

REVIEW OF CORPORATE GOVERNANCE ARRANGEMENTS

Purpose of the Report

1. This report updates Members on the current Corporate Governance Arrangements and explores potential future options.

Background

2. In October 2003 the Corporate Governance arrangements were reviewed and this Committee agreed to:
 - To endorse the Fund's continued membership of the Local Authority Pension Fund Forum (LAPFF); and
 - To agree that the Fund continue to buy the PIRC Corporate Governance Service for a period of 3 years.
3. There are several reasons why a review of this policy and its delivery is now timely:
 - The recent review of the Fund's investment strategy and the appointment of new managers makes this a good time to review other investment issues;
 - The Fund now has a much higher weighting to overseas equities, but it does not have an overseas voting policy; and
 - We need to ensure that the Fund is achieving value for money from its Corporate Governance (CG) / Corporate Social Responsibility (CSR) arrangements.

Main Considerations for the Committee

Corporate Governance Arrangements

4. It is generally accepted that companies that have good CG arrangements perform better, which translates into increased financial value for the Fund. The Fund's current CG policy is for PIRC to provide voting guidelines to our investment managers for all holdings within the FTSE 350. If the investment managers wish to vote contrary to PIRC guidelines they must notify officers in advance, and if we agree, they must disclose it within their quarterly monitoring reports, although such circumstances are rare.
5. For all other holdings (companies outside the FTSE 350 and overseas) the investment managers are able to follow their own internal CG policy.
6. With the implementation of the new Investment Strategy, a greater proportion of the Fund's equities are now overseas based (60%) compared to the UK (40%). This means that potentially for the overseas assets, the investment managers could be voting against each other, because there is no standard voting policy.

7. The current arrangements also rely on the investment managers ensuring their votes are registered correctly and on time, which we do not monitor. Voting could be out sourced to a third party such as a PIRC or one of their competitors.

Corporate Social Responsibility & Activism

8. The Fund fulfils its activism responsibilities through membership of the LAPFF. The LAPFF promote investment interests by maximising their influence as shareholders whilst promoting CSR and high standards of CG amongst the companies in which their members invest.
9. Formed in 1990, the LAPFF brings together a diverse range of local authority pension funds with combined assets of over £70 billion and over 40 funds, including 11 County Councils. There has been a 65% increase in membership over the past 3 years.
10. Continued membership of the Forum makes sense as the effectiveness of individual funds engaging in shareholder activism alone must surely be questionable, but by taking a co-ordinated approach, the level of effectiveness is improved. At the same time, membership of the Forum does not impede the Fund's ability to act unilaterally if the situation should arise for the interest of the Fund.
11. The cost of LAPFF membership is minimal relative to the benefit that is achieved (circa £8,500 p.a.).

Future Options

12. As the PIRC Corporate Governance Service is due for review, officers intend as part of a re-tendering of this contract, to investigate the following:
 - the potential for extending the level of service to acquire a standard voting policy in other international markets, in particular Europe and the US; and
 - the potential for taking voting away from the investment managers and acquiring a third party to vote consistently and report on the way votes have been cast.
13. Officers propose to bring a paper back to this Committee following the tender exercise, so that final policy in these areas can be determined.
14. In terms of activism, it is proposed to continue our membership of LAPFF as the comparative cost of engaging with companies ourselves would achieve little. Membership also includes other benefits such as access to detailed research, focused discussion on non-CG/CSR issues and networking.

Environmental Impact of the Proposals

15. If the Committee decides to adopt the proposals put forward, it will result in continued membership of the LAPFF, which seeks to engage with companies on environmental issues.

Risk Assessment

16. Arguably, failure to engage on CG/CSR issues will potentially lead to lower investment returns. Collective engagement is more likely to lead to real changes in companies for the good. A similar argument relates to the failure to vote at company meetings.

Proposals

17. The Committee is asked to:

- a) note that officers will carry out a re-tendering of the Corporate Governance service to ensure best value is achieved;
- b) agree that officers examine the potential options for extending its standard voting policy to include the overseas markets where major shareholdings are held;
- c) agree that officers investigate the potential for commissioning a single provider to exercise our voting rights and report on the way votes have been cast; and
- d) agree to the Fund's continued membership of the Local Authority Pension Fund Forum.

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Unpublished documents relied upon in the production of this report: None

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