

## Report on The Corporate Governance and SRI Programmes – 2008 - 2009

### Overview

This report discusses the activities carried out by BAPIML to fulfil the Trustees requirements on corporate governance (CG) and Socially Responsible Investment (SRI), the major themes emerging over the last year and suggests the potential next steps in our continual improvement of the programme. The individual reports on UK and International CG and SRI provide more details on specific engagement / company issues. Stock by stock and issue by issue voting records are also provided.

It should be noted that the reporting period has been truncated to bring it into line with the fiscal year end. We receive a number of requests from members or independent organisation surveying engagement results. We believe there is a benefit to reviewing this report and posting it on the members' website concurrently with the annual report and accounts therefore we suggest that in future we discuss this at the June meeting rather than later in the year.

During the last year activity on all aspects of CG and engagement increased. Turbulence in asset markets means that the 'good' companies can need as much attention as the 'bad'. Nevertheless the ruinous actions of some banks and the damage of over leverage have been a dominant discussion point. The fund managers have engaged with companies directly and also participated in the NAPF organised case committee system to make our views known. A case committee is where a group of fund managers join together to discuss issues with company management and often the independent non executives.

In an attempt to avert a similar financial crisis HM Treasury commissioned Sir David Walker to review the Corporate Governance of the UK Banking Industry, the FSA are reviewing remuneration policies and Lord Myners has floated various ideas on voting rights and the role of institutional shareholders which has included the idea of buying rights to vote and a two tiered voting system tied to length of ownership. Whilst we feel the latter could herald a return to the poor governance exhibited in the past by some companies with split share classes, we do sympathise with many aspects of these discussions.

The Institutional Shareholders Committee (ISC) is representing the views of the Investment Management Association and the NAPF amongst others in respect of these matters as well as the contributing to the Financial Reporting Council's review of the Combined Code due by the end of the year, The ISC is "providing suggestions not only as to how ongoing dialogue with companies might be improved but also, particularly, how to deal with the rare instances it is failing". Effectively this widens the discussion beyond the banking system. We are monitoring these discussions and will comment where helpful.

A copy of the Institutional Shareholders Committee report "Improving Institutional Investors' role in Governance" can be accessed via [www.institutionalshareholderscommittee.org.uk](http://www.institutionalshareholderscommittee.org.uk).

In particular, with respect to the interim Walker report, we support the main thrust of the report, but as ever the devil will no doubt be in the detail. Much of what is said on the role of institutional shareholders seems sensible and indeed we believe we could argue that we already have, via the NAPF, a method of collective engagement, which could perhaps be formalised and reported upon to meet recommendation 21.

Of concern here is that excessive emphasis seems to be placed on the role of long term investors, which surely brings extra costs to this type of investment strategy when compared to short term players. We would also argue that it is the growing prevalence of the culture of 'share rental' rather than ownership that has contributed to the recent governance failures and this thrust if not corrected may force less rather than more engagement.

We would also be concerned that should excessive regulatory burden be placed on the owners of UK financial shares in isolation then this may in itself result in value destruction as some investors choose to remove UK financial stocks from their list of potential investments thus potentially resulting in a long term discount developing in certain companies that the Funds already own.

In international equities it can be observed that there is an increase in shareholder activism and greater disclosure.

BAPIML has increased the personnel involved in corporate governance and seek to ensure that the junior fund managers learn the voting process from the outset. We have also increased the use of external research, primarily through greater country coverage of the ISS / RREV voting recommendations service. These actions combined have allowed more detailed analysis at a modest cost.

Elsewhere organisations such as the United Nations Environment Programme (UNEP), United Nations Principles for Responsible Investing (UNPRI) and the Institutional Investors Group on climate change (IIGCC) have continued to broaden their coverage of issues and increase investor education. Whilst the proliferation of organisations that are involved in this area can be a distraction rather than a force for good, it does appear that the UNPRI are gathering other organisations under their umbrella.

There has been an increase in CG and SRI debate in both the private equity and property arenas.

The United Nation Principles for Responsible Investment (UNPRI) and British Venture Capital Association (BVCA) have produced guidelines for private equity investors both at General Partner (GP) and Limited Partner level. It is encouraging that some of the Funds' GP's have become signatories to the UNPRI (more of this later). Indeed the Head of Private Equity believes that the due diligence process undertaken by the Funds' GP's and LP's already adequately considers these risks as they are closer to the private investee companies. These reports are available at the following websites [www.unpri.org](http://www.unpri.org) and [www.deloitte.com](http://www.deloitte.com) (2009 Global Venture Capital Survey)

In property both the IIGCC and the UNPRI have produced guidelines for Investors and Trustees. The Investment Property Databank (IPD) are beginning to collate data on individual buildings, facilitating comparisons for reporting. These reports can be found at [www.iigcc.org](http://www.iigcc.org) and [www.unpri.org/property](http://www.unpri.org/property).

The property team at BAPIML believe that their focus on location, with a bias towards buy and improve type asset management strategies, as well as a development aspect to the portfolio goes a long way to work towards improving building stock. This is communicated to agents and developers. A report from GVA Grimley provided to the Investment Committee discusses some key issues for building owners to consider.

Energy Performance Certificates (EPC) came in to force in April 2008 as part of wider European Legislation the Energy Performance of Buildings Directive (EPBD). This piece of legislation also brought in Display Energy Certificates (DECs) for Government buildings and air-conditioning inspections for systems, initially greater than 250 kW. EPCs are required whenever a building is to be constructed sold or let. The person responsible for commissioning the EPC will depend on the situation, in the case construction the responsibility lies with the contractor, in a sale the vendor and with a letting the landlord.

The primary purpose of an EPC is to provide a national benchmark to measure the energy efficiency of buildings against and is expressed in a sliding scale from A - G, 'A' being very efficient and 'G' being extremely inefficient. The process of producing an EPC entails a survey of the property to establish the building fabric, lighting, heating and so on. The information is broken down in to zones and modelled using the appropriate software and following this stage the building will be given a rating and the certificate published. The EPC and Recommendations Report lasts for a period of 10 years before statutory renewal, although major modifications to the building with inevitably render the EPC obsolete.

British Airways Pension Fund, as part of their corporate social responsibility aim to achieve at least a 'B' rating on all their new build projects. In the case of our existing stock we ensure that where a letting has achieved a rating less than 'C' we target and consolidate those specific areas in to our overall planned preventative maintenance programme, ensuring that these buildings do not slip through the net.

During the Corporate Governance and SRI reporting period 1<sup>st</sup> August 2008 to 31<sup>st</sup> July 2009 we completed four surveys:

1. In early 2009 we completed the seventh annual **TUC Fund Managers Voting Survey** with results available from the end of July 2009. Response rates were lower than last year with replies from 23 organisations including four outside of the target group, with 29 failing to respond. 19 of those completed both sections (voting records and policies and processes), one provided voting data only and three completed section two on policies and processes. Broad trends show that respondents to the TUC Survey are in general more likely to oppose remuneration-related resolutions and management on director elections compared with other fund managers or shareholders in general. There are clear differences in how investors utilise their shareholder voting rights and engage with investee companies. The TUC believes that “Fund Managers’ clients should have access to comparative information on voting in order to understand where their managers sit in the spectrum. The present voluntary system of disclosure, with no guidance or frequency of the provision of data, simply does not allow this”. The TUC also commented that “the Institutional Shareholders Committee (ISC) framework is not working as intended and the Companies Reserve Act 2006 should be enforced by the Government”. This survey can be accessed via [www.tuc.org.uk](http://www.tuc.org.uk).
2. The 5<sup>th</sup> annual **NAPF 2009 Corporate Governance Survey – Pension Funds’ Engagement with Companies** survey was completed by 45 pension funds, and forms part of continuing efforts being made by institutional investors to improve corporate governance, with engagement and transparency being key issues of concern. Pension schemes are engaging indirectly and directly with the companies in which they invest, 93% of schemes responding carry out some engagement tasks via delegation to investment managers. 44% have a policy of direct engagement and for larger schemes, as many as 70% do. Pension schemes cited work priorities, skills and costs as barriers to greater levels of engagement (62%, 59% and 54% respectively). Half of the schemes believe that dialogue with investee companies have been effective, whilst 20% believe it has been slightly effective. A copy of this survey can be accessed via [www.napf.co.uk](http://www.napf.co.uk).
3. British Airways Pensions were ranked 5<sup>th</sup> overall in the **UK Occupational Pension Schemes’ Responsible Investment Performance 2009** rankings. Fair Pensions complimented British Airways Pensions on its creditable position on Responsible Investment (RI) policy, implementation and monitoring and particularly with regards to our strong transparency. The following recommendations were made by Fair Pensions: RI policy, implementation and monitoring: Adoption of a systematic approach to identifying specific Environmental and Social Governance (ESG) risks and opportunities for incorporation into research and investment decisions, further expansion of RI policy across additional non-equity asset classes and consider membership of the UN PRI. Transparency: Expand detail regarding RI policy and its effectiveness for the Annual Report. Expand disclosure of engagement initiatives and outcomes (which the Trustees and their advisors have expressly discussed and rejected due to the disclosure of individual company actions). Notably the top four participants were members of the United Nations Principles for Responsible Investment (UN PRI). This survey can be found on [www.fairpensions.org.uk](http://www.fairpensions.org.uk).

#### **4. UKSIF Responsible Business: Sustainable Pensions 2009**

British Airways Pensions amongst three others retained their silver ranking this year and were joined by a further ten funds. Three funds moved up from their silver ranking to gold in 2009. Only one fund remains the only corporate fund to achieve the platinum ranking. The results of the questionnaire showed that we scored highly on communication, training and knowledge and were weakest on our monitoring and assessment, which proved to be challenging for a number of pension schemes. Providing more information in the survey next year on reporting frequency to Trustees would score this category significantly higher. Recommendations were made to make sure that the Trustees were aware of the United Nations Environment Program Finance Initiative (UNEP FI) Freshfields 2005 report and subsequent UNEP FI Freshfields 2009 follow up report published in July this year. This report discusses the responsibilities with respect to SRI, which will be made available on our website along with the Stern review on the Economics of Climate Change, and the United Nations Principles for Responsible Investment (UN PRI). The UKSIF Responsible Business: Sustainable Pensions 2009 survey can be accessed via [www.uksif.org](http://www.uksif.org).

We continue to believe that it is helpful to complete well structured surveys for influential participants as a way of encouraging those schemes not yet participating/engaging to do so.

We have been contacted by other large funds in conjunction with the NAPF to work on collaborative projects with other investors, funding the cost directly or providing resource to attend meetings. Before we commit resources we believe the objectives need to be clear and each organisation's capabilities and fiduciary duties understood.

#### **The next steps- improvements to the programme**

At a practical level we continue to evaluate external research services from providers mainly in the SRI arena. This information is often hard to access, analyse and benchmark, particularly in international investments and this has improved. The cost of these services is also decreasing towards an acceptable amount. The use of these, in conjunction with a suitable sustainability benchmark would improve International SRI further this year.

We are also instigating a similar process to the one used in corporate governance to log issues and decisions made on SRI as they occur, which we believe will capture a higher level of activity on these issues than may be apparent in the overview, as many are increasingly wrapped up with shareholder votes at AGM's.

As we have already commented it will be increasingly possible to hold data on property which will be helpful in assessing environmental impact.

We are going to send out a monthly e mail to all the Fund Managers to highlight recent issues, surveys and reports and hold the latter on a dedicated electronic file to encourage review.

In addition the survey results are a good starting point to analyse areas for potential improvements and the following actions were agreed with the Committee.

1. Make Trustees more aware of the major developments by making reports readily available. In this report we have provided links to useful reports and organisations and we will continue to make sure these are communicated in the investment update which accompanies every IC.
2. Broaden coverage across asset classes such as Property and Alternatives. As already discussed it is becoming easier to measure and review progress in these areas.
3. During the forthcoming year, carry out the preparatory work to become a signatory to the UNPRI. The last time this was discussed at the Investment Committee the principles were still being formed and scope defined as it was an organisation in a formative stage. This has come a long way and the Principles are described below:

## The Principles for Responsible Investment

Source: UNPRI

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

<p><b>1 We will incorporate ESG issues into investment analysis and decision-making processes.</b></p> <p>Possible actions:</p> <ul style="list-style-type: none"> <li>• Address ESG issues in investment policy statements</li> <li>• Support development of ESG-related tools, metrics, and analyses</li> <li>• Assess the capabilities of internal investment managers to incorporate ESG issues</li> <li>• Assess the capabilities of external investment managers to incorporate ESG issues</li> <li>• Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis</li> <li>• Encourage academic and other research on this theme</li> <li>• Advocate ESG training for investment professionals</li> </ul>	<p><b>2 We will be active owners and incorporate ESG issues into our ownership policies and practices.</b></p> <p>Possible actions:</p> <ul style="list-style-type: none"> <li>• Develop and disclose an active ownership policy consistent with the Principles</li> <li>• Exercise voting rights or monitor compliance with voting policy (if outsourced)</li> <li>• Develop an engagement capability (either directly or through outsourcing)</li> <li>• Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)</li> <li>• File shareholder resolutions consistent with long-term ESG considerations</li> <li>• Engage with companies on ESG issues</li> <li>• Participate in collaborative engagement initiatives</li> </ul> <p>Ask investment managers to undertake and report on ESG-related engagement</p>
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<p><b>3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.</b> Possible actions:</p> <ul style="list-style-type: none"> <li>• Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)</li> <li>• Ask for ESG issues to be integrated within annual financial reports</li> <li>• Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)</li> <li>• Support shareholder initiatives and resolutions promoting ESG disclosure</li> <li>•</li> </ul>	<p><b>4 We will promote acceptance and implementation of the Principles within the investment industry.</b> Possible actions:</p> <ul style="list-style-type: none"> <li>• Include Principles-related requirements in requests for proposals (RFPs)</li> <li>• Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)</li> <li>• Communicate ESG expectations to investment service providers</li> <li>• Revisit relationships with service providers that fail to meet ESG expectations</li> <li>• Support the development of tools for benchmarking ESG integration</li> <li>• Support regulatory or policy developments that enable implementation of the Principles</li> </ul>
<p><b>5 We will work together to enhance our effectiveness in implementing the Principles.</b> Possible actions:</p> <ul style="list-style-type: none"> <li>• Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning</li> <li>• Collectively address relevant emerging issues</li> <li>• Develop or support appropriate collaborative initiatives</li> <li>•</li> </ul>	<p><b>6 We will each report on our activities and progress towards implementing the Principles.</b> Possible actions:</p> <ul style="list-style-type: none"> <li>• Disclose how ESG issues are integrated within investment practices</li> <li>• Disclose active ownership activities (voting, engagement, and/or policy dialogue)</li> <li>• Disclose what is required from service providers in relation to the Principles</li> <li>• Communicate with beneficiaries about ESG issues and the Principles</li> <li>• Report on progress and/or achievements relating to the Principles using a 'Comply or Explain'<sup>1</sup> approach</li> <li>• Seek to determine the impact of the Principles</li> <li>• Make use of reporting to raise awareness among a broader group of stakeholders</li> </ul>

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society. We encourage other investors to adopt the Principles.

We are now much more comfortable that the Funds can meet the criteria in most areas. However it is an aspirational and continually developing set of principles with an annual reporting requirement which requires resource (which we now have). Signatories are delisted for not meeting standards so the decision to sign should not be taken lightly. We recommended that we work towards becoming a signatory over the next year and review UNPRI policy at that time. One remaining area of concern is Principle 4 where there is a requirement to encourage others to participate and collaborate on projects. As we have described above, we think our participation in surveys and sharing practical information with others helps in this area. Our preferred option remains working mainly with the NAPF issues if possible through the confidential case committee system as the best use of resource and consistent with our fiduciary responsibility, although we remain open to discuss other collaborations. The Annual report from the UNPRI can be found on the following link: [\*UN PRI Report on Progress 2009\*](#).

## Class Actions

We continue to monitor class action litigation using two US lawyers to alert us to any claims. One of these firms provided training earlier this year on the role of lead plaintiff as to what that would entail. This has not been necessary as yet as most claims seem to have participants with larger losses and willing lead plaintiffs.

Settlement was declared binding by the Court of Appeals of Amsterdam on 29<sup>th</sup> May 2009 against Royal Dutch Shell plc relating to its alleged reserve account fraud from 1997 to 2003. Distribution of funds to the investors should occur sometime late 2010.

We have also joined an opt-in a claim in the German courts against Hypo Real estate regarding misleading statements made in August 2007 and June 2008 that they had minimal exposure to the subprime industry.

IPS have been appointed to collect our claims for just over a year and claims made are in excess of \$200,000.

**Originator:** CEO BAPIML  
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**Date:** 1 October 2009