Nottinghamshire County Council

Report to Pensions Investment Sub-Committee

22 March 2012

Agenda Item:8

REPORT OF THE SERVICE DIRECTOR FINANCE & PROCUREMENT

REPORT TITLE: LAPFF CONFERENCE 2011

Purpose of the Report

1. To report on the Local Authority Pension Fund Forum (LAPFF) annual conference held in Bournemouth on 1st and 2nd December 2011.

Information and Advice

2. The Fund is a member of LAPFF and receives two delegate places at the annual conference as part of its membership. In accordance with the Pension Fund's training policy and the need to maintain current levels of investment knowledge, the 2011 conference was attended by Mr King, a member of the Sub-Committee.

3. LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest. The 2011 conference was entitled "The Continuing Crisis: Companies and shareholders in uncertain markets".

4. The conference was opened by Cllr Ian Greenwood, Chair of LAPFF, who led into "the hacking scandal: lessons for investors" by reading the submission from Tom Watson MP. This focused on voting against the Murdochs on the Boards of News International and BSkyB, highlighting the failings of the Asset Managers not fully exercising their voting rights and leaving these Directors in place. It was clear that there was likely to be more to come out on the phone hacking scandal.

5. The submission also concentrated on Engagement. When voting at shareholder meetings for the election of Directors there is a need to reflect on previous performance, not just current performance, to ensure that emotion and politics are kept out of decision making and look at what the board are doing to the finances of the Company. It is also recognised that majority shareholders are dangerous and raise big concerns because of the strength of their voting rights. The submission also made a reference that the Select Committee report might criticise the Murdochs by name and questioned what impact Ofcom will have on News Corp and BSkyB.

6. The next session was chaired by John Plender from the Financial Times titled "Owners and Directors: challenges to board integrity".

7. Simon Laffin, former Chair of Mitchells and Butlers spoke about when shareholder challenges are made, shareholders were getting together before 30% of the shares are secured to challenge the Board. This happened at Mitchells and Butlers and a complaint was made about the discussions of shareholders taking place before the 30% of shares were purchased. There followed an Investigative Panel who in its investigation failed to look at the complaint fully which led to changes on the Board. Complacency has to be challenged especially where it is apparent that shareholders are colluding to challenge directors before attaining 30% of the shares.

8. Ken Olisa was formerly Non-Executive Director at Eurasian Natural Resources Company (ENRC). Following comments in the Sunday Times regarding an acquisition the board resigned and then were reinstated. It was quite clear at the time that the board were dysfunctional and not working together. There then followed a self satisfaction survey where the result was low satisfaction. When the board was reinstated Mr Olisa wanted to resign but was persuaded not to. At the following AGM Mr Olisa found himself voted out. This has led to the publication "Private companies with public shareholdings: A handy guide for pension fund trustees".

9. Next Anna Kvam, Norges Bank Investment Management spoke about the £360bn invested across 8000 companies owning 1-2% of each company. She went on to say because of the amount of companies they have invested with they only look to invest in boards that are transparent and accountable thus empowering boards with suitable governance and accountability to be chosen. This allows them to concentrate on finding the right person for the board.

10. The last speaker before questions in this session was Stuart Morgan of National Express who talked about another disclosure in the Sunday Times. The board proposed 3 Non Executive Directors, questions on vision were fought by the board, this led to Activist shareholders wanting an open debate in the press and the nomination was withdrawn. The outcomes were that Activist shareholders can be useful; this can lead to shaking the board up for new ideas, brings the board together thus making team working a useful tool. As a result it found the board worked better for shareholders and by asking difficult questions early this can override diversity at board meetings.

11. After the question and answer session Dr Paul Woolley, Centre for the Study of Capital Market Dysfunctionality spoke about "What pension funds should do now?". He spoke about rewriting theory and understanding of Principals and agents:-

Principals	**Agents**
Pension Funds	Banks
Sovereign Wealth Clubs	Investment Banks
Charitable Funds	Stock Exchanges
Endowments	Insurance Companies
The man in the street	Brokers
	Actuaries

Principal / Agent problems

- Agents have better information and different objectives
- Principals have difficulty assessing competence and diligence of agents
- Principal/agent problem gives rise to mispricing of assets and enables agents to capture excess profits

This has led to the suggestion of ten policies for Giant Funds to introduce, these are

1) Emphasise long-term investing
2) Cap turnover
3) Current risk measures flawed
4) Stable benchmarks
5) No performance fees
6) No alternative investments
7) Total transparency
8) Invest only where publicly quoted
9) Monitor corporate/bank charges
10) Full disclosure

The consequences are

Of action - Higher returns for your pension funds
Of inaction - You will be failing as custodians of society's wealth
- End of free market capitalism

12. John Plender welcomed us back after lunch for the start of the afternoon session "Pay and behaviour roundtable: incentivising executives". The next speaker was Deborah Hargreaves, Chair of the High Pay Commission. Deborah spoke of how in the 1980's directors pay was 13or14 x the lowest salary; it is now 75 x at Barclays. Directors pay normally consists of an annual bonus, a share option scheme and a Long Term Incentive Plan (LTIP) and all the components (with the exception of share option gains) increased at a faster rate over the last 10 years than corresponding measures of corporate performance. Her presentation detailed:

- How did we get here?
- Paying for boardroom performance: the evidence
- What has happened to annual bonus payments?
- Long-term share-based incentive performance trends
- Changes in numbers receiving incentives
- Do incentives help the long-term survival?
- Pay for performance in finance

The summary is that remuneration committees do not fill their remit and they propose that an employee representative sits on the committee to vote on Directors remuneration packages.

13. There then followed an animation called "Drive" by Daniel Pink which looked at incentives and showed that, when you go further up the ladder, financial incentives are no longer a driver and in fact can be a barrier to productivity and job satisfaction.

14. The next session was given by Jim O'Loughlin, PIRC Ltd. Jim spoke about market failures and the remuneration debate. The focus was "The Rider, The Elephant and The Path":

1) You have to Direct the Rider – the logical conscious part of you
2) You have to Motivate the Elephant –the more instinctual part of you
3) You have to Shape the Path - which causes us to attribute people's behaviour to the way they are, rather than to the situation they are in.

Jim spoke about these elements and the results that can happen if the right or wrong paths are taken.

15. After that, there were presentations on the subject of "Women on the Board: achieving change". Anne Richards, Aberdeen Asset Management, spoke about women in the boardroom and seven steps to achieve change, these being:

- Avoid sweeping generalisations
- Show evidence that mixed teams perform better
- Focus on the person, not their gender
- Use targets rather than quotas
- Tackle the lack of executive directors at board level
- Address systematic (and often unintended) biases
- Work on media portrayal of successful women

16. Abigail Herron, The Co-operative Asset Management, spoke about the amount of FTSE 350 companies in 2009 – 94% have an equal opportunities policy and only 3.4% of UK top executives are female, only three companies have chair-women and 130 companies have no women on the board. Abigail then spoke about "The Davies Report – the Aftermath" about how 50 companies have announced board targets and 116 have made statements acknowledging gender diversity and that board seats held by women are increasing.

17. The final session of the afternoon started with "International Financial Reporting Standards (IFRS): fit for purpose?" and a video link to Steve Baker MP who spoke about the way that balance sheets are reported and should not be bolstered to then give a true and fair view of the worth of the companies.

18. Ian Richards, Aviva Investors, spoke about how IFRS allows creative accounting. The major area of concern is misrepresentation and how this contributed to the banking crisis.

19. Tim Bush, PIRC Ltd, showed a presentation on how the International Accounting Standards Board has failed to understand basic maths, that IFRS is nothing less than false accounting and how loss making businesses have been made to look profitable. The consequences are that the UK, US and Irish had overvalued banking books in domestic banks and the rest is history.

20. The last speaker of the day was Terry Crossley from DCLG who spoke about the short term savings required of the LGPS of £900m and the long term reforms post-2015 following the Hutton Review. With relation to the £900m and the consultation ending 6 January 2012, the preferred version would be a change in the accrual rate from 1/60th to 1/67th and the state pension age link which would mean no increase to employees'

contributions. This would be introduced in April 2012. As part of the long-term savings post-2015 proposals the one thing that was introduced on 11th November was the possibility to reform the changes as a "one event" concept linked to the 2013 valuation exercise.

21. Day two started with "Out of the crisis: creative investment". Nick O'Donohue, Big Society Capital, talked about how social investment began 30 years ago and now 65000 social enterprises, organised as companies and driven by government initiatives with funding from old closed bank account balances, are able to get financial returns with capital investment from investors. The investors put up the capital and get a yearly return as projects are completed plus the capital back at the end of the project.

22. Charlie Green from the Private Equity Foundation presented "Social Impact Structures Made Simple". His slide show covered the following topics:

- Why bother with Social Impact structures?
- How Social impact Funds are structured
- How does it work?
- Who takes the risk of delivering success?
- What's the risk of an investor losing money?
- Determining the Payment for Success
- Net cost of current services to the public purse
- Net cash cost with a social impact structure
- What else are investors looking for?
- What is by far the greatest risk in all this?

23. There followed a "Social Finance Roundtable" with Brian Bailey, West Midlands PF chairing. This began with a presentation, "Social Investment from a Pension Fund Standpoint" and how using pension fund resources to invest in opportunities can give an acceptable return and invest in activities such as:

- Economic regeneration
- Overcoming deprivation
- Better outcomes for public services and service users

He went on to outline the Social Investment issues for Pension Funds:

- Returns/Risks
- Liquidity
- Governance
- Fund Structure
- Due Diligence
- Scale of investments
- "Gate Keeper"
- Fund Manager/Consultant

And the opportunities:

- Property
- Regional Development Funds
- Infrastructure
- Private Equity

- Social Impact Bonds
- 'Blended' investors with different objectives
  (pension funds, charities, government [direct/indirect])

24. Michelle Giddens, spoke about how Bridges Ventures is a sustainable growth investor whose commercial expertise is used to deliver both financial returns and social and environmental benefits. They use their three funds (Sustainable Growth, Sustainable Property and Social Enterprise) to invest in key themes with strong fundamentals such as:
    - Underserved Areas
    - Environment
    - Education/Skills
    - Health/Wellbeing

25. After the Q&A session Will Merton, Mercer, gave a presentation on "Asset allocation and minimising climate risk". He started by talking about what we had learnt from the global financial crisis? These were:
    - More 'what if' critical thinking is required
    - Need to think long-term and strategically
    - Risk is more than historical volatility and correlations
    - Source of risk beyond mean-variance analysis
    - Behavioural biases predominate (aka technology bubble, corporate governance failures, the financial crisis…climate change?)
    - We overlook systemic risks
    - Climate change is one of these risks

26. Climatic trends are pointing in worrying directions. CO_2 emissions have rebounded to a record high and energy efficiency of global economy has worsened for the 2nd straight year. A project was set up with partners to examine the implications of climate change for asset allocation. This resulted in a climate change scenario analysis whose sub headings are:
    - Regional Divergence
    - Delayed Action
    - Stern Action
    - Climate Breakdown

27. From this, "technology, impacts and policy" (TIP) were identified as climate change sources of risk for asset classes and a graph was shown with climate change being a proportion of risk and how TIP was broken down within climate change. Further charts were shown showing Pension Plans Sensitivities to Climate Risk and these were summarised at the end of the presentation.

28. Joyce Haboucha, Rockefeller Financial Asset Management spoke on "Engaging with Exxon, lessons learned and what next.

29. Michael Green spoke on "The road from ruin". His speech covered:

    - the current situation

- the dangerous times
- the lack of alternative vision
- how to get capitalism working
- structural regulation not winning
- financial sector and failed shareholders
- find a better way to measure the economy
- public has to accept some responsibility
- lack of leadership – political/city

30. The final presentation was by Terry Smith, Prebon PLC and Fundsmith LLP called "What's wrong with the city". The presentation covered the following:

- What's wrong with the City?
    - Banks
    - Big Bang
    - Short Termism
    - Remuneration
    - Investment

- What is wrong with existing funds?
    - Funds have become closet index trackers
    - Too Diversified
    - Trade too much
    - Performance fees or initial fees punish investors
    - The bottom line: performance suffers

The final comments were:

- "You are your own worst enemy"
- As John McEnroe said "The main person who can beat you is you"
- And finally "We have got the city we Deserve"

Reason for Recommendation

31. That it be noted that attendance at relevant conferences is part of the Funds' trustee training programme and in line with best practice.

Statutory and Policy Implications

32. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION

1) That the report be noted

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For any enquiries about this report please contact: Paul Simpson, Service Director, Financial Services Tel 0115 9773441

Background Papers

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

None

Electoral Divisions and Members Affected
All.