REVIEW OF VOTING POLICY AND IMPLEMENTATION
HERTFORDSHIRE COUNTY COUNCIL PENSION FUND ('THE FUND')

INTRODUCTION AND CURRENT APPROACH

Asset owners, such as the Fund, have a responsibility to hold to account the management of companies in which they invest. For listed companies, one way in which this can be done directly is through the exercise of voting rights attached to the shares owned by voting on all resolutions posted at Annual and Extraordinary General Meetings, where practicable.

Whilst this sounds simple, in practice there are a number of steps in the process and various parties involved. The current approach adopted by the Fund is as follows:

- All management of listed equities is delegated to a number of third party asset managers who are responsible for the decisions to buy and sell shares in companies (and in many cases meeting companies and establishing a relationship with company management as well as ongoing engagement with company management).

- For equities held in segregated mandates, the shares are directly owned by the Fund and are held in custody by the Fund's custodian, Bank of New York Mellon. The Fund's custodian is responsible for managing the operational aspects of the Fund's investments including actually exercising the votes of shares held and, before that stage, receiving shareholder information about AGM and EGM resolutions and passing this on to ISS (Institutional Shareholder Services), a third-party proxy voting advisor.

- For pooled fund holdings, the shares are voted in-line with the voting policy of the investment manager of the pooled fund (e.g. LGIM exercises the votes in respect of the Fund's pooled fund index equity holdings).

- ISS has been appointed by the Fund to provide voting recommendations (typically 'For', 'Against' or 'Abstain') for the Fund's direct shareholdings... The Fund's custodian provides ISS with information on the Fund's holdings as well as identifying the resolutions that are to be voted upon. ISS gathers company information, undertakes research, and has developed its own voting policies, taking account of international standards on corporate governance and stewardship. ISS applies its voting policies to the shareholdings to determine a voting recommendation for each resolution. The recommendation of ISS can be overridden either by the manager in whose portfolio the shares are held or by the asset owner client (the Fund) should there be a particular issue on which the Fund had an explicit direction in which it wanted its votes to be cast (for example, if it was partaking in a collective engagement with other asset owners). ISS then instructs the Fund's custodian to exercise the votes as per the resulting recommendation.

PROS AND CONS OF THE CURRENT APPROACH

The advantages of the current approach are:

- By delegating the decisions on voting the Fund's direct shareholdings to ISS, the Fund removes the need for the Fund's Officers or the Pensions Committee to get involved in either establishing a voting policy (e.g. in terms of board composition) or executing that voting policy through ensuring that all votes are cast at all Company meetings, which is resource intensive.

- There is generally consistency of voting across all the Fund's direct shareholdings (albeit subject to the managers having the ability to override the recommendation of ISS). If more than one manager owns the same shares (and assuming managers don't exercise their right of veto in respect of ISS's voting recommendation) the Fund will vote in a same way across its whole direct shareholding. ISS's policies are also designed to be consistently applied across the full range of the Fund's shareholdings and over time.

- ISS spends time and effort on formulating its policies on voting and on individual voting issues; there should therefore be a clear reason why votes are cast in a particular way.

There are also some disadvantages to the current approach:

- In choosing to delegate its voting activities to a third-party proxy voting provider, ISS, the Fund's Officers or the Pensions Committee need to monitor and periodically review the voting policies of ISS to ensure the service is in-line with expectations.

- By outsourcing the voting to ISS, there is a separation of the voting decision from the buy/sell decision. It also detaches the voting decision from the managers who are likely to have a relationship with the management of companies in which they invest and therefore could result in the voting recommendation being detached from ongoing engagement by the investment manager with company management.

- ISS is not in a position to undertake any engagement with company management, which can lead to conflicting approaches between the manager and ISS with respect to voting recommendations.

- ISS may not have the required expertise to fully assess more specialist resolutions (e.g. on particular environmental or social issues) or resolutions for companies that are less 'well-known'.

- ISS's policies are likely to be consistently applied but are generally 'broad brush' following standard corporate governance codes, which may leave with little room for appropriate exceptions or specific circumstances.

- There is a cost to the Fund involved in subscribing to ISS's service.

  Overall, therefore, the current approach aims to ensure that the shares that the Fund owns are voted, with a consistent policy approach directing the votes. This is, however, likely to be a fairly broad brush, 'one size fits all' policy approach.

THE ALTERNATIVE APPROACH TO VOTING

The alternative to using ISS would be to leave the responsibility for voting the Fund's direct shares with the managers who own these shares in their portfolio. The advantages of this would be:

- There would be a consistency of approach from the manager's perspective and also from the investee company's. If there was an issue (of say board composition) it would be expected that the manager would raise this in its discussions with management and only if there was a clear failure to address an issue would it be expected that the manager voted against company AGM resolutions.

- Votes may well therefore have more ‘robustness’ about them, given greater alignment with ongoing engagement activity, rather than a blanket application of a general policy.

- The managers would not be expected to charge for the service of voting the shares they own and would be expected to report on any key issues (in fact as they do at the moment, whereas the Pensions Committee does not receive reports setting out explanations directly from ISS).

Potential disadvantages of this approach would be:

- There could be a lack of consistency in terms of voting across the Fund’s shareholdings as managers could vote in different ways on the same company resolutions. However, this in itself is not necessarily an issue should each manager be able to clearly articulate its reasons for voting in a particular way (e.g. this may depend on the length of time a manager has owned the shares or how long the manager has been engaging with a company on a particular issue).

- Managers may not be as focussed on ensuring that all votes are cast on all possible occasions, whereas ISS has a specific mandate to ensure this happens. In practice managers are these days generally pretty effective at implementing voting across their shareholdings (this was not the case in the past) and expectations on the approach to voting and engagement can be included in the Investment Management Agreements (IMAs) to ensure managers vote on all resolutions, where practicable.

Under this approach, while neither an explicit advantage nor disadvantage, if the Fund was to give responsibility for voting to the managers, it would be appropriate for the Fund’s Officers or the Pensions Committee to review the managers’ corporate governance policies from time to time and to monitor their compliance with the UK Stewardship Code or other yardsticks of best practice that may be developed in the years ahead.

CONCLUSION AND RECOMMENDATIONS

There was a time when asset managers had the reputation for being “sleeping partners” due to their failure to vote the shares they owned on behalf of clients and, in doing so, failing to hold company managements to account. This is generally no longer the case and the Fund’s equity managers are expected to adopt both robust corporate governance and comprehensive voting policies.

We would recommend that that voting is no longer outsourced to ISS but is made the responsibility of the investment managers instead:

- Our view is that interests are typically more aligned when the voting rights attached to shares are managed by the same entity that is responsible for the buy/sell decision.

- Investment managers are generally better placed (relative to third-party proxy voting providers) to identify and engage with company management on strategic issues as well as Environmental, Social and Corporate Governance (ESG) issues, The exercise of voting rights is typically aligned with such engagement activity.

Prior to implementing this change, we suggest that the Pensions Committee reviews the managers’ voting policies and track record to ensure that best practice is being implemented e.g. in comparison with the provisions of the UK Stewardship Code. We recommend that the Pensions Committee continue to review these policies, including that of LGIM, on a periodic basis.

We believe that this will result in company management being held to account more effectively by the asset managers, whose investment performance depends in part on robust scrutiny of the companies they own, with the aim of seeing value created by management.

IMPORTANT NOTICES

Nick Sykes
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