

London Pensions Fund Authority: Key Issues Facing the Authority and a briefing on the Lancashire and London Pensions Partnership:



LPFA:

The LPFA administers its own £4.6bn (as at 31st March 2015) pension fund providing LGPS benefits to almost 20,000 employees working for non-for-profit, charity, private sector and local government employers and around 77,000 members. The Authority was created following the abolition of the GLC and is open to eligible new members and employers, primarily those connected with performing local government functions.

The Mayor of London appoints the LPFA Board and the LPFA's Strategic Policy Statement and Budget are presented to the Mayor for comment on an annual basis.

LPFA Organisational highlights for the year 2014-15 and key facts:

► Reform of the LGPS

During 2014 LPFA submitted a response to the DCLG consultation on the reform of the LGPS and set out our belief that allowing Local Authorities to pool their assets and jointly manage liabilities would provide a solution to the growing deficits across our industry.

► Lancashire and London Pensions Partnership

We were delighted to announce that we will be going ahead with our £10bn Asset and Liability Management Partnership with Lancashire County Pension Fund. The partnership, which will initially be known as the Lancashire and London Pensions Partnership (LLPP), will cover all aspects of pension fund management and be a fully-fledged pension service organisation, providing both jointly managed administration and pooled asset and liability management activities through newly created corporate structures. The partnership will allow us to pool our assets and consider our liabilities on a consolidated basis, but will also maintain the sovereignty and a framework of local accountability for both Funds.

More information on this is provided below.

► Infrastructure Partnership with Greater Manchester Pension Fund

A £500m infrastructure investment programme with Greater Manchester Pension Fund has been launched. Both funds have committed £250m to a special purpose vehicle in order to make a variety of different infrastructure investments over a three-to four-year investment period, predominantly focusing on UK infrastructure assets. The aspiration is to open this up for other LGPS funds as only around ten funds are able to invest directly in infrastructure as they do not have the scale and in-house resources.

► Security for the Fund

LPFA achieved an additional £311m of employer security in the form of first charge arrangements on Property, Investments, letters of assurance from Government Departments, Escrow accounts and Parent company guarantees. We have also increased employer contributions, delegated treasury management to GLA (resulting in better cash management and £686k interest earned) and moved offices, resulting in ongoing annual savings in excess of £350k.

► Service Excellence

The pension administration teams continue to deliver 98% on-time processing and complaints were reduced to 15 over the year. There was a slight reduction in membership to 77,000 as the Ministry of Justice consolidated probation trust members from around the country into the Greater Manchester Pension Fund.

LPFA continues to administer local government pensions and the fire pension scheme on behalf of 250,000 members in total, including some London boroughs, Fire Authorities and Hertfordshire County Council.

► Staff

The Executive continues to be led by Susan Martin, Chief Executive Officer. We welcomed Chris Rule as our new Chief Investment Officer in October 2014, and his addition has been a strong positive for the team. Mike Allen continues in the role as Director of Pensions and the team has been recently bolstered by Dr Angela Smith as Interim Chief Risk and Finance Officer.

► Board

Sir Merrick Cockell was confirmed as Chair on 8th September 2015 following the resignation of Edi Truell.

A new representative body has also been established under the LGPS Regulations to assist the Board in achieving compliance. This is called the Local Pension Board and each LGPS administering authority has been required to establish a local pension board. It contains member and employer representatives and reports to the main Board on an annual basis. This replaces the LPFA's previous Member and Employer Panels.

The LPFA and the Lancashire County Pension Fund have adopted a cost-effective approach to this requirement by appointing a joint Independent Chair to sit on the respective Local Pension Boards.

► Awards

LPFA was nominated for the Most Innovative Pension Scheme by both Institutional Investor and CIO Magazine, and Pension Scheme of the Year and Best Investment Strategy by Financial News. Susan Martin, was recognised for innovative work on asset and liability management and for successful partnerships with other administering authorities and pension funds, by winning the Industry Achievement Award at the Portfolio Institutional Awards, and to be nominated for Outstanding Contribution to Pensions at the Engaged Investor Trustee Awards 2015.

Investment Review

- 1.1. Our Fund has a global asset mix and includes holdings in the equity (shares) of public and private companies, government and corporate debt (fixed income), currency, property and infrastructure projects. In addition, our assets are managed by a mix of external fund managers, and more recently, internal professionals. The greater use of internal professionals has resulted in fee savings of £3m per annum.
- 1.2. Our integration activities currently focus on exercising our rights as a shareholder - i.e. voting and engaging with the companies we own - close monitoring of our fund managers and collaborating with other like-minded investors, mostly other pension funds.
- 1.3. The current investment strategy comprises an asset allocation which will be implemented over time of 55% equity (range 50-60%), 30% illiquids (range 25-35%), 15% total return (range 10-20%). This will be reviewed by the Investment Committee in the coming months.
- 1.4. As at the end of March 2015 the position of the fund for the year to date was:
 - Net asset value was £4.6bn
 - Funding level on an actuarial basis c96%.
 - The fund is on a recovery plan to reach a fully funded position, on a conservative basis and within a reasonable time period of c.15 years.
- 1.5. In 2013, LPFA decided that for a pension fund to manage its assets effectively, it was essential that the Fund had up to date information on its assets and liabilities. After all, a pension fund exists to meet pension payments and the sum total of these payments are the pension liabilities. Traditional asset-only models analyse risk and reward in terms of investment performance. Asset/liability models take a comprehensive approach to analyse risk and reward in terms of the overall pension plan. Effectively assets/liabilities are two sides of the same coin, hence it is vital that we understand and manage both holistically
- 1.6. We are now in a position to produce our own asset and liability modelling report on demand. This is unique within the LGPS and we are in discussions with other funds to assist them. With this information to hand, we will be able to analyse investment returns, funding status, refine investment strategy, establish a cohesive risk management framework and respond to any market dislocations etc.
- 1.7. **Investment Performance**
- 1.8. Last year brought a range of economic and geopolitical events that one would struggle to forecast. Against all of them, in 2014/15 the Fund as a whole returned an estimated 9.2% (excluding the Fund's Liability Driven Investment Portfolio). This was primarily driven by our Public and Private Equity holdings as well as our infrastructure investments.
- 1.9. The Board is of belief that a broadly diversified portfolio will improve risk adjusted returns over the long term. Further progress towards this goal has been rapid with significant new investments into Private Equity and Alternative Debt. In these areas we are increasingly making use of our internal investment resources to access opportunities in a more direct manner, reducing fees and increasing control. LPFA was successful in 2014 in a bid to develop and manage a GLA owned potential residential site at Pontoon Dock. The planning application with LB Newham is in progress.

- 1.10. In the liquid portfolio, we have now fully invested our 'Buy & Hold' equity strategy of large global stocks to capture high quality and sustainable investment return. Early investment performance results have been excellent and we have also saved over £3m per annum in fund manager fees.

FUND PERFORMANCE AS AT 31 MARCH 2015

(including the Fund's Liability Driven Investment Portfolio)

PERIOD	QUARTERLY	PER ANNUM 1 YEAR	PER ANNUM 3 YEAR	PER ANNUM 5 YEAR
Return (Net figures)	+2.48%	+4.9%	+7.15%	+6.58%

2. **Employers in the fund** – There are some 200 active employers in the LPFA fund, ranging in size from 1 to 2000.
3. **Responsible Ownership:**
- 3.1. One of the LPFA's objectives is to manage business processes to produce an overall positive impact on stakeholders. This means taking into account responsible ownership issues.
- 3.2. As a signatory to the Stewardship Code, LPFA maintain the expectations that our external fund managers understand it and fully apply it as part of their core approach. They report their voting activity on quarterly basis which is published on our website. They also, on annual basis, provide a written overview of how they addressed ESG (environmental, social, governance) factors in the LPFA portfolios. We also continue to monitor and meet with fund managers.
- 3.3. In the recent months, we have seen an increased public interest in fossil fuel investments. This resulted in a number of requests under the Freedom of Information Act 2000, as well as in Mayoral questions. Although LPFA's fossil fuel investments are small in scale (less than 1%), LPFA is aware of pressure from various environmental groups. However, at present the LPFA will not be divesting from such investments. We believe that these stocks continue to offer positive returns to the Fund. LPFA's fiduciary duty is to ensure that we have money available to pay pensions when they fall due. LPFA's duty is to make investments where we see best return to our stakeholders however we aim to do so responsibly. There is a great deal of information on LPFA's investments currently available on the website under <https://www.lpfa.org.uk/How-we-invest>.
- 3.4. During the year we have conducted an external review of LPFA's Responsible Investment initiatives, including a review of LPFA's public policy statements against those of the UNPRI and the Stewardship Code. As a result of the review recommendations, a Stewardship Committee was established to develop and deliver coordinated approach to stewardship and engagement across the LPFA's portfolio of both internally and externally managed investment funds. Subsequently, an analysis of LPFA's internal equity carbon footprint was requested from the Carbon Disclosure Project organisation in order to consider our approach to responsible investment strategy for this portfolio.

- 3.5. LPFA continues to participate in and support collaborative projects such as signing up to the UN Principles for Responsible Investing and participation in networks and specialist knowledge sharing opportunities, such as the National Association of Pension Funds (NAPF) and the Local Authority Pension Fund Forum (LAPFF).

4. Shared Services

- 4.1. The pension administration undertaken on behalf of LFEPA is now performed under a shared services agreement.
- 4.2. LPFA is now based at 169 Union Street having entered into an accommodation agreement with LFEPA.
- 4.3. We are currently reviewing options with the GLA over the discharge of LPFA's inherited functions from the GLC as many of these are internally managed, yet peripheral to pension fund activities.
- 4.4. The LPFA continues to deposit the bulk of its cash portfolio with the Greater London Authority, significantly increasing its short term cash returns. The LPFA's cash portfolio is managed alongside the £2bn GLA Group Investment Syndicate ("GIS") enabling the LPFA to benefit from enhanced liquidity and increased returns from the scale of transactions and the GLA's strong money market relationships.

5. LGPS Reform and Pooling

- 5.1. In July 2015 the Government included reference to LGPS pooling in the Budget. A consultation on this is anticipated in November 2015 and LPFA has already begun discussions with DCLG and HM Treasury over future proposals. The Chancellor George Osborne has made further announcements on pooling on 5th October. The UK Government plans to encourage the 89 local government pension funds across England and Wales into six LGPS pools, with an aim of both reducing costs and increasing investment in British infrastructure. This announcement was welcomed by the LPFA as it proves that the Government strongly encourages LGPS funds to voluntarily demonstrate commitment to pooling initiatives, similar to the Lancashire and London Pensions Partnership.

6. Board Update

- 6.1. The only Board change during the year has been the resignation of Edmund Truell and the subsequent appointment of the Sir Merrick Cockell as Chairman.
- 6.2. The Mayor appoints members of the LPFA Board to ensure the proper discharge of the LPFA's statutory functions. The present Board provides a diversity of view, each member an independent thinker and experienced non-executive. This ensures that Board debates are wide ranging, robust and we take a holistic approach to running our pension fund.
- 6.3. **Annex 1** provides a short profile of each Board and Executive member.

7. The GLC, LRB and ILEA inherited liabilities and what is being done

- 7.1. The LPFA is responsible for the historical pension liabilities of the GLC, ILEA and LRB. There is a material risk that the current level of funding assigned to pay these

pensions will run out within 20 years. Legislation is lacking in that the responsibility for these employer liabilities was not addressed as part of the abolition of the GLC. This means that current scheme employers are responsible for the liabilities of the former GLC members – which could be a challengeable position for many of these charities and small public sector bodies.

- 7.2. The deficit is valued at c£150m. This is a significant sum with no guarantor behind it. This situation has been identified as a significant risk to the fund and good progress is being made in discussions with the London Boroughs, the GLA, Society of London Treasurers and DCLG.

Lancashire and London Pension Partnership: (LLPP): Consultation for the GLA

1. Introduction:

Over the last year London Pensions Fund Authority (LPFA) and Lancashire County Pension Fund (LCPF) have been in discussions over the establishment of an £10bn Asset and Liability Management Partnership. Discussions are progressing well and the aim is to have this established by 1st April 2016, subject to regulatory approval from the Financial Conduct Authority (FCA).

Importantly this is a partnership rather than a merger and focuses on joint management of the liabilities of the funds as well as the assets. The pension administration element is important and is seen as complementary to the asset and liability management aspect of the business, viewed as a pension services organisation in totality.

LPFA is consulting with the Mayor over the proposed Lancashire and London Pensions Partnership (LLPP) and would welcome comments from the Mayor this briefing note. The structure will continue to be reviewed as agreed in the shareholder agreement and progress on achieving this will be reported to the Mayor.

2. Background on LPFA and LCPF

LPFA:

The LPFA administers its own £4.6bn pension fund providing LGPS benefits to almost 20,000 employees working for non-for-profit, charity, private sector and local government employers and around 77,000 members.

LPFA also carries out third party pension administration and other LGPS services, presently looking after the pension benefits of around 250,000 individuals in total. Currently the LPFA provides such administration services for the London Borough of Bexley, the London Fire and Emergency Planning Authority (LFEPA), the London Borough of Ealing, the London Borough of Newham, Hertfordshire County Council and Hertfordshire Fire Scheme.

In 2014/15 the LPFA Fund as a whole returned an estimated 9.2% (excluding the Fund's Liability Driven Investment Portfolio). This was primarily driven by Public and Private Equity holdings as well as infrastructure investments.

The Fund is currently funded to c.96% on a technical provisions basis with a 15 year deficit recovery period.

Lancashire County Pension Fund:

Lancashire County Pension Fund manages £5.8bn of investment assets on behalf of over 150,000 members and around 300 employers. "Your Pension Service" (YPS), which is the trading identity of LCPF's administration team, administers pension schemes for Lancashire County Council, Cumbria County Council, Lancashire's Police and Crime Commissioner, Lancashire Fire & Rescue Service, Merseyside Fire Authority and Cumbria's Fire & Rescue Service. The main activities of the YPS are to administer and maintain records and to calculate benefits on behalf of members and employers of the various schemes.

At the last actuarial valuation the Fund's funding level was 78% with a 19 year deficit recovery period. PWC's comparative analysis of the valuations placed the Fund in the 20% most prudent funds with an assumed real return of CPI+ 2.25% being reflected in the valuation assumptions. Investment performance over the last 10 years has seen the value of the Fund increase by c 8.5%pa, with returns for 2014/15 being 14.87%,

compared to a local authority average of 13.2% (according to WM/State Street). The Fund has developed an investment strategy which concentrates on delivering returns through income generating assets (preferably real assets), with a particular emphasis on infrastructure, where the Fund has a preference for investing directly rather than through fund routes. This strategy has significantly reduced volatility within the Fund over the last few years.

3. Scope of partnership:

LLPP will be a full partnership in nature and the two partners will be LPFA and LCPF on a 50/50 basis. It will create a number of new corporate entities which will pool the combined assets of LPFA and LCPF in a tax efficient manner. This new company will be a full pension services organisation, including all the functions necessary to manage combined fund activities such as pension administration, governance, investment and support.

Officers and Non-Executives/Councillors from both organisations have been working together to facilitate the partnership, which is now in the final stages of the recruitment of an independent Chairperson and Non-Executive members for the new company.

4. Anticipated benefits:

The partnership achieves a scale that both funds believe is advantageous in pension fund management, yet retains local accountability and decision making in both London and Lancashire. It is intended that the partnership will have a positive impact on the deficits of both funds.

Strategic decisions will continue to be made by the LPFA Board and the Lancashire County Pension Fund Committee.

The initiative also supports the Government's LGPS pooling agenda in that other LGPS funds can participate as an investor in the partnership without needing to participate in the governance structure. Eventually, the partnership could also be open to like-minded non-LGPS funds.

In financial terms the partnership is based on three main areas:

- Reductions in investment management fees - **£6m per annum** on a conservative basis
- Anticipated improved investment outcomes – these could reach **£20-£30m per year** based on international research on the wider opportunities that scale could bring. *(Please note that the business case for the partnership is based solely on the £6m annual savings achieved through greater use of in-house management and efficiencies from scale when engaging with external fund managers).*
- Pensions administration efficiencies which are being developed further.

There are a number of legal complexities around the establishment of any partnership and it has been necessary to establish a new corporate structure to support the pooling initiative. This has associated costs but the payback period for those set up costs is very short and is expected to be within 12-18 months.

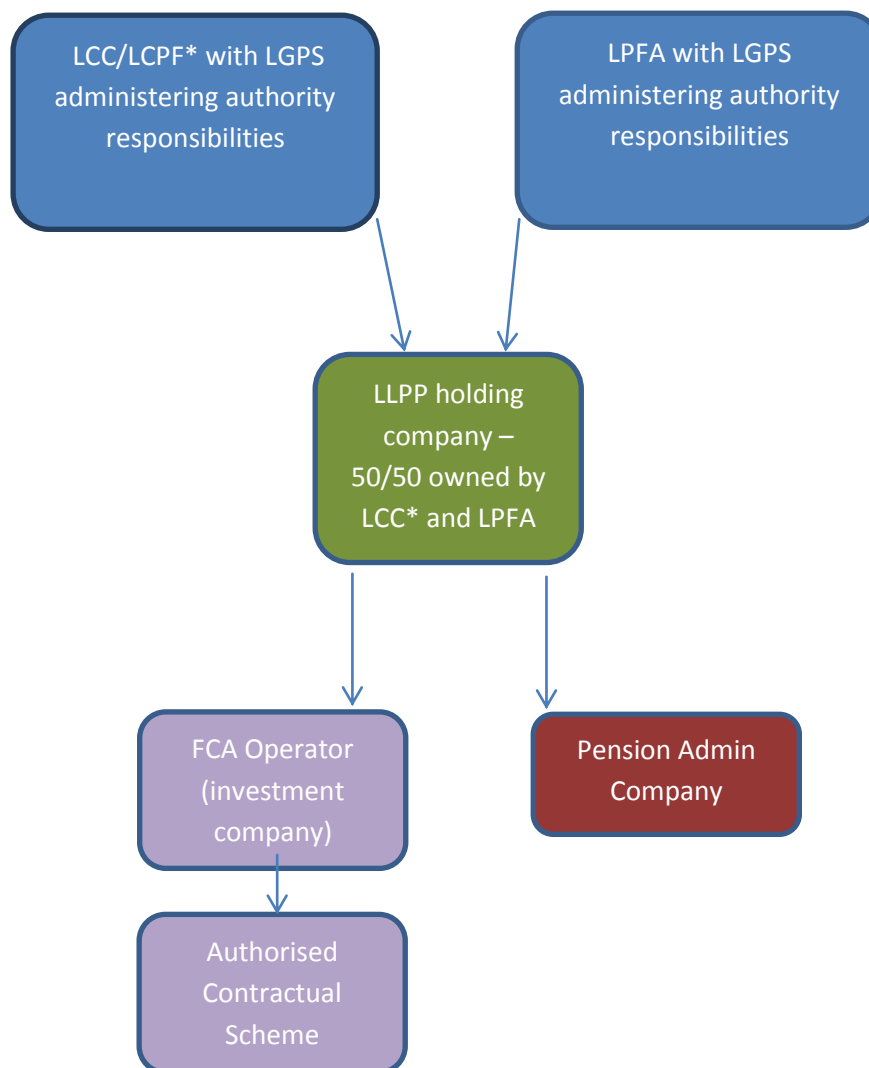
5. Sovereignty guarantee:

Underpinning the partnership are a number of key governance documents, which remain under further refinement, but include a Sovereignty Agreement to guarantee the on-

going sovereignty and decision making of both the LPFA and Lancashire County Pension Fund.

In addition, the shareholder agreement contains a number of 'Matters Reserved' for the Greater London Authority & Lancashire County Council which will require pre-approval before the LPFA or LCPF respectively can vote on certain matters as shareholders. This includes dilution of shareholding and approval of remuneration policy for example.

6. Outline Structure



*Lancashire CC is the legal entity and the administering authority of the Lancashire County Pension Fund

It has been agreed to create a commonly managed, jointly invested pool of assets (an Authorised Contractual Scheme) managed by an FCA registered entity with the whole partnership overseen by a holding company created by the two LGPS administering authorities. The group structure will be reviewed for effectiveness and efficiencies during the initial 3 year period. It is envisaged that staff will TUPE into the holding company from the two shareholders and then further seconded to the FCA subsidiary and the pension administration company accordingly.

An appointment process is currently underway for an Independent Non-Executive Chair and 3 other Independent Non-Executives for the LLPP holding company board.

7. Next steps in the development of the project include:

- Further development of the key governance documents;
- FCA submission in respect of the FCA Operator;
- FCA nomination of identified senior appointments;
- Submission of a more detailed business plan to the LPFA Board and LCPF Committee in November 2015 for final approval of the partnership;
- FCA submission in respect of the Authorised Contractual Scheme (ACS) by 1st Jan 2016
- Go-live 1st April 2016

Annex 1 LPFA Board and Executive:

The information provided below is a short summary of the Board and Executive biographies. The full versions can be found at <http://www.lpfa.org.uk/Who-we-are.aspx>

Appointed by the Mayor of London, the LPFA Board includes:

- **Sir Merrick Cockell** – Recently appointed as Chairman of London Pensions Fund Authority (LPFA), following Edi Truell's decision to step down. He was Deputy Chairman since April, 2013 and was appointed to the Board in 2010. A councillor for over 29 years, Sir Merrick was a key architect in the formation of "Tri Borough", a revolutionary new model of delivering integrated public services between the three London Boroughs of Kensington & Chelsea, Westminster and Hammersmith and Fulham. He has previously been the chairman of the Local Government Association, London Councils and Localis.
- **Dermot 'Skip' McMullan** – Skip joined the LPFA Board on April 2013 and is a member of Investment Committee and Business & Administration Committee. In his early career, he was involved in the creation of the first PFI Company, structuring the financial package and concession for the Dartford Bridge. He was also the managing director at Bank of America in a career across 28 years prior to becoming independent chair of trustees. He is currently a director of the Bank of America Merrill Lynch UK Pension Plan and chairs the trustee board of the SSVC Pension Plan.
- **Kerry Adby** – The Managing Director at Copernican Securities and an independent non-executive Director and Chair of the Audit Committee, Risk Committee and Compliance Committee at Macquarie Point Development Corporation. She has served as a pension adviser to the World Bank. She joined the LPFA Board in April 2013 as part of the investment committee and has brought with her wealth of infrastructure investment and pensions experience.
- **Stephen Brooker** – A former partner in Ernst & Young and Finance Director of the British Red Cross. He was a non-executive director of the East & North Herts NHS Trust for 10 years and served a 6 year term as the first independent Chair of the Audit Committee of the Law Society. He is currently one of three independent members of the Audit Committees of the House of Commons and a founding Trustee at the Honorary Treasurers Forum. He joined the LPFA Board on 1st January 2013 as a non-executive director. He is a member of the Risk Committee, Remuneration & Nomination and Chairs LPFA's Audit Committee.
- **Stephen Alambritis** – Stephen joined LPFA Board on 1st October 2010 and is a member of the Audit Committee and Business & Administration Committee. He is well known for his work with small businesses and was the Head of Public Affairs at the Federation of Small Businesses. He was also a Commissioner at the Equality and Human Rights Commission (EHRC) and is currently a Labour Councillor and Leader of the Council at the London Borough of Merton.
- **Anthony Dalwood** – Tony was formerly CEO of SVG Advisers and Chairman of SVG Investment Managers (SVGIM). He established the public equities business for Schroder Ventures (London) Limited and had the responsibility of managing over £1.5 billion of UK equities while at UBS. He has an honours degree in Economics & Accounting from Bristol University and a degree in Management

Studies from Cambridge University (Judge Institute) and is a member of the CFA Institute. He has recently been named CEO of Gresham House plc as well as an independent non-executive of J.P Morgan Private Equity Limited. He joined LPFA Board on 1st October 2010 and Chairs the Investment Committee. He is also a member of the Risk Committee and Remuneration & Nomination Committee.

- **Mike O'Donnell** – A Qualified Accountant, CIPFA member and an MSc holder at the London School of Economics. Mike was Director of Finance for Swindon Borough Council and previously held a number of other senior finance posts in London local government. He is currently the Director of Finance at the London Borough of Camden. He joined LPFA Board on 1st October 2010 and is a member of the Audit Committee and Remuneration & Nomination Committee.
- **Robert Vandersluis** - Robert sits on a number of pension boards, and he provides strategic advice to pension fund trustees in Europe, the United States, and Japan as the director of Global Pension Investments at GlaxoSmithKline (GSK). Robert established GSK's London-based pension investment department, where he developed and implemented GSK's interest rate and inflation hedging strategies. He has previously held senior treasury and corporate finance positions at Affinity Sutton Group and FCE Bank plc. He joined LPFA Board on 1st October 2013 and chairs the Risk Committee.

Executive Update

In addition to the Board there have been a number of changes to the LPFA Executive Management Team.

Susan Martin, our Chief Executive, continues to lead the Executive Management Team.

- Susan Martin joined the LPFA in April 2007 as Director of Organisational Development bringing over 20 years' experience in managing organisational change, pensions, mergers, acquisitions and partnerships working across all sectors. She has led the LPFA change programme since joining and was promoted to Deputy Chief Executive in 2011, Acting Chief Executive in August 2013 and Chief Executive in December 2013.

The Executive Management Team comprises:

- **Chris Rule** – Chief Investment Officer, joined October 2014

Chris Rule joined LPFA in October 2014 as Chief Investment Officer. He is responsible for managing the Authority's £4.6 billion assets (as at 31st March 2015), developing and enhancing LPFA's investment strategy and directing the work of the in-house investment team.

Chris has a wealth of investing and executive experience within asset management businesses. He has held a number of senior positions including Head of Alternatives at SEB Investment Management (Stockholm's Enskilda Bank); CIO of SEB Alternative Solutions and Key Asset Management Ltd.

- **Mike Allen** – Director of Pensions

Mike joined the GLC in 1982 and since that time he has been involved in all aspects of Local Government Pensions with the GLC and subsequently the

London Residuary Body before moving to the LPFA in 1990. Mike was originally responsible for one of the Authority's pension administration teams. Mike now has overall responsibility for managing strategic technical projects such as Liability Managements and Auto Enrolment as well as the pensions reform to the LGPS 2014 and Firefighters' Scheme 2015.

- **Dr Angela Smith** – Interim Chief Risk and Finance Officer, joined June 2015

As Interim Chief Finance and Risk Officer, Angela supervises all financial and risk management matters for the Authority. In a long career spanning most parts of the financial sector and associated consultancy, Angela has held several top level Finance, Risk, Underwriting and Actuarial roles. She was also a big 4 Partner for several years.