

Annual Report 2009



1 Chairman's Statement

When Forum members met for last year's annual conference, we knew that 2009 looked likely to be a turbulent year. We had just seen governments around the world take stakes in their banking industries in order to prevent a systemic collapse, and the markets were still reeling. LAPFF, therefore, set itself a tough work programme, informed by the need to both respond to the immediate challenges arising from the crisis and to push forward with existing programmes where important work was already underway.

Our focus on governance at Marks & Spencer meant the engagement has had a high profile this year. The Forum's shareholder resolution received just under 38% of votes cast, with abstentions taking the vote not in favour of management to 40%, a very high level of support for a shareholder resolution in the UK. Once again we have learnt a great deal, and made numerous valuable contacts. By taking a stance that was forthright but supportive of the company the campaign earned us credibility in the market which we can draw upon in future activity. In the meantime, we will be continuing to engage with M&S, and with other investors who are also concerned about its governance arrangements.

Not surprisingly, our engagement with the banking sector has been another major focus this year and by the time you read this we will have met with senior management at nearly all the UK's major listed banks. Dialogue centred on remuneration at these meetings, and LAPFF has continued its push for long-term incentives with linkage to non-financial issues. To say that there is a variation in how the banks address remuneration and other governance issues would be an understatement. Our engagement with them has therefore given us a much better appreciation of the challenges facing the industry as it recovers from the crisis, and an insight into which companies may require further attention.



The Forum has also pushed ahead with its expansion of engagement activities outside the UK. The formulation of a 'global focus list' has seen us engage with senior management at companies across Europe and North America. Notably some of the companies identified for engagement because of governance concerns have run into problems. The best example of this is KBC, which had to be recapitalised by the Belgian authorities during LAPFF's engagement with them. In the US, investment firm Legg Mason saw a major shareholder revolt over remuneration. Work is now underway on creation of the 2010 list, while we continue to monitor the progress of those on this year's focus list.

Finally, in addition to the global focus on governance, 2009 has also seen LAPFF continue to engage on a range of thematic issues. Climate change remains a major focus of our work, and we look forward to sustaining productive engagement with US and EU as well as UK-based companies. We have also met with a number of companies regarding overseas employment standards, obesity concerns and have taken part in collaborative engagement with other investors on company workforce practices. It looks likely that a growing number of company-specific engagements will continue as a result.

As 2009 draws to a close, we can look back on a busy year. In many ways investors will have regarded the last 12 months as a period in which governments have 'steadied the ship'. The Forum has used this time productively, particularly in its engagement with the banking sector. In a challenging year the Forum achieved success in its work to promote best practice in the environmental, social and governance factors that pose a risk to our long-term investment interests. As we head into 2010, the knowledge and contacts we have developed throughout our work should ensure that LAPFF can play a constructive role in the post-crisis environment.

Councillor Ian Greenwood
West Yorkshire Pension Fund
Chair

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3 LAPFF Executive



4 This Year's Highlights



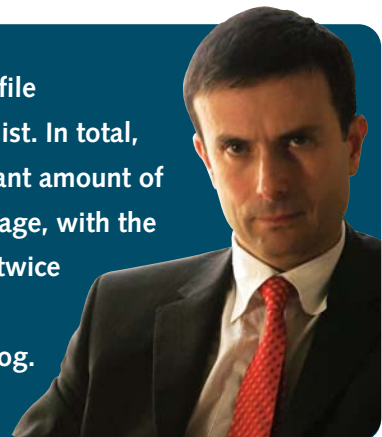
● Climate change	38%
● Global focus list	22%
● Case by case engagement	13%
● Obesity	7%
● Company workforce practices	7%
● Incentivising executives	6%
● Overseas employment standards	4%
● Countries with weak governance	1%
● Audit	1%
● Defence	1%

Press highlights 2009

600+ media hits

Six times the publicity of 2008

The Forum's media coverage has soared during 2009, driven by high-profile engagements with Marks & Spencer and companies on the global focus list. In total, LAPFF featured in over **600 media stories** during the year, with a significant amount of coverage in the national press. We also picked up broadcast media coverage, with the Forum chair being interviewed on **BBC television's lunchtime news**, and twice on **Radio Four's flagship Today programme**. Finally, LAPFF was also the subject of a piece on BBC business editor **Robert Peston's** widely-read blog.



Companies featuring in this report

ABF	Overseas employment standards, obesity
Antofagasta	Climate change
Avis Budget Group	Climate change
BAE Systems	Defence
Barclays	Incentivising executives
BP	Climate change
Britvic	Obesity
Carnival	Company workforce practices
CDP	Climate change
Cia Espanola de Petroleos (CEPSA)	Global focus list
Conoco Phillips	Climate change
Daejan Holdings	Global focus list
Department for Business, Innovation and Skills	Response to credit crunch
Department for Communities and Local Government	Response to credit crunch
ExxonMobil	Climate change
F&C Asset Management	Global focus list
Financial Reporting Council	Response to credit crunch
Financial Services Authority	Response to credit crunch
Forest Footprint Disclosure	Climate change
FTSE 350	Audit
Halliburton	Climate change
Hardy Oil & Gas	Global focus list
HSBC	Incentivising executives
Iberdrola	Global focus list
Inditex	Global focus list
Intermediate Capital Group plc	Global focus list
KBC Group SA	Global focus list
Legg Mason, Inc.	Global focus list
Linear Technology Corp	Global focus list
Lloyds	Incentivising executives
Marks & Spencer	Corporate governance activism
National Express	Company workforce practices
Petrofac	Companies with weak governance
Randgold Resources plc	Global focus list, climate change
Royal Bank Scotland	Incentivising executives
Sainsbury's	Obesity
Shell	Climate change
Stagecoach	Climate change
T Rowe Price Group, Inc	Global focus list
The Unite Group plc	Global focus list
Total	Companies with weak governance
Tullet Prebon plc	Global focus list
Unilever	Obesity
Vedanta Resources plc	Global focus list, Climate Change
Weir Group	Companies with weak governance
WM Morrison plc	Overseas employment standards, obesity

5 Corporate Governance Activism

5.1 Marks & Spencer

The Forum's engagement with Marks & Spencer continued during 2009, with a key focus being the company's AGM in July. LAPFF had already held meetings with the company's senior management during 2008 to express its concern at the decision to allow Sir Stuart Rose to combine the positions of chair and chief executive. The Forum made clear to the company that it would consider filing a shareholder resolution if investors' concerns were not adequately addressed by the time of the 2009 AGM.

LAPFF continued to engage with the board during 2009, meeting in February with the senior independent director, David Michels, to encourage the company to revert to governance best practice. At all time, the Forum stressed its support for Sir Stuart, but also made clear that the governance structure adopted was causing real concern among M&S shareholders. Although the nature of the engagement has been positive, it was clear that the company was intending to 'tough it out'. As a result, LAPFF voted unanimously to press ahead with the filing of a shareholder resolution seeking the appointment of an independent chair by 2010.

The Forum had been talking to various investors about the M&S situation since the announcement that Sir Stuart would combine the two roles. Once the resolution was successfully filed by LAPFF, this process stepped up a gear. The Forum held a briefing for investors after the April business meeting, and the Chair held a series of face-to-face meetings with the largest investors in M&S to make the case for supporting the initiative.

The process of investor engagement had a number of important benefits. First, it quickly became very clear that LAPFF's concerns were widely shared. All the investors that the Chair met agreed with the Forum's analysis that the combined roles were not necessary to implement the M&S succession planning process (the company's official justification). Second, the positive nature of the meetings resulted in the Chair building valuable personal contacts with a number of important institutional investors. Finally, the meetings helped build support for the resolution, with one investor

informing LAPFF that it had changed its position on the initiative as a result of the meeting it had with the Chair.

The resolution garnered significant support, with all the leading voting advisory services recommending that shareholders vote in favour, and major institutional investors voting in favour. At the AGM just under 38% of votes were cast in favour of the resolution. Including abstentions the vote not in support of management rose to 40%¹. Although short of a majority, we believe that this result sent a clear message both to M&S, as well as the broader UK market, that there are serious concerns about governance structures of this type. Feedback from other investors since the vote has also reflected this.

Of course, the situation remains unresolved, with the process of appointing a chief executive still not completed. Therefore, the Forum has continued its engagement with the company, and with other M&S investors. Depending on the responses received, LAPFF will gauge its approach to the company's 2010 AGM accordingly.



¹ <http://corporate.marksandspencer.com/page.aspx?pointerid=2649738303af4099b14e590ca6996b8c>

5.2 Non-financial performance and executive rewards

Our objectives:

- To implement the Forum's engagement strategy on non-financial business performance and remuneration
- To take the lead among institutional investors on the development of a consensus approach to incentivising executives

Throughout 2009 remuneration has remained a core governance issue for LAPFF. The credit crunch has shown that a very narrow conception of incentive and reward resulted in arrangements which may have encouraged inappropriate short-term risk taking at the expense of long-term success. The failure of the boards of financial institutions to properly align managers' actions to the best interests of long-term owners not only gave credibility to Forum's work in this area, but also guided engagement with UK banks.

In John Kenneth Galbraith's *The Great Crash*, a history of the events leading up to the Great Depression, he had something to say about banks that is relevant today: "The bankers were also a source of encouragement to those who wished to believe in the permanence of the boom. A great many of them abandoned their historic role as the guardians of the nation's fiscal pessimism and enjoyed a brief respite of optimism."

In addition to bankers, it seems many investors also got caught up in a rose-coloured world where risk only reaped reward. LAPFF's work to encourage non-financial performance metrics has been an effort to be a guardian of long term investment interests and to push this view into the mainstream.

The Forum went public in March with the results from its ongoing work examining the ways FTSE 100 companies incentivise their executives, particularly regarding the use of non-financial metrics in long-term schemes. The results were based upon the responses of remuneration committee chairs and indicated common themes identified among the challenges faced in implementation.

Despite the challenges, a handful of companies are working through the difficulties and are taking bold moves to incorporate non-financial metrics into their schemes. The Forum is pushing for the approach adopted by these companies to become the norm.

This year the Forum has met with **Barclays, RBS, Lloyds** and **HSBC**. The aim of these meetings was to discuss how incentive schemes may have contributed to a short-term focus on the part of managers, resulting in excessive risk taking. It was clear from the meetings that some were struggling to identify appropriate metrics. Yet progress could be seen and Lloyds, in particular, stands out as exemplifying the type of practices the Forum promotes. This year the bank included a non-financial scorecard as part of its long-term incentive scheme related to the HBOS integration. Engagement is ongoing and will continue into 2010.

In addition to company meetings, LAPFF representatives continue to engage investors and remuneration consultants informally on these issues. For instance, in March, the Forum's ideas were discussed at an investor roundtable hosted by the Network for Sustainable Financial Markets (NSFM) in Amsterdam, which was attended by representatives of some large US and EU investors as well as a number of remuneration consultants.

We said:

“Traditional incentive schemes are failing to protect shareholders' long-term interests. In the current crisis we see bonus schemes that would continue to pay out at bailed-out banks, were it not for a Government ban. We need to address this worrying lack of long-term focus in pay schemes. Investors, remuneration committees and their consultants need to work together towards a reform of market practices in this area.”

Cllr Ian Greenwood, LAPFF Chair



5.3 Audit

Our objectives:

- To encourage companies to provide better quality audit committee reports and disclose policies of awarding non-audit work by:
 - Conducting direct company engagement
 - Continuing regulatory engagement and engaging in relevant lobbying activities
 - Ensuring the Forum's views are heard, in particular by seeking representation on appropriate industry and other bodies
 - Remaining up-to-date on developing issues by monitoring and responding to appropriate reports and consultations

Audit issues have been a fundamental governance concern for the Forum for some time. Its ongoing work in this area has been driven by the need for investor confidence in and understanding of the financial accounts of the companies in which it invests. The financial crisis has resulted in new questions about lack of proper risk accounting, particularly at failed banks and financial institutions. The Forum has continued to promote the need for companies to go beyond formulaic reporting and seek an increase in expertise of audit committee chairs. This year, the Forum has also included a greater focus on risk in its audit engagement. A culture that overvalued the potential gain from risks and failed to capture the potential downside was of particular importance in the financial crisis. In January 2008, the Forum set out an agenda for engaging with the FTSE 350 regarding their audit reporting. Since then constituents of the FTSE 350 were written to, and this engagement has continued into 2009. However, with the increased severity of the financial crisis in late 2008, the Forum took time to assess the best approach to engagement. In September 2009 the Forum emphasised that the problem does not only lie with individual companies, but that there are broader systemic issues to address. It was decided that the Forum must continue to engage directly with companies while recognising the system in which they operate is not functioning properly. Therefore, engagement with government and regulators will also be a priority of the Forum's engagement going forward.

We said:

“Reliable financial reporting is the lifeblood of capital markets. Investors must be able to rely on companies'

audits, and auditors.

LAPFF statement on the financial crisis, May 2009



5.4 Global activism

Our objective:

- To implement the Forum's global focus list-based engagement strategy

2009 was the first year that LAPFF used a global focus list to guide its engagement. This resulted in one-to-one engagement with companies in the UK, Europe and the US and brought the Forum significant media attention.

The use of a global focus list was driven by a shift in asset allocation by LAPFF members beyond the UK market. UK pension funds have steadily moved their equity holdings overseas, with only 42% of assets allocated to the UK in 2008, compared to 70% in 2001². Using top stocks in each market and screening them against a market specific set of metrics, LAPFF identified companies performing poorly in respect of remuneration practices and other core corporate governance areas.

² WM Performance Services: UK Pension Funds Annual Review 2008.

15 companies were chosen for engagement across UK, EU and US markets: CEPSA (Spain), Daejan Holdings (UK), F&C Asset Management (UK), Hardy Oil & Gas (UK), Iberdrola and Inditex (Spain), Intermediate Capital (UK), KBC group (Belgium), Legg Mason (US), Linear Technology (US), Randgold Resources (UK), T Rowe Price Group (US), Tullet Prebon (UK), Unite Group (UK) and Vedanta Resources (UK). The busy proxy season has seen some intense engagement over key corporate governance failings at many of these companies. Engagement has taken various forms, involving conference calls and face-to-face meetings as necessary. Special alerts have been issued in advance of company AGMs to highlight the specific governance concerns at KBC, Tullet Prebon, Unite, T Rowe Price, Inditex, Vedanta, Legg Mason and Daejan Holdings.

Following the issuing of an alert and press release on **Tullet Prebon**, the LAPFF chair was interviewed on the Today programme with Terry Smith, the company's chief executive. A meeting followed and engagement continues.

After the Forum issued an alert on **KBC** raising concerns over the lack of clarity in the remuneration paid to the executive board directors and other members of the executive committee, a phone conference was held with KBC's chief financial officer and chief risk officer (both posts held by one individual). This proved to be a very constructive engagement, as it turned out that KBC had a good story to tell, but had not been able to communicate it effectively.

The Forum sent representatives to the **Hardy Oil & Gas** AGM at which it achieved commitment from the company to engage with the Forum. Meetings with **KBC, Hardy Oil & Gas** and **F&C Asset Management** resulted in solid commitments from the directors and these will be kept under review. Following engagement with CEPSA, the company successfully implemented succession plans to appoint an independent non-executive chairman. In their next annual reporting the Forum will look for increased remuneration disclosure from the company, a commitment agreed by the board. Engagement continues with **Intermediate Capital** through the remuneration committee chair. In addition, as part of the focus list engagement (along with climate change and community concerns) the Forum held a conference call with the senior independent director and chief executive of **Vedanta Resources**, prior to the AGM.

Legg Mason, a target due to its exceptionally poor remuneration disclosure, offered little explanation in its response to the Forum. An alert was issued to members in advance of the companies AGM and as engagement has not achieved progress with the company it will be considered for the 2010 focus list.

Currently, engagement continues across the focus list and research is underway to create a revised list for 2010 that will guide engagement over the next proxy season.

We said:

“ The Forum's members are now exposed to varying levels of corporate practice in the different markets they invest in, highlighting the need to adopt a global governance perspective on activism, while also taking local market variations into account. ”

Global focus list overview, October 2009

6 Promoting Corporate Responsibility

6.1 Climate change risks

Our objectives:

- To engage with FTSE 350 companies on the likely impacts of climate change on industry sectors and companies with long-term research and development programmes, and consequent risk to shareholder value
- Expand engagement on climate change risks to US and EU companies using collaboration where possible

The threat posed by climate change continues to be one of the most pressing issues facing investors as society grapples with its current impacts and potential consequences and as governments enact more stringent legislation. This remains the largest single project area for LAPFF and engagement has continued to expand beyond the UK, to EU and US markets. In October, members deliberated on a Forum Statement on Climate Change drafted as part of ongoing work for trustees on climate change as an investment issue.

Engagement has been progressed with companies in the oil & gas, transport, food & drinks and mining sectors, where the Forum has sought improvements including on disclosure and target setting, as well as on sector and company specific issues. Engagement with the oil and gas sector continued in the UK with **Shell** and **BP**, with the focus moving to their investment into tar sands. This phase of engagement stemmed from an exploration in 2008 by the Forum of the environmental impacts of tar sands and its economic viability from an investor perspective. The Forum also co-signed a letter to 23 companies in the US and Canada requesting further information on the risks associated with investment in tar sands projects.

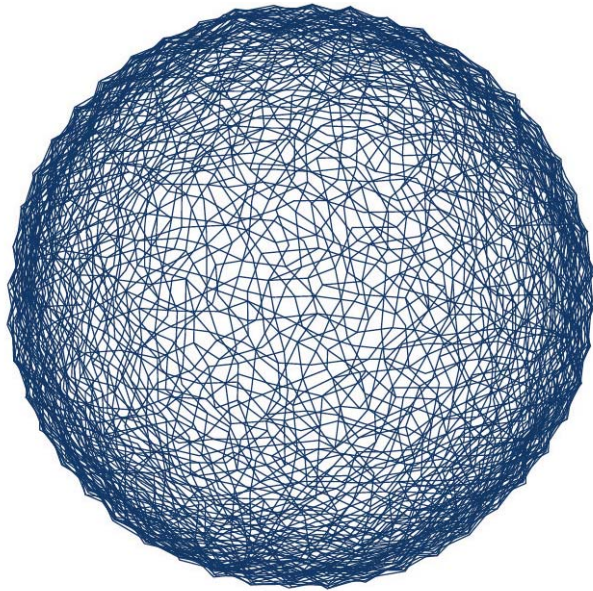
Through its membership in **Investor Network on Climate Risk (INCR)**, and in an effort to achieve the best results in its overseas engagement, LAPFF joined working groups facilitated by INCR in the oil & gas, transport and food & drinks sectors. Alerts were issued to members with voting recommendations to support shareholder resolutions aimed at improved climate disclosure and target setting at **Halliburton**, **Conoco Phillips**,



ExxonMobil and **Avis Budget Group**. Also in connection with the US-based working groups, LAPFF was invited to and was represented at a meeting with **Exxon** CEO Rex Tillerson in February 2009.

In addition to the collaborative efforts via INCR, engagement with the transport sector included analysis of six European airlines, which will guide engagement going forward. Engagement with **Stagecoach** continued as the company works to implement its carbon management programme, following on from LAPFF's attendance at the company's AGM last year.

In the food and drinks sector, there was ongoing focus on UK companies as well as collaborative efforts with investors in the US facilitated by INCR. The issue of palm oil has received increased attention from the Forum in 2009, with LAPFF undertaking the role of facilitator by sharing its research on this issue with UNPRI members in helping to formulate a strategy going forward. In engagement with companies in the sector, palm oil sustainability was discussed and is a focal point for future collaboration.



COP15 COPENHAGEN

UN CLIMATE CHANGE CONFERENCE 2009

One issue which has repeatedly been in the press during the lead up to the Copenhagen Conference is the importance of reducing deforestation in order to combat climate change. To address this issue, the Forum joined 24 other institutional investors in supporting the launch of the Forest Footprint Disclosure project (FFD). The project, which is similar in operation to the CDP, aims to help investors understand how a company's activities and supply chains contribute to deforestation. Questionnaires have been sent to 217 companies from around the world requesting information relating to their forest footprint.

Research has progressed on FTSE 100 mining companies, looking both at business strategy related to climate change and related disclosure, and in some cases on community issues. In 2009, the Forum wrote to **Antofagasta**, **ENRC** and **Kazakhmys**. In conjunction with the global focus list engagement, discussion of climate change issues also took place with **Vedanta Resources** and **Randgold Resources**.

LAPFF has also continued to engage with companies in connection with the **Carbon Disclosure Project (CDP)**, which seeks disclosure from companies on their greenhouse gas emissions and climate change strategies. In June and October, the Forum co-signed UNPRI sponsored letters to non-responding and poorly responding companies in North America, Europe and other parts of the world.

During 2009, the Forum continued its lobbying activities on climate change which included co-signing two letters to the **US Securities Exchange Commission (SEC)**. The first on the disclosure of unconventional oil in reporting of reserves by oil & gas companies and the second requesting the SEC to address corporate disclosure of climate change and other material environmental, social, and governance (ESG) risks in securities filings. This received an individual response to the Forum from the SEC chair, Mary Schapiro.

Letters were also sent to the Obama administration urging legislation on energy and climate change to be passed quickly in order to increase private investment, drive clean technology and reduce greenhouse gas emissions. The Forum also signed the International Investor Statement on a global agreement on climate change, sent to heads of state and global climate negotiators, setting out the investor perspective on key elements of a global agreement needed to drive financial flows to address climate change. This initiative reflected the build-up to the Copenhagen Summit in November. A response was submitted to the **Carbon Disclosure Standards Board (CDSB)** reporting framework which included an expression of support for the proposed single reporting framework for global companies to report on climate change.

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We said:

“ Our members are committed to addressing climate-related risk where it exists at investee companies and membership of the Forum contributes to this effort. LAPFF focuses its approach to climate change through research, corporate engagement, collaboration with other investors, lobbying and by providing related AGM voting recommendations. ”

LAPFF statement on climate change
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6.2 Company workforce practices

Our objective:

- To continue applying the LAPFF *Trustee Guide on Company Workforce Practices* through engagement with companies in the hotels and leisure, and food producers sectors, by maintaining engaging on employment issues with identified company under-performers³

In 2009, the Forum has continued engagement on company workforce practices in the leisure sector as well as expanded its collaborative engagement with international investors.

Low pay and poor working conditions have been identified as core labour issues for agency workers in hotels. For offshore workers, in particular those from developing countries, labour standards are important, posing a challenge for cruise companies. On this latter point, engagement has continued with **Carnival** as the Forum pressed the company for the harmonisation of labour standards across the group and for greater transparency on its employment practices.

The wider engagement campaign continued as the Forum joined other investors in tackling the issue of progress of US labour law reform. In a conference call facilitated by the UN PRI in February, a phased approach to collaboration was agreed. This consisted of letter writing to US legislators, S&P100 companies and a broader group of international companies with significant US operations. In addition, a group of UK investors engaged with UK-listed companies with substantial US operations. Each agreed to lead engagement with a given target company, and the Forum led the process with **National Express**. The engagement began with a letter to the company. As a result of the Forum's scrutiny of the company, which has also involved talking to other stakeholders, further engagement looks likely.

On this issue, in January, US president Barack Obama stated: "I do not view the labor movement as part of the problem. To me it's part of the solution. We need to level the playing field for workers and the unions that represent their interests...you cannot have a strong middle class without a strong labor movement."

Finally, the successful negotiation of an agreement between **G4S** and Union Network International looks to have been a further example of the positive role investors can play in this area. The deal followed the Forum's engagement with the company regarding employee practices outside the UK. Although shareholder engagement was clearly only one part of the process, it was an important one. The agreement reached and the background to it, was the subject of a UNPRI webinar held in October in which the LAPFF Chair told our side of the story.

We said:

“ Investors need to assess how effectively companies are applying their strategic approach to risk and opportunities associated with workforce issues, in order to protect and enhance long-term shareholder value. LAPFF Trustee Guide: *Unlocking Human Capital: Engagement on Employment Best Practice*⁴ ”



⁴ http://www.lapfforum.org/pubs/trustee_guides/LAPFF%20Trustee%20Guide%20Unlocking%20Human%20Capital%202007.pdf

6.3 Overseas employment standards

Our objective:

- To maintain momentum in the engagement with the FTSE 100 on overseas employment standards, particularly in relation to mainland China

The Forum has been dedicated for a number of years to promoting good employment standards in companies' overseas operations. A particular focus in our work has been China, following on from the 2007 LAPFF Trustee Guide '*Labour Standards in China: Best Practice Guidelines*'. Of concern for investors is the lack of democratic or human rights, including the right of workers to join a trade union of their choice, and how the contravention of certain international labour standards may affect companies operating in or with supply chains in China.

In 2009, LAPFF's continued engagement on how companies have managed these challenges through meetings with **Morrisons** and **Associated British Foods (ABF)**. The Forum been engaging with Morrisons directly since 2004, meeting most recently in 2007. At this meeting, the opportunity was taken to continue to press for disclosure of the company's ethical trading code, while noting progress made in terms of independent auditing against the code.

The meeting with ABF was positive and constructive and the Forum learned more about the company's revised approach to its supply chain, particularly in the wake of a widespread concern over the standards in Primark's supply chain. Engagement with both companies is ongoing.

We said:

“ The promotion of overseas employment standards at investee companies is not only consistent with LAPFF's mission statement, but also chimes with our member pension funds' long-term investment interests.

Cllr Ian Greenwood, LAPFF Chair

6.4 Obesity

Our objective:

- To continue the targeted engagement campaign on obesity with companies in the food and drinks sector

Obesity poses a threat to public health and is a concern for both consumers and companies in the food and drinks industry. There is a growing consensus among government, scientists and businesses in the food sector on the need to take action to address obesity. Consequently, food and drinks producers and retailers will increasingly face regulatory pressures concerning labelling and product information. LAPFF believes that companies in this sector should be taking proactive steps to manage risk in relation to obesity. Food and drinks companies are key players in influencing consumption decisions and must respond to changes in consumer demand for healthier options. The Forum believes that proactive companies can capitalise on the business opportunities presented by these developments.

In 2007, the Forum commissioned in-depth research into how companies are tackling these challenges. In 2008, the results were sent to the 22 companies in the FTSE 350 food and drinks sector, seeking their input. This year, engagement based on the responses was underway with a focus on learning from the leaders in order to promote best practice with the laggards in each sub-sector.

The initial focus on the leaders began with **Sainsbury's**, **Unilever** and **Britvic**, companies that had scored well against LAPFF criteria in their respective sectors. All three agreed to meet and in March and April meetings were held with Unilever and Sainsbury's. The meetings provided insight into how each company was prioritising health concerns which proved useful when the Forum continued its engagement with **Morrisons** and **ABF**. Constructive meetings were held with these companies in April and June and dialogue is ongoing.

UK Government says:

“ Obesity is one of the biggest health challenges we face. The Government is committed to taking action to reverse the rising tide of obesity...The cost to the wider economy is £16 billion, and this is predicted to rise to £50 billion per year by 2050 if left unchecked.

Department of Health, 2009

6.5 Countries with humanitarian concerns

Our objective:

- To pursue, as appropriate, engagement on a case-by-case basis with companies in UK, continental Europe and US that have business involvement in Sudan, Burma or other countries with humanitarian concerns or weak governance.

The Forum continues to pay attention to the operational risks faced by companies in politically unstable countries with an insecure business environment.

In 2008, the Forum began engaging with **Weir Group** and **Petrofac** over their operations in Sudan and with **Total** over its operations in Burma and land rights in Sudan. Weir Group has since left Sudan. Through engagement and direct meetings, **Total** and **Petrofac** proved responsive with regard to the significance operations in these countries have to their business strategy. They also explained how these operations are beneficial for the local population, for example by hiring local workers, funding environmental impact studies, and by the method in which they can address human rights issues. In 2009, LAPFF has continued to monitor these issues and encourage improved human rights practices but has not focused resources on new engagement targets.

Throughout 2008, LAPFF participated in collaborative discussions with like-minded signatories via the **UNPRI** regarding companies operations in Sudan. In December 2008 these investors formally established the **Sudan Engagement Group**, of which LAPFF is a member. Throughout this year LAPFF has participated in the group's collaborative engagement. Ideas such as commissioning local research to enhance understanding and further facilitate engagement, and a trip to Sudan have been suggested.

Investors comprising the Sudan Engagement Group are all PRI signatories and have approximately US\$2.5 trillion total assets under management. Signatories recognise that their investments include companies with operations in, or exposure to, Sudan – a country whose human rights record is a subject of growing public and political concern. The group believes that companies' exposure to Sudan poses additional risks and, as fiduciaries, they want to better understand these risks, including company efforts to acknowledge human rights and confront abuses in the region. The group is involved in ongoing engagements with relevant companies to encourage the companies operating in Sudan to act responsibly, respect human rights

and contribute in a positive way to a resolution of the crisis.

They said:

“ Companies have had to acknowledge that business as usual is not good enough for anybody, including business itself, and that they must better integrate societal concerns into their long-term strategic goals... Because the business and human rights agenda is tightly connected to these shifts, it both contributes to and gains from a successful transition toward a more inclusive and sustainable model of economic growth.

UN General Assembly, Human Rights Council, 22 April 2009

6.6 The UK defence industry

Our objective:

- To further encourage **BAE Systems** to adopt a forward-thinking strategy to obviate future difficulties arising from corporate responsibility (CR) risks and to make the most of CR opportunities and monitor **BAE's** efforts to counter alleged bribery/corruption issues

Due to LAPFF members concern for corporate responsibility issues in the defence sector, it has monitored the sector closely since 1999. An opportunity for engagement opened up after the UK government's review of the UK defence industry, and the publication of the Defence White Paper⁵. Corporate responsibility issues go far beyond the most publicised allegations of bribery and corruption: we believe that investors need to address risks and opportunities including industrial capacity; loss of knowledge base; skills shortages and transferability to civilian sectors; and export potential.

This year, the Forum continued its engagement with **BAE Systems**. In April 2009, a joint conference call was held between the corporate responsibility director of BAE, LAPFF and The Cooperative Asset Management (TCAM). The call focused on the company's implementation of the recommendations made by the Woolf committee⁶, as explored in a joint meeting held with LAPFF and TCAM in 2008. The company is doing this via a three-year programme and welcomes investors' input into its annual code of conduct review. The Forum additionally raised the potential of the company extending its policy of linking remuneration to ethics and safety into the long-term incentives structure.

⁵ UK MoD, Defence Industrial Strategy: Defence White Paper, Cm 6697, December 2005

⁶ The Woolf Committee was an independent committee appointed by the Board of Directors of BAE Systems, against the backdrop of criticisms made against the Company in the media, and investigations undertaken by the Serious Fraud Office (SFO) and others, relating to allegations of bribery and corruption in connection with the award of defence equipment contracts in a number of countries

7 Positioning the Forum

As the impacts of the financial crisis continue to be felt, the Forum has stepped up its profile by liaising with government over a range of issues, by providing commentary and consultation responses to regulators and other bodies, by participating in a wider range of networks, by initiating more collaborative investor action and through a heightened media presence.

7.1 Response to the credit crunch

Our objective:

- **To respond to concerns arising from the current global financial crisis, with particular focus on the role played by the banking sector and to review the part played by the regulatory system.**

At the close of 2008, during the LAPFF Annual Conference, Forum members met to discuss a range of issues related to the current crisis, including fund valuation, governance in the banking sector, and the role of credit rating agencies. Events during 2008, including the part-nationalisation of much of the UK banking sector, demonstrated that the financial system was in a severe crisis. Therefore, the Forum devoted significant attention during 2009 to its response to events.

At the January business meeting, LAPFF members agreed a plan for engagement with the banking sector, and further interventions such as research into fund manager engagement. This approach built on and enhanced existing work streams, most notably with the banks as part of the incentivising executive project. As noted previously, the Forum engaged at a senior level with numerous banks and other financial institutions in the UK and overseas during 2009. LAPFF's response to the crisis also contributed to the revised direction of the audit project and emphasised the importance of many of the governance issues used to screen global focus list companies.

The Forum has also carried out research into voting activity by asset managers at UK-listed banks during the 2008 AGM season (and earlier where voting data was available). This confirmed the widespread impression that most investors had not seriously challenged banks and other financial institutions over remuneration issues prior to the crisis. LAPFF also repeated its analysis of public voting disclosures made by asset managers, finding that more managers were making data available, but that the reporting was generally patchy.

In addition, the Forum has also been involved in a significant amount of policy engagement with regulators and others. During 2009 LAPFF has responded to the **Walker Review**, the **Financial Reporting Council's** review of the Combined Code, and the **Financial Services Authority** consultation on remuneration policy in the finance sector. It has also raised issues relating to governance and shareholder engagement with the Treasury, the **Department for Business, Innovation and Skills** (BIS) and the **Department for Communities and Local Government** (CLG). All the Forum's responses to consultations are on the members section of the Forum website.

The Forum's stance on a number of issues emerging from the crisis has proven to be in tune with the direction of reform that has emerged during the year. In May, the Forum issued a statement on the crisis which set its post crisis agenda. This set out actions in the following four main areas: the role of board directors, remuneration, audit and the role of institutional shareholders. A number of the points made in the statement found echoes in reports in the recommendations of the Walker Review, for example. Certainly LAPFF's longstanding encouragement of remuneration policies that rewards genuinely long-term performance appears to have been vindicated by events.

Clearly there is much more to do. Towards the end of 2009 – only a year after the banking system stood on the edge of collapse – there have been increasing concerns about a return to 'business as usual'. Therefore, the Forum will need to continue to be vigilant in 2010. However, this year's activity has built a good foundation for future work as LAPFF and other investors seek to prevent the same failings occurring again.

We said:

“ In the aftermath of the financial crisis long-term shareholders need to take a serious look at what has gone wrong...

We need to address all the areas where there have been failures. Just as we call on companies to reform, as owners of those businesses we must also put our own house in order. Given the scale of what has happened, this is a time for serious reform, not cosmetic changes.

Cllr Ian Greenwood, LAPFF Chair ”



7.2 Passive managers and ESG risk management

Our objective

- To respond to member concerns regarding the ESG risk management of passive managers.

An audit commissioned from RImetrics by LAPFF revealed a significant proportion of equity holdings managed within passive funds are not subject to high levels of environmental, social and governance, (ESG) risk management.

The study provided evaluations of individual fund manager ESG strengths and weaknesses. Fund managers were evaluated and rated across five themes of strategic orientation, engagement, research, proxy voting and transparency. The study found that a significant proportion of equity holdings managed within passive funds are not subject to high levels of ESG risk management.

At the same time, managers profess a willingness to engage in dialogue with clients on these issues and all pointed to the fact that they had not, to date, seen any real client pressure or demand on them to increase their capabilities or resources.

Responding to this lack of a clear message from investors, the Forum engaged with the relevant UK-based passive managers to highlight the importance of this process of risk management. This process fed into part of the response to the **Personal Accounts Delivery Authority (PADA)** on achieving quality corporate governance when using passive managers. LAPFF will continue to push for improvement particularly on voting across global markets and offering of pro-rata voting in pooled funds.

We said:

“ Following our meetings with the relevant passive managers, they have now received a clear message that their clients and our members do take the topic of ESG risk management very seriously. ”

David Sellors, LAPFF, Chief Operating Officer

7.3 Collaborative Action: Networking

Much of the Forum's collaborative initiatives with other like minded investors has already been detailed, for example on climate change engagement and lobbying and over particular company workforce practices. Through its active participation in a range of networks, including the UNPRI, INCR and other investor-led bodies, the Forum has initiated or joined a number of collaborations that support its mission. Some additional examples are provided below, which reflect the extending geographical reach of the Forum's engagement.

The Forum is a supporting investor body to the UNPRI '**CEO Water Mandate**', an initiative designed to assist companies in the development, implementation and disclosure of water sustainability policies and practices.

The Forum chair has written to the **US Government** on governance reform including instituting a comply-or-explain format of best-practice guidelines, a majority vote standard for election of corporate directors and the transition to independent board leadership with a split chair/ CEO. The Forum has also endorsed the US-orientated **Principles of Financial Regulation Reform**, which set out how transparency, independence, corporate governance, investment

opportunity, and systemic risk should be embodied within a regulatory financial market system to instil trust, integrity, and confidence in the investors, beneficiaries, and stakeholders of the global capital markets. These principles will support meetings with key leadership positions of US legislatures, regulators, and the administration. The Forum has also sent a joint letter to **SEC** expressing support for more disclosure on director candidates and the candidate selection process. The head of the SEC responded individually to the Forum chair to commend the Forum for promoting better disclosure on director candidates.

The chair co-signed letters on **EU acting in concert legislation** which has the potential to interpret collaborating activist shareholders as concert parties may become an issue in certain European countries. Liaison continues with other investors on this issue, to share experiences, under the aegis of the UN PRI, although the Forum has noted the positive response from UK negotiation on this issue including the FSA and Lord Myners.

As a signatory to the UNPRI, the Forum is able to participate in webinars on various issues that may be relevant to future work. For instance, the Forum led an investor webinar prior to the Marks and Spencer AGM, and participated in a number of webinars on topics ranging from Brazilian slave labour to US labour reform.

A wide range of other individual and group meetings, conference-calls, webinars and formal and informal networking, ensure that the Forum's views continue to be promoted and its influence as a guardian of shareholder value is maintained.

7.4 Internal management changes

During 2009, the Forum was faced with the prospective retirement of its long-term Honorary Secretary, Stuart Imeson, Director of the West Yorkshire Pension Fund. The Executive decided to take this opportunity to appoint a part-time Chief Operating Officer and were delighted to attract the services of David Sellors, formerly of Capital International to fulfil this role.

The LAPFF will, of course, be forever indebted to Stuart for his enormous contribution to its development and the progress made over many years. No individual has contributed more than Stuart to the Forum's success. He has worked tirelessly in supporting and facilitating our activities and even more so behind the scenes. He will be greatly missed and leaves with our very best wishes for a long and happy retirement.



David Sellors
Chief Operating Officer

8 Communicating With Our Members

.....
Our mission:

LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders while promoting corporate social responsibility and high standards of corporate governance among the companies in which they invest.

.....

Our members make a fundamental contribution to fulfilling this mission. It is the direction they give the Executive Committee which drives much of the engagement programme, and members have the final say over the issues which LAPFF pursues.

Many members are actively contributing to the direction the Forum's work takes: the Forum Executive Committee invites members' suggestions for future workstreams annually.

The Forum's work on passive managers, obesity and palm oil are examples of projects which resulted from member suggestions. Other suggestions are frequently explored by the issuing of position papers. In 2009, Forum members were briefed on subjects surrounding the Forum's response to the credit crunch and on updates in relation to climate change.

The quarterly meetings open to all members of the Forum provide the opportunity for information exchange and discussion over a wide range of investment issues. As part of the LAPFF networking initiative, members are invited to give presentations on relevant subjects of their choice, and this year saw member presentations on topics including hedge funds, rating agencies, what is expected of the local government community in dealing with climate change and the review undertaken by one member fund on the voting and engagement activity of the equity managers it employs.



The Forum issues a quarterly hard-copy newsletter to its members, and a monthly bulletin distributed by email. These inform members not only about current Forum activities, but also provide them with news and analysis from the wider corporate governance/responsibility community. Bulletins are available on the LAPFF website here: <http://www.lapfforum.org/pubs/newsletters/index.html>

Between meetings the Forum updates its members on relevant developments and issues alerts where appropriate in advance of company AGMs. For example, this year member's input was sought as LAPFF drafted its climate change trustee guide.

The Forum is holding its 13th Annual LAPFF Conference on 2, 3 and 4 December, as always, in Bournemouth. This year's theme, 'Strengthening Shareholder Oversight Post-Crisis', was chosen to reflect the governance and financial reform underway, and the role that investors will play in that process. The conference brings together a wide range of expert speakers from the City, the corporate world, academia and civil society, to help delegates make sense of the financial future. Topics covered this year include reforms to bank governance, the role of credit ratings agencies, director capabilities and the future of shareholder engagement.

9 Outlook for 2010

At the close of last year, LAPFF was looking into 2009 amid uncertainty in global markets and the sense that the financial system had just narrowly avoided a catastrophic collapse. As we head into 2010, the economic environment is still challenging, but there is a general sense that the worst has passed.

A major theme of the year ahead looks set to be the implementation of governance and financial reform. For example, 2010 will see the banking sector seek to put into place the Walker Review's recommendations, while non-financial companies will be responding to amendments to the Combined Code. There will be work for shareholders too, as a sizeable element of the Walker Review's agenda is directed at encouraging more engagement by shareholders.

There will inevitably be more attention paid to remuneration too. This is not just a result of interventions by governments and regulators, but also because of a wider sense that there need to be changes to the way that directors are rewarded. We may well see a continuation of the trend in 2009 for large votes against remuneration reports. The Forum has a key role to play here. While we share concerns about some current practices, we also have a positive agenda for change, seeking to encourage remuneration policies that incentivise long-term success.

The Forum's global reach will also continue in 2010, as we press ahead with engagement with a new focus list of companies where we have governance concerns. And as LAPFF extends its global reach, we also expect to see further development of our collaboration with other investors.

Meanwhile, work will continue on our existing engagement workstreams, be it promoting companies' recognition and reaction to the business risks and opportunities posed by climate disruption, the auditing of companies' supply chains or engaging over companies' employment standards where they appear to vary from one continent to another.

The Forum, with its 18-year track record of promoting best practice in corporate governance and corporate responsibility, is committed to playing an important role in all these areas. We are looking forward to another busy year ahead.



LAPFF membership as at 1 November 2009

- Aberdeen City Council
- Avon Pension Fund
- City of Edinburgh Council
- City of London Corporation
- Clwyd Pension Fund
- Derbyshire County Council
- Devon County Council
- Dorset County Pension Fund
- Dyfed Pension Fund
- Falkirk Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Lancashire County Pension Fund
- London Borough of Brent
- London Borough of Camden
- London Borough of Croydon
- London Borough of Hackney
- London Borough of Haringey
- London Borough of Harrow
- London Borough of Hillingdon
- London Borough of Hounslow
- London Borough of Islington
- London Borough of Lewisham
- London Borough of Newham
- London Borough of Southwark
- London Borough of Tower Hamlets
- London Borough of Waltham Forest
- Lincolnshire County Council
- London Pension Fund Authority
- Merseyside Pension Fund
- Norfolk Pension Fund
- Northamptonshire County Council
- Northern Ireland Local Government Officers Superannuation Committee (NILGOSC)
- North Yorkshire County Council
- Nottinghamshire County Council
- Rhondda Cynon Taf Pension Fund
- Shropshire County Council
- Somerset County Council
- South Yorkshire Pensions Authority
- South Yorkshire Integrated Transport Authority
- Surrey County Council
- Teesside Pension Fund
- Tyne and Wear Pension Fund
- Warwickshire County Council
- West Midlands Pension Fund
- West Midlands PTA Pension Fund
- West Yorkshire Pension Fund
- Wiltshire County Council
- Worcestershire County Council

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Local Authority
Pension Fund
Forum