

LAPFF Response to Parker Review I Consultation

The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 72 public sector pension funds based in the UK with combined assets of approximately £175 billion. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

SUMMARY

LAPFF welcomes the opportunity to respond to the Parker Review Consultation. As an investor forum, LAPFF believes that addressing the issues of corporate governance and responsible investment are not an opt in but a requirement to safeguard the interests of pension fund beneficiaries. The report makes clear board diversity is important to the future success of companies, which LAPFF agrees with not least because ensuring diversity helps avoid 'group think'. However, as the report makes clear FTSE companies are falling short of what might be expected in terms of ethnic diversity. LAPFF therefore agrees with the recommendations that there needs to be an increase in the ethnic diversity of UK boards, the principles behind that position and the specific target set to achieve this diversity.

LAPFF considers that the report's recommendations could be strengthened by making a direct call on investors to play their role in ensuring that companies are working towards having more diverse boards. The report could therefore encourage investors to push for greater transparency as well as calling on investors to engage with companies to ensure that ethnic diversity on the board is given the attention and urgency required in order to ensure the creation and maintenance of long-term value for shareholders.

LAPFF Position on Diversity in the Board

LAPFF supports the principle of diversity and encourages boards to select new board members from a diverse pool of candidates.

LAPFF considers this is important principally because it discourages 'group think', which is vital if there is to be an effective challenge process. Gender diversity is a necessary but not sufficient attribution to achieve diversity of thinking on a board, thus we believe the case for diversity on boards

should not rest on gender alone but should include ethnic and international diversity; on thinking styles and experience as well as other aspects of diversity.

In order to widen the basis of experience on boards and improve their accountability and representativeness, LAPFF considers that companies should extend their search for non-executives beyond the boards of other listed companies (and thus avoid 'backscratching') to include individuals with a greater diversity of backgrounds. International candidates, those with relevant experience in the public, academic or voluntary sectors, or at divisional level in other companies may well fulfil the remit.

LAPFF is a supporter of the 30% Club, an initiative to encourage companies to voluntarily commit to improving boardroom gender diversity by striving to achieve the target of 30% women on corporate boards. LAPFF would also like to see companies clearly set out their targets for the percentage of female representatives at the executive committee level and two levels below, as well as disclosure against these targets in order to measure progress against an established time frame.

LAPFF welcomes that the Parker review sets targets for board level ethnic diversity and considers that companies could also set targets for below board-level ethnic diversity.

LAPFF engagement on improving diversity in the board room

In fulfilling its aim of protecting the pensions of members' beneficiaries, the Forum assesses long-term environmental, social and governance risks and opportunities on a case-by-case basis to determine appropriate shareholder engagement strategies. LAPFF believes that pension funds should not now have to opt into considering responsible investment factors, but should be required to address such issues as part of their routine investment processes.

LAPFF uses various forms of shareholder engagement including voting, correspondence, one-on-one company meetings, issuing voting alerts, attending AGMs, participating in investor coalitions, submitting shareholder proposals and encouraging vote declarations depending on the response of the targeted company. Such efforts can be important ways to highlight potential issues and apply pressure on companies.

Over the last year, LAPFF has been engaging with companies on their approach to diversity. For example, at the Tullow Oil AGM, a LAPFF Executive Member asked the Chair how Board diversity, and diversity more broadly, would be strengthened at the Company, particularly through linking pay to key performance indicators. In this instance, the Chair's response was encouraging and showed a willingness to continue to develop the Company's approach, particularly by considering the need for ethnic diversity, as well as gender diversity, and giving consideration to the fact that Tullow is an African-based business. Such engagement can play an important role and apply pressure on boards to consider ethnic diversity without recourse to legislation.

Responses to the recommendations

As the report makes clear, FTSE companies are falling short of what might be expected in terms of ethnic diversity. As an investor forum that supports diversity on boards to safeguard the interests of pension fund beneficiaries, LAPFF agrees with the recommendations that there needs to be an increase in the ethnic diversity of UK boards and action taken to realise this objective including the setting of related board composition goals. LAPFF regards targets as a very useful tool to improve

diversity but does not believe that legislation is the best way to create sustainable, meaningful change in this area.

We support the idea of succession planning and executive pipeline development including all aspects of diversity. The Forum also considers that all new executive director positions should be publicly advertised, accompanied by a job specification document, to encourage robust competition for positions and improve the diversity of candidates.

The role of investors

The report makes reference to the fact that ‘consumers, employees and increasingly investors are seeking to align themselves with companies that reflect their own beliefs, values and priorities.’ However, there is little reference to the role that investors can and do play in supporting greater ethnic diversity on the board.

LAPFF considers that the report could be strengthened by making an explicit call on investors and the role and pressure they can apply in strengthening good corporate governance by improving board diversity. As set out above, this engagement can take different forms. However, focusing on the role of the nominations committee is critical to ensuring diversity.

LAPFF believes that a section of a company’s annual report should be dedicated to the work of the nomination committee, including the process for making board appointments. In LAPFF’s view this should include a statement on the board’s policy on diversity, any measures set for achieving it and progress on achieving those objectives.

As an investor if there is a lack of diversity and a company appears to be paying lip service to the issue (for example, the section in the annual report is general in nature and does not provide adequate insight into the company’s strategy for improving board diversity) we often seek to engage with the chair of the nominations committee. The aim is to raise awareness of our concerns and seek assurances about how they intend to achieve greater board diversity. Such engagement is not always successful. In some instances, depending on the case, we also then issue a voting alert to member funds recommending they oppose the appointment of a board member, usually in this case, the chair of the nominations committee.

The report’s current lack of mention of such roles investors can play contrasts with the recent Hampton-Alexander review into improving gender balance in FTSE Leadership. The review makes recommendations to investors, much of which could be applicable to improving ethnic diversity:

4.1 Governance

Progress on gender balanced Boards and in the leadership ranks of FTSE 350 companies should be assessed as a key corporate governance issue when considering their responsibilities under the UK Stewardship Code.

4.2 Policy on Gender Balance

All institutional investors should have a clear process in place for evaluating disclosures and progress on gender balance for FTSE 350 investee companies at Board level, on the Executive Committee and in the Direct Reports to the Executive Committee.

They should also have a clear voting policy on gender balance which could include voting against the re-election of Chairs, Nomination Committee Chairs and the Annual Report and Accounts, where insufficient measures are in place in investee companies to address gender imbalance.

4.3 Communication

Investors should discuss and engage with investee companies on gender balance in particular where progress has been slow and vote in accordance with their policy. They should also publicly disclose their voting records