London Pensions Fund Authority

Strategic Policy Statement

2013-16

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Forward

Message from the Chairman

I am delighted to have been selected as the new Chairman of the LPFA and thus be able to introduce this Strategic Policy Statement on behalf of the Board of LPFA. You will see contained in this document an emphasis on reviewing LPFA's investment strategy and on managing the key liabilities in the fund. It is vital that we focus on the key risk areas which could impact the employers, members and tax payers.

Achieving value for money is a primary objective and this will manifest itself in the short term via a review of the way we hold our investments and the associated fees, and in the longer term through pushing for One Fund For London. We see the amalgamation of the management and administration of LGPS and other public sector funds within London as being key to helping London boroughs achieve some of the efficiencies they have been asked to find. We should be able to help save many millions by reaping the benefits of scaling up the investment management capability and combining administration. We can then free up many hundreds of millions of pounds for much-needed investment into infrastructure and housing; and from unique liability analysis and management capability reduce the risks of unexpected funding shocks in the years to come. We will push for urgent progress.

Before we remove the mote from the eyes of our LGPS colleagues, we have to examine our own competencies. I have been impressed to date with the expertise shown by the pensions administration function and see LPFA as a centre of excellence in this area. The LGPS is changing and becoming more and more complex. LPFA will ensure it is working with employers and members to make a smooth transition to the New LGPS 2014 and Fire Scheme 2015 and will offer that expertise to other public bodies. We will achieve this with a focus on customer care and communication, enhanced by investment in improved systems.

We have immediately started to implement better risk measurement. It is crucial that we have the necessary tools to hand to assess liabilities and risks in real time. The practice of triennial valuations dates back to the era of the slide rule. No pension board or trustee can claim to be properly discharging its fiduciary obligation if it does not know how its liabilities are changing. If we can add the ability to manage the unrewarded risks of inflation and longevity to the strong asset management culture that is already in place at the LPFA, then we can markedly improve the probability that we can grow assets faster than liabilities. And thus restore the LPFA and other public sector funds under our control to being fully funded. Otherwise the taxpayer faces an ever-deepening financial hole and risks inter-generational conflict.

Edmund Truell
Chairman

Introduction from the Chief Executive

In February 2012 the Investment Committee determined that its strategy was appropriate to seek to return to full funding over a 20 year period. Following the introduction of a new Board and Chief Investment Officer it is timely to review this position again.

2013 will see the results of the triennial valuation. By the end of the year we will also have in place the ability to measure assets and liabilities in real time. This will give the LPFA constant feedback as to how it is performing against the funding targets. Inevitably an action plan will flow from this work and major shifts in asset and liability management (ALM) are to be expected.

However there remains a deficit in the pensioner sub-fund attributable to the former employees of the GLC/ILEA. Without radical action, we will have to push for additional funds to plug that part of the deficit. We expect to merge the funds and so benefit from a better ALM strategy and de-fragmentation.

Although the Mayor has requested a 10% savings in administration costs, LPFA believes that far greater cost efficiencies can be made by examining investment related fees, not only for LPFA but London as a whole. Options are being scoped on how this might be achieved and the scale economies on offer.

Underpinning this strategy will be a programme owned by my Corporate Management Team - One Fund for London. It will focus on shaping the organisation and processes to prepare LPFA for the future. We believe this future should include an alternative structure for LGPS funds within London which would also facilitate investment in infrastructure projects, giving the prospect of long term inflation protection and good risk-adjusted returns.

In terms of pension administration 2013-14 is going to be a unique year for LPFA. We are gearing up for the introduction of the new Local Government Pension Scheme in 2014 and the focus will be on updating our systems, documentation, training and communications. This major shift comes hot on the heels of auto enrolment and other important legislative changes impacting the LGPS environment.

We have decided to focus on these short term challenges for 2013-14 but then will continue our general improvement strategy for 2014-16. This includes greater automation for both the employer and the member, a focus on core administrative excellence, on quality and on developing our business of supporting London boroughs and other public authorities with their pension needs.

The Mayor of London has asked the LPFA to continue the good work in finding savings that has been made over the past three years. He has set a target of an additional 10% savings to be found over four years on the operational budget. We will only be able to achieve that with more pensions under our administration wing if we are to at the same time improve our service levels and that too is a strong feature of our strategy.

Whilst 2013-14 is a year to implement the mandatory changes in the pensions environment, there are a number of projects which have been identified for 2014-16 that focus on helping to achieve the required efficiencies.

Mike Taylor
Chief Executive

Introduction

The Strategic Policy Statement

The Strategic Policy Statement reflects our aims and objectives to improve the performance of the LPFA and sets out our strategic priorities from 2013 to 2016.

The statement is prepared in accordance with section 402 of the Greater London Authority Act 1999. The Act requires LPFA to prepare a statement containing a draft budget, including any levy requirement for each financial year, and a statement of strategic plans and objectives for the next three financial years. Both statements must be submitted to the Mayor by 31st December preceding the start of each financial year.

Part 1 - The Strategic Policy Statement, details our strategic objective for 2013-16 - One Fund for London. Our programmes stem from this objective. The projects contained within these programmes support implementation of the strategy.

Part 2 - The Medium Term Financial Plan, details the financials for the year 2013-14 and sets out the anticipated resources required to deliver the outcomes during 2014-16.

The LPFA

The LPFA is the largest local government pension scheme (LGPS) provider in London and one of the largest in the UK. Home to over 200 employers, with almost 80,000 members and fund assets of over £4.2 billion, the Authority is a regular winner of industry awards for investment strategy, administration, customer service and corporate governance. The LPFA is an international centre of excellence in pensions administration and has a dynamic and expanding business delivering training and third party services to other pension providers. The LPFA administers the Firefighters’ Pension Scheme as agent for the London Fire Service and, under agency agreements undertakes the administration of the pension schemes for four London Boroughs and Hertfordshire County Council.

LPFA's Mission Statement

To provide an excellent cost effective pensions service to meet the needs of our different customers.

LPFA's Objectives

To have best in class levels of core asset and liability management and administration competency whilst ensuring competitive levels of efficiency.

To actively manage investments to meet our liabilities – through the application of investment beliefs, continual monitoring of investment performance and assessment of risks.

To manage LPFA's investment and business processes to produce an overall positive impact on stakeholders and society.

To enhance our workforce capability and align incentives and working practices to the needs of the business.

To effectively communicate with the marketplace to ensure the delivery of value to customers and a positive return to the pension Fund.

Strategic Aim

Our Strategic Aim is to push for a merger of the LGPS and other public sector pension funds in London to create One Fund for London. LPFA's role in this has been to encourage debate on the subject with a view to see how estimated annual £120m savings might be achieved; better risk-adjusted net returns; modern liability management and thus improved prospects for assets to grow faster than liabilities. The proposals could involve the pooling of both LGPS investment and administration functions. The proposals suggest all the funds could benefit from reduced costs and greater efficiencies by pooling funds under management.

Our Strategic Programmes form pillars to support our Strategic Aim.

One Fund for London

- Enabling liability measurement and management
- Enhancing the risk adjusted net returns
- Investment efficiencies
- Administration efficiencies
- Increased potential for infrastructure investment

Investment and Liabilities

Includes:

- Reviewing investment process, philosophy and strategy
- Greater focus on risk monitoring
- Examining investment related fees
- Merging of active and pensioner funds
- Providing an ALM offering to London Boroughs
- Data cleansing initiatives
- Reviewing inflation, longevity and interest rate hedges
- Reviewing employer covenants

Business Growth

Includes:

- Retaining current contracts
- Redefining the service offering
- Managing contract implementations
- Delivering client Value Added Business (VAB) products
- Marketing VAB products and cooperation agreements

Focusing on Excellence

Includes:

- Sustainable Pensions
- Enhancing member and employer communications
- Accommodation
- Quality - Improving the customer experience

Strategic Programmes

There are three Strategic Programmes running for 2013-16 which support our Strategic Aim. Each of these are explained in more detail.

Investment

There are a number of challenges facing LPFA on both the investment strategy and liability front. Our strategic programme aims to put a plan in place to tackle these head on. Each has been outlined below.

Cashflows

Active Fund

Using the outdated 2010 valuation assumptions and reflecting the actual membership numbers as at June 2012, net cashflows on the active fund (contribution income less benefit outgoings) are projected as positive until 2016. By adding surplus investment income the net cashflows are positive until 2025 (table 1).

Since 2010 LPFA has seen a large reduction in active membership - 9% in the two and a half year period from April 2010 to September 2012. There is no indication that this reduction in membership will slow down as austerity measures continue beyond the life of this parliament from 2015.
The big unknowns are :

- The impact of the new LGPS in 2014, where higher levels of the membership could opt out due to increased contribution levels.
- Auto-enrolment, which could bring former opt outs back into the scheme.
- The impact of Government Policy in relation to the state pension.

Scenarios have been modeled on the impact of 5%, 10% and 20% further reductions in active membership and the potential for a higher return strategy, up to 2.5% from 2% which would increase the net inflow of funds. We have not yet taken on board the impact of the recent announcement of the single tier pension

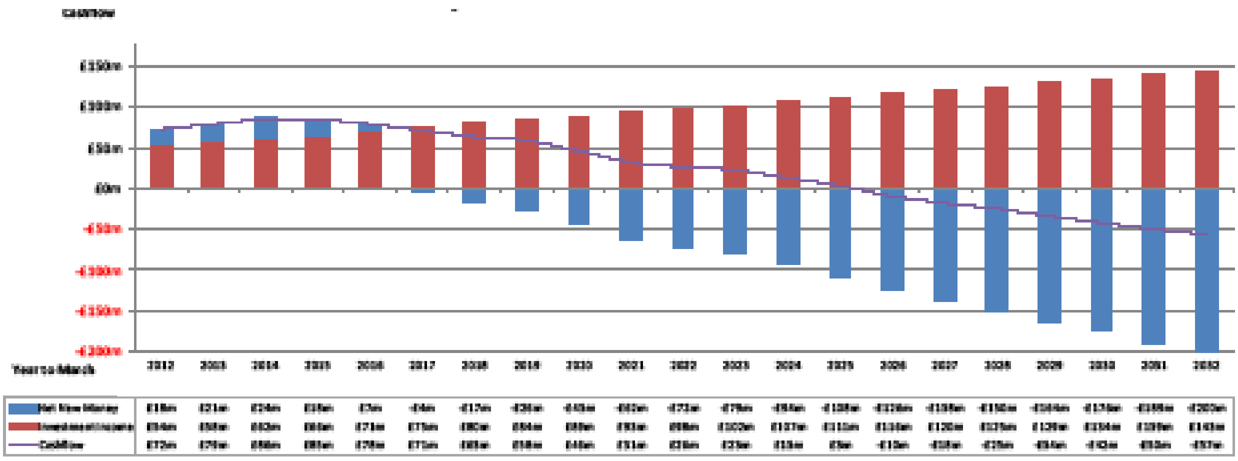

Table 1 - Projected Cashflows Active Fund

On cashflows the active fund does not become negative for several years, 2022 at the worst level of membership reduction, which could be extended to 2025 on the higher income yield assumption. This does not prompt the need for an urgent review of strategy, but clearly the position needs to be closely monitored.

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Pensioner Fund

The pensioner fund is projected to have cash outflows of £113 million in 2012 offset by investment income of £30 million, a net outflow of £83 million. Outflows are projected to be broadly stable at this level until around 2033 when the fund will run out of money. Liabilities are expected to continue beyond 2060 (table 2).

Solvency Levels and Recovery Plans for both Active and Pensioner Funds are being reviewed. The latest projection of the ratio of assets to liabilities, or solvency level, of the active fund is 91% and the pensioner fund 86%.

Asset liability modeling studies show that the current asset allocation strategy has a more than 50% chance of returning the active fund to 100% solvency over the next 20 years. During this time there may be tactical opportunities to de-risk the fund.

However, the pensioner fund has a less than 50% chance of achieving full solvency and the only practical solution is to make radical changes to the asset and liability management. Otherwise it will need additional contributions to the fund from London taxpayers. The GLA has committed to raise this with Ministers at the appropriate time so that it can be addressed in the Government's 2015 Comprehensive Spending Review. LPFA's annual report refers to this issue. A merger of the two funds will be reviewed as part of the Investment Strategy review and should yield significant ALM advantages. The current bond-based asset allocation is guaranteed to produce a deficit once inflation is taken into account.

Strategy for 2013-16

The Board will review the Investment Strategy regularly, especially once the liability estimation tools are in situ; and in light of the experience following the implementation of the new scheme in 2014.

A project to examine investment related fees will be carried out in 2013 together with work to provide an investment offering to London Boroughs as part of the One Fund for London programme.

More specifically the necessary resources and conduits for increasing investment in UK infrastructure with a focus on London and for investment in Residential Property will be created.

Table 2 - Projected Cashflows Pensioner Fund

Liabilities

As with any other defined benefit pension scheme, understanding and monitoring liabilities is critical as the extent and nature of the liabilities determines the investment strategy. In essence there are a small number of key areas to consider:

Data

LPFA ensures that data on scheme membership is as complete as possible. We carry out regular data cleansing exercises and have marketed our expertise in this area to other funds. Although we are not bound by the Pension Regulator's guidance on common data (basic information which every scheme should hold for each member) LPFA is aiming for 100% accuracy against their standards for all records. The areas where we will concentrate in the new plan are address and postcode, where the current accuracy levels are 92% and 90% respectively; and collecting email addresses in order to improve communications and reduce costs. LPFA uses dedicated services to track information regularly on deaths both in the UK and overseas. We are committed also to improving information on dependents

Longevity

Scheme members' longevity has been increasing by some 2.5 years per decade over recent years. LPFA is a member of Club Vita, a Hyman Robertson initiative to provide tailored mortality estimates for individual funds which are expected to be more accurate than national generic data. Whilst mortality is monitored annually and incorporated within the actuary's triennial valuation assumptions, we will seek market pricing for longevity reinsurance, which provides the most reliable estimate of the longevity risk.

Inflation

LPGS deferred members' liabilities and pensions in payment are index linked to the Consumer Price Index (CPI), whereas active members' liabilities rise with pay inflation. From April 2014 and the advent of the new scheme, active members will accrue pensions on a career average (CARE) basis with annual CPI revaluation. LPFA partially hedges inflation risk on pensions in payment in the pensioner fund through its liability driven investment strategy, aiming to mitigate the cost of inflation increases. The extent and nature of inflation hedging will be reviewed as part of the investment strategy review.

Interest rates

Pension fund liabilities are calculated by discounting future cash payments by a discount rate linked to interest rates. LPFA has partially hedgeds against interest rate falls (which increase liabilities) in the pensioner fund through its liability driven investment strategy to mitigate the cost. The extent of interest rate hedging will be reviewed as part of the investment strategy review.

Strength of the employer covenant

There are over 200 employers in the LPFA fund. Those which are not taxpayer backed have had rigorous covenant reviews to mitigate the effects of their possible bankruptcy or liquidation. The results of the reviews are regularly reported to the Board. LPFA will continue to review covenants in light of the new information or changing circumstances and to market its expertise in this area to other funds.

Business Growth

A programme of Business Growth is in place primarily to reduce the overheads to the LPFA fund but also to achieve wider cost reductions throughout the public sector. The focus of the programme will be to widen and deepen existing relationships whilst seeking new opportunities for large scale partnership working.

The Business Growth programme includes:

- Retaining current contracts
- Redefining the service offering to include asset and liabilities management (ALM) and other services
- Managing contract implementations
- Delivering client Value Added Business (VAB) product

The potential benefits include:

- Improved quality of service for public sector
- Wider public sector savings
- Reduced overheads
- Higher staff engagement
- Route map for a return to solvency in the longer term
- Marketing VAB products and cooperation agreements

Focusing on Excellence

From the perspective of pensions administration 2013-14 is a unique year. The significant changes that are due with the new LGPS 2014, coupled with the introduction of auto enrolment, the valuation and other legislative requirements has meant that all of current administration resources will be primarily focused on adapting to these changes.

In addition, the 'Focusing on Excellence' programme aims to continually modernize the customer experience and prepare the LPFA for future changes. It is essential that LPFA continues to encourage the debate on whether LGPS funds within London could be more efficiently organized and being a centre for administrative excellence is key to this aim.

For years two and three of the rolling plan a number of projects have been identified which will assist in achieving the Mayor's efficiency target of 10% reduction over a three year period and build on the savings made in 2012-13. These will be scoped and prioritized based on benefits during 2013-14.

Strategic Projects 2013-14

Sustainable Pensions

Including:

- New LGPS 2014
- Fire Scheme 2015
- Auto enrolment

Potential Benefits:

- Legislative compliance
- Improving the customer experience
- Scale economies reducing overhead

Enhancing member and employer communications -

Including:

- Rolling out the benefits of Altair v4 (the latest release of the pensions administration system) to Dexter House and LPFA Hertfordshire
- Scoping business cases for employer and member self service
- Marketing to current members and employers

Potential Benefits:

- Greater online capability for members
- Reduced printing costs and lower paper usage
- Increased customer satisfaction

Accommodation -
Phase 2

Including:

- Option appraisal and development in preparation for lease expiry in December 2014
- Seeking staff engagement

Potential Benefits:

- Lower operating costs
- Higher staff engagement

Quality -
Improving the customer experience

Already commenced in 2012 but continues into 2013/14

Including:

- Seeking accreditation from the Institute of Customer Service
- Internal customer care workshops

Potential Benefits:

- Increased customer satisfaction
- Reduced complaints

Future strategy 2014 and meeting the Mayor's targets

The following administration projects have been identified as ways to enhance the service provided by LPFA. They seek to modernise and prepare LPFA for the future by considering greater automation and improved self service for the members and employers. They also will assist LPFA in achieving the Mayor's overhead savings target of 10% over a four year period. These are suggestions at this stage but they will be scoped during 2013-14 ready for implementation 2014 onwards. They will be an important part of the LPFA's future strategy.

Quality -
Improving the customer experience

Payroll process review
Potential Benefits:
- Reduced operating costs
- Increased customer satisfaction

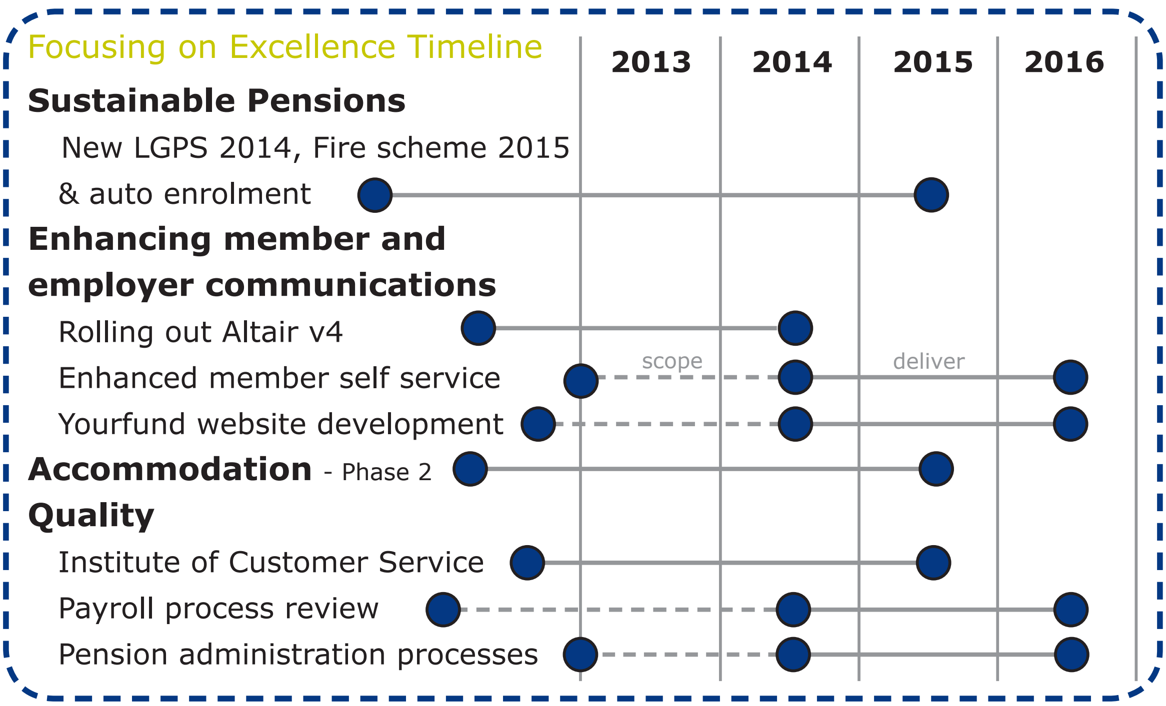
Pension administration processes
Potential Benefits:
- Reduced elapsed time
- Reduced operating costs
- Increased customer satisfaction

Enhancing member and employer communications

Potential system enhancements which will be scoped in 2013-14 include;

Enhanced member self service
Potential Benefits:
- Reduced operating costs
- Increased customer satisfaction
- Reduced customer complaints

Yourfund website development for employers including end of year enhancements
Potential Benefits:
- Reduced operating costs
- Possibility to generate income from ability to market the system



How we measure performance

Monitoring the Strategy

Investment

Investment oversight will happen more regularly to review asset allocation, manager selection and performance. There is also to be a focus on monitoring and managing liabilities. This will be enhanced during 2013 by the establishment of a Risk Committee. Performance is reported annually on the LPFA website.

Business Growth

Internal targets are being developed for both asset and liabilities managment (ALM) and administration third party business. This will be monitored by the Performance & Administration Committee.

Focusing on Excellence

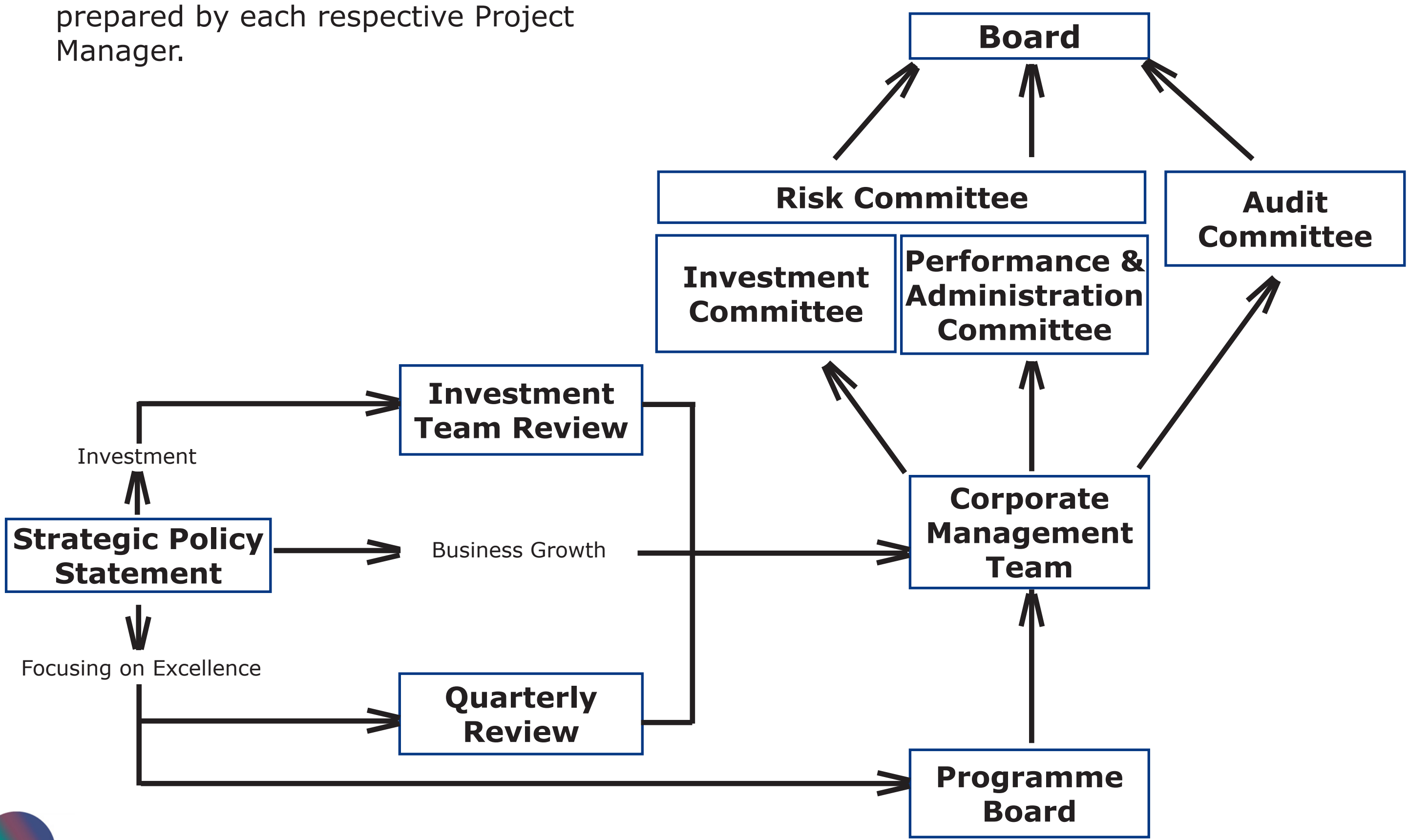
LPFA's Programme Board is tasked with monitoring the 'Focusing on Excellence' projects via monthly status reports prepared by each respective Project Manager.

In addition, a Quarterly Review report of administration performance measured by Key Performance Indicators is presented to the Performance & Administration Committee and subsequently to the Board. These results will be made public on our website.

As in previous years we will include indicators to provide clear and transparent performance targets to the public. More information on LPFA's activities and accounts can be found within our Annual Report 2011-12, available to view on our website;

http://www.lpfa.org.uk/What-we-publish/ANNUAL-REPORTS.aspx

The diagram below shows the links between the Strategic Policy Statement, Investment Team Review, and the Quarterly Review. It also shows how these are monitored.



Key Performance Indicators

LPFA's range of Key Performance Indicators is based on nationally and locally set performance measures which mirror the strategic direction of the organisation.

Our aim is to measure, as far as practicable, the outcomes of our ALM, and of our administration, both in terms of what we have achieved and how effectively we deliver these outcomes.

Corporate (reported annually year on year)

Costs :
- Absolute
- Per member
- As %ge of AUM

- Gross/net

Asset and Liabilities Management
(reported monthly and annually year on year)

Surplus/(Deficit) :
- Absolute
- %ge of total liabilities

Change in liabilities
Source of changes
- Member changes
- Payments
- Interest rates
- Inflation
- Longevity

Change in Assets
Source of changes
- Member changes
- Contributions
- Income
- Capital Values

Risk
- Portfolio VaR (Value at Risk. A statistical technique used to measure and quantify the level of financial risk within an investment portfolio over a specific time frame to a level of confidence, usually 95% or 99%. Value at risk is used to measure and control the level of risk which the Fund undertakes.)
- ∂IR (Sensitivities to changes in the Interest rates expressed as the change in the present value of the liabilities for each 1 basis point (0.01%) change in interest rates.)
- ∂CPI (Sensitivities to changes in UK Inflation expressed as the change in the present value of the liabilities for each 1 basis point (0.01%) change in the inflation rate.)
- ∂[Equity market] (Sensitivities to changes in the Equity market)

LPFA Administration

- Complaints received
- Complaints upheld
- Number of complaints taken further - IDRP and Ombudsman
- % complaints as a percentage of workload
- % of active members where LPFA holds an email address and dependants details
- Cessation value - total at risk debt vs amount recovered

LPFA Cases Completed on Time

- Top ten cases completed on time
- Employer Services end of year queries

Top Ten Cases - more detail

- Top ten cases elapsed time
- Top ten cases outstanding after 6 months

Electronic Interactions

- Number of employers signed up to online pensions administration strategy
- Number of members under administration
- Number of year end error rates
- % of available information submitted online
- Increase in member self service signing with active members

Further policy documents including:

- Statement of Investment Principles
- Funding Strategy Statement
- Valuation Report 2010
- LGPS Compliance Statement

Are available on our website

www.lpfa.org.uk

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