The Local Authority Pension Fund Forum (LAPFF) exists to promote the long-term investment interests of member funds and beneficiaries, and to maximise their influence as shareholders whilst promoting the highest standards of corporate governance and corporate responsibility at investee companies. Formed in 1990, LAPFF brings together a diverse range of 72 public sector pension funds in the UK with combined assets of over £200 billion.

QUARTERLY ENGAGEMENT REPORT

JANUARY TO MARCH 2018

LAPFF focuses on assessing climate risk in the transport sector

Concerns over alleged companies on the UN ‘blacklist’

The Forum publishes two reports, on Share Buybacks and on Precarious Work
Executive Summary

During the last quarter, LAPFF has engaged with 21 companies on issues ranging from climate change resilience to human rights and due diligence process implementation.

The Forum is currently focusing on climate risk engagements with transport companies as the sector rapidly shifts to a low carbon, electric future. LAPFF is interested to see how companies implement climate change resilience and reduce climate risks through cutting greenhouse gas emissions and increasing fuel efficiency.

Following speculation over the Human Rights Council’s list of companies believed to be in violation of international human rights law due to their practices in West Bank and Gaza, the Forum requested meetings with some of these companies to follow up on these allegations. LAPFF is concerned that if an appropriate due diligence process is not in place, both the company and shareholders can face damaging reputational risks.

The Forum also published two reports at the beginning of the year. The first on Share Buybacks discusses the complexities and implications of share buybacks and questions whether they are the right method for distributing capital to shareholders. The second, on Precarious Work assesses the risk these employment practices pose for companies as well as investors. It also provides guidance to assist investors in engaging on the topic.
GOVERNANCE RISK

Share buybacks have been a recent focus of regulatory attention including in the government’s White Paper on Corporate Governance in August 2017. Supporters of buybacks argue they boost share prices and enhance shareholder value, whereas critics see them simply as a means of artificially hitting performance targets to boost executive pay at the expense of independent shareholders.

First issued for members in 2015, LAPFF has now formally published its *Share Buybacks: Solutions or Illusions* report to move the debate forward. The report sheds light on the complexities and implications of share buybacks, a practice that is now commonplace amongst listed companies. In 2014/15 97% of FTSE 100 companies sought authority to purchase shares and over a quarter (28%) actually bought shares. The report offers guidance and insights for members into the merits of share buybacks and questions whether they are the right method for distributing surplus capital. Deliberately taking a broader perspective of the issues than those in the White Paper, the report includes not just the effect on Earnings Per Share and diversion of productive investment, but also covers the implications of buybacks on the transparency of company performance, tax and the alignment of management and shareholder interests.

Voting Alert

The Forum issued a voting alert recommending opposition to a stock option grant to Tesla Chief Executive, Elon Musk. The Forum welcomed the proposal’s incentivisation of Mr Musk’s role as a catalyst for the process of decarbonisation of a large segment of the transport sector which has a valuable environmental and social impact. The Forum was also pleased to see that the performance period was set to a timeframe of ten years; a timeframe unique for public companies.

However, the Forum was of the opinion that the proposed performance award sets an unhealthy precedent for public company compensation. Upon successful achievement of all performance milestones, Mr Musk could own as much as 28.3% of Tesla and be awarded $55.8 billion. The Forum believes that Chief Executives with an already high stake in the Company should not receive further stock as part of their remuneration package. LAPFF was also concerned that in an attempt to hit all operational milestones, ongoing employment and health and safety-related risks at Tesla have yet to be resolved. The Forum continues to engage with the company over these practices as they undermine the ability of Tesla to meet production targets.

Mergers and Acquisitions

The Forum issued a briefing note to assist funds in identifying the best owners of GKN’s assets following a hostile takeover bid from Melrose. The note encouraged funds to critically assess both GKN and Melrose, and analyses which of the two were proposing a better solution to GKN’s performance problems. You can view the note here. The subsequent performance of the GKN assets under Melrose ownership will test our analysis and provide an aide-memoire to member funds over the coming months of integration.

People and Investment Value

At a meeting with Provident Financial’s new Chief Executive Office, Malcolm Le May, LAPFF Vice Chair Ian Greenwood discussed problems facing the company’s home credit division following a staffing reorganisation. The reorganisation involved a transition from a business staffed by 3,800 part-time, self-employed agents to one with a workforce of 2,500 full-time Customer Experience Managers. There were concerns that this had negatively impacted the close relationship between the agents and customers. The Forum also explored the causes of two past regulatory investigations of the controversial doorstep lender.
Cybersecurity
The Forum regularly engages with companies over cybersecurity management. To this end the Forum had correspondence with *Lloyds Banking Group* with regards to Lloyd’s 2017 cyberattack which brought down its digital services for two days.

ENVIRONMENTAL AND CARBON RISK

In conjunction with the Institutional Investor Group on Climate Change’s (IIGCC) resolution working group, LAPFF participated in a collaborative meeting with the new Chair of *Rio Tinto*, Simon Thomas, to discuss a recent shareholder resolution filed for the upcoming annual meeting. The resolutions asks for a review of the company’s oversight and processes related to public policy advocacy and how this maps with positions taken by relevant industry associations. The Chair was of the view that the main focus of the resolution should be the Company’s response to climate change and the potential damage to shareholders. Rio has been engaging with the Minerals Council of Australia (MCA) on their public positioning and following this investor meeting, the MCA issued a new policy position on energy and climate change which now affirms positions on key aspects of climate change policy that Rio considers important.

A climate-related shareholder resolution was also discussed at a meeting with the chair of *Royal Dutch Shell*, Chad Holliday, also in conjunction with the IIGCC resolution working group. In November, Shell was the first oil & gas company to set out a strategy for aligning with Paris goals by setting the aim of cutting the net carbon footprint of its products in half by 2050, and around one-fifth by 2035. The objective of the meeting was to get the Company’s perspective on the resolution filed by ‘Follow-This’, which asks Shell to set targets aligned with the 2-degree Paris goal. This would include most of scope 3 emissions which is customer use of fuel and natural gas products. Mr Holliday noted that the board was unlikely to support the resolution as it could well deter other companies from setting aspirations as Shell has done.

A further meeting with the *Southern Company* co-ordinated by the 50:50 initiative explored in more depth the governance measures put in place to ensure responsibility and consideration of climate change as a strategic matter. The meeting with Chief Legal Counsel James Kerr, was considered to have evidenced good progress.

The Forum liaised with several companies from the transport sector including *Bayerische Motoren Werke*, *Daimler*, *Rolls-Royce Holdings* and *Volkswagen* to understand the companies’ approach to climate risk and their role in a tightening regulatory and tax environment. Of interest are also the companies’ new technologies, including electric and hybrid powered cars and autonomous vehicles. The Forum also communicated with *Wizz Air* in relation to the Company’s role in reducing climate risk. The Company provided detailed answers about fuel efficiency, fuel saving initiatives and elaborated on emissions monitoring and regulations.

Along with other investors, LAPFF signed a letter to *Ford Motor Company* to voice concern over the company’s current and future fleet emissions not being consistent with the Paris Agreement’s climate goals. Concerned about potential financial risks and decreased global competitiveness, signatories urged Ford to meet with them. The Forum also co-signed a letter to *Exxon Mobil* regarding the Company’s governance and climate risk.

The Forum also approached *Hargreaves Lansdown* to discuss the Company’s implementation of the Taskforce for Climate-related Financial Disclosure (TCFD) guidance. LAPFF regularly engages with companies about how to use and integrate the TCFD. A response is awaited.

With the aim to encourage palm oil providers to improve the traceability of their palm oil to prevent deforestation and inappropriate exploitation of land, the Forum co-signed a letter pressing the *Roundtable on Sustainable Palm Oil (RSPO)* to implement a more transparent and responsive complaints mechanism to properly uphold the credibility of the RSPO system.
SOCIAL RISK

Employment Standards
The Forum published a paper on the context, frequency and implications of precarious work for companies and those people performing work on their behalf. The report points to the growing consensus over what needs to change at a government and regulatory level, such as ending opportunities to abuse existing legal categories and greater transparency of terms, conditions and rights associated with employment contracts.

The paper assesses the risk for investors, gives some high-profile examples and provides investors with practical guidance to engage companies on the issue, including asking boards how contracts fit with their approach to human capital management and whether they have undertaken cost-benefit analysis of precarious employment practices.

The Forum has been in communication with Banco Santander over reputational, financial and regulatory risks related to Santander Consumer USA (SCUSA), which is held by the Company through its wholly-owned subsidiary, Santander Holdings USA, Inc. Workforce standards at SCUSA are of concern to the Forum and further engagement is sought to discuss labour rights, alleged racial discrimination, human capital management and regulatory compliance.

LAPFF Vice Chair Denise Le Gal met with National Express Chairman Sir John Armitt to assess how the relationship with the unions had developed and to ensure good workplace practices at the Company’s US subsidiary, Durham School Services, have improved. The meeting also covered safety concerns and board diversity.

Following LAPFF’s attendance at Sport Direct’s Annual Meeting and half-year financial review in December 2017, a meeting was sought with the Company to further discuss back-payments for agency workers. The Forum also suggested Sports Direct reach a joint agreement with Unite on the issue of back-payments. In his reply, the Chairman, Keith Hellawell, did not take up the offer to have a face-to-face meeting.

Human Rights
Amid speculations about the content of the UN Human Rights Council’s ‘blacklist’, the Forum communicated with G4S, Caterpillar and Motorola Solutions. All three are allegedly among the companies that do business with or are operating in the West Bank, East Jerusalem and Golan Heights. The Council believes that operating in this region violates international human rights law and urges companies to carry out human rights due diligence, as well as consider whether it is possible to engage in such an environment whilst respecting human rights.

At a meeting with Motorola, LAPFF Executive Jane Firth noted that the company’s human rights policy was directed mainly at employees. She referred to the United Nations Guiding Principle on Business and Human Rights and asked whether the Company had an appropriate due diligence process in place. She also asked about Motorola’s strategy to reduce reputational risk related to their business in the Israeli-occupied territories. An open channel of communication between LAPFF and Motorola was agreed.

Diversity
Together with other members of the 30% Club Investor Group, LAPFF continued to engage with companies from the real estate sector to determine companies’ initiatives to increase female representation on corporate boards. Discussions focused on executive search firms, succession planning, women in leadership roles and sector-wide initiatives.

RELIEABLE ACCOUNTS/ CONSULTATION RESPONSES

LAPFF’s focus has been on Parliamentary Questions submitted by Baroness Sharon Bowles concerning the FRC and its governance and defective legal positions being taken, with linkage to the collapse of Carillion plc. To date, Baroness Bowles has tabled 51 questions. On the 28 February, LAPFF called for the FRC to be placed in special measures as part of the LAPFF response to the Corporate Governance Code.

On the 21 March, the Secretary of State for the Department of Business Enterprise and Industrial Strategy (BEIS) was asked at a joint Work and Pensions and BEIS Select Committees inquiry meeting about the effectiveness of the FRC. He announced to the Committee that there would be an independent enquiry into the operations of the FRC, and that enquiry would involve Parliamentary Committees.

When asked about the view of the Chief Executive of the FRC that the FRC needed more powers in the wake of it not taking more decisive and timely action on issues, the Secretary of State stated “I don’t agree with Mr Haddrill that there is something that is preventing vigourous action being taken”.

This is a positive response from the Secretary of State, and vindicates the LAPFF position that the problem is not the legal framework, but the FRC itself.
MEDIA COVERAGE

Accounting standards
- Carillion: Politicians press accounting watchdog over ‘going concern’ rules – IPE, 5 February 2018
- UK public pensions call for accounting watchdog to be disbanded – IPE, 13 March 2018
- FRC: Calling all pension funds – IPE, 16 March 2018
- Local Authority Pension Fund Forum calls for accountability watchdog to be scrapped – The Times, 19 March 2018
- Investors need to tighten the screws on auditors – Financial Times, 19 March 2018
- ‘Toothless’ accountability watchdog faces inquiry – The Times, 22 March 2018

Gender Diversity
- Big investors back push for 30% target for female executives – Financial Times, 2 February 2018

Employment Standards
- Public pension funds turn spotlight on ‘precarious work’ – IPE, 16 March 2018
- ‘Precarious’ work could put council pension investments at risk – LocalGov, 19 March 2018

NETWORKS AND EVENTS

LAPFF co-chair, Ian Greenwood, spoke to the London CIV shareholder meeting about LAPFF Engagement approach and practices. Representatives also attended an East Sussex Pensions Board and Committee meeting and a Camden Pensions Committee meeting presenting on workplan concerns.

The Shadow Local Government Pensions Minister, Jim McMahon MP spoke at the January meeting of the All Party Parliamentary Group (APPG) on Local Authority Pension Funds. Chaired by Clive Betts MP, attendees, including LAPFF executive and other members, discussed investment risks, the Government’s oversight of pension funds and the need to connect Councillors to the funds.

Climate Action 100+ IIGCC European Engagement Group call – Several of LAPFF’s climate risk engagements are being continued through the global collaborative of Climate Action 100+. Two calls focused on engagement process and strategy across the range of companies that investors are engaging with in Europe and on selection of companies and procedures for engagement.

PRI Investor working group on sustainable palm oil webinar – the group presented key findings from their recently released report ‘Sustainable Banking in ASEAN: Addressing ASEAN’s FLAWS’. The report reviews the sustainable finance regulatory landscape in the ASEAN region to explore the ESG integration progress of banks and their alignment to sustainable development.

At the BP Energy Outlook, Bob Dudley, the chief executive discussed BP’s views on the speed of transition; intensifying competition; and the importance of carbon emissions reduction. BP recognises that the company has to plan for the transition being faster than previously identified. Spencer Dale, the Chief Economist, explained the greater range of scenarios now used by the company including a new ‘evolving transition’ scenario, as well as those exploring the impact of electric vehicles and ‘new mobility’.

Teamster meeting – The Forum met with a representative from Teamsters regarding National Express operations in America and the treatment of the union and workers. These are ongoing issues that LAPFF has engaged with both Teamsters and National Express over.
## COMPANY PROGRESS REPORT

21 companies engaged over the quarter

### Q1 2018 ENGAGEMENT DATA

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COMPANY ENGAGEMENT ACTIVITIES

Company engagement activities

- Sent letter: 16
- Meeting: 7
- Received letter: 6
- Alert issued: 1

Company domiciles

- United Kingdom: 9
- USA: 6
- Germany: 3
- Jersey: 1
- Netherlands: 1
- Australia: 1
- Spain: 1

Position engaged

- Chairperson: 21
- Specialist staff: 7
- Non-executive director: 2

Outcomes

- Awaiting response: 14
- Dialogue: 11
- Change in process: 2
- Moderate improvement: 1
- No improvement: 1
- Small improvement: 1
## LOCAL AUTHORITY PENSION FUND FORUM MEMBERS

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