



## 1.0 Purpose

1.1 This report is submitted for Members' information.

## 2.0 Background

2.1 For a number of years, the West Midlands Pension Fund has adopted an approach of wanting to position itself by following good corporate governance practices. One way this is reflected is in its approach to active proxy voting. The Fund aims to vote at the majority of company meetings both in the UK and overseas where it has a direct interest. The Fund's voting policy is summarized in the annual report and accounts and published on the web-site.

## 3.0 Voting Activity

3.1 During the period the Fund voted at a total of 371 company meetings – 49 UK, 35 European, 47 US, 38 Japanese, 86 Global and 116 Pacific. In respect of these meetings (a mixture of EGMs and AGMs) the Fund opposed, abstained or withheld\* 1,594 resolutions out of a total of 3,582, representing approximately 45% of all resolutions. During this period there were 46 meetings where the Fund supported all the resolutions put forward by companies.

3.2 The Fund has developed a bespoke template for voting at UK meetings. However, the Fund currently follows the voting advice of the Pensions and Investments Research Consultants Ltd (PIRC) for European US, Japanese and Pacific region company meetings. *\*(It should be noted that due to a combination of US state law and individual company bye-laws, votes pertaining to individual directors cannot be cast as "oppose" but have to be cast as "withheld").*

## 4.0 UK Voting Analysis

4.1 The major issues that were of particular concern during the period are typically illustrated in the examples in the table below:

Company	Meeting	Resolutions Causing Shareholder Concern
Vodafone PLC	AGM	Approve the Scheme Of Arrangement
Easyjet PLC	AGM	Approve the Remuneration Policy
Easyjet PLC	AGM	Re-Election of Directors
Crest Nicholson PLC	AGM	Approve the Remuneration Report
BWIN.Party Digital Entertainment PLC	AGM	Approve new Long Term Incentive Plan

Although the Fund may often oppose a resolution, it will support a resolution if it believes the company has followed best practice, even if there is significant opposition from other shareholders. Background details on some of the resolutions that attracted a high level of opposition are detailed below:

#### 4.2 **Vodafone (AGM)**

On 2 September 2013, Vodafone agreed to dispose of its 45% interest in Verizon Wireless to US telecoms giant Verizon Communications. At the same time, it was agreed that Vodafone would purchase Verizon's 23% in Vodafone Italy, thereby securing full ownership of the Italian subsidiary.

Vodafone agreed to dispose of the US group to Verizon for a total headline consideration of approximately \$130 billion made up of a combination of cash and shares. They also agreed to return more than 70% of the net proceeds to shareholders. Vodafone sought shareholder approval for the transactions at both an EGM and a Court Meeting. Given the prospects of a significant return to shareholders and the resolution of long-standing issues between Vodafone and its US partner, the transaction was deemed in the best interests of shareholders.

**The Fund voted in favour of the resolution.**

#### 4.3 **Easyjet (AGM)**

The remuneration policy was a particular focus of attention for shareholders at the AGM of budget airline Easyjet.

Whilst there were a number of positive aspects to the policy which were welcomed by the Fund, there were equally several areas which were of particular concern.

Total remuneration included the provision of a Long Term Incentive Plan (LTIP). Performance conditions and maximum potential awards payable under the plan were made available. However, the LTIPs had a vesting period of three years, which was not considered sufficiently long-term. Additionally, LTIPs are not considered an effective means of incentivising performance. These schemes are not considered to be properly long term and are subject to manipulation due to their discretionary nature. All the incentive schemes are subject to clawback provisions. However, there is no evidence of recovery provisions under which money already paid must be handed back.

The remuneration policy also failed to disclose the ratio of CEO pay to employee pay in line with best practice. The ratio could be estimated at 30:1 which is considered to be excessive.

**The Fund opposed the resolution.**

The resolutions to re-elect a number of Non-Executive directors including David Bennett and Professor Rigas Doganis attracted a high level of opposition. It is believed that much of the opposition came from Easyjet founder Sir Stelios Haji-Ioannou who has been unhappy at certain decisions that have been taken by the board. However, as the directors were considered to be independent, the Fund was able to support their re-election.

**The Fund supported the resolutions.**

**4.4 Crest Nicholson (AGM)**

The remuneration report also proved to be of concern to shareholders with almost 40% of voting shareholders opposing the resolution.

It was considered that the performance conditions relating to the company's recent IPO were not proportionate with the subsequent awards, which were also considered excessive. Non-Executive Chair Mr. Rucker and CEO Mr Stone were awarded performance shares and options linked to the IPO, equating to £8,107,983 and £12,835,905, respectively and senior staff were also rewarded through this scheme. As a result, total realised rewards under the incentive schemes were considered to be excessive.

**The Fund opposed the resolution to approve the remuneration report**

**4.5 BWIN.Party Digital Entertainment (AGM)**

Shareholders were asked to approve a new Long Term Incentive Plan (LTIP) at the annual meeting of global online gaming company BWIN.

The first element of the plan allows a maximum annual opportunity of 250% of base salary. The second element is an annual bonus scheme up to a maximum of 300% of base salary paid in shares based on the level of satisfaction of transformational and strategic objectives measured each year. The shares earned are subject to a three year vesting period with the conditions that the plan cannot be sold and the Participant has to remain in employment five years after the date of grant irrespective of whether the participant is employed by this Company or not.

The potential award under the proposed LTIP was considered to be excessive as it could represent up to 550% of the participant's base salary.

**The Fund opposed the resolution to amend the Long Term Incentive Plan**

## 5.0 Overseas Issues

### 5.1 Whole Foods (AGM) – USA

Board independence, remuneration and voting procedures were issues at the AGM of food supplier Whole Foods.

There were significant concerns over a number of directors seeking re-election. Non-Executive directors Dr John Elstrott and Gabrielle Greene were not considered to be independent having both served on the board for more than nine years.

In addition, Shahid Hassan was also not considered to be independent as he has previously served as a consultant to the company. Mr Hassan also founded Fresh & Wild Ltd, an organic food retailer which was acquired by Whole Foods in 2004. The situation is exacerbated by the fact that Mr Hassan also serves on the company's audit committee. Therefore this compromises the overall independence of this committee.

With several other directors who had also served on the board for a number of years seeking re-election there was insufficient independence on the board overall.

**The Fund withheld votes for each of the resolutions to re-elect.**

### 5.2 Adobe Systems Inc. (AGM) – USA

The Board was looking to approve an amendment to the annual share incentive plan to increase the number of shares reserved for issuance by 8.85 million of common stock. As of 31 January 2014, an aggregate of 36,123,517 shares of their common stock remained available for future grants under their 2003 Plan. The increases in award limits were designed, primarily, to increase the potential compensation of the CEO, as well as other named executive officers in future years. However, the contracts and compensation of the executive officers were already considered to be excessive.

This proposal was the second consecutive year that an amendment to the share plan was made and in 2013 the request was for the issuance of 17.5 million of common stock. These aggregate requests were viewed as overly dilutive to existing shareholdings.

**The Fund opposed the resolution.**

## 6.0 Shareholder Engagement

6.1 The Fund's second approach to responsible investing involves engaging with companies in partnerships with like-minded investors.

6.2 This approach is implemented through the Fund's membership of the Local Authority Pension Fund Forum. Joining with other pension funds that have similar views to the Fund, produces a large shareholding group which companies are more likely to take note of and respond to. LAPFF has a current membership of 60 public sector pension funds in the UK with combined assets of over £125 billion.

- 6.3 The mission statement of the Forum is “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 they invest, commensurate with statutory regulations”.
- 6.4 LAPFF members regularly meet together to discuss social, environmental and governance issues and ways to promote high standards of corporate behaviour at investee companies. Appendices A-C set out the minutes, newsletter and quarterly engagement report.

## **7.0 Shareholder Litigation**

- 7.1 In addition to voting, the Fund works in partnership with two US lawyers and a class action monitoring agent to return value back to the Fund through litigation where shareholder value has been lost through fraudulent or irresponsible corporate behaviour. These partners are able to identify where litigation has been successful and submit claims on behalf of the Fund. As a result, during the three months to 31 March 2014 more than \$5,800 has been returned to the Fund from several class actions (including US company Pharmacia).
- 7.2 The firms of US lawyers who are responsible for monitoring all of the Fund’s equity holdings are also able to assist and advise the Fund where they feel it may be appropriate to become more actively involved in legal action.
- 7.3 At the previous meeting of the Pensions Committee, members were advised that lawsuits have been brought against Royal Bank of Scotland by shareholders who participated in a £12bn rights issue in 2008, months before the bank came close to collapse and required substantial investment by the Government who still have a controlling shareholding in the bank.
- 7.4 It is alleged that the RBS prospectus for the rights issue contained “serious omissions and misstatements” and that as a result, shareholders lost substantial amounts as the share price fell sharply in the months that followed.
- 7.5 The Fund along with a number of institutional investors including asset managers, wealth managers, pension funds and brokers have recently joined the Group action as a way of recouping some of the losses incurred. The Fund’s losses in the rights issue have been estimated to be in the region of £13m.
- 7.6 Substantial adverse costs protection has been taken out by the law firm leading the group action. Therefore in the event that the action was to be unsuccessful, the adverse litigation costs of the Group should be protected.
- 7.7 Members will be updated as the case progresses.

## **8.0 Labour Blacklists**

- 8.1 Members will recall from the previous meetings of this Committee that Wolverhampton City Council had requested the Fund look into the issue of blacklisting within the construction industry and identify any Fund investments that had been involved in the practice and if necessary to raise this issue with company management. As a result, the Local Authority Pension Fund Forum (LAPFF) has included this matter into their current engagement programme and details of their progress will be reported as it progresses.
- 8.2 So far, two companies are subject to compensation claims over this issue and representatives from LAPFF have approached one of these, Kier Group and have reported a positive dialogue with management who have agreed to set up a meeting.
- 8.3 The other company subject to a compensation claim is Wolverhampton based Carillion and LAPFF representatives have agreed to set up a meeting with the company to discuss this issue further. In addition a letter has been written to Carillion to request an engagement meeting. As no response was forthcoming from Carillion, LAPFF representatives have written a follow-up letter to Carillion and further potential action that can be taken will be discussed at the next quarterly meeting of the LAPFF executive.

## **9.0 Aerospace and Defence Investment**

- 9.1 As reported at previous meetings of this Committee, a number of enquiries and a petition have been received from Mr Paul McGowan who is linked to a Coventry based group known as the Justice and Peace Group. This series of enquiries has expressed concerns about the Fund's investments in companies that have links with the defence industry.
- 9.2 A number of replies have been sent out to Mr McGowan outlining the way the Fund handles responsible investment issues and the need for the Fund to ensure the best possible return for its members. The Fund has also stated that whilst a policy of exclusion can pose an adverse risk to returns, direct engagement with companies enables the Fund to protect and enhance shareholder value.
- 9.3 In March 2014, the Committee agreed that it would not sanction disinvestment but did ask that LAPFF engage with the following companies: Alliant Techsystems (USA), Doosan (South Korea), Textron (USA), General Dynamics (USA), L-3 Communications (USA) and Lockheed Martin (USA). In June 2014, LAPFF agreed to the above noted engagement program and the Fund will report to the Committee on its development and findings accordingly.

## **10.0 UKSIF**

- 10.1 In the past few weeks, the Fund has become a signatory to become an affiliate member of UKSIF, the UK Sustainable Investment and Finance Association.

10.2 The UK Sustainable Investment and Finance Association, commonly referred to as UKSIF, is the membership network for sustainable and responsible financial services. Its job is to promote responsible investment and similar forms of finance that “support sustainable economic development, enhance quality of life and safeguard the environment”. It publishes reports, provides guidance to government and is a staunch campaigner for all aspects of sustainable finance.

## **11.0 Fiduciary duty and exclusion of investments on social and ethical grounds**

11.1 Over the past year, the Fund has been asked to consider excluding investments on ethical and social grounds, notably tobacco and certain armaments companies. With a highly diversified portfolio, it is inevitable that investments are made in sectors that attract a variety of strong views and opinions. To date, the Fund has not excluded any investments on such grounds because exclusion poses an adverse risk to the delivery of required investment returns. Instead it has sought to ensure that the companies in which it invests adhere to the highest standards of social, ethical and governance standards through a programme of engagement. This is carried out with other like-minded investors through groups such as the Local Authority Pension Fund Forum (LAPFF).

11.2 Other LGPS funds have also been asked to consider investment exclusion. In the light of such requests, the Local Government Association, on behalf of the LGPS Shadow Scheme Advisory Board, instructed Nigel Giffin QC on the following:

- Does an LGPS administering authority owe a fiduciary duty and if so to whom it is owed?
- How should the wider functions, aims or objectives of the administering authority influence the discharge of its LGPS investment duties?

11.3 Mr Giffin’s conclusions, set out in an opinion dated 25 March 2014 now available on the LGPS Advisory Board website, are as follows :

- In managing an LGPS fund, the administering authority has both fiduciary duties and public law duties (which are in practice likely to come to much the same thing). In Mr Giffin’s view, the administering authority owes fiduciary duties both to scheme employers and to scheme members.
- 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. In taking account of any such considerations, the administering authority may not prefer its own particular interests to those of other scheme employers, and should not seek to impose its particular views where these would not be widely shared by scheme employers and members (nor may other scheme employers impose their views upon the administering authority).

11.4 Because of the administering authority's fiduciary duties and the risk that investment exclusion will be detrimental to the successful delivery of investment returns as well as increase portfolio risks arising from a more limited investment opportunity set, it is recommended that the Fund continues to adhere to its policy of engagement (thereby influencing and improving corporate behaviour) and does not adopt exclusion. Further, it is recommended that the advice from Mr Giffin, that the administering authority should not seek to impose its views where these would not be widely shared by other scheme employers and members should be noted. If the Fund receives any further requests on such matters, they will be presented to the Committee for specific consideration.

11.5 It should be emphasised that the Fund's primary duty is a fiduciary one. The Local Government Pension Scheme is controlled by Government regulation which authorises the administering authority to make investments which are entirely directed to financially prudent investing and to ensure the best possible return for its members. Instead of adopting a strategy of excluding companies, engaging with company management on a variety of good governance themes allows the Fund to influence and improve corporate practice. Whilst a policy of exclusion can pose an adverse risk to returns, direct engagement with companies enables the Fund to protect and enhance shareholder value.

## **12.0 Financial implications**

12.1 The promotion of good corporate governance amongst companies in which the Fund invests is complementary to the Fund's objective of maximising financial returns, as it is widely believed that good corporate governance improves shareholder value in the long term.

## **13.0 Legal implications**

13.1 The Fund will work closely with one of its advisors, US legal firm Grant and Eisenhofer who have substantial experience in corporate and securities litigation and in acting as corporate governance counsel. They in turn will work with their UK partners Stewarts' Law who are the UK's largest litigation only law firm and specialise in high value and complex disputes.

## **14.0 Equalities implications**

13.1 This report has no implications for the Council's equal opportunities.

## **15.0 Environmental implications**

15.1 Environmental implications are addressed through the Fund's corporate governance policy.

## **16.0 Human resources implications**

16.1 This report contains no direct implications for the Authority's Human Resources Policies.

**17.0 Corporate landlord implications**

17.1 The report contains no direct corporate landlord implications.

**18.0 Schedule of background papers**

18.1 There are no background papers except those listed in the report.