Lancashire County Council

Pension Fund Committee

Friday, 22nd March, 2013 at 10.00 am in Cabinet Room 'C' - County Hall, Preston

Agenda

Part 1 (Open to Press and Public)

No.	Item	
1.	**Apologies**	
2.	**Disclosure of Pecuniary and Non-Pecuniary Interests** Members are asked to consider any Pecuniary and Non-Pecuniary Interests they may have to disclose to the meeting in relation to matters under consideration on the Agenda.	
3.	**Minutes of the Meeting held on 30 November 2012** To be confirmed, and signed by the chair.	(Pages 1 - 6)
4.	**Exclusion of Press and Public** The Committee is asked to consider whether, under Section 100A(4) of the Local Government Act, 1972, it considers that the public should be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the appropriate paragraph of Part 1 of Schedule 12A to the Local Government Act, 1972, as indicated against the heading to the item.	

Part II (Not open to Press and Public)

No.	Item	
5.	**Fund Performance Report** (Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).	(Pages 7 - 20)

Lancashire County Council

6. Investment Panel Report (Pages 21 - 32)

(Not for Publication – Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It is considered that in all the circumstances of the case the public interest in maintaining the exemption outweighs the public interests in disclosing the information).

Part I (Open to Press and Public)

7. Report of the Administration Sub-Committee (Pages 33 - 44)

8. 2013 Actuarial Review – Framework for Setting Contribution Rates (Pages 45 - 54)

9. Credit and Fixed Income Strategy (Pages 55 - 72)

10. The Management of Local Investment Allocations (Pages 73 - 78)

11. Fiduciary duties and ethical investment (Pages 79 - 88)

12. Fund Shareholder Voting and Engagement Report (Pages 89 - 134)

13. Urgent Business

An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the Minutes, the Chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. Wherever possible, the Chief Executive should be given advance warning of any Member's intention to raise a matter under this heading.

14. Date of Next Meeting

The next meeting of the Committee will be held on Friday 7 June 2013 at 10.00 a.m. at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Lancashire County Council

Pension Fund Committee

Minutes of the Meeting held on Friday, 30th November, 2012 at 10.00 am in Cabinet Room 'C' - County Hall, Preston

Present:

County Councillor David Westley (Chair)

County Councillors

T Aldridge	T Pimblett
P Evans	S Riches
H Henshaw	G Roper
F De Molfetta	M Welsh
M Parkinson	K Young

Co-opted members

Councillor Ian Grant, (Lancashire Leaders' Group representative)
Bob Harvey, (Trade Union representative)
Councillor Paul Leadbetter, (Lancashire Leader's Group representative)

1. Apologies and Announcements

Apologies for absence were received from County Councillors M Devaney, K Iddon and J Lawrenson, and Councillor M Smith.

It was reported that Councillor Grant had been appointed to represent the Lancashire Leaders' Group and Councillor Grant was welcomed to the meeting.

2. Disclosure of Pecuniary and Non-Pecuniary Interests

None.

3. Minutes of the Meeting held on 27 July 2012

The Minutes of the meeting held on 27 July 2012 were presented.

Resolved: That the Minutes of the meeting held on 27 July 2012 be confirmed and signed by the chair.

4. Exclusion of Press and Public

Resolved: That the press and members of the public be excluded from the meeting during consideration of the following items of business on the grounds that there would be a likely disclosure of exempt information as defined in the

paragraph of Part 1 of schedule 12A to the Local Government Act, 1972, indicated against the heading to the item. It was considered that in all the circumstances the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

5. Fund Performance Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee considered a report on the performance of the Fund as at 30 September 2012, focussing on the key areas of:

- the funding position;
- cash flow;
- investment performance and allocation; and
- risk management of the Fund.

There was a general discussion on the report presented and officers responded to specific questions on the Fund's cash flow position, investment income, private equity performance and the need to reduce the Fund's liabilities. It was noted that a report on a liability management strategy would be presented to the next meeting of the Committee.

Resolved: That the report be noted.

6. Investment Panel Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee received a report from the Investment Panel setting out the work of the Panel at its meeting held on 24 September 2012. The Committee's attention was specifically drawn to the following key areas:

- The investment context in which the Fund was operating and in particular the effects of the continued weak economic growth, the "fiscal cliff" in the US and the on-going problems within the euro zone;
- Investment decisions that had been taken within the Lower Volatility Strategies Allocation;
- Further allocation work that was being undertaken on a number of investment opportunities; and
- Potential restructuring of Private Equity and Fixed income mandates.

Resolved: That the report be noted.

7. Global Equities Transition Report

(Exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act, 1972. It was considered that in all the circumstances of the case the public interest in maintaining the exemption outweighed the public interest in disclosing the information)

The Committee received an update on the Fund's transition to the new global equities investment managers, as reported to the Committee in May 2012.

It was noted that the transition had been completed with effect from 1 October 2012 and that the transition was within the cost estimates provided despite a falling market.

It was also noted that the Fund had entered into a Commission Recapture programme to obtain rebates on commission costs for the new global equity mandates which should generate significant costs savings per annum. The Committee welcomed this course of action.

Resolved: That the report be noted.

The Committee then returned to the remaining Part I agenda items.

8. Administration Sub-Committee Report

The Committee received the minutes of the Pension Fund Administration Sub-Committee from its meeting on 11 October 2012.

It was noted that the Sub-Committee had considered reports on the following:

- Membership of the Local Government Pension Scheme and Auto-enrolment; and
- Member Self Service.

The Sub-Committee had previously approved a Communications Strategy to encourage a greater take up of the Local Government Pension Scheme. The Committee noted that the Sub-Committee had now approved the roll out of a communications action plan to coincide with the County Council's auto-enrolment date of 1 January 2013. It was reported that the campaign was well underway and that the campaign materials would be made available to other Fund employers including District Councils as the auto enrolment process began to affect them.

It was reported that over 3,000 people had requested access to the new on-line member self-service system. This would give scheme members including pensioners access to their pensions data through a secure website. Around 300 people had requested that information be sent to them in hard copy format.

Resolved: That the report be noted.

9. Update on Local Government Pension Scheme 2014 and the Public Service Pensions Bill

The Committee received an update report on the progress of the Local Government Pension Scheme (LGPS) 2014 proposals and the statutory consultation framework relating to draft regulations. The report also covered the key provisions of the Public Service Pensions Bill and its impact on the LGPS 2014,

It was reported that whilst the draft regulations had been delayed, they were still expected before the end of 2012 with consultations taking place in early 2013. The delay did not change the basis of the LGPS 2014 on Scheme design. Details of the proposals were presented.

The Public Service Pension Bill was published on 13 September 2012. The Bill would work its way through Parliament before being enacted during 2013. Individual schemes, including the LGPS, would then issue secondary legislation defining new scheme regulations ahead of the commencement date, expected to be 1 April 2014. It was noted that the new career average public sector pension schemes would only come into effect after the commencement date and that the pension rights accrued by a member before that date would be protected.

Resolved: That the report be noted.

10. Statement of Investment Principles Report

The Committee considered a report on the Fund's Statement of Investment of Principles.

It was noted that regulations governing the operation of the Fund required the Statement of Investment Principles to be reviewed and if necessary, revised, in case of any material change to the Principles within 6 months from the date of change. The change of investment managers with the implementation of the global equities mandate was considered to constitute such a change.

A revised Statement of Investment Principles was presented and the Committee's attention was drawn to the advice that the Investment Panel was required to provide to the Treasurer of the Fund. It was felt that the advice relating to "Performance measurement" needed to be more specific and that section h. should be amended to read "To oversee the performance of the investment managers appointed by the Fund and to report on the Fund's performance." The Committee approved this amendment.

It was suggested that the Statement of Investment Principles should be further amended to include reference to the Fund investing in local infrastructure. The Committee was informed that local infrastructure investment by Pension Funds was currently the subject of a Government consultation. It was agreed that a

further report on this matter including the possible establishment of a local infrastructure investment protocol be presented to a future meeting.

Resolved:

i.. That subject to section h. of the Investment Panel's Terms of Reference being amended, as set out above, the Statement of Investment Principles be approved.

ii. That a further report on the position of the Pension Fund investing in local infrastructure, and on the development of a local infrastructure investment protocol be presented to a future meeting.

11. Fund Shareholder Voting Report

The Committee considered a comprehensive report on the Fund's shareholder voting arrangements and voting activity for the period 1 July to 30 September 2012. It was noted that the Fund had voted on 330 occasions during this period and had opposed or abstained in 33% of votes.

It was noted that the Australian superannuation fund First State Super had announced its decision to divest from tobacco investments. The implications of the Fund adopting a similar stance were discussed and members were reminded of the Fund's over-riding fiduciary duty to maximise returns for its members. It was agreed that a further report on the Fund's fiduciary duties in so far as they related to ethical considerations and investments be presented to the next meeting of the Committee.

Resolved:

i. That the report be noted.

ii. That a report on the Fund's fiduciary duties in so far as they relate to ethical considerations and investments be presented to the next meeting of the Committee.

12. External Audit, Annual Governance Report 2011/12

The Committee considered the Audit Commission's Pension Fund Annual Governance report for the year ended 31 March 2012.

It was noted that the Governance Report had already been considered by the Audit and Governance Committee. The report included the letter of representation which gave the Audit Commission specific management assurances regarding the accounts of the Lancashire County Pension Fund.

The Committee was informed that the District Auditor had issued an unqualified audit opinion on the financial statements of the Pension Fund. In commenting on the County Council's accounts, Karen Murray, district auditor, informed the Committee that she had not identified any material errors within the financial

statements and those errors which had been identified and which were set out on page 5 of the report, had not affected the underlying financial position of the Council. She also commented that this was a significant achievement on the part of the County Council's finance staff as it had been a particularly challenging year with the introduction of a number of changes.

The audit work had identified a potential misclassification of accounting entries between the County Council. It was reported that action was being undertaken to address this issue.

Resolved:

i. That the Audit Commission's Pension Fund Annual Governance report 2011/12 be noted.

ii. That the Committee's thanks and appreciation be extended to the County Council's finance staff for their work in producing the financial statements of the Pension Fund during a particularly challenging year.

13. Urgent Business

None.

14. Date of Next Meeting

It was noted that the next meeting of the Committee would be held on Friday 22 March 2013 at 10.00 am at County Hall, Preston.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Agenda Item 5

(NOT FOR PUBLICATION: By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972. It is considered that all the circumstances of the case the public interest in maintaining the exemption outweighs the public interest in disclosing the information)

Document is Restricted

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Document is Restricted

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected: All

Report of the Administration Sub-Committee
(Appendix 'A' refers)

Contact for further information:
Chris Mather, (01772) 533559, Office of the Chief Executive,
Chris.mather@lancashire.gov.uk

Executive Summary

The Pension Fund Administration Sub-Committee met on 6 February 2013. A copy of the minutes of the meeting is attached at Appendix 'A'.

Recommendation

The Committee is asked to note the minutes of the Pension Fund Administration Sub-Committee meeting held on 6 February 2013.

Background and Advice

The Pension Fund Administration Sub-Committee met on 6 February 2013 to consider reports on the following:

- The transfer of Your Pension Service to One Connect Limited
- Membership of Local Government Pension Scheme and Auto-enrolment
- Statutory Consultation on the new Local Government Pension Scheme 2014 and related proposals

Further information including the decisions taken can be found in the minutes of the meeting which are attached at Appendix 'A'. However, the Sub-Committee would like to draw the Committee's attention to the following:

1. The transfer of Your Pension Service to One Connect Limited

The Sub-Committee commented on the excellent and cost effective service currently provided by Your Pension Service and requested that assurances from One Connect Limited with regard to maintaining the quality of the Service be brought to the attention of the Pension Fund Committee. Further details about the concerns and reservations of the Sub-Committee can be found at Appendix 'A'.

Lancashire County Council

The following statement is intended to provide assurance to the Pension Fund Committee that the high quality of the existing service to members and their families as set out in the current Service Level Agreement will be maintained.

Specifically, One Connect Limited undertakes to ensure that: -

- Any expansion of the Service will not affect current service standards.
- The Service will continue to be cost effective
- The integrity of the service, including data integrity, will remain secure.

In addition, this transfer will enable Your Pension Service to benefit from One Connect Limited's commercial skills, as well as its ongoing focus on high performance, continuous service improvement and placing the customer at the heart of the organisation. The transfer will see benefits arising from OCL's systems expertise which will enhance, improve and grow existing and future business without detriment to current levels of service.

In summary, the future delivery of the Service will remain in line with current standards and performance targets as set out within the existing Service Level Agreement.

2. Membership of Local Government Pension Scheme and Auto-enrolment

The Sub-Committee requested a further break-down of county council employee opt-outs following auto-enrollment on 1 January 2013.

An updated evaluation as at end of February is set out below:

Targets

The following targets were set in order to measure the success of the campaign:

- Increase the number of LCC employees in the Lancashire County Pension Fund by 5%
- Achieve an opt out rate of less than 50%

The success of the communications campaign, as measured by the above targets, taken as at the end of February 2013, is set out below

LGPS Membership:

Number of LCC members before 1 January 2013	25,635
Number of LCC members following auto enrolment	27,442

The increase in LCC membership due to auto enrolment is 7%

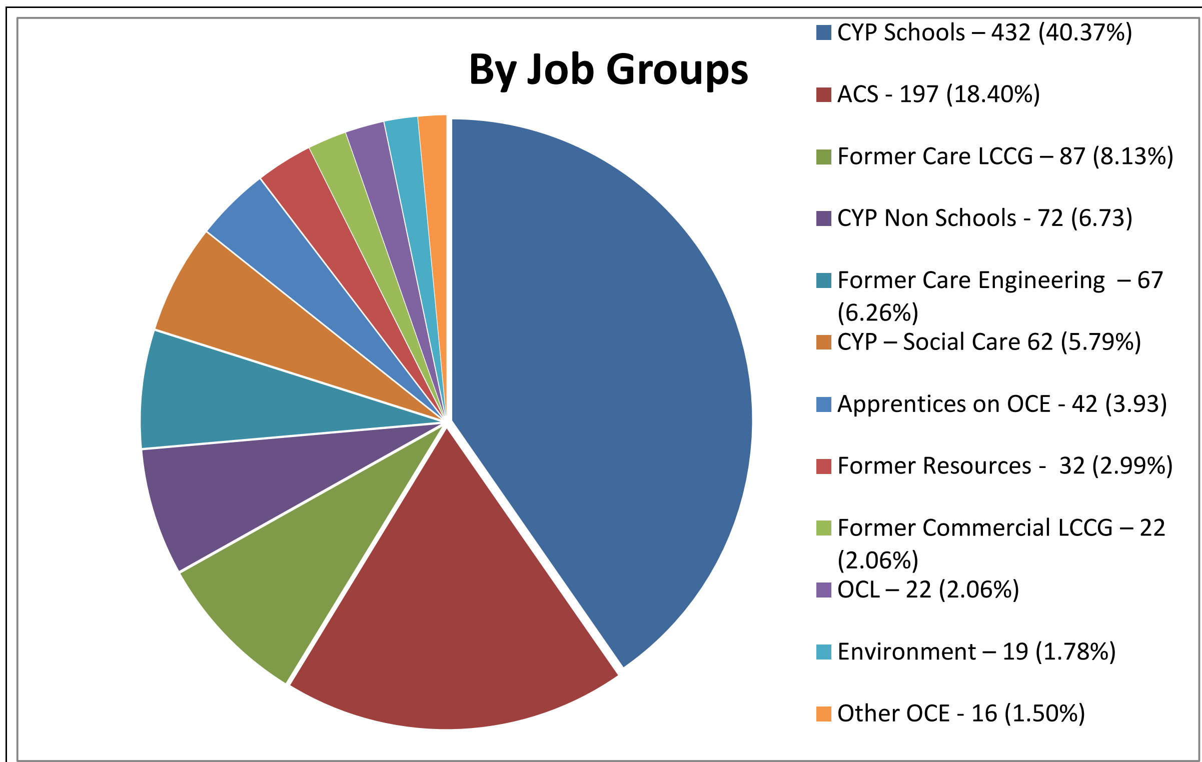
Opt Out Rate:

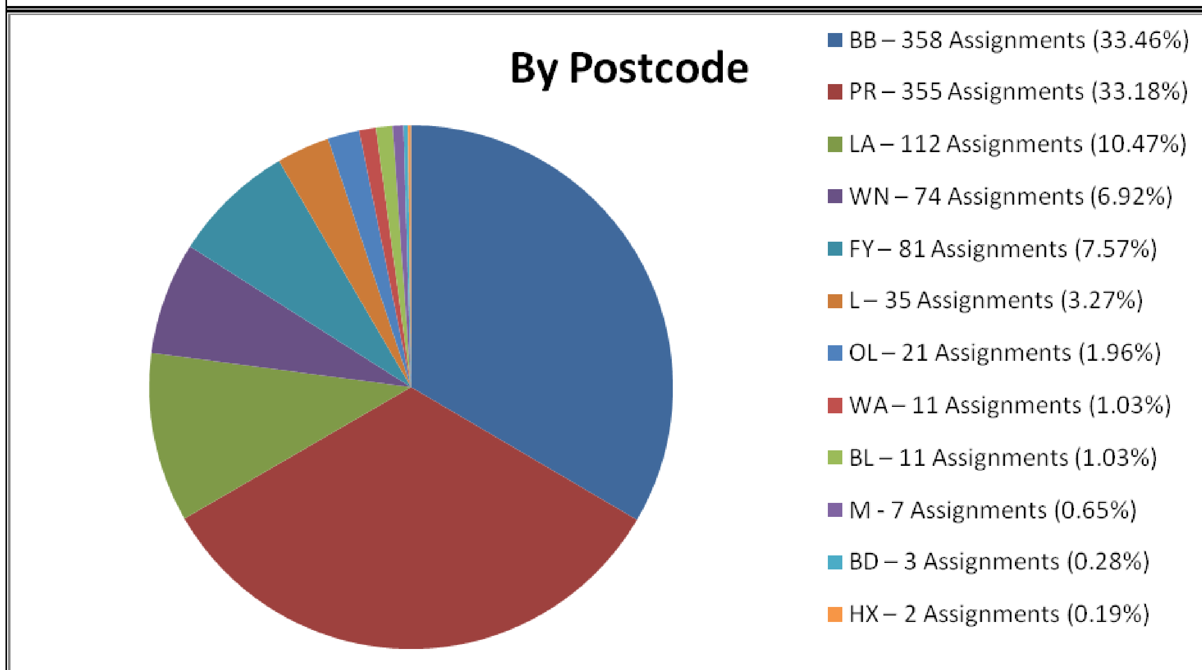
2,877 employees were auto enrolled on 1 January 2013
1,070 employees have opted-out during January & February 2013

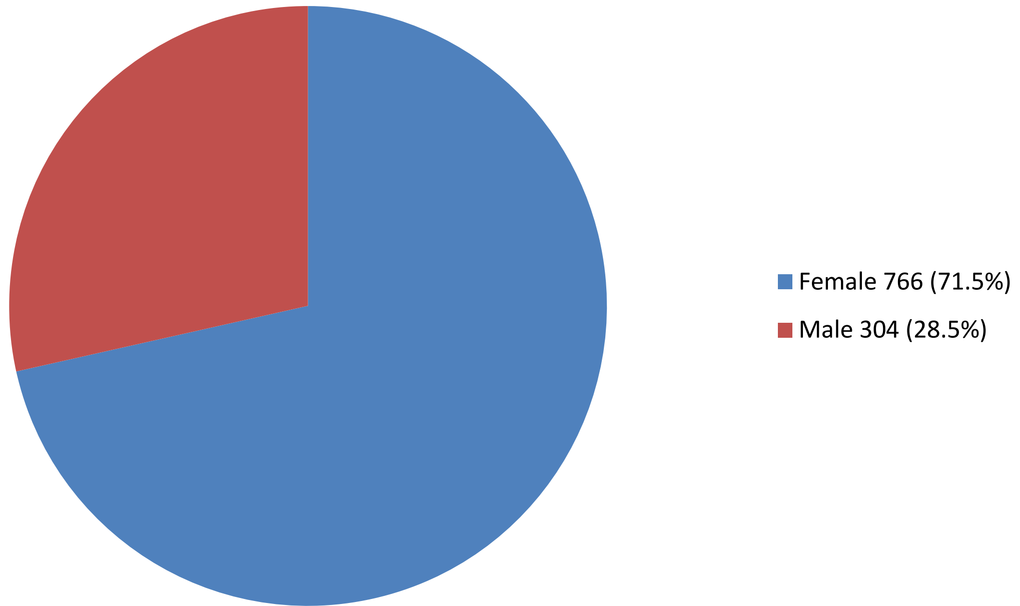
This indicates an opt-out rate of 37%.

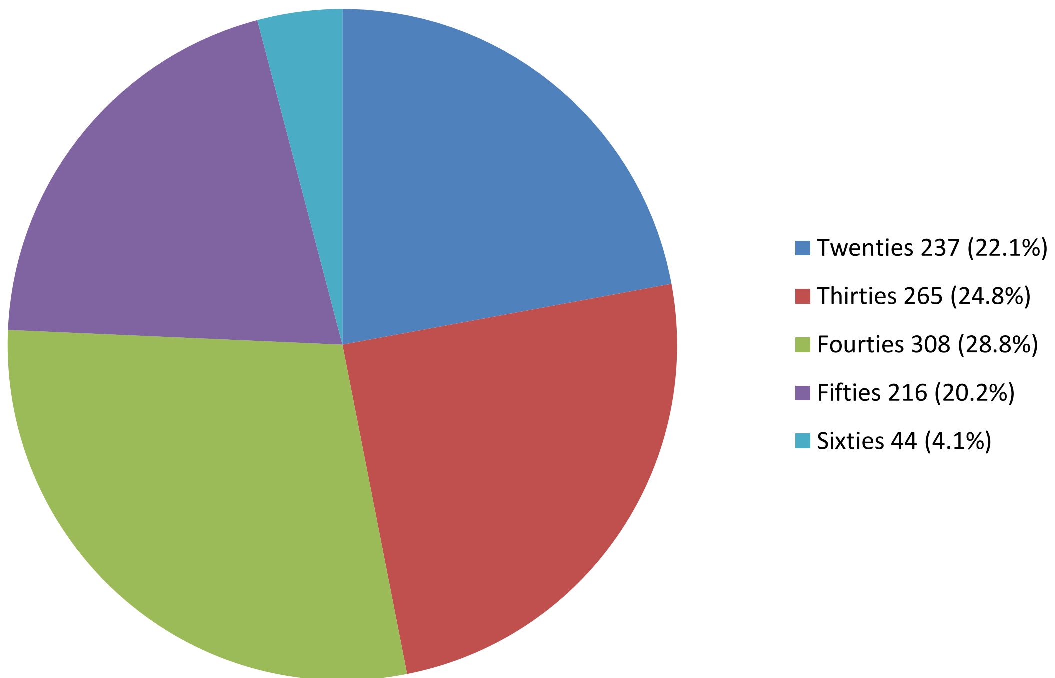
Breakdown

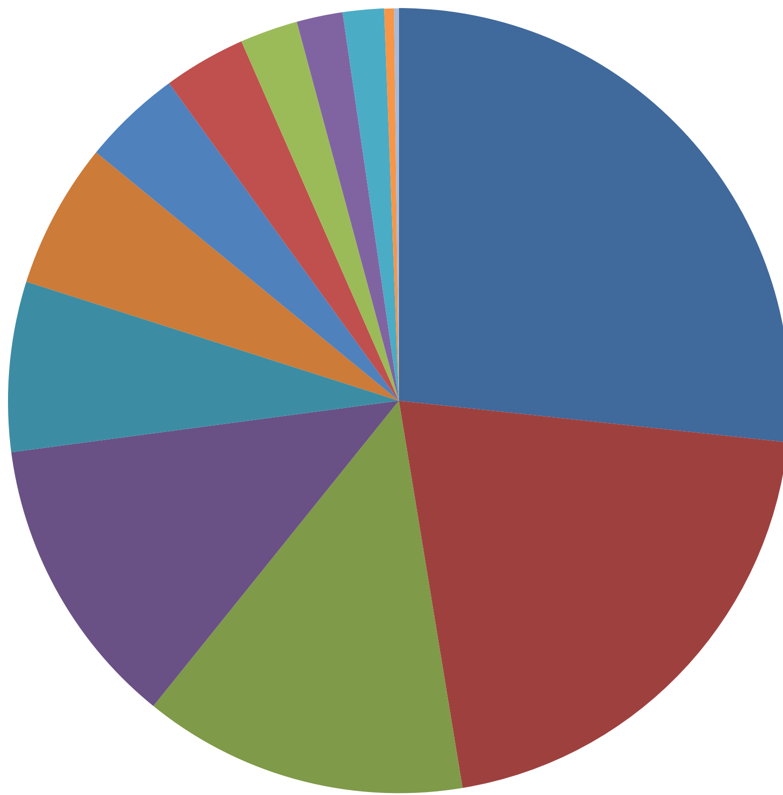
A breakdown of the employees opting out is presented below:

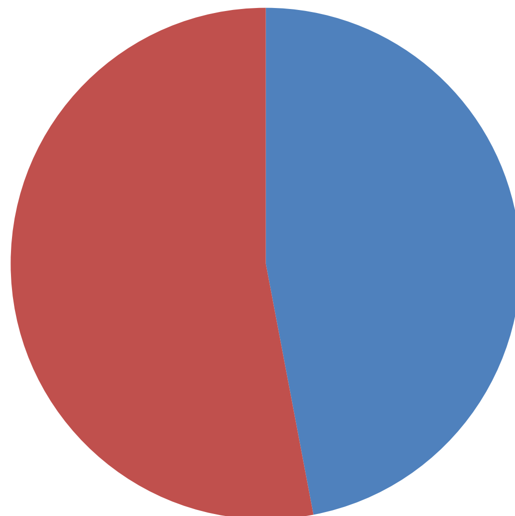





By Gender
Female 766 (71.5%)
Male 304 (28.5%)


By Age
Twenties 237 (22.1%)
Thirties 265 (24.8%)
Fourties 308 (28.8%)
Fifties 216 (20.2%)
Sixties 44 (4.1%)


By Salary
Grade Four 286 (26.7%)
Grade Six 222 (20.7%)
Grade Five 143 (13.4%)
Grade Three 129 (12.1%)
Grade Seven 75 (7.0%)
Grade Eight 65 (6.0%)
Grade One 44 (4.1%)
Grade Two 36 (3.4%)
Other 26 (2.4%)
Grade Ten 20 (1.9%)
Grade Nine 18 (1.7%)
Grade Eleven 4 (0.4%)
Grade Twelve 2 (0.2%)


Full Time/Part Time
Full Time (502) 47%
Part Time (568) 53%

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Reason for inclusion in Part II, if appropriate

N/A

Appendix 'A'

Lancashire County Council

Pension Fund Administration Sub-Committee

Minutes of the Meeting held on Wednesday, 6th February, 2013 at 10.30 am in Cabinet Room 'B' - County Hall, Preston

Present:

County Councillor Michael Welsh (Chair)

County Councillors

M Brindle
F De Molfetta
P Evans
G Roper

Co-opted members

Bob Harvey, (Trade Union representative)
Councillor Mark Smith, (Blackpool Council representative)

1. Apologies

None.

2. Disclosure of Pecuniary and Non Pecuniary Interests

None.

3. Minutes of the Meeting held on 11 October 2012

Resolved: That the minutes of the meeting held on 11 October 2012 be confirmed and signed by the Chair.

4. Your Pension Service – Transfer to One Connect Limited

The Sub-Committee considered a report on the decision by the County Council to transfer Your Pension Service to One Connect Ltd (OCL), the County Council's Joint Venture with BT. The transfer would be effective from 1 March 2013.

This decision had been taken because:

a) There was a significant interaction and interdependence between Your Pension Service and other services already operated by OCL, in particular Payroll Services, ICT and Customer Access.

b) Your Pension Service was a service that already operated in a highly commercial way and positioning the service within OCL would provide it with the necessary commercial support to continue to grow, for the ultimate

benefit of the County Council and the Lancashire County Pension Fund as the key stakeholders.

A copy of the existing Service Level Agreement (SLA) with the Pension Fund Committee was presented. The SLA set out very clear performance standards and requirements around containing the cost of administration and it was noted that the transfer of the Your Pension Service would not result in any changes to the SLA.

Reports on administration matters would continue to be presented to the Pension Fund Administration Sub-Committee.

Members commented on the excellent and cost effective service currently provided by Your Pension Service, and a number of reservations and concerns were expressed about the transfer of the service to OCL. The following points were raised by members:

- The high quality of the existing service to members and their families as set out in the Service Level Agreement must be maintained;
- The expected expansion of the service on commercial lines must not put service standards at risk;
- The price per member (currently £21.50) should remain in the lower quartile;
- Confidential information concerning members and their families must at all times be secure;
- The transfer of Your Pension Service had not been considered or approved by the Pension Fund Committee; and
- There had not been any market testing prior to the transfer being approved.

In responding to the above, officers advised that the transfer would enable Your Pension Service to utilise OCL's commercial skills and systems to enhance and grow the business without affecting the current level of service. It was confirmed that the transfer of Your Pension Service had been market tested as part of the decision to include the transfer in the original list of council services to be transferred to OCL.

The Sub-Committee noted these comments but felt that the reservations expressed by members particularly around the future integrity of the service should be brought to the attention of the Pension Fund Committee and that the Service Level Agreement should be amended to reflect the transfer arrangements and to provide necessary assurances on the future delivery of the service.

The Sub-Committee's attention was drawn to the Pension Fund's Communication Policy Statement that was attached at Appendix 'B' to the SLA. It was noted that the Communication Policy Statement needed to be updated and that a further report would be presented to the Sub-Committee in July 2014.

Resolved:

1. That the County Council's decision to transfer Your Pension Service to One Connect Ltd be noted.

2. That the members' reservations and concerns about the transfer, as set out above, be brought to the attention of the Pension Fund Committee with a view to further assurances on the future delivery of the service being provided by OCL.

3. That, subject to the amendments set out above, the current Service Level Agreement and associated performance standards, presented at Appendix 'A' to the report be confirmed.

4. That an updated Communication Policy Statement be presented to the next meeting of the Sub-Committee.

5. Membership of Local Government Pension Scheme and Auto-enrolment

The Sub-Committee considered a report on the effectiveness of a communications campaign to encourage a greater take up of the LGPS by County Council employees. The campaign which had been approved by the Sub-Committee on 11 October 2012 had been undertaken to coincide with the Council's auto enrolment staging date of 1 January

Details of the campaign which began in October 2012 were presented. The Sub-Committee noted that the campaign and auto enrolment had resulted in an increase in county council membership of the LGPS of 7.5%. This increase had exceeded the 5% target. It was also noted that the number of employees who had opted-out following the auto enrolment exercise was 33% and this was within the opt-out target of less than 50%. The opt-out rate would continue to be monitored and if necessary another wave of communications would be rolled out across the Council. It was suggested that any future campaign might be able to utilise One Connect Limited's marketing skills and that the benefits of the LGPS could be further highlighted in the revised Communication Policy Statement that would be presented to the next meeting of the Sub-Committee.

The Sub-Committee felt that it would be useful to have a break-down of county council employee opt-outs. It was agreed that further information showing the opt-outs by sex, age and salary would be presented to the Pension Fund Committee.

It was noted that the Fund's actuary would be attending the next meeting of the Pension Fund Committee to discuss the framework for the next actuarial evaluation. The impact of auto enrolment and the proposed changes to the LGPS would be considered as part of the evaluation exercise.

The County Council was the first employer in the area to auto enrol its workforce. It was confirmed that all campaign materials would be made available to other Fund employers including District Councils and Unitary Authorities as the auto enrolment process began to affect them. The Your Pension Service had already been asked to provide support to UCLAN and the Service would run surgeries if requested to do so by other Fund employers.

Resolved:

1. That the evaluation of the communications campaign to encourage a greater take up of the LGPS be noted.

2. That a profile of county council employees who have opted out of the LGPS be presented to the next meeting of the Pension Fund Committee.

6. Statutory Consultation on the new Local Government Pension Scheme 2014 and related proposals

The Sub-Committee considered a report on the Department for Communities and Local Government (DCLG) consultation on draft regulations for the new Local Government Pension Scheme to come into force in April 2014.

It was noted that the main elements of the new scheme design reflected the proposals put forward previously within informal consultation. Therefore, on the basis that previous informal consultations had received overwhelming support, including support from Lancashire County Council, the Sub-Committee was asked to agree a response indicating their support for these proposals. It was also noted that the consultation asked practitioners to comment on a number of technical areas and that any response from the Fund would also contain a detailed commentary.

The Sub-Committee was asked to note that a number of related proposals (councillor's pensions, cost control and governance) would be subject to further consultation exercises during 2013. Further reports on these proposals would be presented as appropriate.

Resolved:

1. That a response supporting the draft regulations for a new Local Government Pension Scheme in April 2014 be submitted to the Department for Communities and Local Government

2. It be noted that that further reports on a number of related proposals would be presented during 2013.

7. Urgent Business

None

8. Date of Next Meeting

Resolved: That the County Secretary and Solicitor be asked to arrange the next meeting of the Sub-Committee to take place in July 2103.

I M Fisher
County Secretary and Solicitor

County Hall
Preston

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected: None

2013 Actuarial Review – Framework for Setting Contribution Rates
(Appendix 'A' refers)

Contact for further information:
George Graham, (01772) 538102, County Treasurer's Directorate,
george.graham@lancashire.gov.uk

Executive Summary

The triennial actuarial valuation of the Fund is due to be carried out as at 31 March 2013. The valuation process is the basis by which employer contribution rates are set for the next three years. The valuation process leads to the production of the Funding Strategy Statement which sets out how the Pension Fund intends to bring its assets and liabilities into balance over an agreed period. The Fund is required to engage with Fund employers in the production of the Funding Strategy Statement.

Given the overall significance of this valuation process it is proposed to set out a framework for the setting of contribution rates at this early stage to enable this process of engagement to take place earlier in the valuation process than has been customary.

Recommendation

The Committee is recommended to approve the framework for the 2013 actuarial review set out in Appendix 'A' as the basis for engagement with Fund employers and the initial development of the Funding Strategy Statement.

Background and Advice

Attached at Appendix 'A' is a proposed framework within which the setting of employer contribution rates arising from the 2013 actuarial valuation of the fund will take place.

The 2013 actuarial valuation of LGPS Funds is probably the most significant valuation in the history of the LGPS. There are a number of significant factors coming together at one point in time which will impact on the actuary's calculations. These include:

- The introduction of the new CARE scheme from April 2014 which will affect the calculation of the future service contribution rate.

Lancashire County Council

- The continuing instability in the financial markets, particularly the bond markets which impacts on various factors used within the actuary's calculations.
- The introduction of auto-enrolment on a rolling basis which will impact on fund membership, contributions received and future liabilities.
- The continuation of public sector austerity which will have an impact both on pay growth, scheme membership and the cash flow profile.
- The need to continue to make progress in reducing the past service deficit within the context of ongoing pressure on employers' budgets.

All of these factors combine to make this probably the most challenging valuation in LGPS history.

By setting a clear set of ground rules for the valuation now the Committee will be ensuring that all stakeholders are clear on the parameters for the valuation and have time to prepare to deal with their impacts. It also allows the Committee to fulfil its responsibility to engage with Fund employers around the preparation of the Funding Strategy Statement which forms one of the key outputs from the valuation process.

Given these challenges and the need to ensure both a continuing focus on the reduction of the past service deficit and to maintain stability in contribution rates the following are proposed as the key features of the framework for the valuation, which will have a specific impact in terms of change:

- Changes in the actuarial assumptions around pay growth and life expectancy to reflect current data;
- Changes to the way in which the discount rate is calculated by assuming a normalisation of bond yields at a future point accompanied by the removal of the increased investment return assumption as a risk reduction measure.
- Continuation of the reduction in the deficit recovery period to 16 years;
- Setting contributions to the past service deficit as cash sums for each employer so that they are not affected by reductions in active membership; and
- Removing the options to include an allowance for early retirement in the contribution rate and to make pension strain payments by instalments.

By setting out these ground rules and the overall objectives of the contribution plan that flows from the valuation process now the Committee is very clearly setting out how it plans to address both the past service deficit and contribution stability for Fund employers, while allowing itself the opportunity to reflect on and respond to feedback from Fund employers.

Consultations

Setting this framework allows a process of engagement and consultation with Fund employers to be commenced which will inform the Committee’s eventual consideration of a new Funding Strategy Statement following the completion of the actuarial review.

Implications:

This item has the following implications, as indicated:

Risk management

The various proposals set out in Appendix 'A' in terms of changes to the current approach to the valuation are all intended to reduce the risk to the Pension Fund of not eliminating the past service deficit over a reasonable period of time and ensuring that the Fund has the resources available to meet pension liabilities as they become due.

Financial

There are no immediate financial implications for the Fund arising from the setting of this framework

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Reason for inclusion in Part II, if appropriate

N/A

2013 Actuarial Valuation Framework for Setting Contribution Rates

1. Introduction

The 2013 actuarial valuation of the Fund will take place on the 31st March 2013. This valuation of the assets and liabilities will determine the funding level, and from this the individual employer contributions required from 1 April 2013.

This report presents a proposed framework within which employer contribution rates will be set as a result of the 2013 actuarial valuation of the fund.

It is important for the Committee to agree this framework in advance of the valuation in order that the Committee can effectively exercise its responsibilities for stewardship of the Fund as a whole. Equally, some flexibility in approach needs to be retained, in order to be able to address later on in the process any reasonable issues raised by employers, particularly around the affordability of contributions.

This is an important aspect of the transparent governance of the Fund, and will clearly set out the ground rules for setting employer contribution rates.

The 2013 actuarial valuation of LGPS Funds is probably the most significant valuation in the history of the LGPS. There are a number of significant factors coming together at one point in time which will impact on the actuary's calculations. These include:

- The introduction of the new CARE scheme from April 2014 which will affect the calculation of the future service contribution rate.
- The continuing instability in the financial markets, particularly the bond markets which impacts on various factors used within the actuary's calculations.
- The introduction of auto-enrolment on a rolling basis which will impact on fund membership, contributions received and future liabilities.
- The continuation of public sector austerity which will have an impact both on pay growth, scheme membership and the cash flow profile.
- The need to continue to make progress in reducing the past service deficit within the context of ongoing pressure on employers' budgets.

All of these factors combine to make this probably the most challenging valuation in LGPS history.

By setting a clear set of ground rules for the valuation now, all stakeholders can be clear on the parameters for the valuation and will have time to prepare for the potential impact. It allows the Committee to fulfil its responsibility to the Fund as a whole and to engage with Fund employers around the preparation of the Funding Strategy Statement which forms one of the key outputs from the valuation process. Feedback will be provided to the Committee on the views of Fund Employers in due course which will allow the Committee to make adjustments to the framework if it is not meeting the objectives set.

2. The Objectives of the Valuation Process

The purpose of the valuation process is to establish the scheme's funding level and as a consequence enable the setting of employer contribution rates. In doing this it is important to bear in mind two specific objectives:

1. The need to deliver a credible plan to reduce any past service deficit that might exist within the Fund at the point of valuation. In this context credible is taken to mean a plan that continues to reduce the length of time the deficit exists and which relies upon assumptions which the Fund's actuary is able to agree to as giving a significant chance of delivering the elimination of any deficit taking account of the various uncertainties which exist.

2. The need to maintain stability in employer contribution rates over the longer term, i.e. more than any single valuation period.

What the valuation is seeking to achieve is a "contribution plan" that gives the greatest possible chance of addressing any deficit over the agreed period while giving employers as much certainty as possible over contribution rates.

It needs to also be borne in mind that achieving these objectives at the level of the Fund as a whole will not necessarily mean they will be achieved for each individual employer as the circumstances of each employer are different, While the Committee needs to have regard to the circumstances of individual employers its duty is to the Fund as a whole.

3. The Factors Affecting the Valuation

The valuation of the Fund's liabilities is the result of a complex series of calculations involving a range of assumptions any of which might have an impact on the end result. It is important to set out and agree the assumptions to be made prior to the valuation in order that the process can be seen to be free from undue influence.

The key factors and the assumptions proposed by the Fund's actuary are as follows:

- Pay Growth – Public sector pay restraint has a significant effect on the potential liabilities of the Fund. Previous valuations have assumed a rate of pay growth that is significantly in excess of current experience. It is therefore proposed to assume that pay growth will be limited to 1% in the first three years post valuation and thereafter reduce the previous long term assumption by 0.5% pa. This is considered to be an assumption that more accurately reflects the likely trend of pay growth.

- Life Expectancy – It is proposed to continue the practice of basing assumed life expectancy on Fund specific data, which will reflect the impact on the Fund of the fact that life expectancies in Lancashire tend to be lower than the national average.

- Discount Rate – The yield on government bonds is used as a discounting factor within the calculation of the Fund's liabilities. As has previously been reported to the Committee yields are currently at historic lows which has the effect of increasing the value of the Fund's liabilities. It does not seem

reasonable to assume that yields will remain at these historic lows for the entire life of the Fund's liabilities and it is therefore proposed to assume within deficit recovery periods (and where the employer's covenant is sufficient to support it) that after five years yields will revert to a more normal pattern. The five year period is an assessment by the actuary and Fund officers of the point at which yields revert to a fair value.

- Increased Investment Return – In previous valuations the assumptions for "high covenant" employers have included an assumption around an increased investment return, although this assumption was not applied where it would have resulted in a reduction in employer contribution rates. In this valuation cycle it is not proposed to include any assumption around investment returns over and above the actuary's base assumption as it is considered that within the current investment context increasing return assumptions might result in a need to reassess the Fund's investment risk appetite which would be undesirable in the context of the current market situation. In practice the assumption above in relation to the reversion of yields is an alternative way of allowing for more favourable experience during the term of a recovery plan.

It is considered by the actuary that setting assumptions in this framework will provide a basis for the valuation which is rooted in reality and provides a prudent and sensible assessment of yields.

4. Fund Membership

Overall membership of the Fund is also an issue that will impact on the valuation as the number of members will drive both the level of liabilities and the level of contributions to be received over time. There are two conflicting drivers in terms of membership, firstly the overall reductions in the public sector workforce which have had a noticeable impact on the Fund, in terms of changing the balance between pensioner and active members. Secondly the impact of auto-enrolment where those members who do not chose to opt out will increase the active member and contribution base although increasing liabilities in the longer term.

At this stage it is too early for the actuary to make a judgement on how these two factors will interact within the valuation and members will be updated as the results of the valuation are reported back.

5. Dealing with the Deficit

A key part of the valuation process is to set out how the Fund will address the past service deficit. There are two key variables in the deficit recovery plan:

1. The time over which the deficit is to be recovered. This period is due to reduce to 16 years at this valuation, although Funds do have the option of resetting this period. It is not currently proposed to reset the period and to produce a 16 year recovery plan as it is felt that this is the prudent course given the impact of the new scheme in reducing future service contributions and the other pressures from austerity measures which create risk for the Fund. It is, however, recognised that this aspect may need to be reviewed further as part of the valuation process, partly as discussions with employers begin in connection with the affordability of any new contribution rates

following the valuation. It also needs to be borne in mind that at the 2010 actuarial valuation the deficit recovery period was kept as short as possible, in part due to a desire to offset some of the reductions in contributions which might have emerged through workforce reductions, as outlined below.

2. The amount paid in towards the deficit. This is currently set as a proportion of pay in the same way as the future service contribution rate. However, this means that as employers reduce their workforce the amount paid towards the deficit will reduce although the deficit itself may increase as a result of changes in an employer's membership profile. It is therefore proposed to set deficit contributions as an annual cash amount so that reducing the deficit is not affected by the reducing workforce. This represents the most prudent position and protects individual employers and the Fund. The three local education authorities within the Fund will need to make special arrangements in relation to schools as it is not possible to charge a single cash sum of this sort to the schools budget.

Reducing and eliminating the deficit is a key focus for the Fund and these measures are considered by officers and the actuary to represent the approach most likely to deliver success, all other things being equal, in the context of an overall employer contribution plan.

6. Academies and Free Schools

Academies and Free Schools are deemed to be scheduled bodies and where they are created by the "reclassification" of an existing maintained school they inherit a proportion of the previous host employer's deficit within the Fund. These institutions, unlike maintained schools receive a funding agreement from the Department for Education for 7 years. In ordinary circumstances an employer with a 7 year funding agreement would be treated in valuation terms as having to recover any deficit over 7 years. This is the methodology used for a number of admission agreements resulting from outsourcing contracts.

Guidance to Funds is expected from central government on the issue of how to treat such deficits in due course and therefore it is not proposed at this stage to determine a policy for the Fund.

7. Dealing with Workforce Reductions

The valuation process allows employers to deal with workforce reductions in two ways. While the cost of these is borne by employers they are at the discretion of the Fund, and it is proposed that changes are made.

1. A cash allowance for pension strain payments on early retirement is contained within the individual employer's contribution rate. It is proposed that this practice is ended for two reasons. Firstly it results in the cost of early retirement not being transparent and secondly it creates a timing difference as the Fund is receiving contributions in advance of the pension strain payments which is potentially to the disadvantage of the employer.

2. Cash payments of actuarially calculated "pension strain" are made either as one off lump sums or by instalments over 3 or 5 years. It is proposed that in

future the instalment option will not be allowed, although instalment plans in relation to early retirements which have already taken place will be honoured. This ensures that the amount payable to the Fund in respect of the lost contributions from an early retirement is invested in full as quickly as possible and therefore, all other things being equal, reduces the risk of an early retirement impacting on the deficit within the Fund.

These measures are likely to make early retirement a less affordable option for achieving workforce reductions for some employers. This is accepted, however, there is an overriding need to protect the overall interests of the Fund which is what these measures do to the greatest extent possible.

8. Conclusion

The various assumptions set out in this report represent a clear framework within which the actuary and the Fund's Officers can carry out the work in relation to the 2013 valuation. It is proposed that Fund employers and members are consulted on this framework alongside the valuation process as part of the preparation of the revised Funding Strategy Statement.

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected:
All

Credit and Fixed Income Strategy
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

This paper sets out the Investment Panel's proposed approach to the management of the Pension Fund's allocation to Credit and Fixed Income investments in order to achieve the objectives of the Fund.

Recommendation

The Committee is asked to consider and approve the Strategy.

Background and Advice

On 10 December 2010, the Pension Fund Committee approved the revised Investment and Liability Strategy for the Fund which includes an allocation of 20-40% of the fund to "Lower Volatility Strategies" which provide stability for the Fund and include Fixed Income, PFI, Credit strategies, Infrastructure, Currency and Cash.

The Fund has two objectives in terms of its investment activities:

1. To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.
2. To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.

The current funding target assumptions include an assumed investment return (discount rate) of a yield based on market returns on UK Government gilt stocks plus 2½%.

In the context of the Fund's objectives and assumptions, the Investment Panel has considered the appropriate deployment of the allocation to Lower Volatility Strategies, particularly to Credit and Fixed Income. The Panel recommends that, subject to appropriate ongoing governance and risk management, the Pension Fund should seek higher returns than the historic investment portfolio (comprising mainly Sterling Investment Grade Bonds and Gilts) can be expected to deliver.

Lancashire County Council

The Panel considers that the current economic situation and particularly the change in the regulatory environment to which banks are subject is presenting opportunities to achieve better yields in the Credit and Fixed Income sphere without necessarily taking on significantly more risk.

The Panel therefore supports a strategy that seeks to diversify away from Investment Grade credit into other areas, including but not limited to: *secured* lending to certain higher risk counterparties; long-term lending, preferably secured, where the Fund can earn an attractive term and liquidity premium; non-sterling lending to governments and other high-grade counterparties; investment opportunities driven by changes to banking regulation; and loans delivering a degree of inflation protection through indexation.

The proposed strategy is set out in Appendix A.

Consultations

Investment Panel

Implications:

The switch from two large Investment Grade managed funds to a larger number of less commoditised and more specialist funds will require one-off due diligence effort to ensure the security and appropriateness of any proposed investment. Much of this work will be carried out by LCPF investment management staff; any external advisory fees relating to this are anticipated to be de minimis in the context of the size and expected term of investments being made (equivalent to less than 0.01% per annum).

The annual levels of investment management and administration fees for smaller, specialist funds will typically be higher than those for more commoditised, larger funds. Any investment decision will always be made on the basis of expected return *net* of fees and only if the Investment Panel is of the opinion that the additional returns that are being targeted will more than compensate for any costs necessary to achieve access to more specialist fund management skills.

Risk management

This change will result in a wider range of risk exposures within the portfolio, with risks mitigated through investment due diligence, use of recognised, specialist investment funds and diversification of exposures. However, the different return profile of these investments is expected to provide a more appropriate level of reward for the investment risk taken by the Fund than the current portfolio.

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List of Background Papers
N/A

Reason for inclusion in Part II, if appropriate
N/A

APPENDIX A

LANCASHIRE COUNTY PENSION FUND

CREDIT AND FIXED INCOME STRATEGY

1. EXECUTIVE SUMMARY

As part of the work to implement the Fund's agreed Investment Strategy, a review has been undertaken of the current fixed income exposure, the opportunities available to the Fund in the credit and fixed income space and the place such opportunities may have in delivering the Fund's investment objectives. This paper sets out the conclusions of this review and presents the Investment Panel's proposals for a restructuring of the Fund's fixed income exposure to the Committee for approval.

In summary the conclusions of the review are that:

- Lancashire County Pension Fund (LCPF) needs to use its credit and fixed income investments more actively in order to improve investment returns and deliver against the Fund's investment objectives. Within this LCPF should pursue the strategy of seeking higher yielding investments, ideally Floating Rate, which will therefore exhibit lower levels of capital volatility. The Fund has a long-term strategic allocation to investment in Global Equities. Whilst the anticipation of long term growth underpins this investment decision, it is accepted that this allocation may be volatile in value; in addition, whilst equities can produce income in the form of dividends, these are not guaranteed. The Fund has currently decided to reinvest dividend cashflows within the equity allocation.

- Credit-based investments compliment the fund's equity allocation by delivering regular, more predictable cashflows whilst demonstrating lower levels of capital value volatility. There is always the risk of payment default and typically, the higher the perceived risk of default, the better the running yield that a credit investment will pay.

- The search for a higher yield which offers stable income flows does not mean a rush towards risky investments for the Fund, because current market dynamics present opportunities for the long-horizon investor to lock in high margins based on the ('technical') dynamics of supply and demand, rather than the ('risk') dynamics of risk and reward. There *will* be increased risk; although this is mitigated across a portfolio where and several hundreds, or even thousands of underlying loans may exist. The Investment Panel believe that with careful selection, the increased returns can outweigh the increased risks (which are not significant) and are therefore justified.

- *Fixed-Income* investments can play some role in hedging the fund's liabilities as the drivers for their capital value are closely linked to the drivers of the fund's liabilities. However, it will be almost impossible to match this 'hedging effect' and seeking to do so would likely adversely impact investment returns by severely constraining the choice of investments available. In addition, increasing the investment in Fixed-Income securities at this point risks locking in the funding gap; foregoing the benefit from the reduction in scheme liabilities that would arise in the event that yields revert to former, higher levels.

2. BACKGROUND TO THE CREDIT AND FIXED INCOME INVESTMENT STRATEGY

2.1 The Fund's Position

Actuarial projections show the fund becoming cash-flow negative (i.e. benefits payable will exceed contributions being received) much more rapidly than has previously been forecast.

That cashflow shortfall (the gap between benefits and contributions) could be satisfied by the liquidation of investments; but this would be contrary to the principles of long-term investment for growth. The better alternative is for the cash shortfall to be met from investment income.

Equity investments can pay dividends, but these are not guaranteed and the typical yield is not substantial. In addition, and in common with most funds, the Fund's active management mandates provide for the re-investment of dividend income. Some types of equity investment in the portfolio (i.e. private equity and venture capital) have a specific investment expectation that returns will come almost entirely from capital gains, and generally at the end of a fairly long duration investment cycle, as a result of an event such as a flotation or buy out. In other words, Equity investment is seen by the Fund at this point in time as long-term investment for capital growth.

The rationale for property investment is that such investments should generate both rental yield and capital growth. The fund has recently increased its allocation to real estate to 15% of the portfolio and this level should be kept under review. Ultimately, though, rental yields typically lag behind yields from credit instruments due to the expectation of capital appreciation. In addition, property investment must be seen as long term as the entry and exit costs in terms of stamp duty and due diligence are proportionately high.

That leaves credit-based investments as the key method of generating cash yields to cover the cash-flow needs of the Fund and, through re-investment of excess yield, should lead to an increase in the overall value of the funds under management – thereby helping to close the funding gap in the long run.

2.2 Risks Associated with Credit Investment

The key risk when investing in credit is that the borrower defaults, leading to delays in receipt of income and potentially loss of capital.

The amount of loss in the event of default depends on position of the loan in the borrower's capital structure (i.e. whether any other creditors rank higher), the level of security associated with the lending and the ability to be involved in and influence the outcome in the event of administration and/or insolvency (achieving a higher recovery than other creditors).

The yield on a credit investment includes compensation for the risk of credit defaults and the 'risk' pricing for credit in theory predicts that the margin paid for borrowing would be driven by the probability of default and the expected loss in the event of such default. However, these figures cannot be calculated exactly (as they are effectively predictions of the future) and so their estimation, at least in part, relies on market 'sentiment'.

Where they are tradable, market values of credit instruments can also vary, giving the possibility of capital growth or depreciation. There are two key sources of this 'mark-to-market' volatility.

With Fixed Income assets (such as government bonds), absolute levels of interest rates will make the value of instruments fluctuate. The longer the term of the instrument, the higher this level of volatility or sensitivity to interest rates. This is this same effect that has led the valuation of the fund's liabilities to increase over recent years as long-term interest rates have dropped.

The second source, which has a relatively larger effect in a low-interest rate environment, is that of credit spreads – i.e. the amount of premium over and above the basic risk-free interest rate that any particular lender has to pay to secure credit. As described above, the credit spread of an instrument depends on the market perception of the probability of a default and the loss that would occur in such an event (and the second of these depends to some extent of the position of the debt in the borrower's capital structure).

The current economic situation might be categorised as one of historically low interest rates, but relatively high credit spreads. Ideally, therefore, the Fund would benefit from the current high credit spreads whilst not locking in the downside of low interest rates.

Policy makers are maintaining low interest rates in order to stimulate the economy because of the variety of downward pressures on economic growth. Indications are that the market 'believes' that rates will recover mildly in the medium term, but the opportunity exists for the Fund to take advantage of the current economic environment.

2.3 Why are credit spreads high?

The current depressed economic situation brings increased risk of credit defaults, both in reality and perhaps more importantly in the minds of investors. The market perceives that levels of losses through default might be higher in the coming cycle than they have been to date.

There are other ('technical') factors which are driving up credit spreads, many of them linked to the changing regulatory environment:

1. Liquidity crunch. Banks are having to manage capital ratios, in part by reducing their balance sheets, leading to the removal of leverage in the economy generally (which during growth periods was inevitably driving credit spreads down) and much tighter criteria for new lending / renewal of existing loans. This leaves existing borrowers struggling to refinance and new borrowers struggling to obtain finance in the first place unless they agree to pay a higher borrowing margin.

2. Credit crunch. Downgrading of credit ratings and of banks' assessment of the credit-worthiness of counterparties compounds the liquidity crunch by removing the availability of credit at certain key steps in the credit spectrum. An example would be the position of borrowers that pass the threshold from investment- to non-investment-grade, where the universe of potential investors suddenly shrinks dramatically.

3. Duration-fixation. New regulations for banks and insurers make long-term lending relatively more expensive from a capital perspective. In addition, some traditional long-term investors seem to want to keep their cash liquid to seize strategic opportunities and therefore are not committing long term funding.

4. Capital Rationing. The lower levels of gearing that banks will be allowed under the Basel III regulatory regime means that the breakeven credit spread to achieve a certain return on equity has increased.

5. Fight to Quality. High demand for high quality investments, which is driving down yields on Gilts, Bunds and US Treasuries (and to a lesser extent, Investment Grade Bonds) is balanced by a lack of demand for lower-quality (but still credit-worthy) assets.

The above factors result in a situation where the level of reward from the Fund's traditional, Investment Grade fixed income portfolio is not commensurate with the risks in holding such a portfolio; higher returns are available from investments which do not necessarily have significantly higher risk.

2.4 Strategy Development

Current credit spreads are at least in part driven by supply-side constraints which mean that a better-than-normal risk adjusted return should be available by investing in the credit markets at this point.

As well as the search for good risk-adjusted returns, it is an investment imperative (as discussed above) for the Fund to invest in assets which generate demonstrable and predictable returns. This will not only meet the Fund's medium-term cashflow needs, but also address in part the strategy required to close the funding gap currently being experienced by the fund.

The Fund is not alone in perceiving this situation and first-mover advantage is important to seize this opportunity before yields in relatively attractive areas are driven down by increased demand. Also, as demand (and hence the availability of credit) increases, then the implicit risks in the credit market also decrease, as the lack of availability of credit is as much a source of default risk as perhaps is the poor performance of the underlying entities. A virtuous circle can develop which leads to a further tightening of spreads.

A tightening of credit spreads will lead to capital appreciation of credit instruments and it can be argued is a necessary precursor to the sort of economic growth that will justify a sustained rally in the equity markets. Now would be the time, therefore, to be relatively overweight in credit instruments whilst being relatively underweight in equities.

However, simply investing in high-quality, publicly traded credit instruments will not give access to such attractive returns. The reasons for this are that high-quality investment-grade credit has not experienced the level of restriction in supply that has been the case for lower-quality credit; and that credit spreads have largely recovered in the Investment Grade market.

There are always a variety of credit-based strategies available and it would be wise to spread a portfolio of credit investments amongst them – to spread risk and also to balance out the likely cyclicality of the returns generated from each strategy.

Some strategies are unique to the current situation, whilst others tend to operate throughout the economic cycle. A mixture of these types of investment is recommended in order to provide the best balance of risk and return.

Annex 1 summarises various opportunities for taking credit risk currently available and some high-level 'pros' and 'cons' of each, whilst Annex 2 sets out the recommended allocations between the different credit strategies available.

2.5 Currency Risk

Credit opportunities present themselves in a variety of different economies and may be denominated in a currency other than Sterling.

Currency exposure strategy is not the subject of this paper; however it is clear that currency appreciation or depreciation relative to Sterling could be a constituent of any returns generated by any investment that the fund makes, whether in credit, equity, real estate, etc.

For the purposes of the credit investment strategy, it is assumed that the best credit opportunities globally should be the target investment universe. This is in line with the principles set out in the Investment Strategy of becoming a globally exposed Fund in order to reduce the risk inherent in a concentration of investments which are exposed to the dynamics of one particular economy.

The Fund needs to establish a view in relation to the relative levels of currency exposure it is willing to take and suitable hedges of exposure at a fund level can be put in place to the extent that the underlying portfolio make-up ever departs from the aspirational mix. Further work is required and is being undertaken on the ongoing management of the Fund's increased exposure to currencies other than Sterling and this will be reported back to the Investment Panel and Committee when completed.

2.6 Accessing Opportunities

Unlike equities, there are no large, open, public exchanges in the vast majority of credit instruments and investment opportunities are most likely to be accessed by LCFP via investment in pooled funds, although direct lending opportunities may arise from time to time.

Easily identifiable opportunities (often arising from investment managers with large marketing departments and good name recognition) will always generate more demand from investors and therefore the 'technical' factors will likely drive down the risk/reward or drive up the level of reward that passes to fund administrators.

It is likely, therefore, that better risk/reward investments will be found by LCPF in areas that are less actively marketed and accessing these opportunities must form part of investment strategy through active scanning of the investment environment.

In addition, larger investments will usually command better terms, both from borrowers in the event of a direct investment and from fund administrators where an investment in a pooled fund is made.

LCPF will therefore consider 'clubbing' together with other pension funds and investors with the intended benefit (a) that a wider investor group will become aware of a wider range of off-market investment opportunities; and (b) that by combining investment resources to make larger individual investments, better terms can be negotiated from fund administrations and borrowers.

2.7 Governance

After the Council's Pension Fund management team have identified possible investments or funds that fit within the Fund's Strategy, the Investment Panel will assess their suitability before detailed due diligence on the fund managers is undertaken in line with the agreed investment process.

A final investment recommendation will then be made by Investment Panel to the County Treasurer in line with the agreed Governance Framework.

2.8 Sources of Funding and Implementation Approach

The current allocation to credit and fixed income is concentrated in two funds, being a passive Sterling Investment Grade Credit fund managed by Legal and General and an actively managed portfolio of Investment Grade Bonds and Gilts managed by UBS.

Implementation of the new strategy will mean that these mandates are terminated in order to fund the revised allocations when suitable investments have been identified and approved.

The timing and order of the transfer will be overseen by the Investment Panel in line with the agreed Governance Framework and managed by a third party transition manager in order to ensure an orderly process and to minimise the costs of the reallocation.

In addition, the valuation of the Fund's investments in equities has grown to be in excess of the upper allocation limit (60%) in the Investment Strategy. A portion of the passive equity allocation will therefore be liquidated to perform the joint purposes of remaining within Strategy and funding the increase in credit investments.

Allocating the Fund's credit investments will be an ongoing process, however it should be anticipated that a least 20% of the Fund (i.e. all of the current Investment Grade portfolio) will be invested in the new strategy over the next six months.

Annex 1

Summary of Credit Investment Opportunities

Opportunity	Description	Pros	Cons	Strategic View
Gilts / Government securities	Virtually risk-free lending to governments in developed markets..	Regarded as very safe Could provide a hedge to fund liabilities if durations are matched. Can provide a degree of inflation protection. Can be used to generate additional margin through stock lending activity. Very liquid.	Safety probably at its most questionable level for many years and in some cases returns are negative. 'Flight to quality' has depressed absolute yields. Risk of currency instability if non-UK Gilts. Interest rate increases could erode capital value.	Whilst theoretically safe, the low yield and current high demand dynamics make this look like a poor constituent of the fund for the moment. **Exit now but retain potential allocation as safe haven investment.**
Investment Grade Bonds	Low-risk lending to large international corporates through traded instruments.	Relatively safe. Provides return margin over Gilts. Some credit spreads are relatively wide at present giving potential for capital appreciation. Very liquid under normal circumstances.	Remain a volatile investment with a non-zero risk of default. Recoveries on default are typically lower than direct lending. Publicly traded markets imply little chance of outperformance, so management fees likely to damage rewards.	Higher yields can be obtained in this asset class for similar levels of risk to Gilts. Liquidity is attractive if a short-term home for credit allocation is needed but can dry up in times of market stress. **Exit now but retain potential allocation.**

Non-Investment Grade (High Yield) Bonds	Lending to non-investment grade corporates through traded instruments.	Offer more attractive yields that Gilts or Investment Grade Bonds. Possibility of capital gains in improving credit conditions.	Higher risk of default. Much deeper market in US than UK/EU. Publicly traded markets imply little chance of outperformance, so management fees likely to damage returns.	Whilst yields are more attractive, there is little to suggest that, except in certain special cases, it is possible to achieve outperformance or an outstanding risk/reward analysis. Higher management fees than Investment Grade Credit further damage the analysis. **No current allocation recommended.**
Senior-Secured Loans	Lending on *a secured* basis to relatively highly leveraged counterparties / private equity buyouts. Instruments not typically traded but can be bought and sold on secondary market.	Yields are very attractive and whilst default risk remains, recoveries are expected to be higher due to secured nature of lending. Market not fully public meaning that excess returns may be available.	Relatively illiquid. Wide range of situations requires deep analysis to identify value. Less publicly available information about investments & investment valuation.	A well established market which runs throughout the cycle. Good cash yields. Historic risk/reward performance excellent. **Minimum 5% Allocation.**

Direct Lending – SME	Direct lending to SME entities though loans, either syndicated, club or bilateral.	Current banking system deleveraging is creating supply/demand dynamics which should deliver good yields. Typically secured at least in part giving better recoveries in the event of default. Historic default and recovery experience implies excellent risk/reward attributes. Smaller individual positions create portfolio effect.	Deep credit analysis required and significant risk of individual defaults; likely high level of costs therefore. Potential for reputational risk in the event of default / workout. Limited secondary market, meaning loans could be illiquid and difficult to value with less publicly available information.	Definitely worth consideration in the current environment if good managers / originators can be partnered with. **Potential Allocation along with Senior Secured Loans.**
Emerging Market Local Currency Debt	Lending to governments and occasionally large corporate in second-tier economies, in local currency.	High margins available for what is sovereign risk with default probability sheltered from the traditional risks of currency depreciation. Relatively liquid and possibility of capital appreciation as economies emerge and credit spreads drop. Successful investments likely to show currency appreciation. Adds diversity to portfolio.	Unfamiliar investment conditions require specialist knowledge to analyse. Risk of rapid depreciation of currencies or country default. Higher risks of corruption or conflict which bring reputational risks and the possibility of capital losses / illiquidity.	An improving market which is likely to see significant inflows in coming years and where credit risk is perhaps better than investors' intuition. Capital upside from currency appreciation versus Sterling considered likely, as is tightening of credit spreads which will also lead to appreciation. **Minimum 5% Allocation**

Impaired Credit Opportunities	Investment in situations created by economic situations such as problem refinancing, distressed credit, forced sellers of positions, illiquid situations etc.	High yields available because of the implicit riskiness of thesituations and the relatively strong negotiating position of the investor. Yields are driven by relatively uncorrelated factors giving diversity to the fund. High quality identification and analysis of opportunities likely to yield excellent risk/reward dynamics due to relatively limited investor population and lack of a public market.	Clear risk of some capital losses and reputational risk. Specialist origination and analysis of difficult situations required. Uncertain return horizons and low liquidity. Obscure and uncertain valuation of investments until realised, high monitoring and diligence cost.	The uncorrelated nature of these investments and the fact that they offer higher returns throughout the cycle make the area interesting for investments where there is a compelling and differentiated case for a strategy. Generic ‘recovery’ funds are less attractive. **Minimum 5% allocation combined with other regulatory opportunities below.**
Long-Maturity Debt – Housing / Commercial Real Estate 1st mortgage lending	Long-term loans secured on real estate.	Sensibly underwritten, these loans should offer virtually no risk of loss, even in default situations. Shortage of long term funding in the current market means that returns are at historically attractive levels.	Limited liquidity in the current market and possible reputational risk associated with enforcement of security. Yields are stable but not outstandingly high.	A stable and low-risk investment which nonetheless offers better yields than gilts. The current credit shortage may provide some historically very attractive opportunities in the short-medium term. **Minimum 5% allocation combined with other secured debt as below.**

Long-Maturity Debt – Infrastructure & Project Finance	Long-term loans to public or private infrastructure projects such as roads, public facilities and buildings, energy and waste projects.	Theoretically secure as source of repayment is cashflows from the public purse and ultimately the loans are secured on assets. The yield is therefore attractive for the risk involved and government incentives may further shift the risk/reward profile. Current illiquidity and shortage of funding sources should provide attractive risk/reward characteristics. May provide returns that match Fund requirements – long maturity and also RPI-linked.	Definitely not risk-free and defaults have occurred historically. Detailed and realistic due-diligence required before investments are made, therefore. The illiquidity that drives current yields also means investments could be difficult to exit. Ability to have effective work-out of distressed positions may be compromised by local reputational risks or central government interference.	Attractive in theory due to term and yield characteristics; however selection of projects is incredibly important. Good current political and supply/demand dynamics means that there will be attractive opportunities available although there will also be those best avoided. **Minimum Allocation of 5% combined with Real Estate.**
Ground Rents	Purchase of real estate freeholds in order to collect long-term ground-rent and renewal income.	Incredibly secure as default leads to automatic reversion of the lease. Yield versus risk is excellent and may have RPI-linkage. Very long term matches fund maturities. Probability of capital appreciation as investor universe grows and yields are driven down.	Whilst returns are secure, the analysis is complex and there is some variability to the timing of cashflows. Very granular pool gives relatively high servicing complexity and entry costs. Large pools hard to come by / take time to build up.	A very secure investment yielding excellent risk/reward characteristics if a large enough pool can be constructed. Term and RPI-link also very attractive. **Potential Allocation along with Real Estate and Infrastructure.**

Regulatory Driven Opportunities	Investments that are driven by changes in bank / insurance / investment regulation, where regulatory rather than risk management considerations drive behaviour.	'Forced Seller' environment creates strong negotiating position and therefore likelihood of excess returns for investors. Pricing can be driven by the level of regulatory benefit rather than amount of risk being taken on, therefore improving risk/reward characteristics.	Complex analysis and likelihood of risk transfer may lead to volatile returns if a portfolio is poorly constructed or not granular. The investment is likely to be illiquid. Possible reputational risk.	Current regulatory environment implies excellent current opportunities although that may not persist. **Potential Allocation along with Impaired Credit.**
Hard Asset Financing / Leasing	Investment in hard assets (trains, planes, automobiles) for leasing to corporate or individuals.	Well secured and typically relating to assets that are of strategic importance meaning that repayment will be prioritised. 'Off-Balance-Sheet' treatment for borrower makes the route attractive to borrower for non-risk reasons and therefore there may be excess returns available.	Risk of re-leasing or realising asset values can make returns variable. Needs good quality origination, underwriting and asset management capabilities, which can make costs high.	A possibility if a good quality origination / asset management partner can be found. **Potential Allocation along with other secured lending categories.**

CREDIT AND FIXED INCOME SRATEGY – BROAD ALLOCATIONS

The table below sets out proposed strategic allocation ranges to the various categories of investment which make up the credit and fixed income universe. The ranges set out are in line with the Investment Strategy range of 20% to 40% for Lower Volatility Strategies (defined as including but not exclusively, Fixed Income, PFI, Credit strategies, Infrastructure, Currency, Commodities, Absolute Return, Cash, funds and index, Local development/PPP type allocations).

The broad allocations below imply that at a minimum, 20% of the fund allocation will be to credit and fixed income (compared to a current exposure to such strategies of 26.1% of the Fund), leaving up to 20% available for investment in other lower volatility strategies. Flexibility remains within the allocations below for the entire lower volatility allocation to be invested in credit should it be considered appropriate.

Credit Investment Area	Allocation (as %age of Fund)	Current Allocation (31 January 2013)
Long Dated Secured Lending – Real Estate, Infrastructure and Asset Finance	5%-10%	2.7%
Senior Secured Loans and Direct Lending to SMEs	5%-10%	2.6%
Emerging Market Local Currency Debt	5%-10%	0%
Impaired Credit and Regulatory Driven	5%-10%	0%
Balanced / Club Credit Opportunities Funds (may incorporate the above allocations)	0%-20%	0%
Investment Grade Bonds, Gilts and Cash (safe haven / interim holdings only)	0%-20%	20.8%

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected:
None

The Management of Local Investment Allocations
(Appendix 'A' refers)

Contact for further information:
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Executive Summary

At its last meeting the Pension Fund Committee requested that officers bring forward proposals for the management of a local investment allocation. Following detailed discussion by the Investment Panel, the report at Appendix 'A' sets out various principles which it is proposed to adopt in managing an allocation of this sort, including:

- At least initially local investment should be concentrated in the area of property in line with the Investment Strategy's preference for real income generating assets;
- The Fund should avoid exposure to construction risk; and
- Any allocation should be managed by an external manager in line with a clear investment mandate.

Recommendation

The Committee is recommended to:

1. Approve the implementation, in line with the Investment Strategy of an allocation of 3% of the Fund to local property within the Lancashire area as set out in Appendix 'A'.

2. To instruct officers to bring forward a procurement strategy paper for the appointment of an appropriate manager together with details of the relevant investment mandate to the next meeting of the Committee.

Background and Advice

The Fund's approved Investment Strategy includes provision for a local investment allocation of up to 3% of the Fund. Members of the Committee have asked officers to bring forward proposals as to how such an allocation might be managed.

Lancashire County Council

While accepting that there are a range of wider considerations related to any investment, which are dealt with elsewhere on the agenda for this meeting of the Committee, it needs to be remembered that any investment which the Fund makes needs to meet the primary criteria of being a “good investment” in terms of delivering the optimum combination of risk and return required to ensure the Fund has resources available to meet its liabilities when they fall due. The report at Appendix 'A' sets out how this can potentially be achieved in the particular context of local investment and reflects the advice of the Investment Panel.

The approach set out is considered to be a prudent approach designed to allow confidence in the arrangements to grow over time.

Consultations

The Investment Panel have considered the issues raised in this report, and their advice is set out in the report.

Implications:

This item has the following implications, as indicated:

Risk Management

The proposal to appoint a specific manager for this allocation is intended to manage certain of the key risks inherent in local investment and in particular to ensure that a focus on the Fund’s investment objectives is retained by ensuring that any investment proposal is subject to objective appraisal.

Financial

The process of procuring a manager for this allocation can be managed within existing internal resources.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
N/A		

Reason for inclusion in Part II, if appropriate

N/A

The Management of Local Investment Allocations

Introduction

At the request of the Pension Fund Committee this report sets out proposals for the management of a local investment allocation (of around 3% of the Fund) which forms part of the Fund's agreed investment strategy.

Local investment presents a range of challenges in terms of the potential for conflicts of interest and pressures to compromise decision making criteria which the proposals set out in this report aim to address.

At all times it needs to be borne in mind that local investment is not an end in itself but simply a further route by which the Pension Fund can meet its overriding objective of ensuring that funds are available to pay benefits when required.

The Rationale for Local Investment

While the overriding objective of the Pension Fund's Investment Strategy must be to ensure funds are available to pay benefits when required, it must be accepted that the Fund does not exist in a vacuum and it represents a pool of assets owned by Lancashire people and organisations which can, to some extent, be used to support Lancashire where that support does not conflict with the overall objective.

Thus local investment, which meets the overall investment objective, can form an appropriate part of the investment strategy assisting the Fund in achieving a broader range of objectives from its investments, for example creating growth in the local economy which has a positive impact on the revenue streams of fund employers, while not losing sight of its overall responsibilities.

Defining Local

Local investment in the context of Pension Funds has a reasonably flexible definition, for example the Greater Manchester Fund views the North West region as the scope of its very successful local allocation although actual investment does tend to favour the former metropolitan county area.

For the purpose of this paper local is defined as the Lancashire Sub Region, i.e. the 1974 County Area covered by the County Council and the two unitary councils of Blackburn with Darwen and Blackpool. This may need to be reviewed in the light of actual experience and while it may be appropriate for investment in real assets it may be less appropriate for investment in specific businesses, should the Fund consider that in future.

Types of Local Investment

There are in essence two types of local investment opportunity which might be presented to the fund:

a) Investment in local businesses. Such investments might be in the form of either equity or loan capital. Historically the local private equity funds promoted by the former Regional Development Agencies which LGPS Funds were "persuaded" to support did not perform well, although this is not necessarily an indicator that investment directly into businesses is likely to underperform, if it is entered into for the right reasons.

b) Investment in real assets. Generally this will take the form of investment in property, which again might be either in the form of equity or the provision of loan capital. The Fund has previously discussed supporting investment by a local NHS organisation through the provision of loan capital. While this was not successfully concluded for commercial reasons it provides a template for the sort of negotiating and due diligence processes required. The Fund has also been offered "first refusal" on the sale on of a development being partly supported by the Local Enterprise Partnership, although any formal discussions on this are 12-18 months away.

The Investment Panel has discussed the types of local investment with which the Fund might engage at length and concluded that, taking account of the Fund's risk appetite, the fact that the investment strategy favours real assets which generate an ongoing income stream, and the potential resource implications of managing an allocation in this space that initially any allocation should focus on real assets, specifically property investment.

The Investment Panel's recommendation is that a manager be appointed who would perform for the local investment portfolio the same role as Knight Frank perform for the property portfolio. This would ensure that proposals are examined as objectively as possible and ensure that the portfolio of investments receive appropriate management attention once an investment has been made.

The Investment Mandate

As with all the Fund's investment allocations it is necessary to set out clearly the parameters within which a local allocation should operate in the form of an investment mandate. This sets out limits, or benchmarks around a range of factors which affect the risk profile of the allocation. The following characteristics have been discussed by the Investment Panel, but will need to be firmed up for formal approval by the Committee should the arrangements set out in this report be approved.

- Each individual investment within the allocation will be agreed by the Investment Panel, in the same way as for the core property portfolio.
- Minimum target return – This is suggested as an 8% Internal Rate of Return (IRR) after allowing for any fees. This is in line with the Fund's Infrastructure portfolio.
- A minimum lot size will be specified.

- Investment Duration
- Balance between equity and loan capital
- Exposure to construction risk, if any. At this stage the Investment Panel have considerable reservations about taking on exposure to construction risk
- Asset pricing will be agreed by the Fund's Independent Valuer.
- Investment will **not** be made in schemes in which Lancashire County Council has a direct financial interest or which represent the provision of the Council's (or any other local authorities') statutory functions (e.g. the provision of roads or school places).

A framework of this sort is intended to give officers and fund managers a clear remit within which to work while also setting out clear arrangements for managing any potential conflict of interest between the two roles of the County Council, as a traditional local authority and as the Administering Authority for the Pension Fund.

Achieving a Supply of Investment Opportunities While Supporting Lancashire's Economic Aspirations

If the Fund is to deploy a local investment allocation successfully it needs to do so within the context of the achievement of Lancashire's economic growth agenda, which is what will deliver a supply of potential opportunities. Much of this is currently being driven through the work of the Lancashire Enterprise Partnership and initiatives such as the Preston City Deal and the Fund will want to develop means of engaging with these processes that give it access to a supply of suitable potential projects for investigation.

At the same time any manager appointed by the Committee would need to actively seek out other suitable investments meeting the investment mandate in order to ensure that the Fund can achieve the best overall range of investments possible in this space.

Managing the Portfolio

As indicated above it is the strong recommendation of the Investment Panel that an appropriate external manager be appointed to undertake both the evaluation of opportunities and the ongoing management of any allocation of this sort. Should the Committee agree to this a procurement strategy paper for this allocation will be brought to the next meeting of the Committee in line with the usual process.

Conclusion

Local investment can have a place in the assets of the Pension Fund; however, it is vital that the focus on the over-riding investment objectives of the Fund is maintained through ensuring robust appraisal and due diligence processes which are demonstrably independent and therefore able to provide an objective appraisal of any opportunities presented to the Pension Fund.

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected:
All

Fiduciary duties and ethical investment
(Appendix 'A' refers)

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Executive Summary

At the request of the Pension Fund Committee, this report sets out the position regarding the Fund's fiduciary duties with regard to ethical investment considerations.

Recommendation

The Committee is asked to note the report.

Background and Advice

The previous meeting of the Pension Fund Committee on 30 November 2012 requested that a report setting out the Fund's fiduciary duties with regard to ethical investment considerations be brought to a future meeting.

In particular, Members of the Committee had previously noted that the Australian superannuation fund, First State Super, had announced a decision to divest from tobacco investments. In doing so, Members were reminded of the overriding duty on the Fund to 'maximise returns for its beneficiaries'.

The imminent transfer of public health responsibilities to the County Council from April 2013 has also raised the profile of such investments by the Pension Fund.

Appendix A sets out the meaning of fiduciary duties pertaining to the Fund, relevant case law, relevant research, and regulatory duties. With specific regard to investments in tobacco related interests, and in light of the impending transfer of public health responsibilities to the County Council from April 2013, the report explains how these two seemingly conflicting positions may be reconciled through the maintenance of appropriate separation of duty in carrying out these particular responsibilities.

Consultations

Lancashire County Council

N/A

Implications:

N/A

Risk management

N/A

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Directorate/Tel
Freshfields Bruckhaus Deringer/ UNEP FI Asset Management Working Group, A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment (2005) UNEP FI: Geneva. – commonly referred to as "Freshfields".	2005	Andrew Fox/ County Treasurer's Directorate x35916
The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378)	2005	Andrew Fox/ County Treasurer's Directorate x35916
The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093)	2009	Andrew Fox/ County Treasurer's Directorate x35916

Reason for inclusion in Part II, if appropriate

N/A

Fiduciary duties relating to ethical considerations

Introduction

At the request of the Pension Fund Committee, this report sets out the position regarding the Fund's fiduciary duties with regard to ethical investment considerations.

In particular, Members of the Committee had previously noted that the Australian superannuation fund, First State Super, had announced a decision to divest from tobacco investments. In doing so, Members were reminded of the overriding duty on the Fund to 'maximise returns for its beneficiaries'.

The imminent transfer of public health responsibilities to the County Council from April 2013 has also raised the profile of such investments by the Pension Fund.

What is 'fiduciary duty' in this context?

Fiduciary duties set out the broad parameters within which trustees (and the fund managers and investment consultants whom they have engaged) must exercise the discretionary powers conferred by the terms of the trust. These duties affect the exercising of discretion to make and manage investments, and require trustees and their agents to act prudently and for a proper purpose. In this context the Pension Fund Committee are regarded as trustees.

A combination of statute and case law has articulated this duty, albeit without absolute clarity, to mean:

Fiduciary duty
To act prudently
• Exercise the 'care, skill and diligence' a prudent person would exercise, not just when dealing with their own investments, but when dealing with investments for someone else for whom they feel 'morally bound to provide.
• Apply the special knowledge and experience they possess or, if they are professional trustees, the skills expected of a professional trustee.
• Have regard to the need for 'diversification of investments', in so far as appropriate to the circumstances of the trust.
• Have regard to the 'suitability of each investment'.
• Obtain and consider 'proper advice' on certain matters, such as whether an investment complies with the Statement of Investment Principles required for occupational pension schemes.
• Take account of all relevant considerations and ignore irrelevant considerations.
• Act reasonably.
To act for a proper purpose
• Trustees must also exercise their investment powers for a proper purpose: ie the purpose for which the trust was established. This means for the express purpose stated in the instrument creating the power – the trust deed and rules where they apply.

In the case of the Pension Fund, the 'proper purpose' is ultimately to pay future pension promises to its members, and therefore obtain sufficient returns with which to do so, as set out in the Fund's Statement of Investment Principles:

1. *To ensure that resources are available to meet the Fund's liabilities through achieving investment performance at least in line with actuarial assumptions.*

2. *To achieve full funding (i.e. no funding deficit) over a period no longer than the current recovery period.*

This overriding principle of providing returns for the Fund's beneficiaries has been subject to several notable legal cases as set out below.

Significant case law relating to fiduciary duty

In 1984, a court held in **Cowan v Scargill** that where the purpose of a trust is to provide financial benefits, powers of investment under the trust must be exercised 'so as to yield the best return for the beneficiaries', taking into account risks of the investments in question. In considering what investments to make, in his view, the judge maintained that trustees must put their own personal interests to one side and simply adopt the most 'beneficial' investment.

This decision has since been interpreted by some members of the investment community as imposing a duty to obtain the maximum rate of return possible, effectively precluding trustees and their fund managers and advisers from having regard to any considerations, other than the maximisation of financial returns. This decision, however, predated the provisions of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 as referenced below.

A similar issue arose in **Martin v City of Edinburgh District Council** in 1988. A breach of trust arose since the Council divested from South Africa without expressly considering whether it was in the best interests of the beneficiaries, and without obtaining professional advice. However, the judge expressed the view that trustees did not have an unqualified duty to 'rubber stamp' an investment manager's advice or to invest trust funds in the most profitable investment available.

In addition, **Harries v Church Commissioners (1992)** is relevant in which the court held that excluding investments in certain business activities on ethical grounds could be acceptable where an adequate width of alternative investments remains, but trustees should not take into account such non-financial considerations to an extent which would give rise to risk of significant financial detriment to the proper object of the trusts.

As well as case law, various pieces of research have also been conducted in this area. The law firm, Freshfields Bruckhaus Deringer, commissioned by the United Nations Environment Programme Finance Initiative (UNEP FI) produced what is

considered to be the seminal work regarding the incorporation of environmental, social and governance (ESG) issues into investment risk analyses.

The Freshfields review argues that there are powerful reasons why Cowan v Scargill does not provide good authority for the investment approach that trustees must seek return maximisation at the expense of all other considerations.

Ultimately, Freshfields argued that, no modern court would treat Cowan v Scargill as good authority for a binding rule that trustees must seek the maximum rate of return possible with every individual investment and ignore other considerations that may be of relevance, such as ESG considerations.

The report goes on to suggest pension fund trustees will fulfil their fiduciary duties provided they treat the purpose of the investment power (which for pension funds will ordinarily be to seek a financial return for the beneficiaries) as the primary purpose and, while allowing for the influence of other relevant considerations, do not allow it to be overridden by any other purpose. This means that the consideration of secondary considerations, such as ESG, could legitimately form part of any investment decision as long as they do not override the primary consideration of making a financial return.

Importantly, the assessment of any individual investment should properly include its fit into the investment portfolio as well as its expected return. Considerations such as risk versus return and correlation to the rest of the portfolio are valuable, and it is part of the trustee's role to seek returns across the entire portfolio across a variety of different economic possibilities, rather than on an investment-by-investment basis.

In addition, the fiduciary duties relating to the Pension Fund are enshrined in the relevant regulations affecting such investments as detailed below:

Regulatory requirements

The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378),

The relevant regulations are set out below:

- Regulation 2 (3) (b) (vi) requires Statements of Investment Principles to include the extent (if at all) which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. (Whilst this did not originally apply to schemes established under enactment, its provision was subsequently included in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.)
- Regulation 4(2)(a)states that assets must be invested in the best interests of members and beneficiaries.
- Regulation 4(2)(b) provides that 'in the case of a potential conflict of interest (the assets must be invested) in the sole interest of members and beneficiaries.

- Regulation 4 (3) requires that the powers of investment, or the discretion, must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole.
- Regulation 4(7) states that the assets of the scheme must be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and so as to avoid accumulations of risk in the portfolio as a whole. Investments in assets issued by the same issuer or by issuers belonging to the same group must not expose the scheme to excessive risk concentration.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3093) in relation to ESG within Statements of Investment Principles:

The relevant regulations are similarly set out below:

- Regulation 11 requires an administering authority to formulate a policy for the investment of its fund money, with a view to the advisability of investing fund money in a wide variety of investments; and to the suitability of particular investments and types of investments.

- Regulation 12 states that an administering authority must, after consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement of the principles governing its decisions about the investment of fund money, and repeats at 12(2)(f) the provisions of Regulation 2(3)(b)(vi) referred to above.

In issuing these regulations, the Government did not seek to impose requirements regarding ethical investment, but instead imposed a requirement on administering authorities to include in their statement of investment principles their policy on:

> "*the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments*".

Whilst there is, therefore, no regulatory requirement to take into account ESG considerations, the Lancashire County Pension Fund sets out its position via the Statement of Investment Principles, which, is similar to that taken by the majority of LGPS funds.

Lancashire County Pension Fund Statement of Investment Principles

The extent to which the Lancashire County Pension Fund currently takes ESG considerations into account is set out in the following statement contained in its Statement of Investment Principles:

Social, Environmental and Ethical Considerations

The Fund takes an active stance on corporate governance issues. It uses Pensions Investment Research Consultants ("PIRC") to vote on its behalf at shareholder meetings. PIRC advises on Socially Responsible Investment issues and issues voting guidance and commentary for shareholder meetings. PIRC is instructed to vote the Fund's shares in accordance with its guidelines unless an Investment Manager requests a different vote for investment management reasons. In the latter case, the Treasurer to the Fund will decide how best to cast the vote in the long-term financial interest of the Fund.

The Fund is a member of the Local Authority Pension Fund Forum ("LAPFF"), which is a group of like-minded local authority pension funds that meet to discuss and act / engage in respect of Socially Responsible Investment and Corporate Governance issues.

Tobacco

Clearly, equity holdings by the Fund cover a wide range of companies dealing in a wide-range of activities, all of which are lawful. One of the most high profile of these relates to investments in companies from which a significant proportion of their activity is tobacco-related. As at 31 December 2012, equity holdings in tobacco related companies in LCPF accounted for 1.58% of the total Fund, equating to just under £72 million. In addition, fixed income bonds amounting to just over £6 million are held in relation to tobacco companies.

It should be noted, however, that typically these Fund investments are made by investment managers of pooled funds, as well as direct holdings, which the Fund has appointed / invested in. The practicality of seeking to divest or avoid individual share holdings in tobacco or other individual activity within such pooled funds may be difficult.

There has been significant publicity recently regarding the holding of tobacco stocks by Pension Funds with questions raised as to whether this is compatible with other responsibilities held by administering authorities in relation to Public Health.

Local Authority responsibility for Public Health, and Article 5.3 of the World Health Organisation (WHO) Framework Convention on Tobacco Control

There has been much reference to the impending transfer of Public Health responsibilities to local authorities from April 2013 and the potential conflict of interest that this could provide. In particular, Article 5.3 of the WHO Framework on Tobacco Control, to which the UK is a Contracting Party, is frequently mentioned in this context.

Article 5.3 states *"In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law."*

This Convention obligation relates to protecting public health policies from commercial and other vested interests of the tobacco industry. This does not translate into a prohibition on local authorities with public health functions from investing pension funds in tobacco companies. The Guidelines for implementation are more specific and refer to public bodies not having financial interests in the tobacco industry. The Guidelines are not legally binding although their recommendations have moral force.

It is clear that the investment of pension funds in tobacco companies (undertaken at the discretion of external investment managers) does not directly permit tobacco industry involvement in public health policy making by the County Council. The nature of the mandates with the Fund's investment managers does not provide for such investment services to provide a route for any influence, direct or otherwise, on Council policy, either from the fund managers themselves or the companies in which they invest.

A similar separation is achieved by the distinct nature and governance arrangements relating to individual Committees of the County Council. Public health arrangements will be governed by a new Health and Wellbeing Board, subject to its own objectives and terms of reference. As such, any investment of pension funds in tobacco interests by the Pension Fund will have no effect or influence upon public health decisions made by the County Council.

In addition, an appropriate separation of functions between its distinct responsibilities, which does exist within the County Council's organisation, addresses any potential conflict of interest. In law, the body that oversees the pension fund must be a committee of the Authority, and not the Executive. Further separation is achieved since none of the County Council’s Cabinet Members are members of the Pension Fund Committee.

It is sometimes forgotten however, that the County Council is not the Pension Fund per se, and vice versa. The County Council is the administering authority for the Fund but its responsibility arising from such a role is one of the many responsibilities attributable to it, such as being a Highways Authority etc. Responsibility for public health will soon be added to that list, but these responsibilities are distinctly separate from those relating to the County Council as administering authority for the Pension Fund. With regard to public health, it is noted that many employers represented on the Pension Fund Committee have no such public health responsibilities.

Ultimately, the Pension Fund has a duty to consider the full range of investment options available, and securing an appropriate financial return is the primary objective of the Fund in order to meet future pension commitments. Ethical factors may be relevant as an additional consideration to separate investments with similar

financial characteristics to favour an investment which is viewed as more ethical or socially responsible. The practicality of this, however, is not to be viewed lightly and would require contractual changes in the mandates of fund managers, who currently operate with unconstrained ability to invest, through diversified portfolios, in order to meet the Fund objectives.

The Convention does not impose a legally binding prohibition upon the Pension Fund investing in tobacco companies. In terms of the moral force of the Guidelines, the Council must continue to ensure that there is an appropriate separation of functions between public health policy making and pension fund investment decision-making. Aside from this, members of the Pension Fund Committee are required to act in accordance with their fiduciary duties as referred to above.

The investment policy of the Fund should be guided by the primary purpose of the Fund that investments should be made for the beneficiaries and not made for political purposes. In addition, investment powers should not be used to make moral statements at the expense of the beneficiaries.

Conclusions

Legal commentators have stated that ethical factors may be relevant in pension fund investment decision-making, however, trustees and Fund Managers must not dismiss the possibility of making certain investments because they consider them unethical. They have a duty to consider the full range of investment options available to them and their decision should, first and foremost, be based on the expected investment performance of the asset. Securing a decent financial return in order to meet future commitments to beneficiaries is the primary objective of a pension fund.

In doing so, the assessment of any individual investment should properly include its fit into the investment portfolio as well as its expected return. Considerations such as risk versus return and correlation to the rest of the portfolio are a valuable part of securing returns across the entire portfolio across a variety of different economic possibilities, rather than on an investment-by-investment basis;

Typically these Fund investments are within pooled funds as well as direct holdings. The practicality of seeking to divest or avoid individual share holdings in tobacco or other individual activities within such pooled funds may be difficult, and could have an effect on the overall performance of the Fund.

The County Council is not the Pension Fund and vice versa. The County Council is the administering authority for the Fund but its responsibility arising from such a role is one of the many responsibilities attributable to it. Responsibility for public health will soon be added to its list of responsibilities, but such responsibilities are distinctly separate from those relating to the County Council as administering authority for the Pension Fund.

Article 5.3 of the WHO Convention does not translate into a prohibition on local authorities with public health functions from investing pension funds in tobacco companies. The investment of pension funds in tobacco companies does not directly permit tobacco industry involvement in public health policy making by the County Council. An appropriate separation of functions as set out above should be sufficient to address any potential conflict of interest.

The requirement for Statements of Investment Principles to include reference to ESG considerations, if any, acknowledges that such considerations should be naturally part of an informed investment policy, even if an ultimate decision is made not to specifically divest from certain investment types. It is accepted that ESG issues can affect company performance, and therefore where the pension fund is satisfied as to the financial characteristics of two particular investments, then it could theoretically favour the investment which in its view is more ethical or socially responsible. The practical implications of implementing such a change may be problematical within existing mandates.

Clearly, any ethical restrictions that damaged financial returns could not be justified. However, in comparing potential investment decisions, and where differences in predicted returns are deemed immaterial, ethical considerations could be deployed in deciding upon selection. In addition, ethical considerations may also be valid where it is thought that long-term performance may be enhanced by such consideration.

Judgements arising from relevant case law referred to above make it clear, therefore, that in order to meet its fiduciary duties, the Fund cannot unilaterally decide to divest from an individual investment type without regard to the overall objectives of the Fund, or without taking appropriate professional advice including risk and return considerations.

Pension Fund Committee
Meeting to be held on 22 March 2013

Electoral Division affected:
'All'

Fund Shareholder Voting and Engagement Report
(Appendices 'A' and 'B' refer)

Contact for further information:
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Executive Summary

In accordance with its policies on promoting corporate social responsibility in the businesses in which it invest the Fund works through PIRC as its Governance Adviser and the Local Authority Pension Fund Forum (LAPFF) to both ensure that shares are voted in accordance with sound governance principles and influence companies' behaviour.

This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC and the engagement activity undertaken by LAPFF.

The attached report from PIRC (Appendix 'A') covers the period 1 October to 31 December 2012. The Fund has voted on 193 occasions and has opposed or abstained in 38% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC's focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders' interests.

The attached engagement report from LAPFF (Appendix 'B') also covers the period 1 October to 31 December 2012.

Recommendation

The Committee is asked to note the report.

Lancashire County Council

Background and Advice

Shareholder Voting and Governance

PIRC, acts as the Fund's proxy and casts the Fund's votes on its investments at shareholder meetings. PIRC are instructed to vote in accordance with their guidelines unless the Fund instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility. The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.

There may be occasions when the Fund wishes to cast a vote at a shareholder meeting in a way which does not accord with PIRC's recommendations. For example, an investment manager might request the Fund to vote in a particular way to support or oppose a corporate action. Such requests would be considered by the Fund on a case by case basis and PIRC instructed to cast the Fund's vote accordingly.

PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds).

PIRC's quarterly report to 31 December 2012 is presented at Appendix 'A'. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental and social governance issues.

In addition PIRC produces a detailed document which is reviewed by the Fund's officers, which sets out the circumstances and reasoning for every resolution opposed, abstained or withheld. This document is available on request.

The Fund's voting record using PIRC as its proxy for the three months ended 31 December 2012 is summarised below:

Region	Voting action:				
	For	Oppose	Abstain	Withheld	Total
UK	42	9	6	-	57
Europe	4	3	-	-	7
USA	23	13	1	7	44
Japan	-	-	-	-	-
Rest of World	51	24	10	-	85
Total	120	49	17	7	193

The period October to December is relatively quiet with 193 ballots cast compared with 1,908 and 330 respectively in the two prior quarters. The Fund has voted for 62% of shareholder resolutions and has opposed or abstained in 38% of resolutions. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition.

Remuneration remains a significant theme, and the Fund opposed the approval of the Remuneration Report for a number of well known companies such as Hays, where remuneration was considered excessive and performance criteria insufficiently challenging. Within the US, pay structures proposed by Oracle and Microsoft were opposed, and several appointment resolutions were opposed where directors were not deemed to be sufficiently independent.

As well as continuing to focus upon promoting the election of truly independent directors, PIRC has also opposed appointments where capacity issues may exist from potential over-commitment.

This quarter's PIRC report also makes reference to changes announced by the Financial Reporting Council (FRC) to its governance and stewardship codes. Governance changes relate to the tendering of external audit contracts, effectiveness assessments of external auditors, consistency of annual reports with financial statements, boardroom diversity policies, and explanations where companies choose not to follow Code provisions. Stewardship changes include clarification of stewardship responsibilities for asset managers and asset owners, management of investor's conflicts of interest, and the encouragement of verification of stewardship activities.

PIRC are also closely following events at Rio Tinto who made a significant announcement in January 2013 relating to an expected $14 billion asset write-down (impairment charge) relating separately to its aluminium and Mozambique coal interests. Two senior executives stepped down by mutual consent as a result. PIRC are concerned about how far the alleged mistakes will impact the company’s development and coming to terms with the resulting financial challenges. PIRC are encouraged by the relatively prompt move by the Board to act, however the aluminium loss is so large it can only be regarded as absolute investment failure. Currently, the Pension Fund has no equity holdings in Rio Tinto Group, but has an interest through fixed income bond holdings.

Shareholder Engagement through LAPFF

Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest.

Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix 'B') which covers the period 1 October to 31 December 2012.

It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

Consultations

N/A

Implications:

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well run responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

Risk management

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor oversight and lack of independence.

Local Government (Access to Information) Act 1985
List of Background Papers

N/A

Appendix 'A'

Lancashire Council

Proxy Voting Review
October 2012 – December 2012

January 2013

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Table Of Contents

Table Of Contents 1
UK Corporate Governance Review 2
UK Corporate Governance Review 3
UK Voting Analysis 11
UK Voting Charts 11
UK Voting Timetable Q4 2012 13
UK Upcoming Meetings Q1 2013 13
AIM UK Market Voting Timetable Q4 2012 14
AIM UK Market Upcoming Meetings Q1 2013 14
Fledgling UK Market Voting Timetable Q4 2012 15
Fledgling UK Market Upcoming Meetings Q1 2013 15
European Corporate Governance Review 16
European Voting Charts 18
European Voting Timetable Q4 2012 19
European Upcoming Meetings Q1 2013 19
US Corporate Governance Review 20
US Voting Charts 22
US Voting Timetable Q4 2012 23
US Upcoming Meetings Q1 2013 23
Japanese Reporting Timetable Q4 2012 24
Japanese Upcoming Meetings Q1 2013 24
Global Corporate Governance Review 25
Global Voting Charts 26
Global Voting Timetable Q4 2012 27
Global Upcoming Meetings Q1 2013 27
Asian Voting Charts 28
Asian Voting Timetable Q4 2012 29
Asian Upcoming Meetings Q1 2013 29
PIRC Summary Report Appendices 30

UK Corporate Governance Review

Hays Plc - AGM 7th November

Remuneration was an issue at Hays.

The TSR and EPS targets for the Long term incentives were not considered challenging. Moreover, "the Committee will set EPS targets using market consensus (reflecting the current point in any cycle) being a range of +/- 4% around the consensus forecast EPS as the first year of the three-year cycle with a range of RPI plus 4% to RPI plus 12% over the remaining two years of the cycle for threshold and maximum payment respectively. The Committee considers this range to remain appropriate over several economic cycles." The explanation of how exceptional pay is justified defies attempts to understand it. It is unclear why the company would consider a range that includes a target being slightly below the consensus EPS, i.e. up to -4% below. It is also considered that two or more performance measures should be used in a concurrent fashion.

Variable pay is potentially excessive in PIRC's view as were the awards made during the year under review. Average salaries are high for the comparator group.

We note with concern that a Big 4 audit firm is used for advice on directors' pay.

Directors have one-year rolling contracts allowing for compensation representing one year's salary and contractual benefits. The company considers that directors have a responsibility to mitigate their loss. The remuneration committee also has discretion to pay a predetermined sum in lieu of notice. It is unclear whether the severance payment has been determined or whether the committee has the discretion to determine the severance payment. PIRC does not consider it acceptable for unearned bonuses or other awards to be included in compensation payments and notes that past practices of the company with regards to termination provisions were not in line with best practice.

As the performance criteria for the Performance Share Plan were not considered challenging and remuneration was considered excessive, an oppose vote was recommended.

UK Corporate Governance Review

FRC publishes amended Codes

In late Autumn the Financial Reporting Council (FRC) announced limited changes to the UK Corporate Governance Code and Stewardship Code intended to increase accountability and engagement through the investment chain. Both Codes will continue to apply on a "comply or explain" basis.
Changes to the UK Corporate Governance Code include:

- FTSE 350 companies are to put the external audit contract out to tender at least every ten years with the aim of ensuring a high quality and effective audit, whether from the incumbent auditor or from a different firm. The FRC will be holding discussions with companies, auditors and investors to consider whether guidance on tendering would be useful;
- Audit Committees are to provide to shareholders information on how they have has carried out their responsibilities, including how they have assessed the effectiveness of the external audit process;
- Boards are to confirm that the annual report and accounts taken as a whole are fair, balanced and understandable, to ensure that the narrative sections of the report are consistent with the financial statements and accurately reflect the company's performance;
- Companies are to explain, and report on progress with, their policies on boardroom diversity. This change was first announced in October 2011, but its implementation was deferred to avoid piecemeal changes to the Code
- Companies are to provide fuller explanations to shareholders as to why they choose not to follow a provision of the Code.

Changes to the Stewardship Code include:

- Clarification of the respective responsibilities of asset managers and asset owners for stewardship, and for stewardship activities that they have chosen to outsource;
- Investors are to explain more clearly how they manage conflicts of interest, the circumstances in which they will take part in collective engagement, and the use they make of proxy voting agencies;
- Asset managers are encouraged to have the processes that support their stewardship activities independently verified, to provide greater assurance to their clients.

One issue that does not appear to have been addressed in the revised Stewardship Code is the issue of how asset owners can vote in pooled funds. Many pension schemes invest through pooled funds in order to keep costs low. Some asset managers allow investors to vote a proportion of fund's shares according to their instructions, but others have been obstructive.
Many pension funds invest through pooled funds in order to keep their costs low, but still want to be active on governance issues, and adopt their own voting policies. If asset managers make this difficult to achieve, this means that an important element of stewardship activity is being actively discouraged.

FSA consults on listing rules

The Financial Services Authority (FSA) has proposed a number of changes to the Listing Rules that aim to enhance the effectiveness of the Listing Regime.
The free float requirements are set at an EU level and allow the FSA to consider a free float of below 25% if there is sufficient liquidity. The FSA does not believe an increase in the free float requirement is a proportionate way to address the governance issues that have been raised in this context. The FSA proposes:

- detailing the circumstances where we might consider modifying the 25% free-float requirement for premium listings, indicating that any modification beneath 20% would be unlikely; and
- removing the requirement for a minimum absolute percentage free float within the standard segment, provided that sufficient liquidity is present.

The FSA proposes to further strengthen the Listing Regime by adopting greater corporate governance requirements for companies with a dominant shareholder. The FSA will increase the tools available to independent shareholders to influence the governance of the companies in which they have invested. These proposals include:

- introducing the concept of a ‘controlling shareholder’;
- requiring an agreement is put in place to regulate the relationship between such a shareholder and the listed company;
- and ensuring that this agreement is complied with on an ongoing basis. This will ensure that the company is managed independently from that shareholder.

The FSA also recognises the important role that the independent directors play in these circumstances. Therefore it will also insist on a majority of independent directors on the board where a controlling shareholder exists and introduce a new dual voting procedure to allow independent shareholders to have more say in their appointment. At the same time the FSA is making clear that certain types of company are incompatible with a premium listing including those with voting arrangements that have the potential to subvert or circumvent the investor protections that the premium listing provides.

The silent assassins keep quiet

Although most of the focus on the UK’s ‘shareholder spring’ has been on remuneration, it’s important not to forget that a number of chief executives were also forced out. But who did it?

As we’ve reported previously in PIRC Alerts, there is now a decent amount of voting available for the second quarter of 2012, which includes the period in which most UK AGMs take place. The interesting thing is that when you look at the votes asset managers cast, there is no indication that they had serious issues with at least two of this season’s casualties. Andrew Moss at Aviva and David Brennan at Astrazeneca were both forced out in the days around their companies’ respective AGMs. Media coverage o f their departures, combined with anecdotal feedback, suggests that shareholder pressure was a significant factor in both cases.

But if we look at the AGM results of both companies the votes against Moss and Brennan were paltry – 4.6% and 1% respectively. This picture is confirmed by looking at publicly disclosed voting data. Having looked at the voting records of 16 asset managers, we can only find one that voted against either director. All the others voted for both.

Yet we believe, based on anecdotal feedback, that some investors which voted in favour were privately agitating for change. If so the publicly recorded expression of their opinion – the vote – is the opposite of their actual view. If correct, these shareholders actively chose to vote in favour, when they could have voted against, abstained or not voted at all. Instead it seems they used a legal right to send a public signal opposite to their private view.

When we’ve raised this point in discussions within the industry we’ve heard two principal justifications. The first is that by publicly supporting the directors this allowed a more dignified exit. Given that in both cases there was widespread media coverage of the departures, including the assertion that shareholders had sent the message that it was time to go, it is hard to see what further embarrassment votes against the directors would have caused.

The second justification is that the objective – to remove the chief executive – was achieved, so it doesn’t matter what the votes say. This argument sounds more compelling, but raises further problems. One is accountability. Presumably the asset managers that forced out directors did not disclose this in their quarterly reports to pension funds and other clients. Therefore the message that the client receives – the

votes cast for and against that quarter – will be that they (through their asset manager) supported the directors in question. In terms of public accountability, there are no fingerprints.

But arguably more important is the way that voting is being subverted. If institutional shareholders won't vote against a chief executive that they want to leave even at the point when they are actively seeking that outcome, then when will they? If the answer is "never" then the logical conclusion is that the informational content of asset manager votes on directors is highly questionable. It sounds a bit like analysts making 'buy' or 'hold' recommendations on stocks that they actually have no faith in.

We recognise that, currently, most market participants don't see a particular problem here, but this is perhaps because of a sense of "we've always done it like this" on the part of asset managers. But if stewardship is to have a quasi-public role in ensuring that our largest companies are well run, something does not feel right about this approach to the use of legal ownership rights. It's an issue that we believe needs further discussion.

Opening up the audit market

For years the dominance of the Big Four accounting firms as auditors to the UK's biggest public companies, and the rarity of changes in auditor, has been treated by many as an irrelevance. But is opinion starting to shift?

There is a little recent evidence that companies may recognise that current practice does not look good (even if they are apparently as yet unconvinced that a tougher regime is necessary). In short succession we have seen both Schroders announce that it was going out to tender and BG apparently switching from PwC to Ernst & Young. Two potential changes in service provider would not register as significant in most markets, but in the audit world this is big news.

Meanwhile the Competition Commission continues to report on its own work on the audit market, with some interesting findings emerging. The Commission recently published an overview paper that is well worth a read.6 Essentially the Commission has found no evidence of tacit agreements between firms that might hinder competition, nor is there clear evidence that the dominance of the Big Four has a negative effect on audit quality or price. But there are other issues for shareholders to be aware of.

The Commission suggests that what little competition for services that there is comes largely at the behest of companies. Boards see costs but little benefit to retendering audit services when they are happy with their provider. They also have other priorities. As such sticking with the status quo is common.

The Commission believes the market for the provision of audit services works as a virtuous circle for the Big Four, but a vicious one for mid-tier firms trying to break in. This may be exacerbated by the fact many audit committee members and FDs are ex-Big Four themselves.

The Commission also notes that there is an "inherent conflict" in the auditor being chosen, paid and dismissed by the company, yet being expected to scrutinize management reporting objectively. The Commission clearly sees this as a potential problem and notes that shareholders may not get a look in.

It states: "[W]e are in particular investigating if a disconnect between the demand (from shareholders and other stakeholders) and supply (in terms of the product delivered by auditors) means that auditors direct their competitive efforts to satisfying the demands of those making the purchasing decisions (ie company management and audit committees) and whether those demands are sufficiently different from shareholder demand as to amount to a distortion of competition."

Regulator should judge bank M&A

There should be an explicit requirement for the Prudential Regulation Authority to approve bank takeovers and mergers in future, according to the Treasury select committee.

In its report on the Financial Services Authority's (FSA) own analysis of its role in the failure of Royal Bank of Scotland (RBS), the committee argues that the future PRA should have the formal ability to block deals if necessary. It says: "We need a regulator with the self confidence to intervene, even if it might cause some destabilisation in the short-term. We recommend that Government include an explicit requirement for the PRA to approve major bank acquisitions and mergers in forthcoming legislation."

The recommendation comes after stinging criticism of the role of the FSA in respect of RBS, in particular relating to the banks acquisition of ABN Amro. The committee argues that the regulator could and should have intervened over the deal. The FSA's initial commentary suggested that it did not have the necessary regulatory powers to block the deal. However Lord Turner, chair of the FSA, has argued that it could have used indirect methods to achieve the same outcome. Turner suggests that the FSA could have introduced capital buffers for the combined entity that would have made the deal commercially unattractive.
Of course, the interesting question in all this is the role of shareholders. There is an implication here that regulatory power will trump that of the owners when it comes to bank M&A activity. That, it strikes us, is rather a big deal.

Carroll to leave Anglo American

Following shareholder pressure for change at the top, in October Cynthia Carroll announced her resignation as chief executive of Anglo American.
The decision followed months of semi-public criticism of Carroll by shareholders and can hardly be considered a surprise. According to the company's official statement, Carroll will remain in post until a successor has been appointed and a transition to the new leadership takes place. Carroll's decision to step down means that the FTSE100 could lose two female chief executives, following the news that Pearson's Marjorie Scardino is to be replaced by John Fallon in January.
Whilst Carroll has fallen out of favour with shareholders, it is worth noting that she made a significant contribution to improving safety standards in the industry, with Anglo American's fatality rate falling significantly under her management. Although not an industry leader, other UK-listed miners still lag behind.

BSkyB: a history of inaction

November saw James Murdoch easily re-elected as a non-executive director of BSkyB, despite being criticised by both Parliament and broadcasting regulator Ofcom. Digging a bit deeper into voting at BSkyB however reveals some interesting trends.
First, we should make explicit the scale of shareholder support for James Murdoch. He was re-elected with a vote of 4.98% against, with minimal abstentions. Even accounting for News Corp's stake, that's not a bad result, given the circumstances. It's also well down on last year's vote against of just under 19%. What's more, Murdoch didn't even attract the largest vote against last week. Two other News Corp directors – Arthur Siskind and David DeVoe – saw votes against of 6.99% and 5.6% respectively. This could reflect a decision to focus more on reducing the News Corp influence on the board in general, rather than targeting James Murdoch in particular, right?
Actually that isn't right either. At last year's AGM Siskind saw a vote against of 10.06% and DeVoe a vote against of 8.07%. Similarly the vote against Tom Mockridge, now head of News International, dropped from 5.59% last year to 4.08% last week. In voting terms, this was a retreat, plain and simple. The pressure on News Corp-linked directors was down across the board, with the biggest reduction in opposition being for the director most directly linked to the hacking scandal.
To the uninformed observer, this might look unusual, but, in fact, failing to challenge James Murdoch head-on at BSkyB is something of a pattern for the UK's institutional investors. We can trace this right back to when he was parachuted in as chief executive back in November 2003. Some commentators suggested that perhaps his appointment had more to do with the fact that his father was the chair of the company than his ability, as a 30-year-old, to run a FTSE100 company.
As news of his appointment came shortly ahead of BSkyB's annual meeting James faced a vote on his election at the AGM when it was known that he would take over as chief executive. Shareholders had the opportunity to oppose him. Instead they opted to target the man in charge of the nominations process – then senior independent director Lord St John of Fawsley - who saw a vote of 41% against his re-election.
Fast forward to 2008, and James Murdoch again attracted criticism, for moving from chief executive to

chair of BSkyB, in breach of the Corporate Governance Code. One might have thought that this would be particularly controversial given the lack of independence on the board and the influence of News Corp as a controlling shareholder. Actually he was easily re-elected with just 6% opposing.

Perhaps, though, when it became obvious that News Corp was going to make a bid for the outstanding shares of BSkyB the need for an independent chair would become sharper, and he would see more opposition? News Corp launched its bid in June 2010, so we'd expect to see any opposition reflected in the October 2010 AGM voting results. And there wasn't really any, with James Murdoch recording a tiny vote against of just 1.79%.

As such, last week's AGM should be seen as the continuation of a trend, rather than an aberration. It was the 2011 AGM, when shareholders, briefly, put up a fight, that was unusual. In 2012, BSkyB shareholders reverted to their normal, passive, selves.

MPs query companies over tax

Executives from Starbucks, Google and Amazon faced a grilling from MPs in November, as the row over corporate tax avoidance continues.

In November Britain and Germany announced plans to make the G20 tackle the tax issue, amidst claims multinationals are exploiting loopholes to lower the amount they pay. The previous month it was revealed Starbucks had paid no corporation, or income, tax in Britain in the past 3 years and had paid only £8.6m since 1998. This week MPs on the Public Accounts Committee called in executives from threes well-known businesses that have attracted attention over tax policy. One of the issues that MPs were interested in was how companies could essentially manipulate where their made their profits in order to incur the least tax.

The outcome, from the companies' perspective, could have been better. For example, Amazon's director of public policy repeatedly refused to answer questions about its UK profits, leading to criticism from MPs. According to reports, Amazon avoids UK taxes by reporting European sales through a Luxembourg-based unit. This meant its main UK unit paid under £1m in income tax last year, despite having made total sales worth several billions.

Though shareholders have rarely taken a view on corporate tax policy the fact that political action seems increasingly likely perhaps demands more attention in future.

More investor pressure over IFRS

Concerns over weaknesses in international financial reporting standards (IFRS) have been raised in a paper issued by a group of major European institutional investors, as pressure for reform continues.

The group of 10 signatories, with combined assets of approximately €340bn (£288.5bn), warn that current accounting standards fail to give sufficient priority to prudence, undermining investors' ability to hold company executives to account and weakening companies' long-term decision-making. Signatories include asset managers such as Royal London and Threadneedle and pension funds such as the Universities Superannuation Scheme (USS), Railpen, NEST and the Local Authority Pension Fund Forum.

The paper states that action needs to be taken at three levels:

Design: The International Accounting Standards Board's convergence strategy with US GAAP has resulted in an increased emphasis on neutrality. Prudence needs to be restored as the over-riding guiding principle, and the link to capital maintenance requirements under company law clarified.

Application: Numerous examples exist where accounting rules are apparently followed, but results are misleading. The principles of 'truth and fairness' and 'substance over form' should be paramount.

Monitoring: Independent and objective monitoring by auditors is vital. Situations where auditors become too close to management; depend on management for continuation of their audit; and non-audit, contracts, and do not themselves face close scrutiny fails to provide the necessary control.

One of the paper's authors, Ben Levenstein, head of UK equities at USS, commented: "Our wish in publishing this paper is to highlight that it is not just regulators who need prudence in company accounts, but also long-term investors who rely on accurate numbers to hold executives to account. This is key in

the promotion of long-term decision-making, which in turn will encourage greater macro-economic stability. The gravity of some investors' unease about the international accounting framework is a serious concern which must be addressed."

The publication of the paper follows recent expressions of concern about accounting standards in the banking sector by senior figures at the Bank of England. The signatories of the Paper believe the same issues apply to other sectors too.

Thinking specifically about the banks, one point shareholders perhaps ought to start to consider is what their position would really look like if the picture presented by IFRS is ignored.

The 'shareholder spring' reviewed

Was the so-called 'shareholder spring' a non-event? Two reports out in November have suggested that perhaps it wasn't such a rebellious AGM season after all.

According to research by KPMG, there are reasons for thinking that the relationship between the UK's largest public companies and their shareholders isn't as bad as headlines might suggest. KPMG's 2012 Guide to Directors' Remuneration reveals that there was less shareholder opposition on pay in 2012 than in 2011. The firm points out that during 2012, 10 companies in the FTSE-100 experienced significant levels of shareholder dissent on remuneration report votes (20% plus oppose and abstains). In 2011, this figure was 34. In addition, the overall average level of support remained above 90% in 2012.

KPMG suggests that the real story of the 2012 season was of targeted shareholder opposition, rather than a broad movement against excessive executive pay. The report also points out that in some cases opposition to a company's pay policy overlapped with concerns about individual directors or company performance. KMPG believes that further shareholder activism around remuneration can be expected next year.

But are shareholders really that interested in controlling executive pay? The other report out this week comes from responsible investment campaign group Fair Pensions, and looks at a range of different types of information to form a view of how asset managers are positioned. This includes headline voting level and individual voting records, but Fair Pensions has also taken a look at responses to the Government's recent consultation on new powers for shareholders.

One of the most interesting findings is that most investors opposed the idea of being given a binding shareholder vote on remuneration policy (in case you're wondering, PIRC supported the proposal). Fair Pensions says that overall 72% of institutional investors responding opposed. Their conclusion is that the final reform proposal - a binding shareholder vote on pay every three years - was a compromise between a government keen to give shareholders more power and "institutional investors reluctant to assume these powers."

For what it's worth, we think this is a fair assessment. As we've noted before, in the debate over executive pay, there's rarely an opportunity missed to warn of the dire '"unintended consequences" of a particular reform. The asset management industry has been trying to walk the line between arguing that the Government should not intervene directly, whilst simultaneously trying to resist any formalisation of its own role in overseeing executive pay. The result is the bizarre situation that Fair Pensions describes of the Government trying to give rights to shareholders who do not want them. The contrast with the Arab Spring could not be more stark!

The other point well made by Fair Pensions is that accountability for how asset managers exercise their new powers needs to be backed up by mandatory disclosure of voting records. We can't fault their assessment of current practices:

"[B]eneficiaries seeking to understand how their fund voted and why at a particular company face a lottery at present, with a significant chance that they will not be able to find the information they are looking for in a timely manner. Likewise, attempts to make systematic comparisons of different managers' votes on a particular issue – and, in particular, to understand their stewardship approaches by comparing reasons for controversial votes – are hampered by the incompleteness of the data."

If the reason for shareholders disclosing their voting records is to enable clients (either individual savers or

trustees) to compare managers' approaches to issues like executive pay the lack of standardisation is fatal. Similarly, if we believe there is a legitimate public interest in the exercise of ownership rights by shareholders, then the fact that asset managers can (still) disclose what they want and when they want to seems incongruous.

In reality if the 'shareholder spring' is to be more than a mild grumble about the worst excesses at the top, then asset managers must be accountable too. But this is does not simply require action from the managers themselves – it also requires those with an economic interest in the shareholdings managed by asset managers to speak up.

TUC study shows vote dispersion

There was a sharp divide in the positions taken by fund managers last year, with a small number backing 85% of company resolutions and a small minority supporting 25% or less, according to TUC research.

The tenth annual Fund Manager Voting Survey, published to coincide with the TUC Pension Trustee Conference in November, analyses the voting records of 26 fund managers, pension funds and voting agencies across 76 company resolutions between January and December 2011.

Remuneration remains the issue most likely to be opposed by investors, though bank remuneration reports actually received strong support. The RBS remuneration report received the highest level of support of any in the survey, though this is probably because its Chief Executive Stephen Hester handed back his bonus in the face of shareholder pressure before the report was voted on, says the TUC. The survey shows that a number of respondents undertook considerable engagement with RBS.

The survey shows encouraging progress in the public disclosure of fund managers' voting records, with 26 of the 28 survey respondents now making at least some voting data publicly available. The fact that when the first TUC Voting Survey was published in 2003, just one institutional investor – the Co-operative Insurance Society – made its voting record public, shows just how much progress has been made, says the TUC. However, the TUC still has concerns over the quality of data being made available, with some only disclosing votes against and abstentions, and others only providing headline statistics.

And while many investors cited the Stewardship Code as a reason for making their voting more public, it has had little effect on their voting stances, says the TUC. The TUC would like the Code toughened up so that fund managers are required to consult their clients over their approach to voting and engagement.

LAPFF on employee engagement

Investors should pay more attention to how companies engage employees and ensure their commitment, and move away from an exclusive focus on financial rewards to motivate staff, including executives, according to the Local Authority Pension Fund Forum (LAPFF).

In a report launched at its annual conference, the Forum set out a new agenda for shareholder engagement with companies. Having reviewed the evidence about employee engagement and motivation, LAPFF has concluded that financial incentives have only a limited role to play in the creation of successful businesses.

The Forum believes that companies must work hard to ensure employees will choose them over competitors, stay with the business, and commit themselves to achieving its objectives. The mechanism companies use in order to do this is termed the 'employee value proposition'. Whilst shareholders' views about motivation and engagement have generally been restricted to variations on performance-related pay, the Forum believes that a broader approach is required. Instead the guide explores how companies can develop a compelling employee value proposition.

The guide reveals that the science of non-monetary reward shows that employees care deeply about purpose, are drawn to working with people they connect to, value autonomy, seek to achieve mastery and are fulfilled by achievement and progress. They are also heavily influenced by the context in which they work: whether they feel valued, whether they perceive themselves to be fairly treated, and how they are treated by immediate superiors.

Therefore investors need to ask very different questions if they are going to understand which companies

are getting it right. The guide introduces a set of questions that are designed to enable interested pension fund trustees and asset managers to appraise the link between people and investment value.

The guide is the result of a long-running project looking at incentives and motivation. LAPFF's initial focus on exploring whether companies tie rewards to non-financial factors has now shifted onto non-financial rewards. It is published amidst a growing discussion of the failure of financial rewards to improve motivation and performance, popularised by Dan Pink's recent book Drive.

The guide is available online at **www.lapfforum.org**

Hirschman finally takes the exit

Economist Albert Hirschman, author of the famous book Exit, Voice and Loyalty, died in December aged 97.

The book has been a significant, if often unacknowledged, influence on thinking about the relationship between companies and shareholders. After all, engagement with companies is rooted in the assumption that it is often worth exercising voice, rather than selling out. In addition, the emerging interest in ideas like 'loyalty dividends' bears out Hirschman's point that organisations can introduce mechanisms to encourage voice rather than exit. It should be required reading for all governance types.

UK Voting Analysis

Table 1: Top Oppose Votes

	Company	Type	Date	Resolution	Proposal	Funds Vote	Oppose %
1	SMITHS GROUP PLC	AGM	20 Nov 12	17	Meeting notification related proposal	For	11.15
2	WOLSELEY PLC	AGM	29 Nov 12	15	Issue shares with pre-emption rights	For	9.20
3	SMITHS GROUP PLC	AGM	20 Nov 12	2	Approve the Remuneration Report	Abstain	8.45
4	HAYS PLC	AGM	07 Nov 12	18	Amend existing Performance Share Plan	Oppose	5.94
5	WOLSELEY PLC	AGM	29 Nov 12	20	Adoption of the Wolseley Group Executive Share Option Plan 2012	Oppose	4.08
6	WOLSELEY PLC	AGM	29 Nov 12	2	Approve the Remuneration Report	Oppose	3.90
7	WOLSELEY PLC	AGM	29 Nov 12	19	Adoption of the Wolseley Group Long Term Incentive Plan 2012	Oppose	3.81
8	HAYS PLC	AGM	07 Nov 12	17	Meeting notification-related proposal	For	3.32
9	WOLSELEY PLC	AGM	29 Nov 12	12	Appoint the auditors	Oppose	3.10
10	SMITHS GROUP PLC	AGM	20 Nov 12	14	Issue shares with pre-emption rights	For	2.32

Note: Levels of opposition percentage represent opposition votes cast as a percentage of all votes cast either in favour or against a resolution.

Table 2: Votes by Resolution

Resolution Type	For	%	Abstain	%	Oppose	%	Withdrawn	%	Total
All Employee Schemes	0	0	0	0	0	0	0	0	0
Annual Reports	1	16	2	33	3	50	0	0	6
Articles of Association	0	0	0	0	0	0	0	0	0
Auditors	5	83	0	0	1	16	0	0	6
Corporate Actions	1	100	0	0	0	0	0	0	1
Corporate Donations	1	50	1	50	0	0	0	0	2
Debt & Loans	0	0	0	0	0	0	0	0	0
Directors	22	91	0	0	2	8	0	0	24
Dividend	3	100	0	0	0	0	0	0	3
Executive Pay Schemes	0	0	0	0	3	100	0	0	3
Miscellaneous	2	100	0	0	0	0	0	0	2
NED Fees	0	0	0	0	0	0	0	0	0
Non Voting	0	0	0	0	0	0	0	0	0
Say On Pay	0	0	0	0	0	0	0	0	0
Share Capital Restructuring	0	0	1	100	0	0	0	0	1
Share Issue/Re-purchase	7	77	2	22	0	0	0	0	9
Shareholder Resolution	0	0	0	0	0	0	0	0	0
Undefined	0	0	0	0	0	0	0	0	0

UK Voting Charts

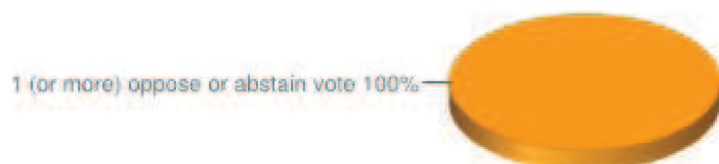
These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	42
Oppose	9
Abstain	6
Withdrawn	0
Total	57

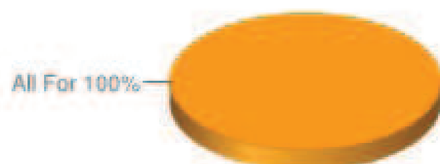
Meetings	AGM	EGM	Total
Total Meetings	3	1	4
1 (or more) oppose or abstain vote	3	0	3

UK Voting Record

UK AGM Record



UK EGM Record



UK Voting Timetable Q4 2012

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 3: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	HAYS PLC	07 Nov 12	AGM	2012-10-23
2	SMITHS GROUP PLC	20 Nov 12	AGM	2012-11-08
3	EXPERIAN PLC	20 Nov 12	**EGM**	2012-11-08
4	WOLSELEY PLC	29 Nov 12	AGM	2012-11-19

UK Upcoming Meetings Q1 2013

List of meetings scheduled to be held throughout the period by UK companies currently in the fund's portfolio.

Table 4: Upcoming Meetings

	Company	Meeting Date	Type
1	WH SMITH PLC	23 Jan 13	AGM
2	IMPERIAL TOBACCO GROUP PLC	30 Jan 13	AGM

AIM UK Market Voting Timetable Q4 2012

There were no meetings held by the client during the period.

AIM UK Market Upcoming Meetings Q1 2013

There are no upcoming meetings for this region.

Fledgling UK Market Voting Timetable Q4 2012

There were no meetings held by the client during the period.

Fledgling UK Market Upcoming Meetings Q1 2013

There are no upcoming meetings for this region.

European Corporate Governance Review

Deal or no deal?

October saw the widely expected collapse of the merger between BAE Systems and EADS, Europe's biggest civil aerospace group. It's also the latest example of deal falling apart amidst shareholder pressure.

Clearly in the BAE-EADS case there are other factors at play, not least the role of politicians in London, Paris and Berlin. In the end it was Germany intransigence that really killed the deal off. But the role of Invesco, a major BAE shareholder, and other investors was also important. In making the case that shareholder value could be at risk this added to the sense that the strategy was muddled.

What's more the collapse of the BAE-EADS merger seems indicative of a wider tendency for shareholders to actively challenge deals that was not in evidence pre-crisis. For years shareholders have been castigated for nodding through deals that appeared to make little sense on the basis that presumably management must know better (RBS and ABN Amro, anyone?). Certainly there is evidence out there that many deals fail to create value, and some active destroy it. So the unengaged approach some big investors have taken in the past was perplexing.

But in the past few years something does seem to have shifted. Just in the FTSE100 in the past few years we have seen the Pru, G4S and now BAE stumble when big deals have been lined up. Meanwhile the 'Glenstrata' saga continues. In all these cases shareholder pushback has been a significant factor.

This year most of the focus has been on the upsurge of shareholder opposition to remuneration, but arguably the growing willingness to resist major deals is as big a story, if not bigger.

Swiss edge towards binding vote

Switzerland will hold a referendum in March on whether to introduce a binding shareholder vote on executive pay.

Thomas Minder, a former businessman who is now a Swiss politician, has put forward the proposal as a way to tackle high pay for executives in the country. Reuters reports that the Government has confirmed the referendum will take place on 3rd March 2013. Under the proposal, shareholders would be granted a binding vote on executive pay, not unlike the new vote to be introduced in the UK, and golden handshakes and golden parachutes would be banned. Reuters reports that the package would also require shareholders to disclose voting records, something the UK Government has, to date, been reluctant to do.

Not surprisingly, already the Swiss business lobby has begun a scaremongering campaign, arguing that the proposals will hamper the competitiveness of domestic companies. Ironically lobbyists have also argued that the measure would drive executive talent overseas. Presumably those executives leaving Switzerland will pass the incoming and long-threatened mass exodus of UK bankers in mid-air. Reuters reports that business lobby group Economiesuisse may put up to 12 million francs into a campaign against Minder's proposal, and in favour of a weaker alternative.

Currently a minority of large Swiss companies offer shareholders an advisory vote on remuneration policy.

IBRC sues Ernst & Young

An interesting little story in the Irish Times caught our eye in December. According to the report, the former Anglo Irish Bank is taking legal action against Ernst & Young.

The paper states that the action relates to E&Y's role as auditor to the bank, now called the Irish Bank Resolution Corporation (IBRC) before it was nationalised. The IBRC has declined to make further information about the action available.

According to the report, Ernst & Young has been criticised for failing to spot the full extent of the

borrowings of Anglo chairman Seán FitzPatrick, and for failing to warn about Anglo's sharp growth in its lending exposure to property.
One to keep an eye on - it may not be the last.

EC governance action plan

The European Commission (EC) has adopted an Action Plan outlining future initiatives in the areas of company law and corporate governance.
The EC has identified several lines of action in the area of company law and corporate governance. Action to increase the level of transparency between companies and their shareholders will include:

- Increasing companies' transparency as regards their board diversity and risk management policies;
- Improving corporate governance reporting;
- Better identification of shareholders by issuers;
- Strengthening transparency rules for institutional investors on their voting and engagement policies.

Initiatives aimed at encouraging and facilitating long-term shareholder engagement will include:

- More transparency on remuneration policies and individual remuneration of directors, as well as a shareholders' right to vote on remuneration;
- Better shareholders' oversight on related party transactions, i.e. dealings between the company and its directors or controlling shareholders;
- Creating appropriate operational rules for proxy advisors (i.e. firms providing services to shareholders, notably voting advice), especially as regards transparency and conflicts of interests;
- Clarification of the 'acting in concert' concept to make shareholder cooperation on governance issues easier;
- Investigating whether employee share ownership can be encouraged.

Initiatives in company law to support European businesses and encourage their growth and competitiveness will cover:

- Further investigation on a possible initiative on the cross-border transfer of seats for companies;
- Facilitating cross-border mergers;
- Clear EU rules for cross-border divisions;
- Follow-up of the European Private Company statute proposal to enhance cross-border opportunities for SMEs
- An information campaign on the European Company/European Cooperative Society Statute;
- Targeted measures on groups of companies, i.e. recognition of the concept of the interest of the group and more transparency regarding the group structure.

In addition, the action plan foresees merging all major company law directives into a single instrument. This would make EU company law more accessible and comprehensible and reduce the risk of future inconsistencies.

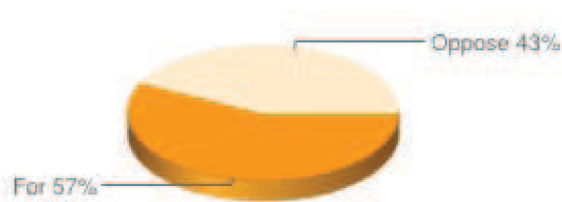
European Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

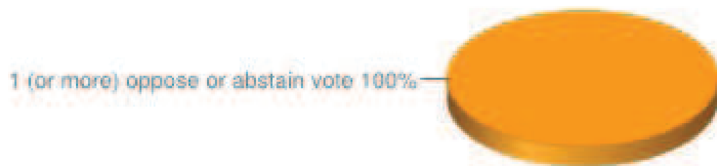
Total Resolutions	
For	4
Oppose	3
Abstain	0
Withdrawn	0
Total	7

Meetings	AGM / Combined	EGM	Total
Total Meetings	1	1	2
1 (or more) oppose or abstain vote	1	0	1

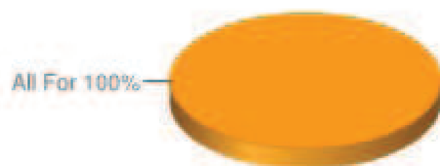
European Voting Record



European AGM Record / Combined



European EGM Record



European Voting Timetable Q4 2012

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 5: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	KONE CORP	24 Oct 12	**EGM**	2012-10-11
2	D.E MASTER BLENDERS 1753	28 Nov 12	AGM	2012-11-12

European Upcoming Meetings Q1 2013

List of meetings scheduled to be held throughout the period by European companies currently in the fund's portfolio.

Table 6: Upcoming Meetings

	Company	Meeting Date	Type
1	NOVARTIS AG	22 Feb 13	AGM
2	KONE CORP	01 Mar 13	AGM
3	ROCHE HOLDING AG	01 Mar 13	AGM
4	SCHINDLER HOLDING AG	01 Mar 13	AGM

US Corporate Governance Review

News Corp investors back reform

Independent News Corp shareholders overwhelming backed calls to split chair and CEO roles and eliminate the company's dual class share structure at the media giant's AGM this week.

In fact the meeting was a much quieter affair than last year's, both in terms of investor attendance and the nature of the back and forth between board and shareholders. Last year the hacking scandal was only a few months old, and there was a great deal of shareholder anger directed at the company. In response chair and CEO Rupert Murdoch dealt with many shareholder questions in a dismissive and abrasive manner. The results of the 2011 meeting tell their own story, with large shareholder votes against several directors, with James Murdoch attracting the most opposition.

In 2012 it is fair to say the discussion has moved on for both company and shareholders. Investor attendance was definitely thinner this year, with press probably outnumbering shareholders. Whereas last year shareholders fired a broadside against pretty much the whole board, this year there was a much more focused approach, with most pressure being exerted in support of the shareholder resolutions on the chair and dual class structure.

Speaking in support of the resolution seeking an independent chair were Julie Tanner from Christian Brothers Investment Services and Ian Greenwood from the Local Authority Pension Fund Forum. Laura Campos from Nathan Cummings Foundation presented the resolution on the dual class structure. The resolutions were backed by contributions in the room from the likes of CalSTRS, the giant Californian teachers' pension fund, and UK asset manager Hermes.

The board's response was largely handled by Viet Dinh who defended the company's policy on both combined roles and the dual class structure. At the risk of reading too much into too little, his contribution in respect of the question regarding an independent chair did at least suggest that this is not a closed option. And where was last year's Rupert Murdoch? In place of 2011's combative chair, the 2012 version was polite, thanking shareholders for their contributions even when they challenged company policy. This was a marked difference from last year when he interrupted shareholders even as they asked questions.

In another break with last year the company also managed to disclose the voting results on the same day, albeit a few hours after the meeting. As expected, there was a drop-off in the votes against directors, and instead independent shareholders voted heavily in favour of the two resolutions seeking significant structural reform.

Just looking at the headline votes, the resolution seeking an independent chair received 30.5% in favour and the resolution on the dual class structure received 28.8%. But when the Murdoch family trust voted is stripped out the vote amongst other shareholders in favour of the resolution on the independent chair was approximately 66%. The independent vote in favour of the resolution seeking to eliminate the dual class structure was approximately 63%. Australian shareholder activist Stephen Maybe has pointed out that if you exclude the votes of long-term Murdoch ally, Saudi Prince Alwaleed Bin Talal, the votes in favour of reform were even higher.

There's a tendency on the part of some in corporate governance to argue that News Corp isn't worth the effort. The votes from this week's AGM show that many shareholders disagree, and, being eternal optimists, we think that there may be light at the end of the tunnel. Shareholders should keep pushing.

Oracle should've seen it coming

Software giant Oracle suffered an embarrassing defeat on executive compensation policy in November.

According to results released by the company, on the executive compensation vote 40.9% were in favour; with 58.9% against and 0.2% abstentions. However that almost certainly undersells the extent of opposition. Founder and CEO Larry Ellison owns 23% of the company's shares, and we assume he voted

in favour of the policy. Taking that 23% in account, it is estimated that 83% of independent shareholders cast their votes against the resolution. Arguably Oracle can't be surprised, given that there was a sizeable oppose vote last year too. PIRC had recommended opposition. All three Compensation Committee members received significant votes against their re-elections with the Chairman receiving only 61% support, and the other two members receiving 66% support.

US Say on Pay defeats pass 60

The UK's record six defeats of remuneration reports for companies listed main market has been dubbed the 'shareholder spring'. So what should we describe the US as, where more than 60 companies have been defeated?

According to executive compensation consultants Steven Hall & Partners, on average, US companies have received an 89% 'for' vote, a 9% 'against' vote and 2% in abstentions. It found 60 companies that had lost the vote, though another has been defeated since its figures were produced. Of these defeats, the company says the average level of opposition was 62%, indicating significant shareholder disapproval. Four companies have lost the vote for the second year running - Hercules Offshore, Inc, Kilroy Realty Corp, Nabors Industries Ltd and Tutor Perini Corp.

HP $8.8bn Autonomy write down

In November Hewlett Packard announced a massive $8.8bn write down relating to its takeover of Autonomy.

According to a formal statement issued in November, the majority of this impairment charge, more than $5b of the write down is linked to serious accounting improprieties, misrepresentation and disclosure failures discovered by an internal investigation by HP and forensic review into Autonomy's accounting practices prior to its acquisition by HP. The company launched its internal investigation into these issues after a senior member of Autonomy's leadership team came forward, following the departure of Autonomy founder Mike Lynch, alleging that there had been a series of questionable accounting and business practices at Autonomy prior to the acquisition by HP. This individual provided numerous details about which HP previously had no knowledge or visibility.

As a result of that investigation, HP now believes that Autonomy was substantially overvalued at the time of its acquisition due to the misstatement of Autonomy's financial performance. It has contacted both the US Securities and Exchange Commission's Enforcement Division and the UK's Serious Fraud Office. In addition, HP says it is preparing to seek redress against various parties to recoup what it can for its shareholders.

Prior to its takeover, Autonomy raised a number of red flags on the governance front. In PIRC's view it lacked proper independent representation, which led us to oppose the election of numerous directors over years. Its auditor also raked in significant non-audit fees, which we found problematic. In fact because of this we recommended that clients didn't support the re-appointment of the auditor from 2008 until the HP takeover.

US Voting Charts

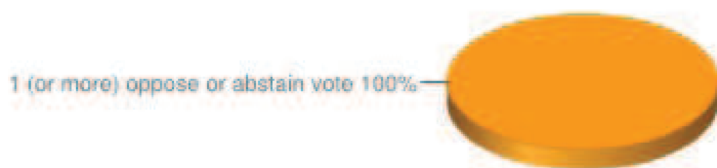
These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

Total Resolutions	
For	23
Oppose	13
Abstain	1
Withhold	7
Withdrawn	0
Total	44

Meetings	AGM	EGM	Total
Total Meetings	3	0	3
1 (or more) oppose or abstain vote	3	0	3

US Voting Record

US AGM Record



US EGM Record

There where no EGMs during the last period in the clients portfolio.

US Voting Timetable Q4 2012

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 7: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	CLOROX CO.	14 Nov 12	AGM	2012-11-01
2	MICROSOFT CORP.	28 Nov 12	AGM	2012-11-21

Not Voted Meetings

Table 8: Meetings not voted in quarter

	Company	Meeting Date	Type	Reason Not Voted
1	ORACLE CORP.	07 Nov 12	AGM	Shares not held at record date.

US Upcoming Meetings Q1 2013

List of meetings scheduled to be held throughout the period by US companies currently in the fund's portfolio.

Table 9: Upcoming Meetings

	Company	Meeting Date	Type
1	VISA INC	30 Jan 13	AGM
2	ACCENTURE PLC	06 Feb 13	AGM
3	WALT DISNEY CO.	01 Mar 13	AGM
4	APPLIED MATERIALS INC	01 Mar 13	AGM
5	TE CONNECTIVITY LTD	01 Mar 13	AGM

Japanese Reporting Timetable Q4 2012

There were no meetings held by the client during the period.

Reported Meetings

There were no meetings held by the client during the period.

Japanese Upcoming Meetings Q1 2013

There are no upcoming meetings for this region.

Global Corporate Governance Review

Unions launch global vote probe

The Global Unions Committee on Workers' Capital (CWC) has launched its Global Proxy Review 2012 - a report and website that encourages investors to take an active role in proxy voting oversight for global equity portfolios.

With a report and a new interactive website the Global Proxy Review gives pension fund trustees and other investors an overview of shareholder votes at companies likely to be held in global equity portfolios. This information can be used to hold fund managers and proxy voting services accountable for the votes cast on behalf of pensioners and investors.

The 2012 report includes 38 votes from eight different countries on environmental, social and governance (ESG) issues of particular importance to the labour movement. This year's votes are from Australia, Canada, the Netherlands, South Africa, Spain, Switzerland, the United Kingdom and the United States of America. They include votes at significant companies in over 20 sectors including: NewsCorporation, Enbridge, TNT Express, AngloAmerican, Banco Santander, Transocean, Barclay's and JP Morgan Chase. More than a third of the votes selected for the Review were 'say-on-pay' resolutions. The votes also include significant social issues, such as risks associated with aboriginal opposition to a major oil pipeline, and issues such as board governance and shareholder rights.

Launched last year with a pilot report, the Global Proxy Review has expanded this year to include two new countries and an interactive website where users can search key votes. The project is a collaboration between the CWC and labour and responsible investment advocates from across the globe. Partners include: Australian Council of Super Investors; Shareholder Association for Research and Education (Canada); Eumedion (Netherlands); Community Growth Fund and Labour Research Service (South Africa); the Confederación Sindical de Comisiones Obreras (Spain); ETHOS Foundation (Switzerland); Trades Union Congress and Pensions Investment Research Consultants (UK); and the American Federation of Labour and Congress of Industrial Organizations (US).

Hedge fund plays at being pirates

Elliott Capital seized a ship belonging to the Argentine Navy in October, as part of its attempt to recoup losses on bonds on which Argentina defaulted in 2001.

The ship, ARA Libertad, was seized in Ghana following a decision by a Ghanaian court. According to the FT, Elliot had been following the ARA Libertad closely and waiting for it to stop in a port where previous legal judgments could be enforced. Elliott is one of a number of investors holding out for full recovery of losses on Argentine bonds.

Interestingly, Elliott is also a major shareholder in one of the UK's transport companies. It holds almost 20% of National Express and, as we've reported previously, appears to have failed to back the company's chair John Devaney at this year's AGM. At the previous year's AGM it had proposed three new candidates for the board, as part of an apparent push to shake up the company's strategy.

Despite this hands-on role in one of the UK's leading transport companies, it states that it does not seek to comply with the Stewardship Code. A brief statement on its website announced that Elliott "does not consider it appropriate to commit to any particular voluntary code of practice". So that's that. Despite owning about a fifth of the company's shares, which enables it (as it has done already) to file shareholder resolutions, or call an EGM, the firm can simply choose to not comply with the Code. Still, no-one ever expected pirates to adhere to a code of best practice!

Global Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

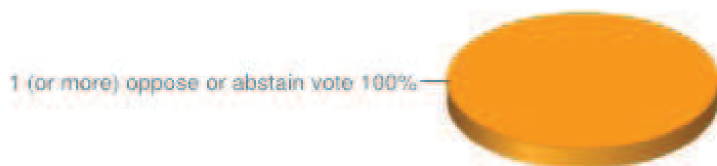
Total Resolutions	
For	44
Oppose	17
Abstain	10
Withdrawn	0
Total	71

Meetings	AGM	EGM	Total
Total Meetings	12	1	13
1 (or more) oppose or abstain vote	11	1	12

Global Voting Record

Global AGM Record

Global EGM Record



Global Voting Timetable Q4 2012

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 10: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	COCHLEAR LTD	16 Oct 12	AGM	2012-10-05
2	TELSTRA CORP LTD	16 Oct 12	AGM	2012-10-08
3	CSL LTD	17 Oct 12	AGM	2012-10-05
4	TATTS GROUP LTD	24 Oct 12	AGM	2012-10-15
5	CARSALES.COM LTD	26 Oct 12	AGM	2012-10-17
6	COMMONWEALTH BANK AUSTRALIA	30 Oct 12	AGM	2012-10-19
7	WESFARMERS LTD	14 Nov 12	AGM	2012-11-01
8	WOOLWORTHS LTD	22 Nov 12	**EGM**	2012-11-12
9	WOOLWORTHS LTD	22 Nov 12	AGM	2012-11-12
10	SONIC HEALTHCARE LTD	22 Nov 12	AGM	2012-11-13
11	INCITEC PIVOT LTD	18 Dec 12	AGM	2012-12-10
12	ANZ-AUSTRALIA & NEW ZEALD BK	19 Dec 12	AGM	2012-12-10
13	MINDRAY MEDICAL INTL	28 Dec 12	AGM	2012-12-18

Global Upcoming Meetings Q1 2013

List of meetings scheduled to be held throughout the period by Global companies currently in the fund's portfolio.

Table 11: Upcoming Meetings

	Company	Meeting Date	Type
1	METRO INC -CL A	29 Jan 13	AGM
2	PETROBRAS-PETROLEO BRASILIER	01 Mar 13	AGM
3	ORION CORP	01 Mar 13	AGM

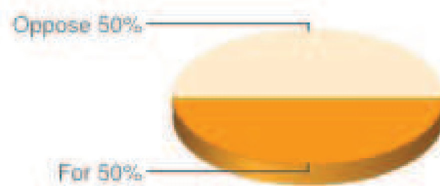
Asian Voting Charts

These graphs include meetings where the client held a voting entitlement exercisable by PIRC according to portfolio details communicated to PIRC prior to execution of the vote.

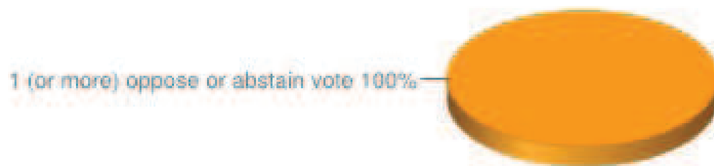
Total Resolutions	
For	7
Oppose	7
Abstain	0
Withdrawn	0
Total	14

Meetings	AGM	EGM	Total
Total Meetings	1	0	1
1 (or more) oppose or abstain vote	1	0	1

Asian Voting Record



Asian AGM Record



Asian EGM Record

There where no EGMs during the last period in the clients portfolio.

Asian Voting Timetable Q4 2012

List of meetings held throughout the period in the fund's portfolio.

Voted Meetings

Table 12: Meetings voted in the quarter

	Company	Meeting Date	Type	Date Voted
1	SINGAPORE PRESS HOLDINGS LTD	30 Nov 12	AGM	2012-11-15

Asian Upcoming Meetings Q1 2013

List of meetings scheduled to be held throughout the period by Asian companies currently in the fund's portfolio.

Table 13: Upcoming Meetings

	Company	Meeting Date	Type
1	SAMSUNG ELECTRONICS CO LTD	01 Mar 13	AGM

PIRC Summary Report Appendices

UK

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at UK meetings for companies held by the fund during the period.

European

Analysis for "Oppose" and "Abstain" votes for resolutions at European meetings for companies held by the fund during the period.

US

Analysis for "Oppose", "Withhold" and "Abstain" votes for resolutions at US meetings for companies held by the fund during the period.

Global

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at Global meetings for companies held by the fund during the period.

Asian

Analysis and final proxy results on "Oppose" and "Abstain" votes for resolutions at Asian meetings for companies held by the fund during the period.

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QUARTERLY ENGAGEMENT REPORT

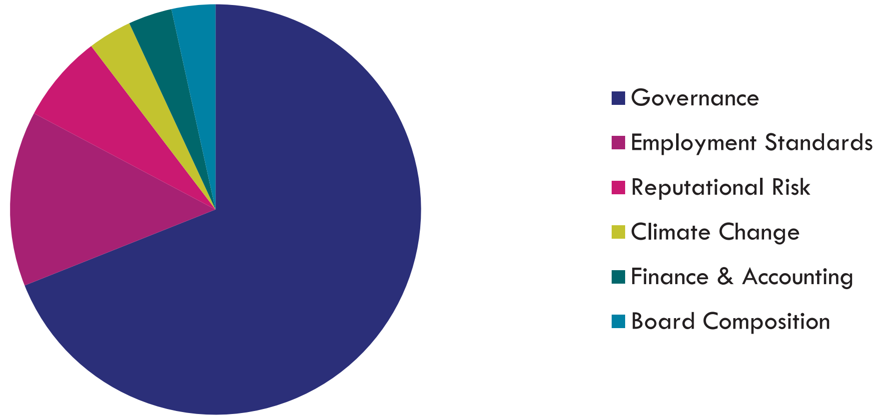
OCTOBER TO DECEMBER 2012

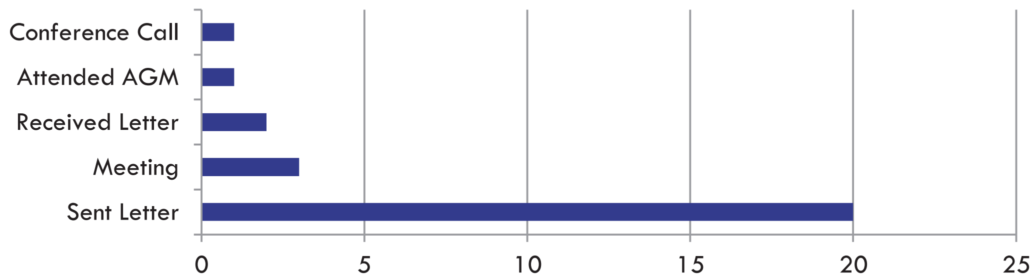
Local Authority Pension Fund Forum

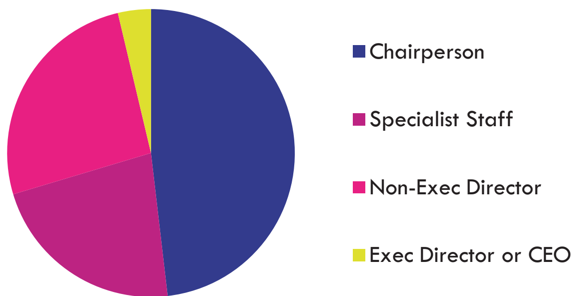
LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, the Forum brings together a diverse range of local authority pension funds in the UK with combined assets of over £115 billion.

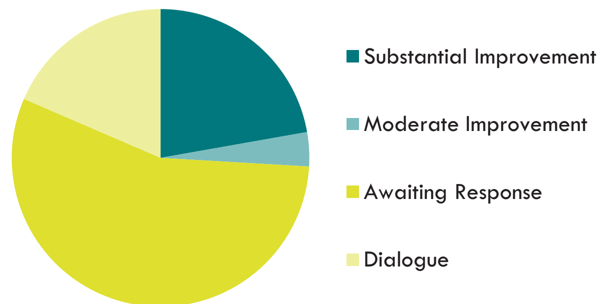
ENGAGEMENT SUMMARY

OCTOBER TO DECEMBER 2012









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ACHIEVEMENTS

- Attended the **News Corporation** AGM in Los Angeles to speak to the resolution filed by LAPFF members and Christian Brothers Investment Services asking for an independent chair. It received 67% support from independent shareholders.

- Responded to DEFRA consultation on greenhouse gas emission reporting regulations flagged up the Forum's long-term support for **mandatory carbon emission reporting** being brought into effect by the regulations. Met with **BP,** together with CCLA, to discuss their carbon emissions management and positioning for a low carbon economy.

- Launched the 'Smith Institute' report '**Investing for Growth**' at a parliamentary event in October, co-sponsored by LAPFF. The Forum's '**People and Investment'** report was launched at the Forum's annual conference.

- Continued to engage companies and policy-makers on the basis that international accounting standards can overvalue assets and supported an USS-led investor coalition promoting **IFRS reform**. This position is beginning to be vindicated by statements by the Financial Policy Committee of the Bank of England.

- Discussed labour relations, succession planning and board diversity with **National Express**. Held a follow-up conference call focussed on employee relations in the US.

- Met with the chairman and chair of the audit committee of **Royal Bank of Scotland** to discuss IFRS, 'true and fair view' accounting, as well as recent fines and reputational risk in the banking sector.

THE FORUM IN THE NEWS

Independent Chair at News Corporation - Bloomberg TV, CNN, CNBC, Sydney Morning Herald, Independent, Guardian, Telegraph

'Aiming for A' Improving carbon reporting at UK companies - Financial Times

'People and Investment' Report - The Independent, Employee Benefits, Board Talk, Global Proxy Watch

International Financial Reporting Standards - Responsible-Investor.com, Financial News, IPE, Financial Times

Infrastructure Investment: Public Finance, Guardian

View more press coverage: http://lapfforum.org/TTx2/press/in-the-news

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COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

The LAPFF chair, Ian Greenwood, attended the AGM of **News Corporation** in Los Angeles and spoke in support of the resolution for an independent Chairman as part of ongoing constructive dialogue with company directors. Two LAPFF funds were co-filers on the resolution. In the run-up to the AGM the Forum spoke with several large News Corp shareholders and proxy advisory services. Subsequently both big US advisers, ISS and Glass Lewis, recommended a vote in favour of the resolution, and major investors including CalPERS and CalSTRS also stated their public support.

The resolution for Independent Chair at **News Corp** received 30% of the shareholder vote.

Excluding the Murdoch family stake, this represents 67% of the vote.

LAPFF's participation in the investor group of the **30% Club**, continued with the group issuing an update on its Best Practice Guidelines on board diversity, 'Diversity and Stewardship: the Next Steps' at an event to mark the second anniversary of the Group at the London Stock Exchange. The update includes proposed voting policies to promote diverse boards.

PROMOTING GOOD GOVERNANCE

Global Focus List Engagement

LAPFF wrote to fifteen companies, listed in the UK, US, France, Spain, Switzerland and Sweden. These companies have been selected for engagement by evaluating company performance on key governance issues. Companies include **Flir Systems**, a former focus list constituent, **Société Générale** where a LAPFF fund co-filed a resolution in 2011 relating to combined roles at the head of the company, and **Carnival Corporation**, where there are ongoing health and safety concerns. The Forum also wrote to five companies that achieved the highest scores in our evaluation in each of the markets to commend them on their good governance practices.

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People & Investment Value

The Forum launched a new publication at the annual LAPFF conference entitled the Forum's publication 'People and Investment Value: Appraising Employee Value Propositions to Distinguish Corporate Performance.' The report identifies how companies can create sustainable value using non-monetary mechanisms to attract, retain and motivate staff. Formulated as a guide for investors, it sets out questions investors can raise with companies or their investment managers.

> "The science tells us committed, as opposed to motivated staff (at all levels), are driven by purpose, a desire to connect with like-minded colleagues, autonomy, mastery and a sense of achievement and progress."
>
> *-'People & Investment Value' Report*

The questions will enable investors to a) distinguish between companies with compelling employee value propositions and those with weak employee value propositions, b) engage with companies on this basis, and c) provide a platform to encourage companies to improve operating and stock price performance through better human capital management.

Financial Reporting & Audit

In December, the Financial Policy Committee of the Bank of England warned that banks have been over-optimistic in valuing their books and will have either to restructure their businesses or raise new capital, and to do that will require prudent accounting. LAPFF continues to call for change to international accounting standards and is working with an investor group including the Universities Superannuation Scheme, Royal London Asset Management and others. The group has set out a position paper arguing that **International Financial Reporting Standards** (IFRS) has failed UK companies and has not provided investors with sufficient assurance that accounting figures prepared under the IFRS provide an accurate picture of the financial health of companies.

A second position paper signed by LAPFF together with twenty-eight other investors expresses deep concern regarding the failure of **auditors** to provide investors with adequate warnings prior to the financial crisis. It highlights problems in the audit profession and calls for improvements to audit quality, mandatory rotation of audit firms at a minimum every fifteen years, mandatory re-tendering every five to seven years, and setting limits on non-audit work conducted by the auditors.

© James Stinger

LAPFF finished its round of meetings with UK banks, with a meeting with the chairman and audit committee chair of **Royal Bank of Scotland** this quarter. At the meeting, the Forum raised its concerns about accounting standards and the risks they pose to shareholder capital, and sought the company's perspective on the issue.

MANAGING ENVIRONMENTAL RISK

Climate Change

The Forum's ongoing involvement in influencing carbon management at corporations continued with the 'Aiming for A' engagement, in conjunction a group of UK charities and pension funds led by investment firm CCLA. The focus of the initiative is on engaging high emitting utilities and extractive companies that have been identified as slower than their peers in implementing carbon reduction measures. An initial meeting was held with representatives of **BP** where we discussed how companies can balance short-term demands against long-term regulatory requirements. Shareholder resolutions are planned for 2013/2014 for those companies that do not provide evidence of how they are improving.

The LAPFF Chair, Ian Greenwood, also met with the Chair of the Institutional Investor Group on Climate Change (IIGCC), Donald Macdonald, to explore where the Forum might align its policy work with that of the IIGCC. The IIGCC has recently announced an agreement to work with similar investor networks in the US and Australia to form the Global Investor Coalition on climate change (GIC).

Environmental Risk Management

In collaboration with other investors, LAPFF helped increase corporate responses to the CDP **Water Disclosure Project**. Overall, investors wrote to 41 companies in 2012 that had not yet committed to improve disclosure of water-related risks. Five of the companies later agreed to respond to the annual water questionnaire. Both **Marathon Oil** and **McDonalds** agreed to improve water disclosure after receiving letters co-signed by LAPFF. Despite these successes, overall engagement for the group was less effective than in 2011. Future engagement will focus on supply and/or operational risks in the food, beverage or textiles sector.

> **"More than 600 million people are expected to lack access to safe drinking water by 2015"**
>
> *-Global Environmental Outlook, 2012*

TARGETING SOCIAL ISSUES

Employment Standards

Engagement with **National Express** continued in October as LAPFF met with the company to discuss unionisation in the US and board diversity issues. Following meetings with union representatives in the US, LAPFF held a second conference call in November. LAPFF outlined its concerns regarding the company's approach to labour relations in the US and there was an agreement to meet again in the New Year.

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The Forum also wrote to **Tesco** this quarter to discuss the future of the US business Fresh & Easy. LAPFF previously identified Tesco's Fresh & Easy subsidiary as presenting certain risks, as it faced significant commercial challenges. There have also been questions regarding human capital management, with reduced staffing levels affecting employee morale and customer service.

CONSULTATIONS & PUBLIC POLICY

ENGAGING POLICY MAKERS

LAPFF is a member of the Investor Network on Climate Risk, which now forms part of the new Global Investor Coalition on Climate Change (GIC). GIC, together with UNEP FI and PRI, released a letter to the governments of the world's largest economies calling for stronger climate and clean energy policies. The letter was announced ahead of international climate negotiations in Doha and coincided with the public launch of GIC.

The Forum met with Baroness Hogg, chair of the **FRC** and Roger Marshall an FRC Board Member to raise concerns regarding IFRS-audited accounts. LAPFF believes that the IFRS accounts of the UK's largest banks do not provide investors with a 'true and fair' view of companies' financial position. The discussion was productive, and extended to cover issues related to the ownership and stewardship responsibilities of investors more generally.

CONSULTATION RESPONSES

LAPFF responded to a consultation on **greenhouse gas emission reporting regulations** in October, by the Department for the Environment, Food and the Regions (DEFRA). Having long pushed for mandatory reporting, the Forum welcomed the new regulations for providing more consistent advice and support to businesses. The Forum noted that companies need to provide adequate information so investors can determine how carbon management is being factored into business strategy. The Forum further commended the principles-based approach of the Carbon Disclosure Standards Board which aims to align reporting with existing principles and objectives of financial reporting.

The Institute for Chartered Secretaries and Administrators, **ICSA,** issued a consultation this quarter on engagement between companies and investors. LAPFF welcomed the ICSA approach but suggested that an overly bureaucratic approach to engagement can dilute the investor message and lead to less productive outcomes in company meetings. The Forum does not see a need for any intermediary mediation service and prefers direct engagement with company representatives.

The Department for Communities and Local Government's consultation on **Investment in Partnerships** afforded the Forum an opportunity to set out its view on amendments that might

appropriate to remove barriers that currently prevent scheme funds from investing in infrastructure projects. The Forum supported the proposal for an increased limit of 30% on investment in limited partnerships. The response also highlighted recent research by the Smith Institute, which was co-sponsored by LAPFF.

All consultation responses submitted by LAPFF can be viewed online at: http://www.lapfforum.org/consultations.

NETWORKS & EVENTS

The LAPFF conference met the usual high expectations with a sell-out event in Bournemouth, with the keynote speaker, **Robert Swannell** chair of M&S starting the event with high praise for the Forum in its previous engagement with the company. Sir Michael Darrington set out his vision for the future on a panel discussing the problem of ballooning executive pay. The panel on the banking crisis addressed concerns regarding IFRS and highlighted the growing chorus of investors voicing concerns. The conference ended with a fascinating keynote speech by Michael Woodford, the former CEO of Olympus, on his experience exposing widespread fraud and mismanagement by the company's directors. Next year's event is expected to take place in Bournemouth in late November or early December 2013.

- **'Investing for Growth'** parliamentary report launch
- **Board Evaluation** seminars by Board Insight & Ffion Hague
- **Institutional Investor Group on Climate Change** AGM
- **Church Investors Group** observer during CDP session
- **Plastic Disclosure Project** webinar on plastic risks
- **Focussed on the Future,** Martin Currie conference on global investment

LAPFF co-sponsored a report, **'Investing for Growth'** which looks into opportunities and barriers to local authority pension fund investment in local projects that offer wider socio-economic benefits. The report was launched at a parliamentary event in October chaired by Clive Betts MP, chair of the DCLG select committee, Paul Hackett of the Smith Institute, and Ian Greenwood.

LAPFF representatives also attended two events that explored current best practice and relevant success factors in revising the UK Corporate Governance Code. The Code introduced provisions on board evaluation almost ten years ago, and more recently has suggested that FTSE 350 companies should have their board evaluations externally facilitated at least every three years.

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COMMUNICATIONS

Forum communications have had a 'revamp' with a redesigned website (www.lapfforum.org), the publication of LAPFF's 2012 Annual Report, and an update to the layout and format of the members' monthly email bulletin.

COMPANY PROGRESS REPORT

Company	Topic	Progress
ASML Holding	Governance	Awaiting Response
Assurant Inc.	Governance	Awaiting Response
Bellway	Governance	Awaiting Response
BNP Paribas	Governance	Awaiting Response
BP plc	Climate Change	Dialogue
Burberry	Governance	Awaiting Response
Carnival Corp	Governance	Awaiting Response
Centrica	Governance	Awaiting Response
Coach Inc.	Governance	Awaiting Response
Cognizant Technology Solutions	Governance	Awaiting Response
Comcast Corp	Governance	Awaiting Response
CRH plc	Governance	Awaiting Response
Flir Systems	Governance	Awaiting Response
Freeport McMoran	Governance	Awaiting Response
Imagination Technologies	Governance	Awaiting Response
Inditex	Governance	Awaiting Response
Lindt & Sprungli	Governance	Awaiting Response
Marshalls	Governance	Awaiting Response
National Express	Employment Standards	Dialogue
News Corporation	Board Structure, Reputational Risk	Dialogue
Resolution Ltd	Governance	Awaiting Response
Royal Bank of Scotland	Finance & Accounting	Dialogue
Société Generale	Governance	Awaiting Response
Svenska Handelsbanken	Governance	Awaiting Response
Tesco	Employment Standards, Reputational Risk	Dialogue

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The Local Authority Pension Fund Forum was established in 1991 and is a voluntary association of local authority pension funds based in the UK. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which its members invest. The Forum's members currently have combined assets of over £115 billion.

Aberdeen City Council
Avon Pension Fund
Bedfordshire Pension Fund
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
Enfield
Falkirk CC
Greater Gwent Fund
Greater Manchester Pension Fund
Gwynedd Pension Fund
Hackney LB
Haringey LB
Harrow LB
Hillingdon LB
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lewisham LB
Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Shropshire Council
Somerset CC
South Yorkshire Integrated Transport Authority
South Yorkshire Pensions Authority
Southwark LB
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Warwickshire Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC

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Local Authority Pension Fund Forum

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