Pensions CIV Sectoral Joint Committee

Item no: 15

London CIV Stewardship Update

Report by:	Jill Davys	**Job title:**	Client Relations Director
Date:	12 July 2017		
Telephone:	020 7934 9968	**Email:**	Jill.davys@londonciv.gov.uk

Summary: This report provides the Committee with an update on Compliance against the UK Stewardship Code, voting and engagement over the quarter, an update on the Members Stewardship Working Group meeting and wider Responsible Investment Guidance.

Recommendations: The committee is recommended to:

i. Consider and note the contents of this report

London CIV Stewardship Update

Background

1. The London CIV as a regulated fund manager looking after the assets of the London Local Authority Pension Funds takes its stewardship responsibilities seriously recognising that good stewardship plays a key role in the management of assets delivering long term financial benefits.

2. This report sets out how LCIV is meeting its stewardship responsibilities and also provides an update on the work of the Member's Stewardship Working Group.

Compliance with FRC Stewardship Code

3. At the time of the last PSJC, LCIV had submitted a statement of compliance with the Stewardship Code to the FRC. This has been accepted by FRC as meeting the requirements of a Tier One Asset Owner for the purpose of assessment against the Code i.e. the highest tier for an asset owner. A copy of the Statement can be found on the FRC website: https://www.frc.org.uk/FRC-Documents/Corporate-Governance/Stewardship-Code/London-CIV.pdf

4. For asset managers there are 3 levels of compliance with the Code against which asset managers are assessed In terms of LCIV's external managers, both current and those scheduled for sub-fund launch over the coming months, the table below sets out the levels of compliance with the Code:

External Manager	Stewardship Code Compliance Tier	Asset Class	Additional Comments
Allianz	1	Global Equity	
Baillie Gifford	1	Global Equity DGF	
EPOCH	TBA	Global Equity Income	Statement of Compliance submitted to FRC for evaluation
Henderson	1	Emerging Markets	
Longview	1	Global Equity	
Majedie	1	UK Equity	
Newton	1	Global Equity Real Return	
Pyrford	2	Total Return	Manager seeking to upgrade to Tier 1
RBC	1	Sustainable Global Equity	
Ruffer	1	Absolute Return	
Passive Manager			
LGIM	1	Passive Life Funds	External to LCIV platform
BlackRock	1	Passive Life Funds	External to LCIV platform

5. Members will also be aware that individual pension funds under the new guidance for the Investment Strategy Statement (ISS) which Fund have had to issue by 1st April 2017, have to include an explanation on their policy on stewardship with reference to the Stewardship Code. From the FRC website, there are 4 London Funds who have submitted and been assessed under the Stewardship Code as level 2 asset owners, namely: Bexley; Ealing; Hackney and Hillingdon. LCIV officers are aware that a number of other LLA's are considering their own statements and it is anticipated that the number LLAs demonstrating compliance against the Code will increase over time. London Funds may therefore find the LCIV statement useful when either compiling their own statement or setting out their approach to Stewardship in their ISS.

Voting & Engagement

6. Members will recall that this Committee has agreed a voting policy which recognises the importance of collaborative working and will use as a basis for voting, the alerts issued by LAPFF in connection with voting. The alerts issued by LAPFF are forwarded to LCIV's external managers and asked to vote in accordance with the alert and for clear explanations to be provided where for wider investment or company reasons they have not followed the alert.

7. Over the quarter to 30th June 2017, LCIV received 11 voting alerts from LAPFF which were passed across to the LCIV delegated and direct managers for action. The table below sets out the voting alerts received and the manager response. Where they did not vote in line with the alerts, fuller explanations have been sought and these have been set out in Annex A to this report.

LAPFF Voting Alerts		Equities				DGF/TRF				Passive
Voting Alert	Date	Allianz	BG GAG	Majedie UK	Newton GE	BG DGF	Pyrford	Ruffer	Newton TR	LGIM
Fund Inception Date		02/12/2015	11/04/2016	18/05/2017	22/07/2017	15/02/2016	17/06/2016	21/06/2016	16/12/2016	
Smith & Nepwhew - Oppose Remuneration Policy	03/04/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted for policy post consideration of issues
GlaxoSmithKline - Oppose pay policy	21/04/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Vote in line with alert	Nil holdings	Voted for management	Voted for policy post consideration of issues
Wells Fargo - Vote for reviewing business standards	21/04/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted in line with alert
PPL - Vote for providing 2 degree analysis	02/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted in line with alert
BP - Vote for pay policy	02/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Voted in line with alert	Vote in line with alert	Nil holdings	Vote in line with alert
EnQuest - Oppose re-election of Chair of nomination committee	08/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted in line with alert
Shell - Vote for pay policy	09/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Vote in line with alert	Nil holdings	TBA	Voted in line with alert
Exxon - Climate Change Policy Impact Reporting	17/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Vote in line with alert	Nil holdings	Voted in line with alert
Chevron - Produce a report on its low carbon transition efforts	17/05/2017	Nil holdings	Nil holdings	N/A	N/A	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted in line with alert
WPP - Oppose Pay Policy	19/05/2017	Voted for policy post consideration of issues	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Voted for policy post consideration of issues
Babcock - Oppose Pay Policy	29/06/2017	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	Nil holdings	TBA

8. Looking at the table above there were 2 instances where LCIV's external managers did not vote in accordance with the voting alert issued by LAPFF. LGIM who are not contracted by LCIV, but whom LCIV monitor in accordance with government guidelines did not vote in accordance with the LAPFF voting alerts on 3 occasions. Detailed notes have been provided to explain their approach and these have been included within Annex A. On all occasions, managers have demonstrated that whilst they have not voted in line with the alerts issued by LAPFF, they have had a policy of ongoing engagement with the individual companies to try to ensure improvements in the relevant areas under consideration.

9. In addition at the regular quarterly review meetings held with the LCIV sub-fund managers, time is given to consideration of the engagement activities of the managers. A full annual voting and engagement report has been circulated to LLAs for information, where they have direct investments with LCIV.

Stewardship Working Group

10. The Joint Committee has established a Member working group to work closely with the CIV to develop stewardship activities and to consider matters relating to responsible investment.

11. The Member Stewardship Working Group met on 12 April 2017 (minutes attached at Annex A for information), with the purpose of considering a number of discussion papers on low carbon initiatives. For a number of local authorities this is one of the key strategic imperatives in that they are developing policies in terms of divestment or lowering carbon exposure.

12. The Working Group considered an initial limited survey of LLAs interested in seeking investments in the area of low carbon to assess whether demand was likely to be active or passive management and low carbon or fossil free. The initial survey yielded no firm conclusions on an approach and the Working Group agreed that a wider survey be commissioned and that all authorities should be contacted for views and that the survey should cover Members of the PSJC. At the time of writing the survey is being compiled and is expected to be issued shortly.

13. An initial date for a low carbon workshop had been agreed, however the Working Group were concerned that it was scheduled for the same day as a PSJC meeting and asked for the date to be rescheduled. Whilst another date was selected, on canvassing LLA officers, it has been deemed necessary to move the date from mid-July to September and a save the date notification is due to be issued shortly.

Responsible Investment Guidance

14. The LGPS Scheme Advisory Board (SAB) is currently assessing additional guidance for Administering Authorities on Responsible Investment, a draft of which was considered at the SAB meeting in May. LCIV officers are currently working with members of the Cross Pool Stewardship Working Group and the LGA to review the draft Guidance and to agree wording in advance of the final draft Guidance being submitted to a future SAB meeting.

Recommendations

15. The committee is recommended to:

    i. Consider and note the contents of this report

Legal Implications

16. There are no legal implications at this time.

Financial implications

17. There are no financial implications for London Councils

Equalities Implications

18. There are no equalities implications for London Councils

Attachments

Annex A – LCIV External Manager Explanations for not voting in line with LAPFF Voting Alerts

Annex B – Member Stewardship Working Group Minutes 12 April 2017

ANNEX A

LCIV External Manager Explanations for not voting in line with LAPFF Voting Alerts

Allianz

WPP - Oppose Pay Policy

For executive remuneration-related proposals (Res 3 and 4):

Sir Martin Sorrell's headline realised pay for FY2016 is £48.1m. This number is primarily driven by LEAP III, a controversial legacy equity incentive plan, and represents a c. 32% decrease compared to last year's pay-out. Given that this is the final vesting under the LEAP, that the awards are contractual, and that, similarly to last year, a large portion of the amount is attributable to share price appreciation and dividends accrued, we recommend voting For (in line with our approach last year). We note that the Remuneration Committee anticipates "substantially lower" vesting outcomes under the current LTIP scheme, the EPSP, as compared to LEAP.

We note further reductions in the quantum of executive pay proposed by the RemCo. This includes: 1) a reduction of annual bonus opportunity from 4.35x salary to 4x salary at maximum, and from 2.175x to 2x salary at target level with 50% of annual bonus deferred for 2 years; 2) a reduction in LTIP opportunity from 9.75x salary to 6x salary subject to TSR, EPS and ROE targets over a period of five years; and 3) a reduction in pension contribution from 40% salary to 30% salary. This means that CEO Martin Sorrell's maximum pay opportunity will be reduced by c. 30% as compared to the existing policy. We note high quality disclosure of performance targets, including reduction in the % of LTIP award for reaching target performance level (see details in ISS report). We think the steps taken by RemCo are positive and recommend support.

As discussed previously, for compliance reasons (i.e. shareholder disclosure) we are not permitted to split our vote. BAFIN's rules are quite strict and the fines are very high – in order to do so we would, as discussed, need a formal agreement in place that the London CIV would be responsible for market disclosures on a stock if votes were to be directed. This would also require our Compliance team to transfer the holding to the London CIV for aggregation with all other managers holdings for disclosure.

Newton TR

GlaxoSmithKline - Oppose Pay Policy

For GSK, Newton supported all resolutions at the company's 2017 AGM.

In the year following GSK's 2016 AGM, Newton continued engaging with the company on a variety of ESG matters; including areas such as executive remuneration, succession planning, audit, risk and wider corporate responsibility (see Newton's Responsible Investment Quarterly Reports for details of these engagement activities).

Following these engagements, GSK made a number of improvements and provided explanations for certain ESG policies and practices, which helped support and inform our investment case for the company.

While Newton do not register abstentions, Newton will vote against resolutions should we deem the underlying matter of sufficient concern. In 2016, Newton voted against management recommendations at 37% of all meetings, globally. Each voting decision is made on its own merits, taking into account our investment expectations.

Passive LGIM
Smith & Nepwhew - Oppose Remuneration Policy

Legal & General Investment Management (LGIM) takes its stewardship obligations seriously and pro-actively engages with companies in order to bring positive change to their governance structures. We use our position as a large shareholder to influence and promote best practice. Voting is an important tool for escalating issues which have not been resolved through our engagement activities.

Background:

At the 2016 AGM, Smith & Nephew failed to receive the majority support of shareholders on the approval of the remuneration report. LGIM continued its engagement with Smith & Nephew plc throughout 2016, including on executive remuneration.

We can confirm that in our considerations for this meeting, the following aspects were reviewed by LGIM's corporate governance team:

- LGIM's engagement with the company during the year
- The performance of the company and changes to the board during the year
- The changes proposed to the remuneration structures

Other considerations for this meeting discussed by LGIM's corporate governance team when taking this final vote decision included a review of the disclosures in the annual report on gender diversity and conformation of the notice of meeting against the Pre-Emption Group's Guidelines (industry best practice on this resolution).

With regards to the resolutions to approve the Remuneration Policy and Remuneration Report, LGIM noted the following:

- Introduction of a number of best practices including a two year holding period, which LGIM have been pushing for
- An increased minimum shareholding requirement for the executive to 3x salary, which is aligned with LGIM's policy
- That there were no changes to the pension provisions within the policy
- The introduction of ROIC into the performance targets, which we consider will more closely align pay with long-term shareholders
- The downward discretion used by the remuneration committee during the year to reduce bonuses to the executive by 10%

- That no 2016 bonus award was received by the Finance Director, who stepped down from Smith & Nephew in January 2017 and that all outstanding share plans lapsed in full.

LGIM's voting policy regarding discretion:

We continue to believe that Boards should retain ultimate flexibility to apply discretion and 'sense-check' the final payments to ensure that they align with the underlying performance of the business. This is because a purely quantitative based assessment on a handful of performance criteria may not always fully reflect the long-term performance of the company nor align appropriately with long-term shareholders. In accordance with our policy we are likely to oppose the approval of the remuneration policy if there is insufficient disclosure or explanation on the use of discretion.

Where companies exercise discretion during a year, LGIM will review the appropriateness of the use of that discretion and the relevant disclosures in the remuneration report. We are likely to oppose the approval of the remuneration report with respect to discretion issues when discretion is exercised to allow a bonus or long-term incentive to vest without sufficient justification and/or when discretion is used and pay is not demonstrably aligned with performance of the company.

GlaxoSmithKline - Oppose pay policy

Background:

At the 2016 AGM, 85% of shareholders voted in favour of GlaxoSmithKline's (GSK) remuneration report. As set out in LGIM's 2016 Corporate Governance Report, on page 36, we had substantial engagement with GSK during 2016 on a range of issues, including board composition, management succession, corporate reporting and remuneration. We held four meetings with GSK Chairman and non-executive directors in 2016 on these issues; so far in 2017 we have held face to face meetings with GSK twice, with the Remuneration Committee Chairman and a separate meeting with the new CEO.

The 2016 Corporate Governance Report can be accessed here: http://www.lgim.com/library/capabilities/CG_Annual_Report_2016-full.pdf

How did LGIM vote last year at GSK?

Last year LGIM voted against the approval of the Remuneration Report due to concerns that the payment of a maximum bonus to the executive did not fully reflect the performance of the company.

How will LGIM be voting at the forthcoming general meeting?

Whilst we are unable to disclosure our voting intentions in advance of the AGM, we can confirm that in our considerations for this meeting, the following aspects were reviewed by LGIM's corporate governance team:

- LGIM's engagement with the company during the year
- The performance of the company and changes to the board and management during the year
- The changes proposed to the remuneration structures

With regards to the resolutions to approve the Remuneration Policy, LGIM noted the following:

- Incorporation of LGIM's feedback following engagement

- Remuneration structure and quantum for the new CEO verses the former CEO
- Removal of matching share scheme – something we have been asking for and is aligned with LGIM's policy
- Removal of individual performance multiplier – something we have been asking for
- Increase in mandatory bonus deferral – in line with best practice
- An increased minimum shareholding requirement for the executive to 6.5x salary, which is aligned with LGIM's policy
- Continued provisions for recruitment related remuneration
- Leaving arrangements for the previous CEO and other executives

LGIM's voting policy on pay ratios:

We support the publication of pay ratios, and wrote to all companies in the FTSE 350 in September 2016 encouraging the disclosure of the pay ratio between the CEO's total single figure and the median employee. This is also a disclosure we have supported in recent government consultations on remuneration and governance. As this is a relatively new request, we are not currently voting against companies who did not disclose the pay ratio in their 2016 Report and Accounts.

LGIM's voting policy on remuneration committee discretion:

We continue to believe that Boards should retain ultimate flexibility to apply discretion and 'sense-check' the final payments to ensure that they align with the underlying performance of the business. This is because a purely quantitative based assessment on a handful of performance criteria may not always fully reflect the long-term performance of the company nor align appropriately with long-term shareholders. Where companies exercise discretion during a year, LGIM will review the appropriateness of the use of that discretion and the relevant disclosures in the remuneration report.

WPP - Oppose Pay Policy

Background:

In 2009, WPP put to a shareholder vote a value sharing co-investment plan that was subject to TSR relative to its industry peers and weighted by market cap. LGIM opposed the introduction of this Plan on account of quantum, yet, it was approved by a majority of their investors, 83%.

What did LGIM do?

Having voted against WPPs remuneration for a number of years, we worked with the company to introduce a long term incentive with a significantly lower quantum, where performance is measured over 5 years and is subject to more than just TSR but also ROE and EPS. The awards under this plan will start to vest in 2018.

We continued to engage with the company to push for further reductions in overall quantum.

This year the Company is introducing the following changes despite delivering TSR of 210%.

- The maximum bonus opportunity will reduce from 435% to 400% of salary for Sir Martin Sorrell and from 300% to 250% of salary for Paul Richardson.

- The maximum award opportunity under the EPSP will reduce from 974% to 600% of salary for Sir Martin Sorrell and from 400% to 300% of salary for Paul Richardson.
- The pension allowance will reduce from 40% to 30% of salary for the Chief Executive.
- Benefits will be capped at £200,000 for Sir Martin Sorrell and $85,000 for Paul Richardson.
- In addition, the maximum variable remuneration opportunity will reduce from 1,000% to 800% of salary for newly appointed Directors, whilst the maximum pension contribution offered will be reduced from 40% to 25% of salary.

In aggregate, the proposed changes will have the effect of reducing the CEO’s overall maximum pay opportunity (before any account is taken of share price appreciation or dividends), by 27% or £4.8 million. This brings the total reduction since 2011 to 58% or £18.1 million.

ANNEX 2

PENSIONS SECTORAL JOINT COMMITTEE – LONDON CIV

Stewardship Working Group

12th April 2017 – Minutes

Attendees:

Borough	**Representative**
Ealing	Cllr Yvonne Johnson (YJ), Chair – (by Phone)
Hackney	Cllr Rob Chapman (RC)
Islington	Cllr Richard Greening (RG)
Wandsworth	Cllr Maurice Heaster (MH), Vice Chair

London CIV	
Chief Executive	Hugh Grover (HG)
AD, Client Management	Jill Davys (JD)

Agenda Item Number	Agenda Item	Actions
1.	**Apologies:** Cllr Toby Simon (Enfield), Cllr Thomas O'Malley (Richmond) Cllr Simon submitted comments: a) Keen to see low carbon options available on LCIV platform b) Engagement is also important in the low carbon debate c) Further development work should be carried out to assess strategic needs for London Funds	
2.	**Minutes and Matters Arising** Minutes Agreed Matters Arising: • Stewardship Code – the Committee were pleased to note that a Tier One level had been achieved by LCIV in their Statement of Compliance with the Code.	
3.	**Assessing Demand for Low Carbon or Fossil Free Options** The Committee discussed a briefing report provided which covered a recent survey of Funds keen to access low carbon options. This had covered a limited number of Funds, known to have either considered or being considering low carbon options for their Funds. However, it was clear from the survey that initially there was little commonality in the approaches required and that Funds were still determining their exact strategic approaches in this area. Cllr Chapman noted that this area had been raised in the Pre-Joint Committee meeting and that there were a number of	

authorities keen to get together to asses what they might need collectively. There are lots of commitments being made but not always clear what the immediate outcomes are. However there was clearly the view that any divestment or reduction to carbon should be on risk based reasons.

Agree that any low carbon survey should be extended to cover all London Funds and be sent to Members of the Joint Committee for completion as well.

JD to develop survey and to circulate to all authorities including those Members on the Joint Committee

4. **Low Carbon – Passive/Active Options**

It was noted that this time there was a lack of clarity over individual Pension Fund requirements and that the range of options was growing all the time, although clear that there weren't a large number of funds with long term track records in this area.

It was noted that a number of managers that had applied for the sustainable equities mandate, whilst not specifically targeting low carbon or fossil fuel exclusions, the nature of the strategies that they followed led to lower carbon exposure.

Members recognise that greater clarity was required from the Pension Funds themselves to assist LCIV in developing suitable products and that Funds themselves may need to be flexible and accept strategies where some commonality can be achieved.

5. **Carbon Foot Printing:**

Members were provided with an update on views on carbon foot printing including the different methodologies of third party providers in assessing carbon foot printing,

It was noted that a small number of London Funds had already undertaken a carbon foot printing exercise to assess their own Funds. Having raised the option of undertaking London wide carbon foot printing with officers, there had been a mixed response on this with concerns about this leading to a league table on carbon exposure when measures of carbon exposure aren't always reliable.

Agree to capture wider views within the survey as to levels of interest in developing options possibly through the National Stewardship Framework.

Members were keen to continue talking to the managers about what steps they were taking to assess their carbon foot print. Felt it was important to keep the issue on the agenda

	for future meetings and also perhaps a topic for consideration at a future low carbon seminar.	
5.	**Low Carbon Workshop:** The proposed date for the Low Carbon Workshop had been set for the same day as the next PSJC meeting, however Members felt that this would extend the day too much and not allow sufficient time. It was agreed to find an alternative date that was a standalone date. Some of the key requirements for the day from Members were: a) What is available in terms of low carbon funds, choices and costs (Cllr Johnson) b) Understanding how to implement divestment and how to pursue greater levels of engagement (Cllr Greening) c) What are the issues that need to be consider d) Survey results to be published when available	
6.	**Dates of Future Meetings:** The Group were content to have a further meeting possibly in advance of the workshop	JD to provide possible dates for further meetings
7.	**A.O.B** None raised	