Appendix B

Winter 2013/14 edition

www.lapfforum.org

Local Authority Pension Fund Forum

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The Local Authority Pension Fund Forum (LAPFF) is a voluntary association of 60 public sector pension funds based in the UK. LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance among the companies in which they invest.

For more information about the Forum, contact Forum Officer, Keith Bray on 07811 800612.

Alternatively, you can email postmaster@keithbray.plus.com or visit our website at www.lapfforum.org

LAPFF membership as at 10 February 2014

- Avon Pension Fund
- Bedfordshire Pension Fund
- Cheshire Pension Fund
- City of London Corporation
- Clwyd Pension Fund
- Cumbria Pension Fund
- Derbyshire County Council
- Devon County Council
- Dorset County Pension Fund
- Dyfed Pension Fund
- East Riding Pension Fund
- East Sussex Pension Fund
- Falkirk Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Gwynedd Pension Fund
- Hampshire Pension Fund
- Lancashire County Pension Fund
- Lincolnshire County Council
- London Borough of Barking & Dagenham
- London Borough of Camden
- London Borough of Croydon
- London Borough of Ealing
- London Borough of Enfield
- London Borough of Hackney
- London Borough of Haringey
- London Borough of Harrow
- London Borough of Hounslow
- London Borough of Islington
- London Borough of Lambeth
- London Borough of Lewisham
- London Borough of Newham
- London Borough of Southwark
- London Borough of Tower Hamlets
- London Borough of Waltham Forest
- London Pension Fund Authority
- Lothian Pension Fund
- Merseyside Pension Fund
- Norfolk Pension Fund
- Northamptonshire County Council
- North East Scotland Pension Fund
- Northern Ireland Local Government Officers Superannuation Committee (NILGOSC)
- North Yorkshire County Council
- Nottinghamshire County Council
- Rhondda Cynon Taf Pension Fund
- Royal Borough of Greenwich
- Shropshire Council
- Somerset County Council
- South Yorkshire Pensions Authority
- South Yorkshire Integrated Transport Authority
- Staffordshire Pension Fund
- Surrey County Council
- Teesside Pension Fund
- Tyne and Wear Pension Fund
- Warwickshire County Council
- West Midlands Pension Fund
- West Midlands PTA Pension Fund
- West Yorkshire Pension Fund
- Wiltshire Pension Fund
- Worcestershire County Council

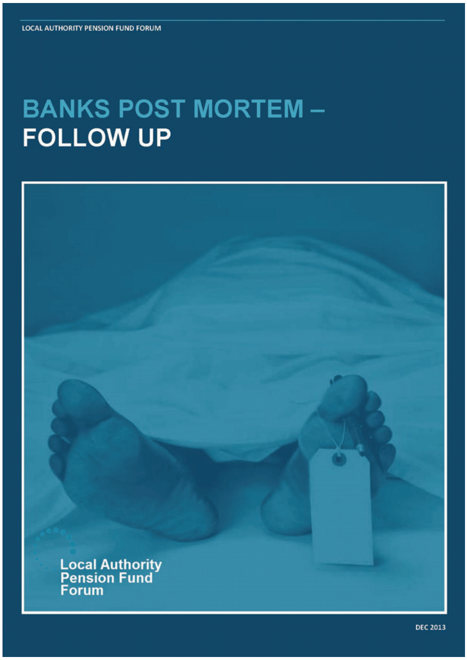
Banks' post mortem follow-up: reliable accounts

In December 2011, LAPFF published *'UK and Irish Banks Capital Losses - Post Mortem'* which considered the collapse of the capital adequacy regime of banks in the UK and the Republic of Ireland.

These two jurisdictions have common accounting standards in terms of UK/Irish Generally Accepted Accounting Principles (GAAP) and have a similar method of implementation of International Financial Reporting Standards (IFRS).

It was clear from the LAPFF analysis that the Basle capital adequacy regime failed due to the systematic failure of the accounting standards regime. In large part, this was due to the fact that it made sub-standard lending appear highly profitable whereas, for example, French banks in contrast used prudent French GAAP which does not mask insolvency.

Since then, the LAPFF's analysis has been fully supported by the outcome of the Prudential Regulatory Authority's (PRA) review in late spring 2013, which addressed the overstatement of bank capital, including systemic IFRS overvaluation of loans. LAPFF has since met with representatives of European central banks as well as Japanese government representatives, and the analysis and conclusions of the banks' post mortem have not been challenged. Through the autumn of 2012 and the spring of 2013, LAPFF worked closely with a consortium of other asset owners and managers including USS, Railpen Investments, Royal London Asset Management, Sarasin Partners, Governance for Owners and the UK Shareholders Association to track down the origin and causes of this fundamental weakness in the way IFRS had been



implemented and were actually operating in the UK capital market. This consortium, known as the **IFRS Investor Coalition**, pooled their knowledge and experience together to seek independent redress of the problems identified.

In the summer of 2013, LAPFF, together with the Investor Coalition, sought counsel's opinion to advise on the consistency between International Financial Reporting

continued overleaf →

Standards and the Companies Act 2006 and this opinion, from Mr George Bompas QC, was submitted as evidence to the Parliamentary Commission on Banking Standards, which was published on 19 June 2013 in the commission's final report.

That opinion cast doubt about the requirements under IFRS compared to the law applicable under the Companies Act 2006. Mr Bompas also addressed whether Mr Martin Moore QC's opinion in 2008 for the FRC (Financial Reporting Council) could be relied upon.

Mr Moore responded on behalf of the FRC in October 2013. However, having made a detailed analysis of that response the LAPFF notes the following:

- The Moore response is in the form of a statement; it is not given the title of an 'opinion'.

- In the statement, Mr Moore still does not state whether in his opinion IAS 1 both requires and permits an override of an IFRS that does not give a true and fair view - without qualification to extraneous material, such as referring to other 'frameworks' that are not actually company law.

- Every question that Mr Bompas was asked, and responded to, has been changed materially in the Moore statement by words being left out, changed and, in one case, an entirely different question altogether being presented.

- The Moore statement also opens up a new dispute with Mr Bompas' position on a specific point of law. The point of law is whether companies should be **showing**, as distinct from **accounting** for privately, distributable reserves and profits versus undistributable reserves and unrealised profits. The Forum notes that a failure to show such reserves and profits creates problems:

  - It is inconsistent with explicit auditor duties in the Companies Act, including their duty to be passing an opinion on the distributable profits as stated in the accounts, the point on which the FRC has explicit guidance.

  - It is inconsistent with the explicit requirement in the Companies Act that auditors cannot sign off on accounts where the numbers in the accounts are not in agreement with the underlying records, and unless they state that fact, they are guilty of a criminal offence.

  - It cannot be explained by the construction of the 1947 Companies Act where 'true and fair view' is explicitly the legal standard to satisfy both internal control requirements ('the books') as well as for the annual accounts.

  - LAPFF notes that the only authoritative basis cited by Mr Moore for a difference of opinion with Mr Bompas is from technical advice from the Institute of Chartered Accountants in England and Wales (ICAEW) which Mr Moore had reviewed for the ICAEW. However, it does not address the problems above, and no formal opinion seems to exist for it. The Moore position is therefore

Mr George Bompas QC

Mr Martin Moore QC

different not only to that of Mr Bompas, but also to Mr Bompas' citation of very clear case law.

A statement from Baroness Hogg, Chair of the Financial Reporting Council (FRC), in October 2013 appears to be a positive step, and is a partial concession that something indeed has been very wrong. **However, the fact remains that five years on from the banking crisis, investors are still not receiving adequate information from the annual accounts, nor assurance from auditors, and this appears to be due to the accountancy profession and standard setters operating to a different model to that of the law.**

LAPFF is still of the view that until there is an independent enquiry into the failures of the IFRS standard-setting and adoption process, matters will not be settled within an appropriate timescale. The consequences of faulty accounts not discharging solvency duties under the Companies Act create too many conflicts for the various parties involved, particularly when the companies involved are as large as banks.

Footnote
In an article published on February 10, *'Watchdog for financial reporting breaches its own rules'*, The Telegraph has revealed that the IFRS whose job it is to set "high quality, understandable, enforceable and globally accepted" financial reporting rules, has, for more than a decade, delivered late and inaccurate filings at Companies House.

The Forum continues to take legal advice with regard to these matters.

Board diversity strategy

A LAPFF member requested that the Forum consider supporting Legal & General Investment Management's (LGIM) new voting policy with regard to board diversity. **On 10 October 2013 it was reported that from 2015, LGIM "will vote against the chairman or the chairman of the nominations committee if they have not installed any women on the board, or if aspirational targets have not been set, or if disclosure about gender balance is inadequate."**

LAPFF has been a member of the 30% Club Investor Group since 2012. The group's mission is to promote board diversity by seeking personal commitments from chairmen of UK companies. The 30% Club emphasises a voluntary approach, led by corporate directors, and is strictly against implementing quotas for fear it would lead to tokenism. Other investor members include LGIM, Aviva Investors, Blackrock, and Aberdeen Asset Management.

30% Club
GROWTH THROUGH DIVERSITY

While progress has been made, there is still more work to be done. Women comprise 24% of non-executive director (NED) positions in the FTSE 100, but only 19% of overall board positions due to a lower representation of women in executive posts. Improvements by FTSE 250 companies have also been steady, with female board representation overall at 14.9%, an increase from 7.8% in 2010.

In October 2013, Vince Cable issued a press release stating: "I am confident we can get over the finish line. But appointing more women as non-executive directors is not an end in itself. This is about more talented women getting executive experience, so that they will not only advise, but run this country's great companies."

The Forum has been routinely raising board diversity as an issue with companies since joining the 30% Club in 2012. Often, this has taken place as part of engagement with a company on other governance issues but together with four other investors in this group, LAPFF has written to Vedanta, Antofagasta and London Stock Exchange as companies that currently have no women on their boards, to request a meeting.

A meeting with the chairman of the London Stock Exchange has been arranged.
In keeping with LAPFF's commitment to the 30% Club, the following action will be taken. The Forum will:

- Issue a public statement in support of LGIM's board diversity initiative;
- Adopt a recommended voting position as follows:
  - Vote against the chairman of the nomination committee if there are no women on the board;
  - Abstain on the chairman of the nomination committee if female representation on the board is less than 25%.
- This voting position will be reviewed to take into account the particular circumstances of individual companies;
- Write to companies in the FTSE 100 informing them of the LAPFF voting position;
- Issue voting alerts in the 2014 season on the FTSE 100 companies that fail to meet the above criteria.

Leadership on key campaigns

The Forum met with Rod Eddington, the lead independent director of 21st Century Fox (formerly News Corporation) at the start of October, shortly before the company's AGM.

LAPFF repeated its belief that the company would benefit from the appointment of an independent chair, and that this could aid the succession process. At the company's AGM in the middle of the month, two thirds of independent shareholders backed a resolution calling on the company to appoint an independent chair. LAPFF had issued an alert advising members to support the resolution.

Blacklisting

Following a request from a member fund, LAPFF has undertaken work on the issue of blacklisting. At the October business meeting, it was agreed to write to the major construction firms, and to encourage them to press ahead with the creation and implementation of a compensation scheme for those workers who had been affected by blacklisting.

Other news in brief

The LAPFF:

- Met with **Standard Chartered, M&S** and **Burberry** to discuss remuneration issues and get company feedback on LAPFF's *'Expectations for Executive Pay'* document.

- Attended AGM of **Lonmin** and, in questions, pressed the company on timescales and metrics of its plans to improve social, community, and labour relations following last year's shootings by police of striking miners.

- Corresponded with **Afren, easyJet** and **G4S** regarding pay practices and pay complexity and is to seek further meetings

- Focussed on 'stranded assets', carbon management strategies and CDP performance scores with **BP**. A meeting with **GlencoreXstrata** also initiated a discussion on these issues.

- Sent a letter to **Oracle** outlining LAPFF's concerns about executive pay. The company lost its pay vote for the second year in a row, but the board remains defiant.

- Co-signed letters to major US, European and Japanese consumer companies in the palm oil supply chain on the sustainability of their supplies.

- Responded to the FRC consultation on the strategic report raising concerns about its status and compatibility with UK company law and the preparation of annual accounts for shareholder approval. Provided input to the SEC on pay ratio disclosure.

LAPFF membership hits 60 as Hampshire, Lambeth and East Sussex join the Forum.

Councillor Kieran Quinn, Chair of the Local Authority Pension Fund Forum, has welcomed decisions by the Hampshire Pension Fund, London Borough of Lambeth Fund and the East Sussex Pension Fund to join the Local Authority Pension Fund Forum.

Hampshire County Council

Lambeth

East Sussex County Council

Three more local authority pension scheme funds have joined the Forum since the beginning of the year, taking our membership to 60. The Hampshire Pension Fund and London Borough of Lambeth Fund joined following discussions with the funds' officers, and the East Sussex Pension Fund joined following a presentation to the East Sussex Pension Fund Investment Panel by Forum Officer, Keith Bray.

Forum Chairman, Councillor Kieran Quinn said: *"It is brilliant news that the LAPFF has reached 60. We already have a very high profile and this is raised even higher by the decisions of Hampshire, Lambeth and East Sussex to join the Forum.*

"They will receive the warmest of welcomes and we look forward to benefitting from their contributions to our development. A clear majority of local government pension scheme funds are now LAPFF members, and recognise the immense value of the Forum as the only national organisation focussed entirely on LGPS issues at this particularly challenging time. We urge the remaining funds to come aboard too – by acting together we can achieve so much more."

Funds wishing to learn more about the LAPFF should contact Forum Officer, Keith Bray at postmaster@keithbray.plus.com or by calling **07811 800612**.

Keith will be happy to meet informally or to make a presentation about the benefits of membership to your fund's management committee or investment panel.

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