Nottinghamshire County Council

**Report to Pensions Sub-Committee**

**13 December 2012**

**Agenda Item: 9**

# REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

# LOCAL AUTHORITY PENSION FUND FORUM (LAPFF) CONFERENCE 2012

## Purpose of the Report

1. To report on the LAPFF Conference 2012 held in Bournemouth.

## Information and Advice

2. The LAPFF Conference 2012 was held on 28th to 30th November 2012 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 Mr Chris King (joint trade unions representative) and Mr Simon Cunnington (Senior Accountant – Pensions & Treasury Management).

3. ***Robert Swannell – Chairman, Marks & Spencer***
The conference began with Robert Swannell, current chairman of Marks & Spencer (M&S). LAPFF has had an ongoing dialogue with M&S, following concerns over combining the roles of chair and chief executive at the company. Mr Swannell regarded this as a productive relationship and believes that it is important to engage with shareholders. He emphasised the corporate values of trust and integrity in establishing a connection with society.

4. The founders of most companies imparted their own cultures and these generally included integrity. Companies with integrity make fewer mistakes and recover quicker from those they do make. Shareholders should focus on these values at least as much as on quarterly performance

5. ***Pay reform: what shareholders should do about pay***
This session began with Sir Michael Darrington, former MD of Greggs and founder of Pro-Business Against Greed (PBAG). Greggs had core values – treat people as you would want to be treated. It was accountable to shareholders but also focused on employees and customers in the belief that, by doing this, shareholder returns would follow.

6. Executive remuneration used to be set with reference to inflation and staff wage increases. Now it is set almost entirely with reference to the market. PBAG's beliefs are that remuneration packages need to be simpler and more transparent

and the gap between staff and executive pay needs to reduce – the quantum of executive pay is simply too high.

7. Deborah Gilshan from Railpen followed and urged us to ask ‘how much is too much’. Shareholders should challenge assumptions made by boards over pay such as bringing in a new CEO at the same level of pay (or higher) than the previous occupant. She also questioned the old excuse of ‘needing to pay more or the executives will leave’ suggesting that pay is not the only motivator and that transferable skills of executives are not as great as made out.

8. The session concluded with Ashley Hamilton from PIRC Ltd who outlined 7 problems with executive pay.
    i. Money is not always the best motivator.
    ii. More pay does not necessarily equal better performance.
    iii. Incentive structures are too complex.
    iv. Long term incentive plans are not long term enough.
    v. Fairness in pay matters.
    vi. Conflicts of interest breed dysfunction (particularly as regards company consultants).
    vii. IFRS accounting can create distortions in profits on which rewards are based.

9. ***Shareholder Spring***
The next four speakers considered the impact of the ‘shareholder spring’. Helen Wildsmith from CCLA (who provide investment services for churches, charities and local authorities) outlined how engagement with companies forms a big part of their ethical investment policies. She believes the 2012 voting season could be the start of something different but thinks that collaboration between shareholders will be vital.

10. Daniel Summerfield from the Universities Superannuation Scheme (USS) stated that the overall level of shareholder dissent in 2012 was very similar to previous years. However, business as usual is no longer an option and the key test will be in the proposed incentive schemes for 2013. Current remuneration metrics are flawed and should be more specific to the individual company but it is actually more important to focus on getting the right people for the job, as they are likely to perform well regardless of remuneration.

11. Robert Talbut (CIO, Royal London Asset Management) was clear that the remuneration problem was not simply a matter of poor communication (as some companies have claimed) – most shareholders believe there is an insufficient link between pay and performance. He also believes that abstaining on a vote is pointless as most companies ignore abstentions.

12. Cllr Peter Brayshaw, vice-chair of LAPFF, stated that voting doesn’t give a full picture. A vote against a resolution may follow a long period of (failed) engagement. High profile coverage of some AGMs in 2012 lead to greater leverage for shareholders but greater resources may be needed to continue the progress.

13. ***People and investment value***
Jim O'Loughlin from PIRC Ltd presented a new guide from LAPFF to help trustees raise the link between people and investment value. The 'awkward truth' is that there is no link between pay and performance in complex tasks. According to Dr Steve Peters, the team GB cycling psychologist, it is commitment not motivation that matters. Commitment to a greater purpose is the transformation element that drives people to put effort into meeting objectives. This can make a real difference to company performance but is not necessarily high on most companies priorities.

14. ***Investor concerns – media standards***
Julie Tanner (Christian Brothers Investment Services) outlined the US approach to responsible investing. The majority of successful changes have resulted from shareholder resolutions. In the US it is relatively easy to file resolutions as a single shareholder with only $2,000 worth of shares. A resolution calling for an independent chairman was co-filed with LAPFF at the News Corp AGM

15. Ian Greenwood, chairman of LAPFF, gave more detail on the News Corp experience. LAPFF had been engaging with the company regarding governance and succession planning well before the hacking scandal. There had been little progress so agreed to co-file a resolution. LAPFF discussed this move directly with News Corp and emphasised the non-personal nature of the concerns. They also discussed the issue with other major shareholders in advance of the meeting. Although defeated, the resolution achieved the support of 2 thirds of the non-Murdoch related shareholdings.

16. Patrick Daniels from the US law firm Robbins, Geller, Rudman & Dowd then ran through the history of press regulation in the US. He concentrated on two key events. The first was a series of lawsuits against the NY Times for publishing adverts relating to the civil rights atrocities in the south. These were thrown out by the Supreme Court who declared that public debate must be open. The second was during the Vietnam War when newspapers published secret government reports. Injunctions were refused with one judge stating that 'a free, obstinate and cantankerous press must be suffered'. However, Mr Daniels concluded by saying that "obfuscation" by the media (as in the recent News Corp scandals) makes discussion of press regulation much more difficult.

17. ***Banks, reputational, ethical crisis and accounting***
Tim Bush (LAPFF) covered the effects of IFRS accounting on pension funds and banks. Prior to IFRS, pension funds reported actuarially calculated costs and investment returns following the expected cash flows of the fund. IFRS, however, placed the emphasis on 'mark to market' with the effect of reducing the value of equities and pushing down bond yields (thereby increasing funds' liabilities). This has consequently diverted company investment into supporting pension funds (with the ultimate result of many closures).

18. IFRS has, however, had almost the opposite effect on banks. Banks are overvaluing trading books and leaving out 'likely' losses (which would previously have been included as prudent) thereby increasing accounting profits on which

dividends and bonuses are based. This then results in overlending and ultimately failure.

19. Cormac Butler (Ardmore Derivatives) told the same story but from the viewpoint of the Irish banks. Prior to 2005, the Irish Companies Act required companies to deduct provisions for likely losses in determining profits. IFRS allowed companies to only provide for these when the customer admits there is a problem with repayment leading to the same spiral of unsupportable dividend and bonus payouts.

20. Natasha Landell-Mills from USS reminded delegates that company accounts should provide investors with information with which they can hold managers to account. They are not there to provide market value. Companies law reflects the evolution of accounting to this end but IFRS failed to appreciate this history. USS and LAPFF are calling on the government to review and asking for a return to prudence.

21. ***Bob Holloway, DCLG***
Mr Holloway gave an update on progress with the LGPS 2014 project. Consultation on the regulations to create the new scheme was likely to start 21 December 2012 and last for 6 weeks. The Public Service Pensions Bill is currently at 3rd reading stage and has caused some consternation within the LGPS.

22. The Bill covers all public service pension schemes but is sometimes unclear exactly how new requirements will apply to the funded LGPS. Particular uncertainties surround the new pension boards, the role of the Pensions Regulator, independent oversight of valuations and the possibility of the Treasury dictating valuation assumptions. The Bill also refers to existing schemes ‘closing’. Mr Holloway tried to reassure delegates that the Treasury regretted using this word and that the existing scheme would not become closed. The question and answer session following the presentation was at times quite heated.

23. ***Investing in growth – how can local authority pensions contribute to the UK economic recovery?***
Paul Hackett from the Smith Institute presented a joint report (produced with the Centre for Local Economic Strategies, PIRC Ltd and LAPFF) on the possibilities of using local authority pension funds for ‘impact investment’. The LGPS has been identified by numerous parties as a potential source of funding for various infrastructure and regeneration schemes. The possible amounts available have rapidly grown from £3 billion to £20 billion. The report attempts to inject some reality. There are a couple of interesting initial schemes (mostly involving housing) and many may be waiting to see if these succeed before committing.

24. The Manchester scheme was highlighted by Cllr Kieran Quinn from the Greater Manchester Pension Fund (GMPF). GMPF currently has assets of about £11.2 billion and was 96% funded at last valuation. It has agreed to set aside 5% of the fund for local investments but it is very clear that these need to demonstrate sufficient returns to the pension fund. The current scheme is to build 250 homes.

25. Luke Fletcher from law firm Bates Wells & Braithwaite outlined the legal position regarding ‘impact investments’. The LGPS is not a trust based scheme but those with responsibility for funds have a similar fiduciary duty to act prudently in the best interests of beneficiaries. Primary interest is financial returns but other interests can be considered as well. The ‘Freshfields Report’, compiled for the UN, makes it clear that environmental, social and governance (ESG) factors should be taken into account where they are likely to influence value. It also introduced the concept of the ‘ethical tie-breaker’ – where two alternatives are equal on financial aspects, funds should choose the one with the most positive ESG impact.

26. ***The Olympus crisis: what can investors learn?***
Michael Woodford MBE gave an interesting talk on his experiences at Olympus (and took the opportunity to promote his new book on the subject). Mr Woodford was appointed as president of Olympus in 2011, only the fourth non-Japanese to hold such a role. Within weeks of taking over he uncovered evidence of a $1 billion fraud potentially involving organised crime within Japan. The company’s chairman and vice-president refused to discuss the issue and eventually called a board meeting at which a unanimous vote was recorded dismissing Mr Woodford. He believes that the culture in Japan of politeness and etiquette prevents people challenging those in authority

27. ***John Kay: the Kay Review***
In the final session, Professor Kay, the author of the *Kay Review of UK Equity Markets and Long-term Decision Making*, presented his main findings. Current equity markets are almost entirely secondary markets as companies are able to finance themselves without issuing equity. This means that corporate governance is key. The main players in equity markets are now the big asset management companies and the high number of intermediaries (eg registrars, custodians etc) gives great potential for a misalignment of interests. There is a real problem with long term decision making resulting from the focus on quarterly reporting and earnings management. In addition many CEOs want to make an impact and so treat their company as if they were running an investment portfolio.

28. Two main themes run through the report – trust & confidence and incentives. The former is treated by companies as a public relations exercise but really comes from behaviour not rhetoric. Trust is built through personal relationships not through regular trading of shares. The latter will only change if the incentive structures are changed.

## Statutory and Policy Implications

29. 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/S

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

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**Background Papers**
None