Investment Report 2008-09

London Pensions Fund Authority

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Annual market review – year to 31 March 2009

During the year to 31 March 2009, financial markets suffered their most significant set-back for a generation. Financial institutions, thought to be invincible just months earlier, all but collapsed under the stress of the credit crunch. Many owe their survival to government intervention; some are now effectively state owned.

As the year progressed, the crisis spread from the financial sector to the real economy. In the UK, the scale of the decline was dramatic with the economy contracting by 4.1% over the year.

In response to events, the Bank of England reduced short-term interest rates, from 5.25% to 0.5%, during the year. In early March 2009, and with little scope to lower short-term interest rates further, the Bank of England resorted to quantitative easing, the purchase of privately held assets to boost the supply of money in the economy. Quantitative easing must be implemented with care as it is potentially inflationary in the medium to long term; however, it is being introduced against the backdrop of the deflationary pressure of massive economic deleveraging. The adoption of quantitative easing reflects the deep concerns of the authorities over the economic outlook.

Other major economies (the US, Euro zone and Japan) also moved into recession during the 12 month period. The response from the authorities was similar to that of the UK, including the reduction of short-term interest rates to close to zero, fiscal stimulus packages and, in the US, quantitative easing.

Against this gloomy economic background, equities fell sharply. In the UK, the FTSE All Share index returned -29.3%. In Sterling terms, the FTSE All World (ex UK) fell by 19.6%, depreciating sterling flattering the underlying stock returns. The best performing sectors in a global context (relative to the 'All World' Index) were Health Care (+38.2%) and Technology (+16.1%): the worst performing were, unsurprisingly, Financials (-25.5%) and Basic Materials (-16.0%).

Fixed interest government bonds performed well, as investors sought the safety of this asset class. UK fixed interest government bonds (gilts) returned 10.3% during the year. In contrast, corporate bonds weakened (All Investment Grade issues returned -13.5%), as credit spreads expanded due to increased default risk.

Major shifts in currency exchange rates during the year reflect the economic dislocation and meltdown in the global financial sector. Sterling fell sharply (-27.9% against the US$ and -13.9% against the Euro) on concerns over the scale of public debt in the years to come.

The worst of the financial crisis may have passed, but the damage inflicted on the real economy is now biting deeply. The rebuilding of financial structures and restoration of economic growth will take time. The various economic stimulus packages implemented around the world have resulted in an explosive growth in public debt which has to be serviced and, ultimately, re-paid. This raises profound questions over the course of fiscal policy in the years to come. In addition, it seems that the state is set to play a greater role in financial markets as the relationship between government and business changes.

Prepared by:-
John Dickson
Partner
April 2009
For and on behalf of Hymans Robertson LLP

Introduction

This year's report discusses the development of our investment strategy which started after the 2004 valuation. It also reports on the performance delivered against the most challenging background of the last fifty years, the governance of the fund and our developing environmental, social and corporate governance (ESG) policy. It covers both the Active Sub-Fund and the Pensioner Sub-Fund. The Pensioner Sub-Fund consists predominately of employers who no longer have members making contributions. A summary of the economic context in which we have operated, provided by our Investment Consultant Hymans Robertson, is attached.

Funding and investment strategies

A new long term funding strategy developed after the 2004 valuation of LPFA's liabilities gave rise to a new investment strategy which was implemented in late 2005. The 2007 valuation enabled the first detailed analysis of how well the strategy was working, albeit over a short time horizon. In summary, the results of the 2007 valuation showed an improvement in the funding level of the Active Sub-Fund, from 74% to 82% of long term liabilities, largely due to the strength in global equity markets which is the foundation of the investment strategy in the Active Sub-Fund. However, the valuation also showed a deterioration in the funding level of the Pensioner Sub-Fund, from 91.5% to 86% principally caused by the adoption of new mortality assumptions which reflect the increasing life spans of our members.

The huge downward movement in asset values over the last year coupled with declining interest rates (used to value the fund's liabilities) means that there has been a marked deterioration in the funding levels of both sub-funds as at 31st March 2009. The estimated funding level of the Active Sub–Fund was 55% and that of the Pensioner Sub-Fund, 61%. The figures are estimated as full liability valuations are a huge task and only take place every three years. Consequently, the figures above take into account changes in the asset values which are readily available but estimates only of the change in the value of liabilities. The funding level is as volatile as the value of the fund's underlying assets and so has changed dramatically month by month over the last year. At the time of writing (June 2009) markets have recovered enough to expect the funding levels to have increased by 10% from the lows of March!

Despite it being early days for the investment strategy, the unprecedented shifts in values of assets and the volatility in investment markets have prompted us to initiate a complete review of the investment strategy of the Active Sub-Fund over the summer of 2009. So, at the time of writing, no major shifts in strategy have occurred due to the credit crises and traumas of the global financial system. The strategy remains as reported in 2008, which is described below.

The starting point for the investment strategy is always the liability profile of each of the two Sub-Funds. In the case of the Active Sub-Fund, the liabilities are very long term, given the age profile of its members. It was concluded in 2004 and reaffirmed in 2007 that the Sub Fund's objective of achieving 100% funding over 20 years is appropriate. The expected risk and return of the investment strategy was set in the light of this. Global equities remain our favoured long term asset and diversification is provided by investment in target return funds, private equity, property, infrastructure and commodities. This diversification provides attractive returns, but also substantial risk reduction benefits.

After consideration of the 2007 valuation results, and with the benefit of observing the first three years of the new strategy in action, it was decided to make no major changes to the strategic pattern of investment derived in the 2004 strategic review. There have been some minor modifications made to allocations which are detailed below. The mismatch of investing in global assets and sterling liabilities continues to be reduced by the imposition of a hedge back into sterling equal in size to 50% of the global equity exposure. This significantly reduces the impact of sterling movements against other currencies on the funding level.

In the case of the Pensioner Sub Fund, the strategy is to match annual cash flows into the fund with the predicted pension payments out, this is a liability driven investment (LDI) approach. Unfortunately at the implementation of this strategy in 2005 the pensioner sub-fund was not 100% funded and so fund managers were appointed with a brief of producing annual cashflows plus additional returns to close the deficit.

Also, a small exposure to equity markets was retained where we expect a higher return than from bond markets. As mentioned above, despite this strategy delivering the returns that could be expected from it, the funding gap of the Pensioners Sub-Fund increased between 2004 and 2007 due largely to improving longevity. A Recovery Plan was established to close this gap. The deficits are planned to be recovered over a 22 year period by charging an appropriate levy to each London Borough commencing April 2009.

Investment Strategy and Governance of Investment Decisions

The investment strategy and governance of investment decisions was reviewed and agreed by the Board on 1st April 2008. Allocation ranges for the main asset classes were adopted. These allocation ranges were updated by the Board in March 2009 to reflect the reduction of the funds exposure to target return funds. The proceeds generated by the sale of one of these funds are held in cash and their final destination awaits the strategy review this summer.

Active Sub-fund

Asset Class	Minimum	Benchmark	Maximum
	% of fund	% of fund	% of fund
Global Equities	45	55	65
Private Equity	0	5	7.5
Target Return	0	10	15
Diversifying Assets	20	25	30
Cash	0	5	10

The investment strategy was developed with an objective to ensure the funding deficit is eliminated over 20 years. The greatest exposure to global equities markets is retained since these markets are expected to deliver the best return over the long term. Global equity markets can be volatile as has been witnessed recently, so to manage this risk and to take advantage of the extra returns that exists in some classes, exposure to diversifying assets has been increased.

The Board has delegated the responsibility of asset allocation at the level below to the Investment Committee. The table on the next page details their decisions.

Asset Class	Minimum	Benchmark	Maximum
	%	%	%
Global Equities	**45**	**55**	**65**
MFS (active)	15	17.5	20
Newton (active)	15	17.5	20
Legal&General (passive)	10	15	30
Satellite (quoted)	0	5	7.5
Private Equity	**0**	**5**	**7.5**
Target Return	**0**	**10**	**15**
BlackRock	7.5	10	12.5
Diversifying Assets	**20**	**25**	**30**
Global Property	5	7	10
Commodities	0	3	5
Infrastructure	0	5	7.5
Opportunities (including Hedge Funds)	0	5	7.5
Investible Cash	**0**	**5**	**10**
Currency			
Hedging		50% of quoted overseas equity exposure	
Active Overlay			
2 complementary mandates		£1 billion total	

The satellite and opportunity funds were established to take advantage of good ideas that may present themselves to add return to the fund, but where it is not appropriate for them to become core managers/ideas for the portfolio. The difference between the two is that the satellite will be comprised of funds investing in quoted equities and bonds and the opportunity fund of ideas within the non quoted investment arena.

It is envisaged that investment will not be made for less than £25m but anything above £50m would have to be approved by Investment Committee. Below £50m the Investment Director in conjunction with the Chairman of the Investment Committee and Chief Executive can take the decision. We have made our first investments in both funds: for the satellite fund a £35m holding in the Sarasin OekoSar Fund, which specialises in sustainable investing and for the opportunistic fund a £25m holding in a European Credit Management corporate bond fund.

Currently, the Active Sub-Fund manager roster consists of three global equity managers; Legal & General; Newton and MFS; one total return manager, BlackRock and one currency manager Record Currency Management. In addition, the diversified assets portfolio consists of one global property manager ING; infrastructure; and commodities. All of these plus private equity are managed by specialist managers and overseen by the Investment Committee.

Global Equity

This key area is managed by three managers (MFS, Newton and Legal and General). MFS and Newton are active managers, Legal and General are a passive index-tracking fund manager. The qualities that all of these managers possess are a clear philosophy combined with strong performance and risk control, which have been severely tested in the investment environment of the last year. All three managers have proved their abilities well. Combining three different styles of management has further reduced the volatility of returns of the sub-fund.
Both active managers are now measured against the MSCI All Country World Index, whilst Legal and General is measured against the FTSE All World Indices.

Private Equity

The private equity asset class has been separated from the diversifying assets class in acknowledgment that the returns from private equity are most closely correlated (between 60% to 90%) to those of quoted equity. It operates within its own target and range, a 5% target and a 0%-7.5% range. Investments are made in funds managed by our three fund of funds managers: Pantheon, LGT and Harbourvest.

To date three “programmes” have been established (2004, 2006 and 2008) each with commitments of some £125m and with lives of 10 to 12 years. The £60m portfolio of quoted private equity investment trusts, which had been utilised over the last 4 to 5 years to provide exposure to private equity until such time as actual investments equalled the committed amount, were sold in April and May 2008 and realised considerable profits.

As a consequence of the global financial situation, three main features have dominated our private equity portfolio: (1) the pace of calls has slowed, (2) distributions have effectively ceased and (3) the UK listed private equity investment trust sector has collapsed (since September). A mixture of no distributions and the fact that private equity valuations have not declined to the same extent as quoted equity valuations means that we have almost 10% of the active sub-fund invested in private equity as the end of March 2009. Increasing the range to 15% is being discussed at the June 2009 Investment Committee as we do not wish to sell any exposure at depressed values.

Total Return

The two total return funds were envisaged originally as a counterweight, within the overall investment strategy, to the more traditional equity mandates. These funds have absolute targets of RPI +5% unlike global equity funds where the targets are relative to equity markets. Target return funds have an unconstrained mandate allowing the fund managers to invest across a range of asset classes and achieve an investment return that reflects the Sub-Fund's inflation-linked liabilities.

The disruption and subsequent malfunctioning of financial markets generally has exposed weaknesses in this strategy, with the result that a review of this type of fund will form a key part of a general investment strategy review to be completed by September. Our holding in the UBS fund was sold in September 2008, not only because of poor performance but also because the loss of investment professionals from the firm had destroyed our faith in their ability to generate good performance in the future. The more diversified and better performing BlackRock fund continues to be held.

Diversifying Assets

Four separate elements now make up this portfolio: global property, infrastructure, commodity related and (from July 2008) opportunities.

The ING managed global property fund of funds "Global Osiris" was established in July with the LPFA as the lead investor. By the end of March, 74% of the fund had been invested in funds in Europe, North America and Asia. Whilst the transition from our original portfolio of UK Property Unit Trusts into this fund had taken longer than originally anticipated (mainly due to tax issues) the property market has weakened considerably recently and the manager can now take advantage of a wider choice of opportunities available at much lower values.

Within infrastructure, social infrastructure includes investments in schools, hospitals and other government accommodation related programmes. Environmental infrastructure covers investments in solar, wind and waste minimisation / waste to energy projects. Economic infrastructure consists of projects like roads; ports; rail and power grids. Commitments to the social and environmental allocations have been effectively completed, whilst in the economic allocation there are just a couple more funds required to complete. In addition to this split by type, the funds are further diversified by geography and manager.

The commodity related allocation currently consists of a fully diversified commodity fund and a global timber fund. Another global timber fund and an agricultural land fund (predominantly Southern Hemisphere) are currently under consideration.

Currency

Record Currency Management as the currency manager has two tasks to perform for us. Firstly, in relation to exposure to overseas currencies in the equity portfolios managed by the active equity managers, Record provides the hedge for 50% of this exposure back into sterling. Given the liabilities of the fund are denominated in sterling, it enables the fund to invest in global equity markets whilst reducing the currency mismatch between assets and liabilities and hence reduces the risk of the fund not being able to meet it's liabilities.

Secondly, Record has an active management brief to add extra return. We are investigating the addition of another currency manager who would take half of the money that Record have for active management as a further risk reduction exercise.

Pensioner Sub-fund

Global Equities	Cash flow matching bonds (LDI)
Index tracker	liability cash flows +1.5%
12.5%	87.5%

As mentioned above, there is no change to this strategy from the initial implementation in late 2005. The core investment strategy is based around the management of risk relative to the Sub-Funds liabilities ensuring greater control over the funding position. This requires a trade-off between hedging the risk of the liabilities and investing in return-seeking assets. As the Sub-Fund was underfunded there were insufficient assets to fully hedge all the liabilities and so the fund managers were given return-seeking active mandates as well as a mandate to hedge cash flows.

Currently, the liabilities driven approach is implemented through three fund managers who were appointed to hedge specific components of the liabilities; ECM (fixed liabilities), Barclays Global Investors and Insight Investment (inflation-linked liabilities). In addition, these managers are mandated to actively invest across global fixed interest markets to achieve an aggregate 1.5%pa outperformance.

A mix of investment styles was an essential ingredient in the manager selection process. However the Board have given approval to simplify the LDI arrangements by appointing one manager to hedge all the liabilities but retain the three managers for active management. The appropriateness of retaining exposure to equities with the expectation of generating excess performance above that of the liabilities and to diversify risk is being investigated as part of the strategy review this summer. The equity mandate is managed on a passive basis by Legal and General Investment Management.

Fund Valuation and Asset Allocation @ 31st March 2009

Active Sub - Fund

The table below shows the asset allocation and valuation at the year end against the long term benchmark ranges that applied on 31st March 2009.

Active Sub-Fund at 31 March 2009

	Benchmark		**Fund**	
	Minimum	**Maximum**	**Distribution**	**£m**
	%	%	%	
Global Equities	45	65	58	1,105
Private Equities	0	7.5	10	185
Diversifying Assets	20	30	16	300
Target Return Fund	0	15	10	203
Cash	0	10	6	117
			100	**1,910**

The private equity exposure has exceeded the limit of 7.5% of the fund, due principally to the huge drop in value of global equities reducing the value of the fund. The diversifying assets are below the range but this is because of the programme underway to increase exposure in this area which cannot be implemented quickly.

At the Investment Committee in June 2009 and ratified by the Board later in the same month, it was agreed to move the range of private equity up to 0%-15% and that of diversified assets down to 10%-20%. No new commitments will be made in private equity but it was considered to be exactly the wrong time to attempt to sell exposure in this area which would be the usual reaction to moving outside a target range. However the Board were concerned that the maximum exposure to illiquid assets be limited to 35%, hence the reduction in the target for diversified assets.

Pensioner Sub – Fund

The table below illustrates the asset allocation as at 31 March 2009.

	Benchmark	Fund	
		Distribution	**£m**
	%	%	
Global Equities	12.5	8	91
Cash Flow Matching	87.5	91	1,019
Cash	0	1	8
	100	**100**	**1,117**

Net current assets/(liabilities) of the Scheme at 31st March **£3.020 Billion**

Details of largest holdings as at 31 March 2009

Active Sub - Fund

The Fund holds equities either in segregated funds (where we are the owners of the shares in question) or in pooled funds (where we own units in the pooled fund rather than the underlying equity shares per se). Fund Managers hold equity assets as follows:

- Legal and General – pooled funds covering the FTSE world index of 3,172 stocks, with separate funds for UK, Europe, North America, Japan, Asia Pacific, Middle East and Africa.
- MFS – segregated fund with an average of 90 stocks across all world markets.
- Newton - segregated fund with an average of 100 stocks across all world markets.
- BlackRock – segregated fund with an average of 50 UK equity holdings plus other global pooled fund holdings.
- Sarasin OekoSar – Pooled fund with an average of 70 stocks across all world markets.

Property investments and some alternative investments are also held in pooled funds.

The ten largest holdings in the Active Sub-Fund are detailed in the table below, all are pooled vehicles.

Fund	**£ in million**	**%**
Legal & General North American Index	190.6	9.9
ING Real Estate Select Global Osiris	159.6	8.3
Legal & General Europe Index	74.7	3.9
Legal & General World Emerging Markets	42.5	2.2
Legal & General Japan Index	37.4	1.9
MLIM Institutional Liquidity Fund (BlackRock)	34.7	1.8
Semperian (previously known as Trillium)	33.9	1.8
Sarasin OekoSar Equity Global	33.8	1.8
Legal & General UK Equity	32.9	1.7
Legal & General Asia Pacific ex Japan Index	20.8	1.1

As can be seen, our largest ten investments in pooled vehicles are all bigger than individual equity holdings held in segregated funds. As at 31 March 2009, our only directly held equity investments that comprise more than 0.25% of the active fund are as follows:

Largest directly held equity investments

Equity	£ in million	%
Roche	19.1	1.00
Nestle	19.0	0.99
Phaunos Timber	14.4	0.75
HSBC Infrastructure Co	8.9	0.47
Heineken	8.6	0.45
Oracle	8.6	0.45
Linde	8.4	0.44
Babcock & Brown Public Partnerships	8.4	0.44
Pepsico Inc	8.3	0.43
Reckitt Benckiser plc	8.1	0.42
3M Co	7.9	0.41
Sprint Nextel	7.9	0.41
LVMH	7.5	0.39
Nike	7.5	0.39
Diageo	7.2	0.38
Wyeth	7.2	0.37
Bank of New York	6.5	0.34
Impax Environmental	6.4	0.33
Merck	6.4	0.33
Walt Disney	6.1	0.32

Largest directly held equity investments (continued)

Equity	£ in million	%
Medtronic	5.9	0.31
Walgreen	5.9	0.31
United Parcel	5.8	0.30
Schneider Electric	5.8	0.30
Statoil Hydro	5.8	0.30
Cisco	5.6	0.29
Johnson & Johnson	5.3	0.28
Vodafone	5.2	0.27
GDF	5.2	0.27
Total	5.1	0.27
Kao	5.1	0.27
Synthes Inc Wilmington	5.0	0.26
3i Infrastructure	5.0	0.26
Millicom	5.0	0.26
State Street	4.9	0.26
Canon	4.9	0.26
Royal Dutch Shell	4.8	0.25
Omnicom	4.8	0.25
Jardine Matheson	4.8	0.25
Accenture	4.8	0.25
Cable & Wireless	4.7	0.25

The Pensioner Sub-Fund holds three liability matching funds with Insight, BGI and ECM which comprises 87.5% of the fund.

Investment Performance

Annualised Performance returns as at 31 March 2009	1 Year	3 Year	10 Year
Active sub-fund	-20.88	-5.89	0.43
Benchmark	-16.52	-4.13	1.45
Pensioner sub-fund	-4.23	0.57	3.81
Benchmark	8.21	6.46	5.52
Headline RPI	-0.38	4.82	2.62

The Last Year

Active Sub-Fund

The active sub-fund returned -21% which is disappointing but explained by the huge drop in asset values in equity, property and commodity markets. Also sterling was weak and so hedging 50% of the overseas equity exposure back into sterling further reduced the return over the twelve month period. A bright spot is that our global equity portfolio outperformed the benchmark and target return (+2%) set for it. Another is that diversification into private equity, infrastructure, global property and target return reduced the underperformance as none of these fell as far as equities. The explanation for the active sub-fund underperforming the benchmark lies with the RPI + 5% benchmark for the non equity holdings which are roughly 40% of the fund. RPI + 5% equated to 4.61% and nothing apart from our private equity holdings and government bonds matched that return.

Pensioner Sub-Fund

The good news here is that the strategy of matching cash flows using fixed income proved to be the best strategy in a time of market extremes, the benchmark returning +8%. The bad news is that the addition of equities was unhelpful to the return this year and the performance of all of our active managers was poor, the best performing returning 2% below the benchmark. The reason was that unless you were invested totally in UK gilts you would underperform last year. One of our managers, ECM are invested in a broadly spread portfolio of European corporate bonds with in excess of 20% in bank capital which used to provide stability to the portfolio. We have kept our investment in ECM under close scrutiny, but concluded that we believe there is substantial recovery potential in our portfolio and so have remained invested with them.

Longer term performance

The last twelve months has had a huge impact on both the three and ten years returns of the fund. The active sub-fund has fallen short of RPI for both periods but the pensioner sub-fund return has exceeded RPI over ten years. Clearly, the fund could not stand too many years like the last! We do believe that the actions being taken globally to stabilize the banking system and stimulate growth will allay the fears being discounted in markets in March 2009 and consequently the fund performance will recover.

Responsible investing

One of the LPFA's five strategic objectives is to manage its business processes 'to produce an overall positive impact on stakeholders and society'. From an investment perspective this means taking full account of environmental, social and governance (ESG) issues as we develop our investment strategy and ownership activities. The Fund's view is that ESG issues have a material impact on the long term return of investments. Considering ESG within the investment strategy is therefore a prudent approach to the management of the Funds assets.

The Board has taken a significant step towards this goal in early 2009 with the appointment of an additional Investment Manager to the Investment Team to focus on developing and implementing the LPFA's ESG activities. During the next financial year the 'Investment Manager – ESG' will be conducting a review of our activities, with the aim of ensuring that the LPFA's ESG activities are aligned with the financial objectives of the Fund. Further details will be made available to our members on the conclusion of this review.

The LPFA currently delegates authority for voting and ESG engagement with investee companies to our fund managers. We hold meetings with the fund managers dedicated to discussing ESG issues; these are in addition to the regular manager accountability meetings (see below for more details). The Investment Committee receives quarterly updates on the voting and engagement activities of our fund managers, including details of any contentious votes and significant areas of engagement.

During the year under review, the LPFA voted a total of 2,962 resolutions. Of these, LPFA supported management in 78% of cases (2,319 resolutions), voted against management in 5% of cases (161 resolutions) and abstained or withheld support in 16% of all cases (482 resolutions).

In addition to the activities of our fund managers, the LPFA participates in and supports a number of collaborative projects directly. Since 2007 the LPFA has been a signatory to the UN Principles for Responsible Investing (UN PRI), a global initiative to promote best practice amongst investors on ESG issues. The Fund also participates in networks that provide valuable opportunities for sharing knowledge and experiences with other investors on ESG and ownership practices including the Institutional Investors Group on Climate Change, the Enhanced Analytics Initiative (now a part of the UN PRI), the National Association of Pension Funds and the Local Authority Pension Fund Forum.

The LPFA's Chief Executive speaks regularly at industry events on our approach to ESG issues and recently the Chairman of the Investment Committee addressed the NAPF on this topic.

Governance Reporting

Investment Committee Meetings

The Investment Committee met four times during the year and on four occasions considered reports on investment strategy, performance, monitoring, responsible investment and compliance reports covering corporate governance, securities lending, transaction cost disclosure and custody

Manager accountability meetings

Meetings are held with all investment managers on a regular basis. These meetings are conducted by the investment team for the purpose of analysing and reviewing the investment process by which the Scheme's assets are managed as well as the progress being made by the managers against the objectives set out in their respective investment management agreements. These meetings cover a wide range of topics, including investment performance compared to stated objectives, changes in the management team, performance attribution analysis and economic and political developments. These meetings also provide a useful opportunity to directly convey any concerns that the Authority may have. The outcome of these meetings, including a comprehensive analysis, is presented to the Investment Committee quarterly. Managers will be called to account where they depart from the mandate requirements or underperform consistently.

Due to the size and complexity of the mandates the Investment Committee receive presentations on the operations of the mandates and on specific asset classes as a part of a formal training program.

Securities Class Actions

The LPFA currently uses a US legal firm – Coughlin, Stoia, Geller, Rudman and Robbins LLP – for the monitoring of the Fund's US/UK holdings to identify losses due to breaches of US/UK securities laws and potentially seek to recover these losses via litigation (securities class actions). All potential class actions are highlighted to the Investment Sub-Committee (the Chairman of the Investment Committee; the Chief Executive and the Investment Director) who then determines their merits and whether or not to proceed as a lead plaintiff. In 2008/09 the LPFA did not pursue any class actions as a lead plaintiff. Where the LPFA has not taken a lead role but is still entitled to a claim, the Fund's custodian JP Morgan processes claims on the Fund's behalf. During 2009 the LPFA will be conducting a review of its approach to securities class actions.

Securities lending

The securities lending programme was suspended temporarily from September 2008 to March 2009 pending investigation by the LPFA regarding the risks and benefits. An amended securities lending agreement was subsequently agreed with JP Morgan who undertake the securities lending programme exclusively on behalf of the LPFA. The amended agreement stipulates that LPFA only lend against non-cash collateral which is fully indemnified by JP Morgan. The total loan portfolio can not exceed 35% of the lendable portfolio value as required by the LGPS 1998 regulations.

The securities lending programme incorporates the Active Sub-Fund (i) global equities mandates, which are managed on a segregated basis (ii) the Blackrock segregated UK equities fund and (iii) the listed Diversifying Assets. The remaining portfolios are managed on a pooled fund basis in which LPFA is not the direct owner of the underlying stock. The Investment Committee approved the restart of the Securities Lending programme in late March 2009. In addition to the improved collateral arrangements, the LPFA aims to implement best practice in relation to stock lending as proposed by organisations such as the International Corporate Governance Network (ICGN). As at 31 March 2009 no securities were lent.

Custody and banking

JP Morgan was re-appointed in 2006 as global custodian to the Authority on considerably improved service terms. Service delivery is monitored on a regular basis and quarterly review meetings are held with the custodian. A reduction in some transaction fees was negotiated last year. JP Morgan also provides LPFA with a private equity administrative service since 2008.

Statement of Investment Principles (SIP)

A new SIP which reflects the changes in the investment strategy and governance was approved by the Board and published in December 2008. The SIP will be reviewed and updated annually to reflect changes proposed and approved by the Board during the year and any changes in regulations.

Myners Compliance

LPFA complies with the six updated Myners principles and a 'comply or explain' statement will be included in the next update to the SIP due December 2009.

Review role of independent advisers

The decision was taken to extend the contracts of the two independent investment advisers until June 2009. A review is currently underway.

Investment communications

The corporate website provides a regular update of standardised monitoring information. Employer Forums are used to communicate changes in investment strategy. External newsletters produced for employers and members contain investment updates.

Familiarity and training

The Authority supports the practice of regular training to ensure trustees are sufficiently familiar with the issues on which they are required to make decisions. Trustees attend training seminars, workshops and conferences provided by external providers, including the National Association of Pension Funds. Internally trustees have separate training sessions on specialist issues, and receive reports submitted by officers.

The advisers play a key role in this respect explaining new investment approaches and providing feedback on actions and decisions.

For additional information relating to LPFA's investment activities please contact:

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This document forms part of the suite of full Annual Report and Accounts 2008-09. The following documents are available on the LPFA website: Summary Annual Report, Annual Accountst, Annual Governance Report, Performance Report. In edition, LPFA has also published on our website www.lpfa.org.uk, a Funding Strategy Statement, Statement of Investment Principles and a Communications Policy Statement.