

Summer 2011 Edition

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**Local Authority
Pension Fund
Forum**

the **f** the view from **forum**

**Effective Company Stewardship:
Enhancing financial reporting
and audit**

**Shell: Proposed engagement
to address risks to
shareholder value**

2011 UNPRI survey

Stewardship Code



The Local Authority Pension Fund Forum (LAPFF) is a voluntary association of 53 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 1 June 2011

- Avon Pension Fund
- Bedfordshire Pension Fund
- City of London Corporation
- Clwyd Pension Fund
- Derbyshire County Council
- Devon County Council
- Dorset County Pension Fund
- Dyfed Pension Fund
- East Riding Pension Fund
- Falkirk Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Lancashire County Pension Fund
- London Borough of Brent
- 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 Hillingdon
- London Borough of Hounslow
- London Borough of Islington
- London Borough of Lewisham
- London Borough of Newham
- London Borough of Southwark
- London Borough of Tower Hamlets
- London Borough of Waltham Forest
- Lincolnshire County Council
- 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
- Shropshire Council
- Somerset County Council
- South Yorkshire Pensions Authority
- South Yorkshire Integrated Transport Authority
- 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

Effective Company Stewardship:

Enhancing Financial Reporting and Audit

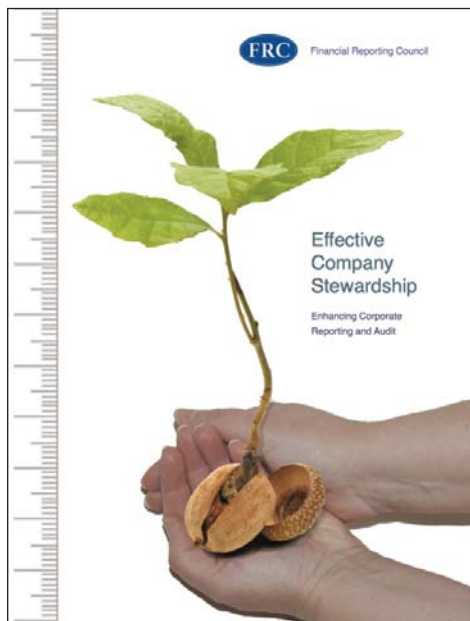
The Financial Reporting Council (FRC) (which is an accounting regulator as well as a corporate governance regulator) has issued a consultation paper on *'Effective Company Stewardship: Enhancing Corporate Reporting and Audit.'*

This follows questions raised by politicians about the audits of banks which appear to have failed both shareholders and society at large in having allowed the presentation of accounts with unqualified audit opinions.

The core issue (within the remit of the FRC) is the shift to accounting standards laid down by International Financial Reporting Standards (IFRS) in 2005 which omit stewardship as an accounting and hence auditing outcome. The FRC then replicated the errors in IFRS into UK GAAP (Generally Accepted Accounting Principles).

With IFRS, capital, pay and dividends can all be based on unreliable and dysfunctional numbers. This is the antithesis of stewardship. The nub of the issue is that IFRS is not a creditor protection model of accounting and audit. Creditor and shareholder protection is dependent on accounting standards identifying losses. IFRS can actively cover up losses.

Because the shareholder model of corporate governance is set to function on



the basis of reliable audited accounts for annual general meetings, any distortion of capital or profit undermines both the ability to assess the true business position and company performance, and the conduct of the AGM itself. The accounts can therefore be a misleading 'manifesto' for shareholder purposes as well as legitimising imprudent and value destroying behaviour.

continued overleaf →

The FRC consultation skirts around the accounting issue to the extent of denying the existence of a problem with accounting and audit and the key role that it played in the banking crisis.

Given that this is a consultation from a corporate governance and accountancy regulator, LAPFF is perturbed by the fact that:

- there is absolutely no reference to the core function of statutory accounts for annual general meetings, or the requisite standard of accounts required in law for that function, that stand up on a 'going concern' basis,
- there is confusion in the document about the corporate governance regime that applies in both law and the FRC's own Combined Code, viz the auditors and who is accountable to whom.
- there is a clear avoidance of discussing the problems that flow from accounting standards, despite these being particularly relevant in the context of

annual accounts of banks, or the accounts that were also used in prospectuses for capital raisings by banks.

LAPFF notes that the FRC has the remit to ensure 'confidence in financial reporting'. It is difficult to see that there has been a satisfactory outcome in this regard in the case of certain banks. Furthermore, it would seem inappropriate to make hasty changes to the corporate governance regime based on the unintended consequences of the radical changes that took place with the accounting standards regime.

Some of the proposals in the consultation document are not consistent with the Corporate Governance Code and, perhaps, most notably members of the Economic Affairs Committee of the House of Lords are concerned that the FRC had been captured by the Big 4 accounting firms, and had 'dropped the ball'.

The Forum will respond in detail to the consultation and monitor future developments closely.



Shell: Risks to shareholder value over alleged breaches of OECD guidelines

A complaint has been filed against Royal Dutch Shell, by Amnesty International and Friends of the Earth, over alleged breaches of basic standards for responsible business set out by the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises.

LAPFF has a long history of engagement with Shell over its human rights performance in Nigeria beginning in June 1995, when the Forum looked into Shell's decision not to dispose of the Brent Spar oil storage unit in the North Sea and the resultant damage to the company's reputation. It was around this time the Forum became concerned about the extent of alleged human rights violations and environmental damage in the Ogoni area of the Niger Delta. Shell faced a host of serious accusations including pipeline spillages, lack of engagement with local communities and collusion with military authorities.

In 1997, LAPFF, together with the Ecumenical Council for Corporate Responsibility (ECCR), felt that only a shareholder resolution could push the company forward in formulating and implementing a strategic policy on human rights. A joint shareholder resolution called on the company to allocate responsibility at board level for social and environmental issues, to develop appropriate policies and to report regularly. A few months after the AGM, LAPFF considered that Shell had met most of the resolution's criteria.



Photograph: George Osodi/AP

In May 2006, LAPFF received a formal approach from ECCR to file a second resolution at Shell concerning the Shell Petroleum Development Company of Nigeria Ltd's (SPDC) human rights record in Nigeria and their failure to reach a Memoranda of Understanding (MoU). LAPFF agreed that this matter was a matter of sufficient importance to issue a LAPFF Alert, but left it to individual member funds to decide how to vote on the resolution.

continued overleaf →

In 2005, the Forum started engaging with Shell on climate change issues, the company's environmental performance and executive remuneration to try to gain a clear understanding of the company's approach to climate change. In 2007, the Forum continued engagement in particular regarding concerns over Shell's greenhouse gas (GHG) target, which effectively increased GHG emissions over the next three years. The Forum also highlighted the lack of safety process targets in the company's remuneration. LAPFF indicated it would be recommending members oppose the company's remuneration report if there was no satisfactory response from the company. Shell's response to LAPFF concerns on executive remuneration and climate change were not considered to substantively address the issues, and another LAPFF Alert was issued to members recommending opposition to the company's remuneration report.

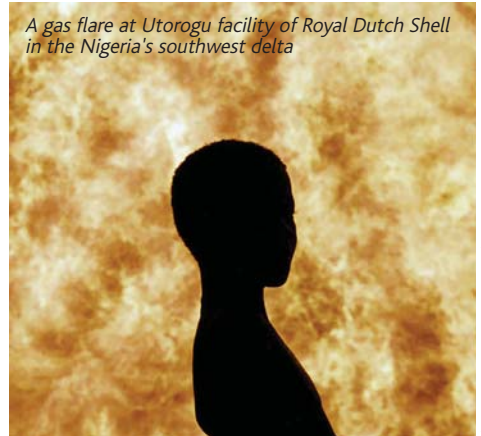
In August 2008, a meeting was held with Shell which discussed non-financial business performance and the need for executive remuneration to be linked to the company's environmental performance and the nature of future emissions reduction targets.

In 2009, Shell blamed 98% of oil spills of the SPDC joint venture on sabotage but this figure is disputed by the NGOs.



Spilled crude oil floats on the waters around a Niger Delta village in Ogoniland, which hosts the Shell Petroleum Development Company (SPDC)

(Pius Utomi Ekpei/AFP/Getty Images)



A gas flare at Utorogu facility of Royal Dutch Shell in the Nigeria's southwest delta

(Reuters/George Esiri RSS)

Since the BP Deepwater Horizon oil spill, there has been a greater awareness of health and safety, environmental and human rights practices and risk management for oil and gas companies, and of the scale of damage that oil spills can cause. However, despite the passing of fifteen years since the Forum first pursued concerns over pipeline spillages, gas flaring and a lack of effective engagement with local communities, it appears the company still faces difficulties in managing these aspects of its operations in Nigeria. The court hearings draw attention to the difficulties the company is already facing in managing stakeholder expectations with associated inherent risks. It also means there will be a heightened investor awareness of the potential level of environmental liabilities embedded in the Niger Delta operations.

Shell represents a major holding in most LAPFF member portfolios. Engagement with the company will continue and will include exploring the transparency not only of metrics provided by the company, but the rigour in which procedures are followed to produce the relevant data, and the extent to which it can be externally verified.

2011 UNPRI survey

There are six UN Principles for Responsible Investment (UNPRI):

- 1 to incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making processes.
- 2 to be active owners and incorporate ESG issues into ownership policies and practices
- 3 to seek appropriate disclosure on ESG issues by the entities invested in.
- 4 to promote acceptance and implementation of the principles within the investment industry.
- 5 to work together to enhance effectiveness in implementing the principles.
- 6 to report on activities and progress towards implementing the principles.

The LAPFF itself is a signatory to the UNPRI - being registered as a service provider - however, service providers have different membership obligations to asset owners and managers, and are not required to answer the annual questionnaire which seeks to monitor progress with regard to the application of the principles. Other signatories such as LAPFF members are asked to complete the questionnaire, and the 2011 PRI questionnaire has 88 questions pertaining to ten areas, six of which address the UNPRI principles. Following a request from a LAPFF member, the Forum has, for the past few years, provided members with a report annually, setting out the ways in which it acts to fulfil the principles. This assists LAPFF members who have signed up to the UNPRI, and those who are planning to do so, in completing the annual survey.



Principles
for Responsible
Investment

OTHER NEWS

The Forum has received updates on engagements with:

The logo for Tesco, featuring the word 'TESCO' in a bold, red, sans-serif font with a blue horizontal line underneath.

The logo for UniCredit Group, featuring a stylized red and white circular icon to the left of the text 'UniCredit Group' in a bold, black, sans-serif font.



Nestlé



vedanta

Stewardship Code

At the March meeting, Forum members were pleased to welcome Peter Montagnon (right), Senior Investment Advisor to the Financial Reporting Council who gave a presentation on the Stewardship Code.

Peter advised the LAPFF that there were 157 signatories to the Stewardship Code and of the 24 asset owners signed up, nine were member funds of the LAPFF.

The FRC has estimated that 40% of the UK market is owned or controlled by the signatories to the code and of the 30 top investors in UK equities, 25 are signatories to the code.

The code has also had support from outside the UK, notably from CalPERS and ACSI, (Australian Council of Superannuation Investors). The FRC will continue to put the case around the world encouraging owners to support the code. The EU will produce a green paper on corporate governance shortly which will have a comply or explain approach. Peter thinks that this will show that the EU has a role to play for better monitoring of shareholders' role in holding companies to account. Peter said that he thought it would be a tremendous step forward if the OECD supported similar principles on stewardship.

He said that the code should help to improve and build constructive relationships between shareholders and companies so that value is preserved and capital markets work better: "Preservation of value is what really matters at the end of the day.



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Those who did not challenge the RBS/ABN AMRO takeover lost a lot of money for their beneficiaries. The code is trying to make shareholders less vulnerable to that happening in the future. At the least it is an insurance policy against making stupid decisions."

He wondered how much pension funds actually spend on trading in their portfolios: "If you add up the trades, there is no great certainty that it brings value to the portfolio. Some of the money spent on trading could be channelled into engagement."

Peter took questions from members, and the Chair thanked him for his interesting and thought-provoking presentation.

SAVE THE DATE!
LAPFF ANNUAL CONFERENCE
30 NOVEMBER – 2 DECEMBER 2011
LAPFF members are entitled to two free places at the conference.
The programme and booking form will be available later in the year.

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