Nottinghamshire County Council

Report to Pensions Sub-Committee

4 February 2016

Agenda Item:

REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT & IMPROVEMENT

LAPFF CONFERENCE 2015

Purpose of the Report

1. To report on the Local Authority Pension Fund Forum (LAPFF) Conference 2015 held in Bournemouth.

Information and Advice

2. The LAPFF Conference 2015 was held on 2nd to 4th December 2015 at the Highcliff Marriott Hotel in Bournemouth. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills, the conference was attended by Councillor Chris Barnfather and Neil Robinson (Group Manager – Financial Management). The theme of the conference was 20 Years of Responsible Investment: Where Next?

3. **Councillor Kieran Quinn, Chair of LAPFF; Paul Hackett, The Smith Institute**
   The conference began with a welcome from Councillor Kieran Quinn who reflected over what was happening twenty years ago on 3rd December 1995 (which included Newcastle being ten points clear at the top of the English Football League!) and the changes that have taken place in technology over the past twenty years. One percent of people in the UK had access to the internet two decades ago compared with ninety-four percent today and, of course, social media was unheard of.

   Mr Hackett reinforced the view that LAPFF is a successful organisation with an expanding membership and with a voice, which occupies a unique place in investor engagement. He cited a list of the major issues and initiatives with which LAPFF has been involved over the last twenty years:

   - In 1995, the "Cedric the Pig" campaign at British Gas;
   - The dual roles of chairman/CEO at Marks and Spencer;
   - Poor governance at News Corporation (before the phone hacking scandal);
   - The 'true and fair view' issue with the Financial Reporting Council;
   - Environment and governance issues at Shell.

   These are in addition to the many other current and ongoing initiatives that are covered in the LAPFF 2015 Annual Report.

4. **Investor Engagement: does it work?**

This session began with Martin Gilbert, CEO, Aberdeen Asset Management, outlining his view that engagement is crucial if investment interests are to be served. With Aberdeen holding two percent of UK shares, often for ten years or more, it is important that they act as share owners and engage with companies. There may be periods of underperformance but he encourages his fund managers not to sell if they believe in the stocks they hold and for them to take a long term view. He referred to the example of Rolls Royce where, in his view, positive engagement with the company over a long period played a large part in turning it around.

Mr Gilbert stated that, in his experience, engagement encourages good company governance through attending annual general meetings, insisting on seeing the chairman of the board on his or her own and taking time to understand the business. It is important also, however, that the share "owners" are not seen as activists, even though engagement may focus on fundamental aspects of company structure (e.g. separate roles for the chairman and CEO) and issues of policy. There have been notable engagement failures, though, and in his view there had been an over supportive relationship with the Royal Bank of Scotland and Bank of Scotland.

5. **Engagement through the ages: the Chairs**

The next session on the first morning of the conference provided an opportunity for past Chairs of LAPFF to reminisce over their experiences with the organisation. The four protagonists were Councillor Kieran Quinn, current Chair of LAPFF and three former Chairs of LAPFF - Ian Greenwood, West Yorkshire PF, Councillor Darren Pulk, Nottinghamshire PF and John Saunders, L B Newham PF.

Mr Saunders began by reflecting on the growth of LAPFF, increasing from a membership of thirty in 2004 to a current membership of sixty-six. In the early days it was difficult to challenge companies on governance; it was very much a team effort between members, activists, individuals and PIRC.

Councillor Pulk reaffirmed the purpose of LAPFF; to serve investment interests by promoting the highest standards in:

- Corporate governance;
- Corporate social responsibility;
- Awareness of climate change;
- Improving transparency and reporting.

The major themes that he recalled from his time as Chair of the Forum included workforce practices, equal pay for women, carbon emission targets, remuneration policies and anti-union activity in the USA.

Mr Greenwood stated that the biggest single thing was the ability to meet with the chairs of boards of the major companies and the progress that has been made through this engagement; now these leaders ask to see LAPFF!

Councillor Quinn ended the session by offering praise for PIRC and pointing out that the membership of LAPFF is still growing (sixty-nine funds by the end of 2016). The work must continue with the next big issue, in his view, being tax transparency.

6. **What are the dynamics of a successful board?**
   After having been introduced by Councillor John Gray, L B Newham, Phil White, Chair of the Kier Group, in a very well received presentation, started to answer this question by showing a video to demonstrate that Kier is all about people. Mr White stated that he had enjoyed every minute of his career, having dealt with real people and having gained a tremendous amount of experience of the difference between right and wrong when running a business and of running directors' boards.

   He was keen to point out that, with organisations being so diverse (with different owners, values and people, etc.) directors' boards have to be 'created'; it is not something that can be googled and there is no simple checklist that, when ticked, will ensure a successful board. Things can go wrong with any board, no matter how successful it appears to be (e.g. Tesco, VW, FIFA, Kids Company, Co-Op, Northern Rock) and directors need to stick it out and not "run for the hills". Mr White put forward his basic rules:

- Know the difference between right and wrong;
- Things are not black or white but grey and often involve a compromise;
- Good governance has to come from the top;
- Look for different skillsets in appointing to the team.

   Together with good chairing and having a good CEO, individuals' understanding of their respective roles and the aims and values of the organisation, together with putting the organisation first and operating to the highest standards are all important.

7. **Directors' duties, directors' succession planning**
   The next session continued the theme of engagement with company boards with James O'Loughlin, PIRC considering LAPFF's challenge when trying to ascertain the dynamics of a successful board and its policies, processes and procedures. Using the interesting analogy of an iceberg, he asks if good succession planning (as the visible element, exemplifying the level of risk taking) can indicate the dynamics of a successful board (the invisible part). His answer is that it can, but only in certain circumstances.

   Using the example of an unexpected CEO death and where the reaction of the stock market is near zero, then this could indicate that there is good succession planning in place. It could also indicate, though, that either the markets don't care or there is a fundamental attribution error. In the end it is the quality of the business that counts but, with ever higher competitiveness, the CEO's contribution and importance is growing. This is particularly important when there is an iconic CEO in a situation of rapid company growth, where culture gives the company an advantage and where that advantage is being eroded. In this sort of context succession planning is a very clear indicator of the dynamics of a successful board.

8. **Corporate accountability in a globalised world**
   In this session Martin Day, Senior Partner, Leigh Day LLP, who specialises in "bringing chickens home to roost", and Daniel Balint-Kurti, Global Witness gave examples of how the law has been used to challenge global corporations. Most notably:

- In 2006, a ship chartered by the Dutch-based oil and commodity shipping company, Trafigura, offloaded toxic waste at the Ivorian port of Abidjan. The waste was then dumped by a local contractor at as many as twelve sites in and around the city of Abidjan. The gas caused by the release of these chemicals was blamed by the Ivorian

Government for the deaths of seventeen and the injury of over thirty thousand Ivorians. After being sued, and at first denying responsibility, the company paid $46m in compensation.
- In a similar case of environmental pollution causing damage in Nigeria, Shell offered £4,000 to a community of fishermen; this was increased to £55m after a successful lawsuit.

A recent landmark case, Chandler v Cape plc, became the first time that an injured employee of a subsidiary company established that an employer's parent company owes a duty of care. Mr Day pointed out, however, that there are obstacles to justice including funding issues, delay and intimidation.

Mr Balint-Kurti, whose campaign group investigates corruption scandals, advised that investors need to ask tough questions and, in his case, he buys a share and goes to annual general meetings in order to embarrass the board!

9. **Carbon transition management: how should investors respond?**
Tom Harrington, Senior Investment Manager, Greater Manchester Pension Fund began the next session by describing the pressure that has been brought to bear on the GMPF with regard to divesting of carbon assets. The pressure tactics used have ranged from protesters with banners outside council offices brandishing slogans like, "Don't be a dinosaur, move our money out of fossil fuels" to internet postings attacking individual companies in which the Fund has holdings, for their alleged activities.

The GMPF's approach is to echo the UNISON view that:

- The first duty of the LGPS is to pay the staff their pension benefits when they retire;
- Divesting of carbon assets without having found adequate renewable investment returns would create huge economic uncertainty;
- It would be irresponsible to begin any programme of disinvestment in fossil fuels that threatened in any way the ability of the funds to pay people's pensions.

The GMPF engages, of course, through LAPFF and takes part in other collaborative initiatives.
Further, the GMPF has investigated and taken opportunities to invest in various companies which deal in cleaner energy such as:

- Energias De Portugal - integrated power company – 70% of assets are CO_2 free;
- Fortum Corp – heat and power generation company - 90% of assets are CO_2 free;
- Beijing Enterprises Holdings – a gas operator taking part in the government's efforts to make the city coal-free.

10. **LGPS Developments**
The first day of the conference ended with a consideration of hottest topic currently on the LGPS agenda: pooling. The panel was introduced and chaired by Councillor Mary Barnett, Greater Gwent (Torfaen) PF, LAPFF Executive and the four protagonists were Brian Bailey, PIRC, Bob Holloway, DCLG, Cllr Kieran Quinn, Chair of LAPFF & GMPF and Terry Crossley, PIRC.

Bob Holloway began the discussion by outlining briefly the evolution of the policy, which began when the question was asked “why are there eighty-nine funds?” Merging funds was quickly ruled out as was the possibility of making passive investment mandatory. The position has been reached now of pooling assets (but not 100% of assets) and non-mandatory collective investment vehicles, with the twin goals of reducing investment fees and achieving greater efficiency through economies of scale. Mr Holloway’s view is that the ball is now firmly in the Funds’ court.

The rest of the panel were sceptical of what Mr Holloway described as a “backstop power”, for the Secretary of State to intervene under certain circumstances and take over Funds’ powers. Mr Holloway insisted that he thought intervention would be minimal and that ministers, in agreeing to let go of certain controls, had to have a backstop.

Councillor Quinn ended the discussion by recommending that, if they had not already done so, delegates should read the latest Government document and make up their own minds.

11. **How investment engagement with companies has changed over the last twenty years**
The second day of the conference began with Deborah Gilshan, Railpen Investments, adding to the messages of the previous day: that engagement is not just about information gathering. The concept of stewardship is more accepted and what it is to be an owner of shares is more understood. Companies, too, recognise that amplifying the voice of the long term shareholder is helpful.

Amanda Mellor, Company Secretary, Marks & Spencer described shareholder engagement from a company’s viewpoint. According to her, twenty years ago the company didn’t even bother about votes cast at the AGM. Over more recent years, though, a great deal more thought has been given to engagement and working together. The company has learnt the value of long term investor relationships and has positively nurtured them. The more time given to consultations the better and she considers that Marks & Spencer is lucky to be so high profile which encourages investors to attend and engage at large events.

12. **What’s been going on in the European Parliament on IFRS?**
Councillor Richard Greening LB Islington, LAPFF Executive, Syed Kamal MEP and Tim Bush, PIRC updated conference delegates on the International Financial Reporting Standards (IFRS) issue which calls into question the purpose of accounts.

Mr Kamal (via a video link from the European Parliament) described the recent activity in the Parliament where some time ago questions were raised about accounting standards: “How did the banks get away with it?” “Why weren’t alarm bells rung?” During the last four years there have been no satisfactory answers. Mr Kamal is part of the group of MEPs who is scrutinising IFRS9 and examining the need for loss provisioning and the reliance on “experts” who seem to be intent on outsmarting the authorities. His view is that company accounts should not be just for accountants but for the purpose of governance, especially with the reporting of a “true and fair view” partly underpinning European financial stability.
Tim Bush, in his presentation, reinforced the view that, since the audit failure with regard to HBOS, the Financial Reporting Council simply has not followed up adequately. LAPFF has engaged a specialist Queen’s Counsel whose opinion is that the FRC is reading the basic legislation wrongly: the legislation applies to the specified numbers in the accounts (i.e. they need to be correct) whilst the FRC prefers to regard a “true and fair view” as denoting usefulness of the accounts as a whole! The debate continues.

13. **What's changed in LGPS investments since 1995?**
The next session of the morning involved a discussion involving Karen Thrumble, State Street, Paddy Dowdall, GMPF and John Harrison, Independent Consultant. The panel started by acknowledging that funds have significantly more choice now than they did twenty years ago: equity investment is more diversified and alternatives now comprise nine percent of the average fund. The greater complexity has brought with it both opportunities and challenges. There is the opportunity to reduce volatility, reduce reliance on a small number of managers and a chance to increase diversification. The wider choice of investment opportunities, however, requires greater time, training and governance from all involved (and has brought about a greater reliance on advisors). In addition, the wider choice of managers makes manager selection an ever more difficult task.

    Funds that have become extremely complex have not performed better than their less complex peers and this partly reflects the relatively high investment of many of these funds in alternative assets. These assets have reduced risks but have usually resulted in lowering returns. The conclusion is that funds need to continue to view all decision making in the clear context of their long term objectives.

Statutory and Policy Implications

14. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, 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.

RECOMMENDATIONS

1. That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2. That the report be noted.

Report Author: Neil Robinson
Group Manager – Financial Management

For any enquiries about this report please contact: Neil Robinson

Constitutional Comments

15. Because this report is for noting only, no Constitutional Comments are required.

Financial Comments (SRC 13/01/16)

16. There are no direct financial implications arising from this report.

Background Papers and Published Documents
None