

QUARTERLY ENGAGEMENT REPORT

APRIL TO JUNE 2012



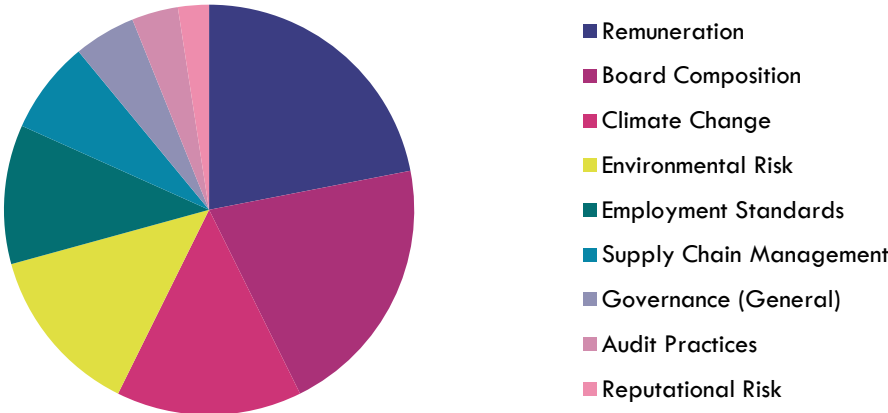
Local Authority Pension Fund Forum

LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, the Forum brings together a diverse range of 55 local authority pension funds in the UK with combined assets of over £100 billion.

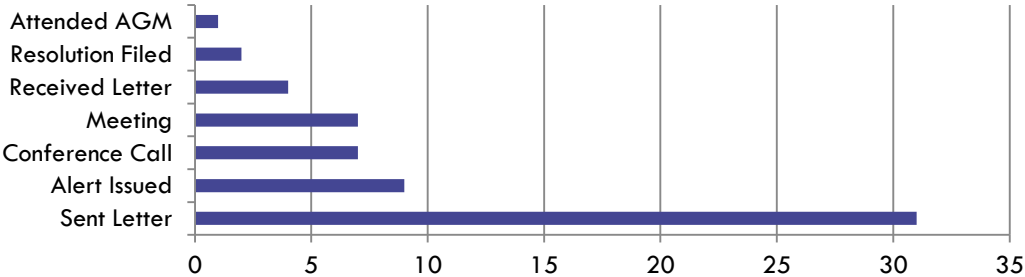
ENGAGEMENT SUMMARY

APRIL TO JUNE 2012

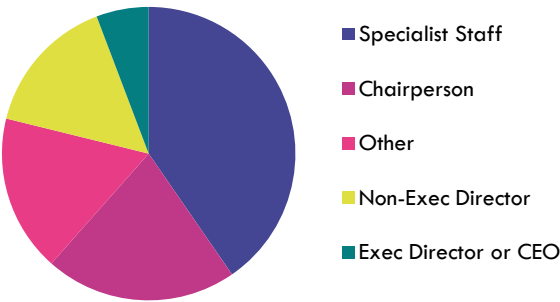
Topics



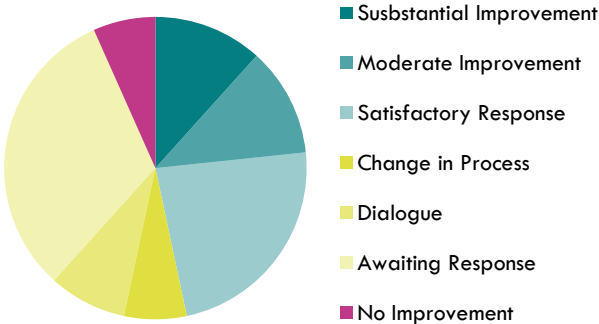
Activities



Company Contact



Outcomes



ACHIEVEMENTS

- Issued statement calling for **Barclays** to claw-back bonuses in response to the record fines levied against by US and UK regulators for manipulating the London Interbank Offered Rate (LIBOR).
- Met with **News Corp's** Senior Independent Director, Sir Rod Eddington and Andrew Knight to discuss opportunities for governance reform following the company's decision to split the company into separate publishing and media businesses.
- Issued voting alerts on executive pay at **Barclays, Intesa Sanpaolo, and Cookson Group**; alerts were also issued on audit and accounting concerns at **HSBC** and **RBS**.
- LAPFF members co-filed a proposal at **News Corporation** calling for an independent Chair. West Yorkshire Pension Fund co-filed a proposal at **Société Générale** on the separation of management functions into Supervisory and Management Boards.
- Received response from **Goldman Sachs** regarding share buybacks and distribution of profits. The company will increase its dividend in response to feedback from LAPFF.
- Met with the Chair of **BP plc** to receive an update on the company's health and safety culture and risk management following the Gulf of Mexico spill. Discussed ongoing environmental remediation and the response to the recent UNEP report with the managing director of **Shell Petroleum Development Company** in Nigeria.
- Met with **Renault, Daimler, Fiat** and **Stobart Group** regarding climate change, vehicle efficiency and greenhouse gas emissions reductions.
- Expressed support for a binding vote on executive remuneration in consultation held by **BIS**. Advocated for a 'comply or explain' approach to board diversity at the **European Commission**. Argued that effective financial governance is dependent on properly audited accounting information to the **Treasury Select Committee**.

THEFORUM IN THE NEWS

Barclays LIBOR fixing – [FT, 29 June](#) and [ITV News, 29 June](#)

Voting Alert at HSBC - [Professional Pensions, 25th May](#)

Board independence at News Corp - [The Telegraph, 1st May](#)

UK Parliamentary Committee report on Murdoch – [MSNBC, 1st May](#)

Barclays' pay [The Guardian, 22nd April](#) and [Sky News, 27th April](#)

View more press coverage: http://www.lapfforum.org/press_coverage

COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

CEO pay and the ongoing controversies at the banks have been the hot topics as this years' proxy season kicked off. **Barclays** in particular has been in the eye of the storm, first with a row over Bob Diamond's pay, which included a controversial "tax equalisation" payment, and

most recently the fines levied by regulators for manipulating the London Interbank Offered Rate (LIBOR). LAPFF raised serious concerns about remuneration at Barclays in a [voting alert](#) to members issued in advance of the annual meeting. Coverage of the LAPFF stance at the Barclays AGM was picked up by ITV News at Ten as well as BBC and Sky News. The Forum also [issued a statement](#) calling for Barclays to claw-back bonuses to 2005, when the interest rate fixing first started.

THE SHAREHOLDER SPRING

Votes against remuneration

- Central Rand Gold – 75%
- Cairn Energy – 67%
- Pendragon – 67%
- Centamin – 63%
- WPP – 60%
- Aviva – 54%
- Barclays – 32%
- Cookson Group – 32%

Debate about the future of **News Corp** was reignited this quarter with announcement of the intention to split the company into separate media and publishing arms, as well as a result of the publication of the Parliamentary Select Committee report. The Forum stepped up its engagement as LAPFF members co-filed a shareholder

resolution at News Corp asking for the appointment of an independent Chair. The Forum subsequently met with Sir Rod Eddington, the company's Senior Independent Director, and non-executive director Andrew Knight, to discuss governance issues and press for significant governance reforms at the new companies. News Corp faces ongoing and increasingly severe reputational, legal and regulatory risks.

Finally, Forum member West Yorkshire Pension Fund expressed concern regarding the concentration of power at the head of **Société Générale**, opting to co-file a shareholder proposal with PhiTrust Active Investors requesting that the board split the roles and functions of the Supervisory and Management Boards. This governance concern is one the Forum continues to highlight, with voting alerts issued to members on the Soc Gen shareholder resolution, and in advance of the **Flir Systems** AGM.

PROMOTING GOOD GOVERNANCE

Global Focus List

In just a few short months, the Forum has made significant progress in reaching out to the fifteen companies on the Global Focus List this year. We were very pleased to receive a response from **Goldman Sachs**, outlining the company's strategy for distributing profits amongst its employees and shareholders. LAPFF had questioned the company on its strategy of buybacks and raised concerns regarding dilution. In response to the feedback of LAPFF and other investors, Goldman Sachs has agreed to significantly increase the dividend, providing for improved distribution of profits to shareholders.

Goldman Sachs increased the dividend **31%** from \$0.35 to \$0.46, returning **\$233m** in capital to shareholders each year.

LAPFF also had a productive discussion with **Meggitt**, a UK specialist in aerospace, defence and energy engineering. The conversation centred on the company's succession planning processes, its ongoing business strategy, and the steps it is taking to improve the number of women on the board. The company is moving in a positive direction and has entered into a robust succession planning and director recruitment process.

Danone, the French manufacturer of dairy products, also showed significant improvement in corporate governance practices. LAPFF wrote to the company asking for better alignment of pay and long-term value, consideration of separating the Chair and CEO roles, and improvement in the balance of independent directors. In a conference call with company representatives, each of our concerns were largely addressed: recent changes to executive pay provide for longer-term performance measurement; the company will implement the 12 year independence rule set out by French corporate governance standards; and the role of Chair/CEO will be reviewed in 2013.

A conference call with the **Berkeley Group** also led to a satisfactory outcome. The company's unusual remuneration target for executives of returning a £13 per share dividend to shareholders over ten years was a point of focus for the discussion. Despite not having the usual comparative measures and vesting scales, LAPFF was impressed with the company's remuneration strategy, which appears to focus attention on returning cash to shareholders while focusing executives' attention on building a long-term business. The Forum also pressed the company on boardroom independence, and stressed the importance of ensuring non-audit fees do not compromise the independence of the external auditor.

Finally, our engagement with **Afren** produced some notable results. The company has made changes to its board as well as its remuneration practices – two issues we raised with the company when LAPFF met representatives in January.

Financial Reporting & Audit

Raising concerns about the distortive effects of international accounting standards remains one of LAPFF's core projects. Following on the publication of "[UK and Irish Bank Capital Losses – Post Mortem](#)," LAPFF has been lobbying both companies and regulators to address deficiencies in the standards.

US \$ 16 billion

Estimate of shareholder funds at HSBC that have not been accurately accounted for under IFRS.

This quarter LAPFF issued two voting alerts on the issue – one at **Royal Bank of Scotland**, and the other at **HSBC**. The concern centres on LAPFF's view that IFRS standards allow banks to register future expected income as profits on their books, despite the fact that such assets (such as mortgages) may not fully pay off for 20 or 30 years. The Forum considers that the accounts of HSBC and RBS have been negatively affected by the application of IFRS, which may significantly impact on audit quality and the reliability of

accounts, and is material to calculations of net assets and profits. Most concerning is that this accounting method can make it look like a bank is running a profit, allowing it to pay out bonuses to staff, when in fact it is running a loss.

MANAGING ENVIRONMENTAL ISSUES

Climate Change

The Forum held a series of meetings with car manufacturers and transport firms, including Daimler, Renault, Stobart and Fiat. In each meeting, we discussed how each company approaches climate change risk. The series of meetings provided LAPFF an opportunity to compare and contrast each company's strategy for reducing greenhouse gas emissions. **Renault** is taking a focused approach by placing a large investment in plug-in electric vehicle technology, whereas **Daimler** is engaging with a number of different strategies in an effort to reduce its average per vehicle fleet emissions in line with EU directives. As market leader, it was instructive that **Fiat's** focus was on energy efficiency and improving existing engine technology to reduce emissions. The company's view was that most alternative technologies were not immediately applicable and a realistic time-frame for their adoption would be nearer 25-30 years.

UK transport and logistics firm **Stobart** is reducing emissions by initiating a shift of goods transport from road to rail, and by reducing the number of 'empty miles' that are driven by its fleet. Pricing mechanisms for off-peak transport and long-established relationships with supermarket chains is helping the company achieve its goals. Interestingly, Stobart uses in-truck computer technology to track driver performance for fuel use and efficiency, and then uses this to remunerate staff for demonstrating efficient and safe driving.

As a final step in its participation in the **Carbon Disclosure Leadership Index (CDLI)**, LAPFF co-signed 24 acknowledgement letters to companies in the 2011 engagement that improved companies' CDLI scores. This joint investor initiative was seeking to encourage companies in carbon intensive sectors (energy, industrials, materials and utilities) to improve their responses to the Carbon Disclosure Project. Letters had originally been sent to the 98 companies with scores in the lowest quartile of the CDLI seeking improved disclosure on greenhouse gas emissions.

Environmental Risk Management

The Forum met with the Chair of **BP**, Carl-Henric Svanberg, to discuss the board's oversight of risk management after the Gulf of Mexico spill, as well as health and safety reforms for offshore drilling rigs. In the eighteen months since the previous meeting, it is evident that Svanberg has overseen a significant reorganisation of BP to address safety concerns and strengthen the cross-functional risk management team. BP is now using fewer contractors, conducting deeper due diligence and establishing longer relationships with suppliers, which LAPFF believes is a step in the right direction.

In April, **Shell** hosted a meeting at its London offices to discuss the recent UN Environment Program report on environmental liabilities in Nigeria. LAPFF has been engaging with Shell on the issue of Nigeria for many years. In 1997, LAPFF filed the first ever shareholder proposal on a social issue in the UK to address concerns about Shell's operations in Nigeria. Forum representatives met with the company's Managing Director for Nigeria. The meeting emphasized the challenges facing Shell, particularly regarding illegal refineries, pipeline sabotage and establishing a safety culture. The company has made significant progress in reducing flaring, and is implementing a robust process with the goal of eliminating operational oil spills. However questions still remain as to how Shell can best address ongoing environmental liabilities in the Niger Delta.

30% reduction in the volume of onshore operational spills in 2011 from Shell's Nigeria facilities

- Shell 2011 Sustainability Report

Hydraulic fracturing ('fracking') has been in the spotlight as of late. Fracking is a process whereby formerly inaccessible reserves of natural gas can be accessed by injecting water and chemicals at high pressure into underground deposits. The use of this technology in the Eastern US, Canada and the North West of England has raised questions about the potential environmental impacts of the technology, and in particular, the effect on the drinking water in local communities. The issue is a challenging one, as unconventional gas has the potential to unlock large energy reserves at a time when energy prices and consumer demand are high and growing. Appropriate management of this resource by companies will be crucial as the technology develops.

In response to member interest in this issue, LAPFF co-signed a series of letters to 21 oil and gas companies involved in hydraulic fracturing (or 'fracking') regarding the use of flaring by the industry.

LAPFF is a member of the Investor Network on Climate Risk (INCR) which, together with UK and Australia/New Zealand investor groups, [issued a joint statement](#) on calling on companies and governments to minimise methane emissions from rapidly growing unconventional oil.

200 investor members with total assets of over \$20 trillion signed the joint Investor Statement on methane emissions

TARGETING SOCIAL ISSUES

Employment Standards & Sustainable Supply Chains

This quarter, LAPFF wrote to four companies seeking information on their sustainable supply chain management strategies: **Walgreen**, **Reckitt Benckiser**, **Kingfisher** and **Diageo**. To date, the Forum has met with **Diageo** where the discussion covered a range of topics including governance of sustainability at the board level, management of agricultural supply chains to ensure high labour standards, and the company's progress in meeting its water efficiency goals. The issue of alcohol in society was also discussed, particularly in relation to the UK's consideration of minimum unit pricing of alcohol.

Representatives of LAPFF also participated in an investor briefing on **National Express** and ongoing labour rights concerns in the US. LAPFF has been engaging with National Express about its anti-freedom of association strategy since 2009 and remains concerned over worker rights at the company's US subsidiary, Durham and the potential reputational damage to the company. LAPFF continues to support the need for a robust and transparent freedom of association policy from National Express.

CONSULTATIONS & PUBLIC POLICY

ENGAGING POLICY MAKERS AND CONSULTATION RESPONSES

The Department of **Business Innovation and Skills** (BIS) issued a consultation this quarter seeking investor feedback on shareholder voting rights. One of the questions up for discussion was whether the government should establish a binding shareholder vote on executive remuneration. In its response, the Forum expressed support for the proposal of a binding vote, suggesting it would be a more effective mechanism for providing feedback to companies on

“A binding vote may strengthen public confidence in shareholders’ ability to restrain executive pay where this is required.”

- LAPFF Response to BIS Consultation

pay. It would also make companies more willing to engage with shareholders in advance of establishing pay packages, and would allow shareholders to more effectively restrain pay when appropriate. LAPFF also expressed its general agreement for the government to increase the level of shareholder support required for the remuneration vote to pass.

Some of these issues also fed into the Forum’s response to the publication of the **Treasury Select Committee’s** terms of reference for a new inquiry into corporate governance in systemically important financial institutions. In its response LAPFF reiterated that effective financial governance, on which the rest of governance depends, is dependent on properly audited accounting information. The Forum observed that the original governance Code from the Cadbury Committee was actually entitled “The Financial Aspects of Corporate Governance” and focussed on accounting and auditing practice. LAPFF continues to argue that a good deal of effort has been expended in deflecting attention from defective accounting standards and audits. The Forum’s ‘Post-mortem on the Banks’ was submitted as additional evidence to support the argument that IFRS is not always able to provide the ‘true and fair’ accounting required by law.

In keeping with its support for the 30% Club, an initiative seeking to improve gender diversity on corporate boards through voluntary mechanisms, LAPFF submitted a response to the **European Commission** consultation on gender imbalance on corporate boards in the EU. Support for voluntary measures was expressed in LAPFF’s cover letter, which encouraged the Commission to take a ‘comply or explain’ approach and to request that companies disclose their gender diversity targets. It is the view of the Forum and of the 30% Club that greater transparency by companies will provide for greater opportunities for investors and other stakeholders to hold companies accountable for making specific and measurable improvements in board diversity.

“Voluntary action by companies, investors and executive search firms is the best and most appropriate way to initiate sustainable long-term improvement in boardroom diversity.”

- LAPFF response to EU diversity consultation

LAPFF’s consultation responses can be viewed online at: <http://www.lapfforum.org/consultations>

NETWORKS & EVENTS

- **Marks & Spencer** Corporate Governance investor meeting
- **BP plc** Conference Call for Analysts
- **Aldersgate Group and Department of Energy and Climate Change** Raising the Bar on EU Climate Targets
- **30% Club** Launch of Cranfield Report on Executive Search Firms and Board Diversity
- **UNPRI** Webinar on 2012 Annual Assessment
- **HSBC** Sustainability call for Analysts

In March, **BP plc** hosted a roundtable conference call for analysts to discuss its sustainability report. The company discussed how non-financial incentives fit in with its overall strategy and the environmental and economical initiatives in the Gulf of Mexico. BP also highlighted how it has improved risk management and greater transparency within the sector. **Marks & Spencer** also hosted a meeting for analysts focusing on its governance and sustainability strategy in June.

At an event organised jointly by the **Aldersgate Group and the Department of Energy and Climate Change** in May, Bloomberg presented analysis on the costs for the EU to move from a 20% to a 30% carbon reduction target. Under the simplest scenario presented, this move could result in an additional cost of €3.5bn per year to 2020. In general, the wealthiest fifteen Member States would carry the larger burden, especially those with established and carbon-intensive power sectors. This macro-level analysis provides useful context to consider policy strategy at a national level.

At the end of May, the **30% Club** hosted a launch event for new research produced by Cranfield School of Management for the UK's Equality and Human Rights Commission. The focus of the report was on the role of executive search firms in increasing the number of women on boards. Opening remarks were made by the founder of the 30% Club, Helena Morrissey, with comments by the report's authors and one of the founding Chairmen of the 30% Club (and Chair of M&S), Robert Swannell. Swannell invited investors to ask companies to disclose, not only their targets for diversity on the board, but also to disclose diversity at all employee levels throughout the company. He further stated that investors may want to consider asking companies to tie their diversity initiatives to executive remuneration.

Meetings were also held with **UNPRI** and the **Church of England Ethical Investment Advisory Group** to explore avenues for future collaborative engagement.

COMPANY PROGRESS REPORT

Company	Topic	Outcome
Afren	Board Composition, Remuneration	Moderate Improvement
Barclays	Remuneration	Moderate Improvement
Berkeley Group	Board Composition, Remuneration	Satisfactory Response
Boeing Company	Climate Change	Awaiting Response
BP plc	Employment Standards, Environmental Risk	Change in Process
British Sky Broadcasting	Board Composition	Dialogue
Cable & Wireless Worldwide	Remuneration, Board Composition	Change in Process
Colt Group SA	Remuneration, Board Composition	Satisfactory Response
ConocoPhillips	Environmental Risk	Change in Process
Cookson	Remuneration	Awaiting Response
Daimler	Climate Change	Satisfactory Response
Danone	Remuneration, Board Composition	Substantial Improvement
Diageo	Employment Standards, Environmental Risk	Satisfactory Response
EOG Resources	Environmental Risk	Awaiting Response
ExxonMobil	Climate Change	No Improvement
Fiat Spa	Climate Change	Substantial Improvement
Flir Systems	Governance (General)	No Improvement
Goldman Sachs	Remuneration	Moderate Improvement
Heineken NV	Board Composition, Remuneration	Moderate Improvement
Hewlett Packard	Governance (General)	Satisfactory Response
HSBC Holdings plc	Audit Practices	Awaiting Response
Intesa Sanpaolo	Remuneration	No Improvement
Kingfisher	Supply Chain, Employment Standards	Awaiting Response
Marathon Oil	Environmental Risk	Awaiting Response
Marks & Spencer	Employment Standards	Awaiting Response
McDonalds Corp	Environmental Risk	Awaiting Response
Meggitt	Board Composition	Substantial Improvement
News Corp	Board Composition, Reputational Risk	Dialogue
Reckitt Benckiser	Supply Chain, Employment Standards	Dialogue
Renault	Climate Change	Satisfactory Response
Rolls-Royce	Climate Change	Awaiting Response
Royal Bank of Scotland	Audit Practices	Awaiting Response
Shell	Environmental Risk	Moderate Improvement
Société Générale	Board Composition	Awaiting Response
Stobart Group	Climate Change	Change in Process
Walgreen	Supply Chain, Employment Standards	Awaiting Response
Wal-Mart	Environmental Risk	Awaiting Response
Whitbread	Remuneration, Audit Practices	Satisfactory Response



Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum was established in 1991 and is a voluntary association of 55 local authority pension funds based in the UK. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which its members invest. The Forum's members currently have combined assets of over £100 billion.

Report prepared by PIRC Ltd. for the
Local Authority Pension Fund Forum

PIRC

www.lapfforum.org

Aberdeen City Council
Avon Pension Fund
Bedfordshire Pension Fund
Brent LB
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
Enfield
Falkirk CC
Greater Gwent Fund
Greater Manchester Pension Fund
Gwynedd Pension Fund
Hackney LB
Haringey LB
Harrow LB
Hillingdon LB
Hounslow LB
Islington 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
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Shropshire Council
Somerset CC
South Yorkshire Integrated Transport Authority
South Yorkshire Pensions Authority
Southwark LB
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Warwickshire Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC