerns may appear to persist.
- State Street, Schroders, Genesis and Invesco's support for management is all notably lower than general shareholder support. As overseas equity managers it could be an indicator that the use of voting rights is likely to play a more significant part of the engagement process with companies than for the other fund managers and the opportunities for engaging directly with companies are fewer.

2.3.3 Voting Themes and Conclusion

The Manifest voting analysis also identifies some common themes:

- Although the volume (in absolute terms) of the most common governance concerns that Manifest identified is heavily affected by the sheer number of director election resolutions compared to other types of resolution, readers should not dismiss the significance of board related considerations.
- The election of directors, and the governance structures which they constitute on the board, is the lifeblood of accountability between boards and owners.
    - 6 of the top 8 concerns identified (indeed, 11 of the top 17) relate to director independence and the effect that has on the functioning of the board and its committees. This is identical to the pattern of 2013.
- The second most common group of issues identified relate to remuneration.
- The introduction of the vote on Remuneration Policy in the UK has had a large effect on this year's analysis. With a lot of investors adopting a "wait and see" approach with regard to policy proposals (preferring to see how the Regulations bed in over 3-5 years), all but the most controversial policy proposals received

respectable levels of support. By contrast, where opposition was expressed by shareholders, it was often at a very high level, suggesting a more targeted approach on the part of investors.

- Both director elections and remuneration concerns remain as prevalent today as they did 5 years ago.

The following conclusions and outlook can be drawn from the Manifest analysis:

- By and large corporate governance risk-related issues change over the long term, rather than due to short term pressures.
- We expect to see overall trends improving gradually, but this is mitigated by the fact that some companies may 'lapse' and new companies may enter the market carrying with them the legacy of private ownership governance practices which also may fall short of the standards expected of publicly listed companies.
- What is more important is to understand how the fund's managers respond and react to identified concerns, and fund manager vote monitoring plays a central role in understanding this.
- The three year trend both in identification of concerns and support for management proposals by fund managers suggests that gradual improvement is underway.
- The report shows evidence that governance concerns at portfolio companies during 2014 were at a lower level than in previous years, although in the emerging and Far East markets there is still clearly more cause for concern on certain issues, especially relating to control.
- It is anticipated that incentive performance measures, proxy access, the role and rights of shareholders and the theme of "one-share, one-vote" may prove to be prominent themes in commentary in 2015.
- In the context of the new Remuneration Policy votes in the UK, Manifest correctly anticipated in last year's report that claw back may once again be a prominent theme for 2014, now that remuneration policy has an explicit vote of its own. Going forward it is anticipated that companies may start to set out how they intend to engage with investors in the event of significant dissent on remuneration issues.

2.4 Engagement and Collaboration

Engagement and collaboration activity is undertaken by the Fund's external investment managers (described in section 2.2) on the Fund's behalf and directly by the Fund through its membership of LAPFF.

2.4.1 Investment Manager Engagement

The extent to which managers undertake engagement with companies depends largely upon their investment approach. The Panel and Officers focus on gaining assurance that managers are undertaking engagement activity in line with their policy and test this at meetings through specific questioning on voting and engagement.

TT and Genesis do not have specific RI engagement programmes but as active investors who put a lot of value in quality of management, they are meeting management continually and where RI issues are impacting performance these are raised with management as part of the investment process.

The Fund encourages managers to actively participate in industry collaborative bodies where appropriate.

Manager activity is described in greater detail in section 2.2.2.

2.4.2 LAPFF Engagement Activity

The Fund continues to be an active participant in LAPFF which promotes the investment interests of local authority pension funds, and seeks to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Committee members and Officers attended all four LAPFF business meetings in 2014/15. LAPFF activity and achievements are reported quarterly to Committee via LAPFF's quarterly engagement report. LAPFF groups its engagement activities within the following categories and highlights this year are discussed below.

<u>Leadership on key campaigns:</u>

- Board Diversity (LAPFF continues to engage with companies on this issue):
    - Glencore was the sole FTSE 100 Company with an all-male board. LAPFF had written to the company and engaged with a board member at an investor meeting but progress seemed to stall and LAPFF issued a voting alert. ***Outcome:*** First female board director appointed in June 2014.
    - Voting alert also issued to Travis Perkins who only has 1 female board member and does not disclose any targets for further appointments.
- Cluster Munitions:
    - LAPFF contacted a total of 9 companies in the aerospace and defence sectors to clarify their awareness and adherence to the Oslo convention.
- Other:
    - Met with the Chair of Trinity Mirror to discuss media standards and ethics. LAPFF remained sufficiently concerned over the potential extent of claims in relation to phone hacking and issued a voting alert.
    - LAPFF co-signed an international investor statement in a letter sent to the Italian Government to express concerns about their proposal that double voting rights should be granted to shareholders who have owned their shares for over 2 years. Although the measure was intended to prevent short-termism it raised concerns that certain shareholders would receive preferential treatment over the expense of others as has been seen in France already. ***Outcome:*** The Italian Government later decided not to extend a legal provision allowing listed companies to grant double voting rights.

<u>Promoting good governance:</u>

- Reliable Accounts:
    - Met with the new Chief Executive of RSA Insurance Group over concerns about accounting irregularities and reliable accounts linked to a rights issue; also discussed the change of company auditors.
    - LAPFF issued a voting alert in response to Betfair stating in its annual report that it paid illegal dividends and share buyback distributions in 2011, 2012 and 2013. LAPFF recommended abstaining on the resolution to approve further dividend payments for the year as it was still unclear whether accounting problems rectified.
    - LAPFF sent a letter to the Financial Reporting Council regarding Afren and expressed concerns about the failure to disclose certain transactions in their accounts in 2012 and 2013. LAPFF were concerned that Afren's practices did not comply with the Listing Rules or part of the Companies Act 2006 and the implications of these defects. LAPFF asked the FRC to address this issue.
- Executive Pay (LAPFF has taken an increasingly public approach to tackling the complexity of pay and high pay):
    - LAPFF issued a voting alert for Barclays due to concerns over the level of executive pay and staff bonuses. Subsequently attended the AGM and welcomed the appointment of a new Chair of the Remuneration Committee.
    - LAPFF issued a voting alert for the 2^{nd} year in row for WPP. Attended the AGM and asked if the company would commit to simplifying its variable remuneration packages as well as increasing transparency around the numerous schemes in operation. The Board acknowledged that variable pay packages were complicated but stated it had adopted the existing arrangements in response to shareholder requests.
    - At the G4S AGM LAPFF questioned the use of adjusted metrics for Long Term Incentive Plans and had a follow up meeting. ***Outcome:*** G4S engaged with major shareholders and acknowledged some elements of the EPS adjustments were confusing and would be removed.
    - LAPFF contacted Hays and Centrica to request feedback on its 'Expectations on Executive Pay' document.

<u>Managing environment risk:</u>

- Palm Oil:
    - LAPFF participated in collaborative engagement with a number of US companies on sustainable Palm Oil. ***Outcome (i):*** General Mills joined the growing number of companies that have pledged to only source from suppliers that provide fully traceable, deforestation-free Palm Oil. ***Outcome (ii):*** A group of Palm Oil growers released a sustainable Palm Oil manifesto directed at ensuring future Palm Oil developments are subject to high standards of environmental protection and limit deforestation. LAPFF welcomed the change but highlighted it still fell short of strong standards set by major industry leaders. LAPFF continues to work with the PRI Investor Group and is participating in collective

engagement over remaining concerns. ***Outcome (iii):*** Wilmar who operates in the Palm Oil industry revealed that it has fully mapped its supply chain and made public all of its 800 suppliers in Indonesia and Malaysia. Other companies have also made improvements such as; beginning to use the industry standard definition of High Carbon Stock forests and applying its Sustainable Palm Oil Policy to its subsidiaries and trading partners.

- Energy and Environmental Risk:
    - LAPFF attended the BP AGM and collaborative meetings and raised points around the company's approach to carbon asset risk, low carbon technology development, climate policy debates and business sustainability/plans to diversify into low carbon energy sources.
    - Following on from previous meetings LAPFF attended the AGM of Rio Tinto and asked about the potential for thermal coal to become a stranded asset. ***Outcome:*** Rio Tinto believe there is a place for thermal coal in the future.
    - Attended the Shell AGM and questioned the Board over future energy policy and pricing in response to Shell's detailed response to investor concerns over carbon asset management.
    - Climate risk questions were asked of the chair of National Grid at the AGM, specifically regarding the measurement and reporting of scope 3 emissions. This continues LAPFF's participation in the 'Aiming for A' engagement which encourages company progress within the Carbon Disclosure Project's Climate Performance Index. The Chair noted that LAPFF were the first investor group to raise the issue of progress on monitoring scope 3 emissions.
    - LAPFF met with the Chairman of both Shell & BP to discuss planned shareholder resolutions to encourage these companies to provide more focused disclosure on their longer-term carbon management plans. ***Outcome:*** Both Shell & BP announced their advice to shareholders to support 'strategic resilience' resolutions filed by LAPFF members as part of the Aiming for A coalition. This is unprecedented in the UK.

<u>Targeting social issues:</u>

- Employment Standards:
    - LAPFF have engaged with National Express since 2012 regarding their approach to health & safety concerns and unionisation issues in the US. At the most recent meeting in 2014 it was identified that the company had not implemented previous commitments. LAPFF supported a shareholder resolution at the AGM requesting that the company implements a mechanism to ensure appropriate board oversight and develop a policy based on the ILO declaration on fundamental principles and rights to work. ***Outcome:*** The resolution achieved strong support from independent shareholders.
- Social and Reputational Risks:

- Over a number of years LAPFF has voiced concerns about the level of control the Murdoch family holds over News Corp, BskyB and 21st Century Fox Boards. LAPFF issued voting alerts for these companies in order to call for greater independence on the Boards. Concerns also raised with News Corp and Trinity Mirror over phone hacking.

In addition:

- LAPFF also engaged with policy-makers regarding some companies proposing to delist from premium listings in order that they have less stringent requirements on governance compliance. A collaborative meeting was held with the UK listing authority to highlight concerns that minority shareholders were perhaps being forced into accepting a given offer for a potentially less liquid stock following the delisting.
- LAPFF responded to the FRC consultation on changes to the Corporate Governance Code. LAPFF focused on aspects which impacted shareholder rights and the going concern statements which LAPFF view as a weakness of International Financial Reporting Standards. Weaknesses were also highlighted in proposed revisions on certain remuneration concerns.
- LAPFF submitted a report to the LGA Leadership Board describing the activities and outcomes of LAPFF during the year. The introduction of National Advisory Boards was highlighted in last year's report.
- LAPFF engaged with a total of 61 companies in 2014/15 through various methods which include attending meetings, attending AGM's, sending letters to and having a dialogue with the company.

2.4.3 Avon Pension Fund Activity

The Fund participated in a variety of activities during the year as follows:

- The Fund responded to a number of share action email campaigns on the following topics:
  - Concern for climate change and encouraging the formation of a low carbon economy (ie; increasing renewable energy, water & energy efficiency, forestry, waste management and recycling).
  - Ensuring employees and contractors are earning atleast the UK living wage. Also seeking that Directors pay should be controlled through shareholder voting.
  - Concern for Shell's plan to drill for oil in the arctic ocean and the impact on the environment. Also the negative effect that new fossil fuel projects have on the efforts to tackle climate change.
- The 'Aiming for A' coalition which includes LAPFF prepared a shareholder resolution in preparation for the BP AGM in April 2015 and Royal Dutch Shell in May 2015. The Fund was supportive of LAPFF's backing to the coalition. The resolution was publicly supported by the Fund and covered 5 areas:
  - Ongoing operational emissions management
  - Asset portfolio resilience to post-2035 scenarios

  - Low carbon energy R&D and investment strategies
  - Strategic KPIs and executive incentives
  - Public policy interventions
  - ***Outcome:*** BP resolution received 98.28% support and Royal Dutch Shell 98.91% support.
- The Fund responded in July 2014 to the DCLG consultation on ‘LGPS: Opportunities for collaboration, cost savings and efficiencies’. In addition to our investment managers responding to the consultation both JLT Employee Benefits and Mercer Limited also responded. The objective of the consultation was noted within the Manager Updates section above. With regards in particular to RI and ESG the Fund’s response highlighted the following points:
  - The consultation did not detail how responsible, sustainable or long term investing approaches as put forward by the Kay Review would be incorporated in these proposals.
  - Requiring Fund’s to invest passively would require even more rigorous corporate governance, environmental and social risk oversight and engagement.
  - There was no consideration of responsible investing approaches and corporate governance activities. The issue of responsible investing has significant relevance for passive portfolios as the investors have no option but to invest in potentially poorly governed companies.
- The Fund forwarded all LAPFF voting alerts to the relevant investment managers, monitored the voting outcomes and questioned the investment managers where they did not vote in line with the LAPFF voting recommendation.
- The Fund continued to engage with its investment managers on a number of topics throughout the year which the Fund’s committee and Investment Panel had identified as particular areas to address. Through this on-going communication and questioning the Fund’s managers are reminded of the importance that the Fund places on the engagement activities undertaken by them.
- The Fund continued to participate in share action claims through a portfolio monitoring program operated by Robbins Gellar Rudman & Dowd LLP. Such claims arise when the court has ruled that fraudulent activity or misleading information has resulted in losses to shareholders. During the year the Fund took part in filing and the receipt of recoveries for 11 new claims. Although most monetary claims are small, this activity is important as it supports the principle of holding companies and management to account.
- The Fund continues to participate in a share action group against Royal Bank of Scotland in relation to the rights issue launched in April 2008 in which it is contended that the information in the prospectus did not reflect a fair view of the financial strength of the bank.
- There is significant public pressure for pension funds, especially those in the public sector, to divest from socially or environmentally damaging investments, such as tobacco and fossil fuels. To assist the LGPS funds respond to requests

to divest, the LGPS Shadow Advisory Board obtained Counsel's opinion on the fiduciary duties of the LGPS funds.

- Specifically the Board asked for advice on whether an LGPS administering authority owe a fiduciary duty and if so, to whom it is owed; and how should the wider functions, aims or objectives of the administering authority influence the discharge of its LGPS investment duties.
- The opinion concluded that in managing an LGPS fund the administering authority has fiduciary duties both to the scheme employers and to the scheme members. In addition the administering authority's power of investment must be exercised for investment purposes, and not for any wider purposes. Investment decisions must therefore be directed towards achieving a wide variety of suitable investments, and to what is best for the financial position of the fund (balancing risk and return in the normal way). However, so long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as that does not risk material financial detriment to the fund.
- This opinion supports the Fund's policy, that environmental, social and governance considerations should be taken into account in investment decisions as long as it does not pose a material financial risk to the Fund's ability to achieve its investment objective.

Section 3: Statement of Compliance with Stewardship Code

The Fund's statement of compliance with the Stewardship Code remains unchanged since June 2013 following the small amendments made to the Code in 2012

The Fund's statement of compliance can be found at: http://www.avonpensionfund.org.uk/financeandinvestments/corporategovpolicy.htm

Appendix: Monitoring Review of Shareholder Voting 2014