



Local Authority
Pension Fund
Forum

Incentivising Executives

*Non Financial Performance and Executive Long Term Variable
Pay*

UN PRI Webinar, 28 February 2008

Susanna Rust - Research Executive, PIRC

Laura Aarnio - Consultancy Services
Executive, PIRC



Local Authority Pension Fund Forum

What is LAPFF?

LAPFF, established in 1991, is a voluntary association of 48 UK public sector pension funds with combined assets of over £85 billion. It exists 'to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote CSR and high standards of corporate governance amongst the companies in which they invest'. PIRC is the research and engagement partner for LAPFF.

Incentivising Executives cont...



What is the Project?

- The project looks at the linkage between non-financial performance targets and long term executive pay.
- Beginning in 2007, LAPFF has called for the inclusion of non-financial targets into long-term incentive schemes, based on the belief that financial growth and value creation are only sustainable in the long-term if founded on good corporate governance and corporate social responsibility.



Why is this an investor concern?

- The business case for sustainable development
- The need to focus executive directors' minds on the key operational determinants that influence a company's long-term prospects

BP and the business case in practice

- Shareholder value at risk: Texas City Refinery blast in March 2005 and shutdown of Prudhoe Bay oilfield in Alaska in 2006 following discovery of pipeline corrosion and oil spills
- LAPFF analysis: inadequate board oversight of HSE issues
- Baker Panel report: “BP has not provided effective process safety leadership and has not adequately established process safety as a core value”

Incentivising Executives cont...

What are non-financial metrics?

- In its research, LAPFF takes the view that the term 'non-financial' encompasses all matters which are not directly related to the income statement, balance sheet or cash flow statement.
- Examples of 'non-financial' measures: subscriber increases, reduction of staff turnover, drug development pipelines (for pharmaceutical/biotech companies) or climate change targets
- Companies Act 2006: new Business Review requirement to report key performance indicators (KPIs)

Different forms of Performance Targets

- Performance measures attached to incentive plans can take three forms:
 - They can operate as fully fledged targets that stretch over a vesting scale between a lower and higher point.
 - They may also act as an underpin, i.e. a performance threshold or preliminary hurdle that must be met if any awards are to vest at all or that may lead to bonus payments being forfeited or reduced.
 - Remuneration committees may also have discretion to scale-back awards depending on the company's underlying performance against certain measures.



LAPFF Research into the FTSE100

- Over 50% of companies in the sample disclose non-financial performance targets in the annual bonus.
- Only seven FTSE 100 companies consider non-financial performance measures important enough to build them into an LTIP.
- United Utilities is the best performer with 17 non financial performance targets linked to its Share Matching Plan.



LAPFF Engagement

So far:

- 2007: Calls for BP and Shell to include health and safety (H&S) targets in their long term incentive schemes

Going forward:

- Mail campaign to the FTSE 100
- 'Learn from the leaders': engagement with United Utilities in March 2008



Local Authority Pension Fund Forum

For Further Information:

Stuart Imeson

Honorary Secretary

LAPF Forum

C/O Britannia House

Hall Ings, Bradford

West Yorks, BD1 1HX

Tel: +44(0) 1274 432 111

www.lapfforum.org

Laura Aarnio

Consultancy Services Executive

PIRC (Engagement Partner to LAPFF)

Cityside

40 Adler Street

London, E1 1EE

Tel: +44(0) 2073927875

Lauraa@pirc.co.uk