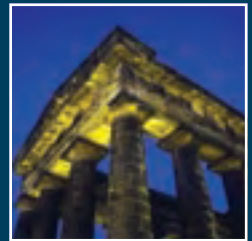


Tyne and Wear
Pension Fund

Report and Accounts

Administered by
South Tyneside Council

05/06





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Members of the Pensions Committee, Investment Managers, Advisors & Officers

Committee Members

South Tyneside Council

Councillor S. Stratford (Chair)
Councillor E. Leask (Vice Chair)
Councillor E. Battye
Councillor G.R.W. Elsom
Councillor G.H. Finch
Councillor E.M. Gibson
Councillor J.N. McKie
Councillor A. Meeks

Gateshead Council

Councillor J.I. Mearns (*substitute – Councillor K. Childs*)

Newcastle City Council

Councillor D. Slesenger (*substitute – Councillor B. Renton*)

North Tyneside Council

Councillor R. Glindon (*substitute – Councillor C. Gambling*)

City of Sunderland Council

Councillor J. Heron (*substitute – Councillor P. Young*)

Trades Union Representatives

G. Clements – UNISON
W. Flynn – UCATT
S. Forster – UNISON

Employers' Representatives

J. Fenwick – National Probation Service – Northumbria
D. Chesser – Northumbria University
D. Scott – Stagecoach Travel Services

Investment Managers

Indexation

Legal and General Investment Management

Global Equities

Capital International

Emerging Market Equities

Capital International

Pan European Equities

UBS Global Asset Management

UK Equities

Fidelity Pensions Management

Far East Equities

Schroder Investment Management

Corporate Bonds

Prudential M&G

Global Government Bonds

Henderson Global Investors

Currency

Barclays Global Investors

Currency

Record Currency Management

Property Manager

Arlington Property Investors

AVC Providers

The Prudential Assurance Company
Equitable Life Assurance Society

Advisors

Actuary

Hewitt Bacon and Woodrow Limited

Investment Advisor

Hymans Robertson Consultants and Actuaries

Officers

Executive Director Regeneration and Resources

D. Slater

Head of Pensions

S. Moore

Head of Corporate Governance

B.T. Scott

Pensions Manager

D. Smith

Investment Manager

I. Bainbridge

Review of the Year

We are pleased to present the 2005/06 Report and Accounts for the Tyne and Wear Pension Fund.

On the regulatory front, this has been a very demanding year as there have been several consultation exercises that have led to Scheme amendments, including the introduction of the single tax regime. This has involved system changes, staff training and the communication of these changes to members and employers.

During this period, we have continued to improve the services we provide. In particular, there has been a commendable, ongoing improvement in pensions processing.

We regularly seek the views of members and employers on the services we offer. In 2005/06, we issued surveys to our deferred members and to all employers. We were pleased to see that 97% of the deferred members who responded stated they were satisfied with the service we provide, as did 97% of the employers who responded to their survey.

Since 1999, we have produced annual benefit statements for our active members that set out their current and projected Scheme benefits. In 2004, we worked in partnership with the Department of Work and Pensions on a pilot project, targeted at 10% of our active members, for a combined pension forecast that also included information on their current and projected State Pension entitlement. This project was so successful and well received that we provided all of our active members with a combined forecast in 2005 and will continue to do so in future years. We have participated in a promotional campaign run by the DWP to encourage other pension funds to take up this facility.

Regrettably, it has been necessary to introduce increased employers' contributions in order to address the fall in the funding level that was revealed by the 2004 valuation. This was a common position across the Scheme.

The fall in the funding level was expected. It was largely attributable to the worldwide bear market in equities that took place between 2000 and 2003. This led to investment returns being below the level assumed in the 2001 valuation, although this was alleviated in part by the Fund's performance being stronger than the peer group return. Movements in interest rates also contributed to the fall.

The Fund has used a number of measures to assist employers to manage the increase, the most significant being an increase in the deficit recovery period for employers with a suitably strong covenant.

The Fund's investment strategy is derived from asset liability modelling. Early in 2005, our Investment Advisor, Hymans Robertson, completed the latest study using liability data from the 2004 valuation. It was determined that the optimal strategy for the Fund is an allocation of 67.5% to equities, 22.5% to bonds and 10% to property. Relative to the previous strategy, this is an increase of 2.5% in the exposures to both equities and property and a reduction in the bonds exposure of 5%. A further change is the introduction of active currency management.

The move to the new strategy took place during 2005/06 and was managed on a pragmatic basis to minimise transaction costs and disruption to portfolios. The existing line up of managers was used to implement most aspects of the revised strategy, the exception being currency management for which two new managers, Barclays Global Investors and Record Currency Management, were appointed.

The allocation to private equity remains unchanged at 5%. During the year, commitments were made to funds managed by Pantheon and Lexington to run alongside our existing programme of investment with HarbourVest and Capital International.

In 2005/06, selective modelling work has been carried out on the use of the Fund's risk budget and on further areas for investment. This has focussed on identifying approaches to reducing risk relative to liabilities, whilst increasing the return opportunities. Areas that are receiving consideration include absolute return, portable alpha strategies and tactical asset allocation.

The modelling indicated that further investment into active currency management has the potential to reduce risk and enhance returns. Accordingly, the allocation has been increased in 2006/07 by further investment with the existing currency managers.

Turning to investment performance, the year was characterised by strong returns from most asset classes.

Despite concerns over the rising oil price and interest rates, equity markets rose strongly, driven by robust corporate earnings and merger and acquisition activity. This is a continuation of the impressive gains made since the low point in markets in March 2003, with this period of recovery following three years of negative returns when equity values fell significantly from the high point attained in early 2000.

The best performing equity market was emerging markets, with a spectacular return of over 60%. The US market produced the lowest, but still a strong return of 24%.

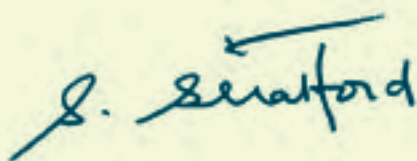
Property continued to perform strongly with a return of 19%, whilst UK bonds produced a return of over 7%.

In this environment, pension funds have been able to post good positive returns for the third year in succession. The Fund's return for the year was 25.4%, which was 0.4% below the benchmark return of 25.8%.

In order to avoid taking too short term a view of investment performance, pension fund returns are generally assessed over at least five year periods. The five year return is 7.3% per annum, which is 0.5% above the benchmark return of 6.8% per annum, whilst the ten year return is 8.3% per annum, which is 0.4% above the benchmark return of 7.9% per annum. The returns for both periods are above both inflation and the increase in average earnings.

Looking forward, we will continue to develop the investment strategy and improve the services we provide to members and employers.

The Scheme itself is subject to further change. Consultation has begun on options for a new scheme, with the intention of producing regulations by April 2007 that will take effect from April 2008. This timetable will allow actuaries to take the new scheme into account when preparing the 2007 valuations. The Fund will participate fully in the consultation exercise and will ensure members and employers are kept informed of developments.



Councillor Shirley Stratford
Chair of Pensions Committee



David Slater
Executive Director Regeneration
and Resources



South Tyneside Council is the administering authority of the local government pension fund for the Tyne and Wear County area.

The Council has established a Pensions Committee whose role is to control and resolve all matters relating to the Fund. The Council's Constitution requires the Committee to:

- Prepare, maintain and publish the Governance Policy Statement.
- Ensure that the Fund complies with the Local Government Pension Scheme Regulations 1997, the Local Government (Management and Investment of Funds) Regulations 1998 and all other legislation governing the administration of the Fund.
- Prepare, maintain and publish the Funding Strategy Statement.
- Ensure that the Fund is valued as required and receive and consider reports on each valuation.
- Ensure appropriate arrangements are in place for the administration of benefits.
- Set the admissions policy.
- Prepare, maintain and publish the Communications Policy Statement.
- Ensure appropriate additional voluntary contributions arrangements are in place.
- Prepare, maintain and publish the Statement of Investment Principles.
- Set the investment objectives and policy and the strategic asset allocation in the light of the Fund's liabilities.
- Appoint, dismiss and assess the performance of investment managers and custodians.

The Committee has eighteen members. South Tyneside Council nominates eight members and the other four district councils within the County area nominate one member each. The trades unions and the employers collectively nominate three members each, who sit on the Committee in an advisory capacity.

The Committee has a training policy that recognises the requirements of the Myners' Report. The training programme is designed to meet the Fund's specific training needs and includes those items from the Pensions Regulator's Code of Practice on Trustee Knowledge and Understanding that are relevant to the Scheme.

The Committee meets quarterly to consider pension matters. Additional meetings are called should an aspect of the Fund require an in-depth review.

The Committee has set up an Investment Panel to provide a greater focus on, and scrutiny over, the investment strategy and the performance of the investment managers. The Panel consists of three members of the Committee, the Investment Advisor, the Head of Pensions and the Investment Manager. It meets in advance of the Committee, reports its findings and makes recommendations on any action that is required.

Annual meetings are held for the employers and for the trades unions. The agenda for these meetings includes presentations by the Actuary and the Investment Advisor and covers the actuarial position, the benefits structure and investment performance.

The Governance Policy Statement includes further information on the Fund's governance arrangements. It may be viewed on the Fund's website, for which the address is www.twpf.info

Service Plan and Vision Statement

The vision and aims of the Fund are set out in our Service Plan. This is a three year rolling plan that is reviewed annually. It sets out the objectives and actions that we must concentrate on in order to achieve our vision.

The Pensions Committee approved the 2006 – 09 Service Plan on 27th February 2006.

The Service Plan may be viewed on the Fund's website.



Vision Statement

Our goal is to provide an attractive and affordable pension arrangement that is seen by employers and members as an important and valued part of the employment package.

We will:

- promote membership of the Fund
- keep employers' contributions as low and as stable as possible through effective management of the Fund
- work with our partners to provide high quality services to employers and members
- make pensions issues understandable to all.

We will know we are succeeding when:

- we are consistently achieving our investment objective
- there are sufficient assets to meet the liabilities
- we are consistently achieving our service standards
- we are recognised as being amongst the leading UK pension funds.

Legal Framework

Introduction

The framework for the Scheme is set out in Regulations that are made by the Department for Communities and Local Government (DCLG). These Regulations apply nationally to local authorities in England and Wales.

The framework for investment is set out in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998, as amended. These Regulations set out the types of investments that can be made, which include company and government securities, property and unit trusts. The Regulations also set out restrictions on the proportion of a fund that can be held in different types of investment.

The Local Government Pension Scheme Regulations 1997, as amended, set out the rates of contribution and the method of calculation of benefits.

These Regulations introduced a common contribution rate of 6% for all members. Manual workers who were members of the Scheme prior to 1st April 1998 retain the right to pay 5% for as long as they remain in the Scheme, in continuous employment and in the same capacity.

The Scheme provides an extensive range of benefits for members and their dependents, including:

- A pension and tax free lump sum on retirement.
- Widows', widowers' and civil partnership benefits.
- Children's pensions.
- Index-linking of all pensions.
- A lump sum on death in service and, sometimes, on death in retirement.
- Transfer values to other pension arrangements or index-linked deferred benefits for early leavers.
- A refund of contributions where no other benefit is due.
- Facilities for paying additional voluntary contributions to provide benefits.

The Stocktake

In July 2001, Ministers authorised a review, or "Stocktake", of the Scheme to ensure that it operates effectively and efficiently and that it provides value for money.

A number of discussion papers have been published by the DCLG inviting comment on possible changes to the Scheme. The Local Government Pensions Committee acts as the primary respondent for local government employers.

The Fund has submitted its own comments on all proposals. We have kept employers advised of progress and encouraged them to submit their own views. We have also hosted meetings between employers and the DCLG to consider the possible changes.

Phase I of the Stocktake became effective from April 2004 and introduced a number of changes, most of which were relatively minor technical changes.

The more significant changes were requirements for:

- Administering authorities to produce Funding Strategy Statements.
- Annual benefit statements to be produced for active, deferred and pension credit members. The Fund was already compliant with this requirement.

Phase II introduced changes to contribute towards stabilising the cost of the Scheme. These are contained in the Local Government Pension Scheme (Amendment) (No.2) Regulations 2004, which were issued in December 2004 and took effect from April 2005.

These Regulations:

- Removed the Rule of 85 voluntary early retirement provision.
- Increased the minimum retirement age from 50 to 55 for early retirement other than on the grounds of ill health.
- Provided limited protection in respect of both changes for members close to retirement.

The trades unions balloted their membership over these changes. In the light of strong support for industrial action, it was announced in March 2005 that the changes would be revoked and that a committee comprised of key stakeholders would be established to consider and negotiate the long-term future of the Scheme.

The changes were then revoked by the Local Government Pension Scheme (Amendment) Regulations 2005, which became effective from August 2005.

Many local government funds, including this Fund, took the impact of the changes contained in the 2004 Regulations into account when devising the strategy for the 2004 valuation. This is because they were law at the time the valuation came into effect. Accordingly, their impact is included in the employers' contributions that the Fund has been collecting since April 2005.

In March 2006, the DCLG issued the Local Government Pension Scheme (Amendment) Regulations 2006. The majority of the provisions became effective from April 2006, with the more significant changes being:

- The introduction into the Scheme of the single tax regime.
- The removal of the Rule of 85 voluntary early retirement provision, with limited protection for members close to retirement.
- Retiring members and some deferred beneficiaries may increase the amount of their benefits package taken as a lump sum to a maximum of 25% of the value of the package. The conversion rate is twelve pounds of lump sum for every pound of pension given up.

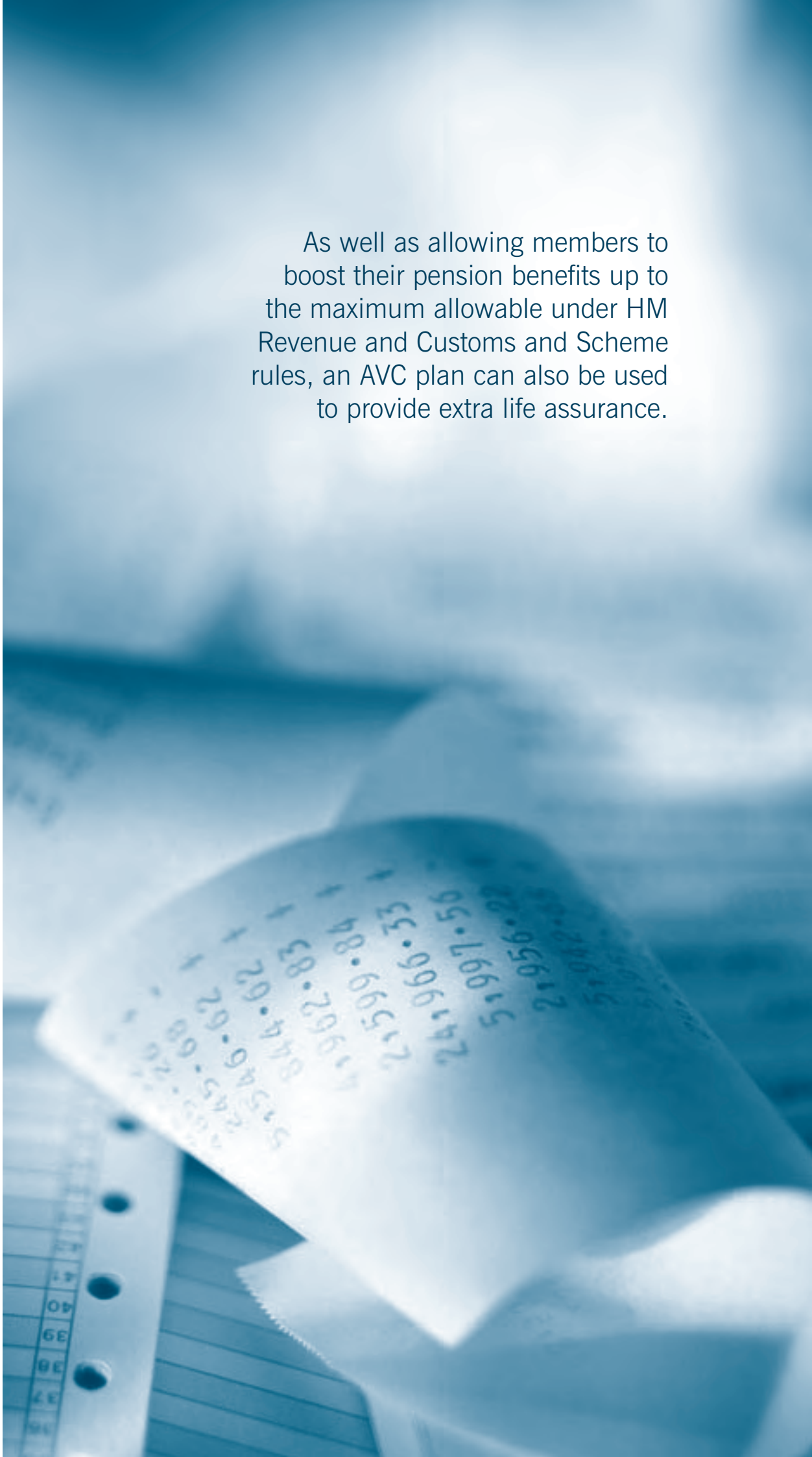
The removal of the Rule of 85 prompted the trades unions to take industrial action. This led to further negotiations, followed by the issue of the Local Government Pension Scheme (Amendment) (No.2) Regulations 2006 which have extended the protections available in respect of the removal of the Rule of 85.

A New Scheme

In June 2006, the DCLG began consultation on the structure of a new scheme that will be sustainable and affordable over the long term and that will meet the continuing needs of employers, members and taxpayers.

It is intended that regulations will be produced by April 2007 and that the new scheme will take effect from April 2008. This timetable will allow actuaries to take the new scheme into account when preparing the 2007 valuations.

As well as allowing members to boost their pension benefits up to the maximum allowable under HM Revenue and Customs and Scheme rules, an AVC plan can also be used to provide extra life assurance.



Additional^s Voluntary Contributions

Introduction

Whilst the Scheme provides a good benefits package, it is normally possible to increase benefits and thereby take full advantage of the available tax relief. This can be done either by purchasing additional periods of membership within the Scheme or by paying into the Fund's in-house additional voluntary contributions plan.

As well as allowing members to boost their pension benefits up to the maximum allowable under HM Revenue and Customs and Scheme rules, an AVC plan can also be used to provide extra life assurance.

In April 2006, HMRC and Scheme rules were changed to allow members at retirement to take all or part of their accumulated in-house AVC fund as a tax-free lump sum. The value of this is dependant on whether the member draws their AVC benefits at the same time as their Scheme benefits.

The Prudential

The Fund has an AVC plan arranged with The Prudential that offers a comprehensive range of funds including with-profits, unit-linked and deposit funds. The unit-linked fund includes a lifestyle option.

We carry out an annual review of AVC provision. The 2005/06 review was carried out with the assistance of Hewitt Bacon and Woodrow. It was concluded that The Prudential should remain as the sole provider. This review also led to a small change to the range of funds available.

Equitable Life

With the exception of existing life cover policies, the Fund has closed its AVC plan with Equitable Life to new members and transfers.

Acting in the light of advice from its legal and financial advisors, the Fund conducted a bulk transfer exercise in 2003. This involved the transfer of the majority of members' Equitable Life AVC funds to comparable funds with The Prudential.

A number of members who have with-profits investments still remain with Equitable Life. This is because it was not believed to be in the individual member's best interests to transfer as the withdrawal penalty applied on transfer may not be made up by future investment returns.

The position of these members has been re-examined in our latest annual review. The Fund is considering a further bulk transfer for some members.

The Fund continues to keep these members informed of their position.

Employers' Contributions and the Valuation Process

Introduction

The Scheme benefits are paid from investment income, employees' contributions as set by the Regulations and employers' contributions. The employers' contributions are adjusted in triennial valuations to ensure that the Fund has sufficient assets to cover its liabilities.

Funding Level

The Fund has been in deficit since 1992. It is important to understand the background to this position.

The 1989 valuation revealed a funding level of 118%, with this surplus being attributable to actual investment returns having greatly exceeded expected returns. This over-funded position led to the scheduled employers agreeing to take a contribution holiday. This eroded the surplus so that the funding level by the time of the 1992 valuation was 98%. The contribution holiday was ended and an employers' contribution for the scheduled employers was gradually phased back in.

The 1995 and 1998 valuations both identified funding levels of 87%. The 1998 result was adversely affected by the removal of the tax credit that was attached to UK equity dividends, which took effect from the July 1997 budget.

The 2001 valuation revealed a funding level of 82%. This reduction was attributable to increased longevity and some employer specific factors such as pay awards, restructuring, ill health retirements and early retirements. The outcome was also influenced by investment returns being below the levels assumed in the 1998 valuation, although this was alleviated in part by the Fund's performance being strong relative to its peer group.

The worldwide bear market in equities between 2000 and 2003 led to a further and significant fall in the funding level.

The 2004 valuation showed that the funding level had fallen to 64%. The fall was largely attributable to investment returns being below the levels assumed in the 2001 valuation, although, again, this was alleviated in part by the Fund's performance being stronger than the peer group return. A reduction in interest rates also contributed to the fall.

Employers' Contributions

The employers' contributions that resulted from the 2004 valuation were implemented from April 2005.

The average future service contribution is 240% of employees' contributions, whilst the contribution to address the deficit is 105%. The total rate of contribution is 345%.

Valuation Strategy

The strategy for the 2004 valuation is set out in the Funding Strategy Statement, which may be viewed on the Fund's website, and in the Valuation Report.

The requirement to prepare a Funding Strategy Statement was introduced in 2004/05. It is the responsibility of each administering authority to prepare, publish and maintain such a Statement, having regard to guidance and to the Statement of Investment Principles. The Fund consulted employers and considered their views in the formulation of the strategy.

The Fund has deployed a number of measures to assist employers to manage the increase in contributions, the most significant being an increase in the deficit recovery period for employers with a suitably strong covenant.

A deficit recovery period of thirteen years, equivalent to the average future working lifetime of active members, was generally used at the 2001 valuation. It was accepted across the Scheme that longer periods had to be used at the 2004 valuation if increases in employer contributions were to be held at manageable levels. The Fund used this approach selectively. It is an increased source of risk to the Fund and to individual employers because:

- Some employers directly guarantee the deficit of certain admission bodies and transferee admission bodies.
- If an employer without a guarantee closes in circumstances where they cannot pay the contributions due, then all employers in the Fund are required to pay revised contributions to meet the shortfall.

On the other hand, not extending a recovery period for an employer with a poor covenant could impose an additional financial pressure that might, in extreme cases and for non-statutory bodies, lead to a wind up. This could lead to a loss of the service provided by that employer.

Information supplied by employers in response to the Fund's Annual Employer Survey was taken into account in setting recovery periods. All employers were then asked for their views as part of the consultation exercise on the Funding Strategy Statement. Further consultation took place with the five district councils because if an employer without a guarantee closes in circumstances where it cannot pay the contributions due, a significant proportion of the shortfall would fall on the councils as they comprise such a large part of the Fund. In addition, they act as guarantors to a large number of other employers.

Having taken all views into account, deficit recovery periods were set within a range from twenty five years for employers with the strongest covenant to average future working lifetime of active members, which is generally around thirteen years, for employers with a weaker covenant.

For most contractors, this decision was also subject to a maximum of the remainder of the contract period.

Other measures that have been used to assist in managing the increase in contributions include:

- A smoothing adjustment to the market value of the assets. This took account of asset values over a three year period and slightly increased the funding level.
- The use of up to three annual steps in the deficit payments.
- The Fund's policy has been to group some smaller employers for the purpose of setting contribution rates. This serves to protect such employers from the risk of high volatility of contribution rates. Following careful consideration, the number and type of groups was revised to provide for greater homogeneity within each group.

The changes resulting from Phase II of the Stocktake were taken into account in the 2004 valuation and led to a reduction of about 30% in future service rates. This was because the changes were law as at April 2005. In August 2005, the Phase II changes were retrospectively revoked and administering authorities were provided with a power, but not an obligation, to carry out an interim valuation. Following discussion with the Fund's Actuary, it was decided that an interim valuation should not be carried out. This was a common approach across the Scheme.

The 2007 Valuation

The next valuation will be undertaken as at March 2007.

Since the 2004 valuation, the Fund has been monitoring the estimated movements in the funding level. This monitoring has been showing an improvement in the funding level, but with the possibility of some upward pressure on contribution rates. The strategy for the 2007 valuation will take into account the impact of changes in regulations, affordability and updated financial, inflation, salary and mortality assumptions.

Statement of the Actuary

Introduction

The Local Government Pension Scheme Regulations 1997 require that a full actuarial valuation is carried out every third year. The purpose of this is to establish that the Tyne and Wear Pension Fund (the Fund) is able to meet its liabilities to past and present contributors and to review employer contribution rates. The last full actuarial investigation into the financial position of the Fund, in accordance with Regulation 77(1) of the Local Government Pension Scheme Regulations 1997, was completed as at 31st March 2004.

Actuarial Position

1. Rates of contributions paid by the participating employers during 2005/06 were based on the actuarial valuation carried out as at 31st March 2004.
2. The valuation as at 31st March 2004 showed that the financial position of the Fund had deteriorated since the previous valuation with the market value of the Fund's assets of £2,355.7m, after application of a smoothing adjustment, covering 64% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable remuneration.
3. The valuation also showed that the required level of contributions to be paid to the Fund by participating employers (in aggregate) with effect from 1st April 2005 was as set out below:
 - 240% of members' contributions to meet the liabilities arising in respect of service after the valuation date.

Plus

- 140% of members' contributions to restore the assets to 100% of the liabilities in respect of service prior to the valuation date, over a recovery period of twenty-five years.

Less

- 35% of members' contributions in respect of higher assumed investment income over the short term.

These figures were based on the regulations that applied at the time of signing the valuation report, and in particular allowed for changes to the Fund benefits effective from 1st April 2005.

4. The majority of employers participating in the Fund pay different rates of contributions depending on their past experience, their current staff profile, and the recovery period agreed with the administering authority. For many employers where the valuation indicated a significant increase in contributions from 1st April 2005, the administering authority has agreed with employers that the increase can be stepped over a period not exceeding three years.

If our assumptions are borne out in practice, the rate of contribution for each employer would be expected to continue stepping up to the end of the relevant stepping period. The rate would subsequently increase, due to cessation of assumed short term additional investment returns (see 7 below), and continue at the resultant level for the balance of the relevant recovery period before reverting to the relevant long term rate. In practice, each rate will be reviewed at the next valuation due as at 31st March 2007 and further assumptions may be made at that time concerning short term additional investment returns.

5. The rates of contributions payable by each participating employer over the period 1st April 2005 to 31st March 2008 are set out in a certificate dated 30th March 2005 which is appended to our report of the same date on the actuarial valuation.

6. The contribution rates certified in our valuation as at 31st March 2004 were based on the benefit structure of the Fund as indicated by regulations as at the date of signing our certificate. New regulations (the 2005 Regulations), backdated to 1st April 2005, have since been issued which increased the theoretical cost of Fund benefits relative to those on which the certificate was based. No adjustment has been made to contribution rates in respect of that change as it was indicated by the government that further changes would occur which would offset these additional costs. Further regulations have recently been issued, effective at 6th April 2006 and 1st October 2006 which will, in theory, reduce the cost of Fund benefits to below that on which our certificate was based and will also recoup the additional costs arising from the 2005 Regulations. However, discussions are still ongoing between government, employer and union representatives about improvements to benefits for existing members and there may be further changes to the regulations. The impact of all of these changes will be taken into account at the next Fund valuation.
7. The vast majority of contribution rates were calculated using the projected unit actuarial method, and taking account of the Fund's funding strategy as described in the Funding Strategy Statement.

The main actuarial assumptions were as follows:

Discount rate for periods in service	6.2% per annum
left service	5.2% per annum
Rate of general pay increases	4.4% per annum
Rate of increases to pensions in payment (in excess of Guaranteed Minimum Pensions)	2.9% per annum
Return over the three years following the valuation on equities/property	6.45% per annum
other assets	5.2% per annum
Valuation of assets	smoothed market value

8. The next actuarial valuation of the Fund will be carried out as at 31st March 2007.
9. This statement has been prepared by the Actuary to the Fund, Hewitt Bacon and Woodrow Limited, for inclusion in the accounts of the Tyne and Wear Pension Fund. It provides a summary of the results of the actuarial valuation which was carried out as at 31st March 2004. The valuation provides a snapshot of the funding position at the valuation date and is used to assess the future level of contributions required.

This statement must not be considered without reference to the formal valuation report which details fully the context and limitations of the actuarial valuation.

Hewitt Bacon and Woodrow Limited does not accept any responsibility or liability to any party other than our client, the Council of the Borough of South Tyneside, in respect of this statement.

Membership of the Fund

As at 31st March 2006, there were 121 employers participating in the Fund. This includes the five district councils and a wide range of other organisations that provide a public service within the Tyne and Wear County area.

A number of employers outsourced parts of their functions during the year. The transferred employees have continued to be Scheme members where the contractor has been admitted to the Fund.

The Fund had 97,436 members as at the 31st March 2006. This is an increase of 3,283 over the membership of 94,153 as at 31st March 2005.

	31st March 2005	31st March 2006
Active Members	48,660	48,986
Deferred Members	16,471	18,887
Pensioners	29,022	29,563
Total Membership	94,153	97,436



Employers in the Fund and their members as at 31st March 2006:

District Councils	Actives	Deferreds	Pensioners
City of Sunderland Council	8,809	3,661	5,403
Gateshead Council	7,128	2,982	4,786
Newcastle City Council	9,137	3,196	6,544
North Tyneside Council	6,156	2,339	3,680
South Tyneside Council	5,745	2,242	3,317
Sub Totals	36,975	14,420	23,730

Other Scheduled Bodies	Actives	Deferreds	Pensioners
City of Sunderland College	447	137	51
Former North East Regional Airport	0	0	35
Former Tyne and Wear County Council	0	101	277
Former Tyne and Wear Residuary Body	0	5	30
Gateshead College	237	110	43
Gateshead Housing Company	321	21	5
Monkwearmouth College	0	1	5
National Probation Service – Northumbria	669	152	269
Newcastle College	656	200	101
Newcastle Education Action Zone	0	3	2
North Tyneside College	0	55	20
Northumberland Magistrates Court	0	44	82
Northumbria Police Authority	1,945	597	901
Northumbria University	1,465	618	459
South Tyneside College	265	101	101
South Tyneside Education Action Zone	0	2	0
Sunderland Education Action Zone	0	0	1
Tyne and Wear Fire and Rescue Service	264	80	178
Tyne and Wear Passenger Transport Authority	97	30	79
Tyne Metropolitan College	213	13	6
Tynemouth College	0	21	7
University of Sunderland	873	453	278
Wearside College	0	4	9
Your Homes Newcastle	590	24	21
Sub Totals	8,042	2,772	2,960

Resolution Bodies	Actives	Deferreds	Pensioners
Birtley Town Council	6	3	5
Blakelaw and North Fenham Parish Council	0	0	0
Blue Square Trading	11	4	0
Learning World	0	9	0
Nexus	982	431	1,394
Sub Totals	999	447	1,399

Admitted Bodies	Actives	Deferreds	Pensioners
Age Concern Newcastle	64	26	21
Assessment and Qualifications Alliance – AQA	0	3	12
Association of North East Councils	26	9	5
Balfour Beatty Power Networks Limited	22	0	0
Baltic Arts Flour Mills Visual Arts Trust	5	4	0
Benton Grange School	0	0	8
Benwell Young Peoples Development Group	2	0	0
Bovis Lend Lease (BLL)	9	0	0
Brunswick Young Peoples' Project	3	2	0
Catholic Care North East	0	23	25
Community Action on Health	5	0	0
Compass Group UK and Ireland Limited	6	0	0
Disability North	18	17	4
Gateshead Law Centre	8	6	0
Hebburn Neighbourhood Advice Centre	5	0	0
Higher Education Funding Council for England	0	2	8
Information North (Northern Regional Library System)	0	0	3
International Centre for Life	13	7	2
Jarvis Accommodation Services Limited	7	0	0
Jarvis-Sandhill View	5	1	1
Kenton Park Sports Centre	5	4	0
Managed Business Space Limited	2	0	1
Mitie Cleaning (North) Limited	0	1	0
Mitie PFI Limited	2	0	0
Morrison Facilities Services Limited 1	67	0	1
Morrison Facilities Services Limited 2	268	0	0
National Car Parks Limited	8	2	2
National Glass Centre	1	1	1
Newcastle Family Service Unit	0	4	3
Newcastle Healthy City Project	16	6	0
Newcastle International Airport Company Limited	225	264	302
Newcastle Law Centre	6	3	2
Newcastle Tenants Federation	2	4	0
Newcastle Theatre Royal Trust Limited	50	23	15
Newcastle West End Partnership	0	2	0
Newcastle Youth Congress	0	2	0
No Limits Theatre	2	0	0
Norcare	0	1	1
Norland Road Community Centre	0	1	0
North East Innovation Centre Company Limited	13	12	7
North East Museums, Libraries and Archives Council	20	6	3
North East Regional Employers' Organisation	7	2	5
Northern Arts Association	0	35	11
Northern Council for Further Education	1	14	12
Northern Counties School	0	21	20

Admitted Bodies	Actives	Deferreds	Pensioners
Northern Grid	8	0	0
North Tyneside Child Care Enterprise	3	15	1
North Tyneside City Challenge	0	4	1
North Tyneside Disability Advice Centre	0	0	1
Northumbria Tourist Board	0	39	9
One North East	0	2	7
Ouseburn Trust	0	2	0
Passenger Transport Company	0	0	97
Percy Hedley Foundation	32	0	0
Port of Tyne Authority	0	0	6
Praxis Service	1	3	0
Raich Carter Sports Complex	28	13	0
Saint Mary Magdalene and Holy Jesus Trust	7	6	3
Saint Mary the Virgin Estate Management Charity	0	0	1
Scolarest	26	2	1
Search Project	3	1	2
Simonside Community Centre	1	0	0
Southern Electric Contracting Limited	34	0	0
South Tyneside Groundwork Trust	5	3	2
South Tyneside Victim Support	0	2	0
Stagecoach Travel Services (Busways)	238	210	539
Sunderland City Training and Enterprise Council	0	48	20
Sunderland Empire Theatre Trust Limited	0	7	4
Sunderland Housing Group	1,494	229	118
Sunderland Outdoor Activities Association	0	3	0
Sunderland Streetlighting Limited	62	2	4
The Ozanam House Probation Hostel Committee	27	10	6
Thomas Gaughan Community Association	2	0	0
Tyne and Wear Development Company Limited	13	10	3
Tyne and Wear Development Corporation	0	28	22
Tyne and Wear Enterprise Trust Limited	18	13	12
Tyne and Wear Play Association	1	0	0
Tyne and Wear Small Business Service	38	6	7
Tyneside Deaf Youth Project	3	0	0
Tyneside Training and Enterprise Council	0	46	29
Tyne Waste Limited	0	11	11
Valley Citizens Advice Centre	0	2	0
Viacom Outdoor Limited	2	1	0
Walker Profiles (North East) Limited	31	0	0
Wallsend Citizens Advice Centre	0	2	1
Wallsend Peoples Centre	0	3	2
Workshops for the Adult Blind (Palatine Products)	0	17	90
Sub Totals	2,970	1,248	1,474

Grand Totals	48,986	18,887	29,563
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Working with Members and Employers

Introduction

The provision of a statutory pensions service to 97,000 members and 121 employers is a substantial task. This service is provided by the Pensions Office, which is organised into five teams of experienced officers who are encouraged to obtain a recognised professional qualification.

Each employer is allocated to one of our three administration teams, which are responsible for maintaining the member records for the employer and for calculating and paying benefits. These teams manage contact with the employers at an individual level.

Our Communications Team produces Scheme and Fund specific information for members and employers. It manages contact with members, mainly through the helpline, newsletters and annual benefit statements. It prepares mailshots for employers and runs meetings with groups of employers. It is also responsible for maintaining the website.

Our Technical Team arranges the actuarial valuations and provides support to the other four teams, with particular regard to IT systems and solutions, financial control and information on the Scheme's regulatory background.

Communications Policy

Our vision statement sets out our aim of making pensions issues understandable to all our stakeholders.

The Fund has a Communications Policy Statement that sets out the services we provide to members, prospective members and employers. We review and revise the Policy regularly.

The Statement outlines:

- How we communicate with our stakeholders.
- The format, frequency and method of our communications.
- How we promote the Scheme to prospective members and employers.

The Statement is available on the website.

Surveys

We are committed to continually improving the services we offer.

To assist with this, we regularly seek the views of members and employers through surveys. In 2005/06 we issued surveys to our deferred members and employers.

We were pleased to see that 97% of our deferred members who responded stated that they were satisfied with the service we provide, as did 97% of the employers who responded.

A number of helpful comments were made on service provision, which have received consideration.

Services to Members

The main services that we provide to our members are:

- We maintain a website.
- We provide a helpline, which last year received over 45,000 calls.
- We welcome personal callers. An appointment is not necessary.
- We provide combined pension forecasts for our active members and annual benefit statements for our deferred members. Pensioners receive an annual update and details of their pensions increase. These are sent directly to the member's address, accompanied by an annual report.
- We provide newsletters to keep members informed of changes to the Scheme.
- We provide seminars to members covering topics such as induction, midlife and pre-retirement planning.
- We provide a comprehensive range of information booklets that are available from our website or on request from the helpline.

We adopt the principles of plain English in our documents and are pleased to say that our recent survey of deferred members showed that:

- 98% of members who responded found their annual benefit statement easy to understand.
- 97% of members who responded found the annual report easy to understand.

All information supplied by the Fund is available in a range of formats including other languages, large print and Braille. We also have access to audio aids and British Sign Language interpretation services.

When joining the Fund, members can register to receive all future information in their required format.

Combined Pension Forecasts

Since 1999, we have produced annual benefit statements for our active members that set out their current and projected Scheme benefits.

In 2004, we worked in partnership with the DWP on a pilot project, targeted at 10% of our active members, for combined pension forecasts that also included information on their current and projected State Pension entitlement.

This project was so successful and well received that we provided all of our active members with a combined forecast in 2005 and will continue to do so in future years. We have participated in a promotional campaign run by the DWP to encourage other pension funds to take up this facility.

Services to Employers

The main services that we provide to employers are:

- We provide each employer with a client manager whose role is to ensure efficient processing and communication.
- We have a programme of meetings to discuss issues related to pensions administration and regulatory changes.
- We have a partnership agreement that sets out our respective roles and responsibilities.
- We provide an Employers' Guide to the administration of the Fund. This is available online.
- We offer training courses that aim to educate and inform staff on pensions matters and working procedures. In the past year, we have provided training to forty-eight representatives from seven employers.
- We hold an annual general meeting.
- We send out mailshots to advise employers of developments.

Our Website and Electronic Communications

The use of email, electronic communication and our website is an increasingly important part of the service delivery package. We are committed to developing and improving these approaches to communication.

We encourage our members, prospective members and their representatives to contact us by email at pensions@twpf.info

Through our website, members have access to:

- Details on how to contact the Fund.
- Latest news and topical issues.
- Information booklets.
- Pension payment dates and details of pension inflation proofing.
- Links to other useful websites.
- The Report and Accounts.
- The Fund's main policies, including the Funding Strategy Statement, the Communications Policy, the Governance Policy, the Statement of Investment Principles and the Policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance.

In addition to the main website, the Fund has a password-protected area for employers. So far, thirty one employers, including the five district councils, have registered to use this service which provides them with access to:

- The pension records of their own employees.
- The Employers' Guide and templates of administration forms.
- Latest news and topical issues.
- Pensions Committee Reports.

The Fund is working towards expanding the interactive nature of the website. We intend to introduce systems that will allow members to view their personal record and calculate estimates of their benefits. We are also looking to introduce online automated data transmission and processing for employers.

The Fund has developed an email alert facility to provide important news and latest information. Employers are actively encouraged to register for this facility and forty one have done so to date. This facility greatly improves the efficiency of keeping employers informed and allows them to distribute information within their own organisation.

Events During the Year

This has been a very demanding year for the Pensions Office as there have been a number of regulatory consultation exercises and Scheme amendments to implement and prepare for, including HMRC's simplification of tax on pensions known as A-Day. This has involved system changes, staff training and the communication of these changes to members and employers.

Through all this, we have continued to work to improve the services we provide to employers and members. In particular, there has been a commendable, ongoing improvement in pensions processing.

The Fund's branding had been in place for a number of years. Last year we redesigned this and changed to what we believe is a fresher, brighter and clearer look. The new branding was launched through the annual benefit statements and has been well received by members.

Introduction

The Investment Office of the Pensions Service manages the investment of the Fund.

The formal objectives are:

- To maintain securely a portfolio of assets of appropriate liquidity which will generate income and capital growth which, together with employer and employee contributions, will meet the cost of current and future benefits which the Fund provides, as set out in the relevant statutory documentation.
- To minimise the long term costs of the Fund by maximising the return on the assets, whilst having regard to the objective set out above.
- To comply with regulations relating to the investment of local government pension funds.

Strategy

The Fund's strategy is derived from asset liability modelling. This examines the Fund's financial position, the profile of its membership, the nature of its liabilities and includes an analysis of projected returns from differing investment strategies.

The Fund's Investment Advisor, Hymans Robertson, completed the most recent study early in 2005, using the liability data from the 2004 valuation.

The study determined that the optimal strategy for the Fund is 67.5% in equities, 22.5% in bonds and 10% in property. Relative to the previous strategy, this is an increase of 2.5% in both equities and property and a reduction in the bonds exposure of 5%.

A further change is the introduction of active currency management. The allocation to private equity is unchanged at 5%.

The move to the new strategy took place during 2005/06. This was managed on a pragmatic basis to minimise transaction costs and disruption to portfolios. The existing line up of managers was used to implement all aspects of the revised strategy, with the exception of currency management for which two new managers were appointed.



The changes and the new strategy are summarised below:

Asset Class	Previous Strategy %	Change %	New Strategy %
UK Equities	30.00	-2.50	27.50
Overseas Equities			
US	9.75	+2.75	12.50
Europe ex UK	12.25	+1.25	13.50
Japan	6.50	+0.50	7.00
Other Far East	3.25	+0.25	3.50
Emerging Markets	3.25	+0.25	3.50
Total Overseas Equities	35.00	+5.00	40.00
Total Equities	65.00	+2.50	67.50

Fixed Interest			
UK Gilts	8.75	-1.75	7.00
UK Index-Linked	5.00	-1.00	4.00
Sterling Non Government	11.00	-2.00	9.00
Overseas	2.75	-0.25	2.50
Total Fixed Interest	27.50	-5.00	22.50

Property	7.50	+2.50	10.00
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Most changes took place in the first half of 2005/06. The increased allocation to property was not fully in place until nearer the year end because of the time required to identify appropriate properties for purchase.

Further Development

During 2005/06, selective modelling work has been carried out on the use of the Fund's risk budget and on further areas for investment.

This analysis has shown that the main investment risk for the Fund comes from the exposure to equity markets. Whilst the investment is well spread globally, there is a high correlation between market movements. This risk is considered to be acceptable, given that the Fund has a long-term expectation of an excess return from equities, relative to its liabilities, and that the Fund's employers collectively have a strong covenant.

The modelling work focussed on identifying approaches to reducing risk, relative to liabilities, whilst increasing the return opportunities. Areas that are receiving consideration include absolute return, portable alpha strategies and tactical asset allocation.

The modelling suggested that further investment into active currency management has the potential to reduce risk and enhance returns. Accordingly, the allocation to active currency funds has been increased in 2006/07.

Developments During 2005/06

The most significant developments to the investment management structure during 2005/06 are summarised below:

Dates	Activity
June 2005	Commitment of €48 million to HarbourVest Private Equity Partners Fund V, which seeks private equity opportunities outside the US.
June 2005	Commitment of €20 million to HarbourVest Private Equity Partners V Direct Fund, which invests directly in companies in Western Europe and the US.
June 2005	Commitment of \$10 million to Pantheon Asia Fund IV, which seeks out private equity opportunities in Asia.
June 2005	The Fidelity UK equity mandate was amended to allow tactical investment into overseas companies.
July 2005	Commitment of €25 million made to Pantheon Europe Fund IV, which seeks out private equity opportunities in Europe.
July 2005	Commitment of \$30 million made to Pantheon USA Fund VI, which seeks out private equity opportunities in the US.
July 2005	Increased equity allocations and changes to the regional equity allocations were achieved, in line with the new strategy.
August 2005	Commitment of \$30 million made to Lexington Capital Partners Fund VI, which seeks out secondary investments into private equity funds on a global basis.
September 2005	Changes were made to the Henderson bond mandate to allow investments in high yield debt, emerging market debt, secured loans and an absolute return fund. The risk control target was changed to a tracking error target.
October 2005	Implemented active currency mandates with BGI and Record Currency Management, each of £20 million.
November 2005	Increased securities lending limit from 25% of assets to 35%, in line with the increased flexibility in the Scheme Regulations.
November 2005	Changes to the Prudential M&G bond mandate to include investments in secured loans and collateralised debt obligations and to permit a bond fund to use swaps. The benchmark was adjusted to allow for improved tactical opportunities.
December 2005	The Fidelity UK equity mandate was transitioned from a single manager product to a multi-manager product. The outperformance target was increased to 2.0% per annum from 1.5% per annum, to be in line with an increase in the permitted risk.
December 2005	Decision taken to invest into a private finance initiative fund managed by Henderson Global Investors.
March 2006	Increased allocation of 10% to property was achieved, in line with the new strategic benchmark.

Investment Management Structure

The Fund employs ten specialist managers over fifteen investment mandates. This broadly-based structure seeks to ensure that investment returns should not be overly influenced by the performance of any one manager.

The structure is set out in the following table:

Manager	Portfolio
Legal and General	Indexation UK Equities US Equities Corporate Bonds UK Index-Linked
Capital	Global Equities Emerging Market Equities
UBS	Pan European Equities
Fidelity	UK Equities
Schroder	Japanese Equities Pacific Rim ex Japan Equities
Barclays Global Investors	Active Currency
Record	Active Currency
Prudential M&G	Corporate Bonds
Henderson	Global Bonds
Arlington	Property

When this investment management structure was being designed and implemented in 2001/02, consideration was given to its flexibility and resilience to change. This provided the ability for the new strategy to be implemented largely through the existing line up of managers. The exception to this was the appointment of the two new active currency managers.

Private Equity

The Fund's objective is to have a 5% allocation to private equity, financed out of the 67.5% allocation to the quoted equity markets. As at March 2006, 1.5% of the Fund was invested in private equity.

Since 2002, the programme has been comprised largely of investment into fund of funds managed by HarbourVest. The Fund also has an investment in an emerging markets fund managed by Capital International.

In order to diversify this exposure and to speed up progress towards attaining the target weighting, the Fund has made commitments to fund of funds managed by Pantheon Ventures and to a secondary fund managed by Lexington Partners. These additional providers are considered to complement the programme offered by HarbourVest and Capital International.

Further investments are under consideration.

Assets Under Management

The value of assets with each manager and invested in private equity at the year end is shown below:



	£m		£m
Legal and General	642.7	Barclays Global Investors	22.7
Capital	485.2	Record	23.2
UBS	619.8	Henderson	246.1
Fidelity	382.6	Arlington	304.2
Schroder	322.8	Private Equity	50.3
Prudential M&G	290.0		

Investment Managers' Objectives and Restrictions

The Pensions Committee has set objectives and restrictions for the investment mandates with the aims of ensuring a prudent approach to investment and allowing each manager to implement their natural investment style and process.

In addition to the specific restrictions on each mandate, all managers are required to comply with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998, as amended.

The managers have been set targets, based on appropriate indices, which generally require outperformance over three year rolling periods. Annual downside targets or tracking error targets have also been set.

Investment in private equity is made largely on a fund of funds basis. Whilst an outperformance target of 5% above quoted equity has been set, official measurement against this target is inappropriate at this early stage of investment.

The property portfolio has a target based on the Investment Property Databank Index.

Custody

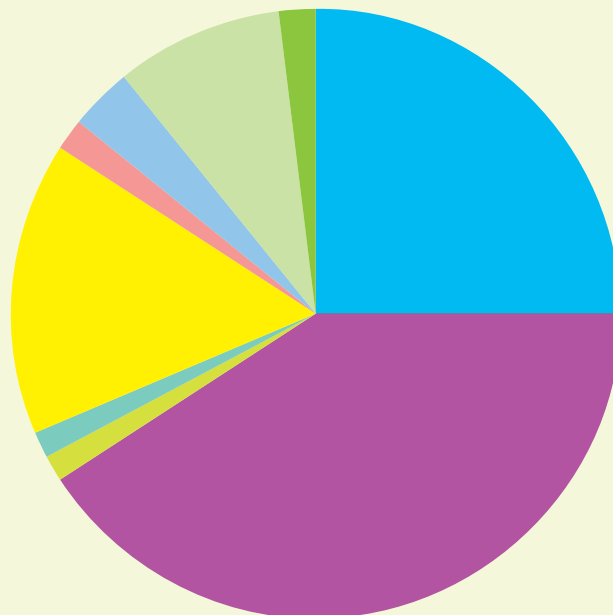
Northern Trust was appointed in 2002 to provide custody services for four segregated mandates. In early 2005, the remit was widened to cover the remainder of the segregated assets in the Fund. As at March 2006, Northern Trust was providing custody for approximately £1,900 million of assets held in seven mandates.

Asset Allocation

The asset allocation is maintained within pre-determined ranges around the strategic benchmark. When a range is breached, the Fund is rebalanced back within the ranges. Legal and General provides management information that assists with this process.

The active managers that invest in more than one market are permitted to take tactical asset allocation decisions within their portfolios. This does not impact on the Fund's overall strategy but provides additional scope for managers to outperform their targets.

The asset allocation as at March 2006 is shown below:



	£m	%		£m	%
UK Equities	851	25	Overseas Fixed Interest	60	2
Overseas Equities	1,396	41	UK Index-Linked	112	3
Private Equity	50	1	Property	306	9
Currency	46	1	Net Current Assets	67	2
UK Fixed Interest	532	16			

Performance Measurement

2005/06 is the third full year for which performance has been measured against a fund-specific strategic benchmark. A hybrid benchmark is used for longer periods that end on March 2006. This is based on a median up to and including periods ending on January 2002 and on the strategic benchmark thereafter.

Performance was measured against a rolling benchmark for the first six months of 2005/06 to take account of the phased shift to the new strategy. With the exception of the increased allocation to property, the shift was largely complete by October 2005, and it was considered appropriate to use the new strategic benchmark from that date.

Returns for 2005/06

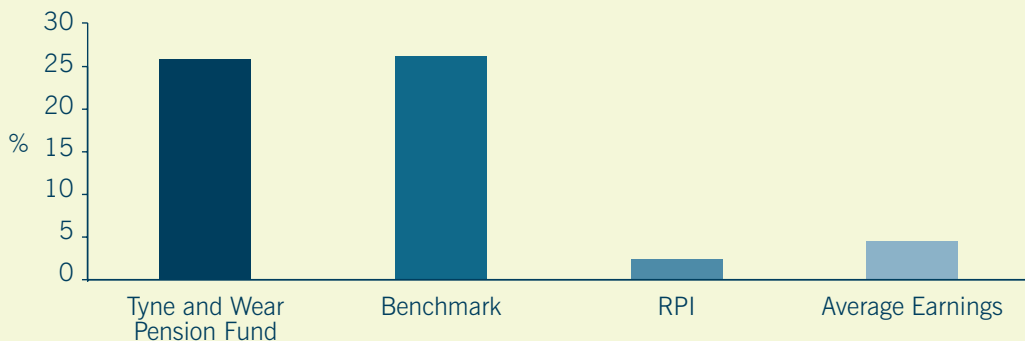
Despite concerns over the rising oil price and interest rates, equity markets rose strongly over the year, driven by robust corporate earnings and merger and acquisition activity. This is a continuation of the impressive gains made since the low point in markets in March 2003. This period of recovery followed three years of negative returns when equity values fell significantly from the high point attained in early 2000.

The best performing equity market was emerging markets, with a spectacular return of over 60%. The US market produced the lowest, but still a strong, return of 24%.

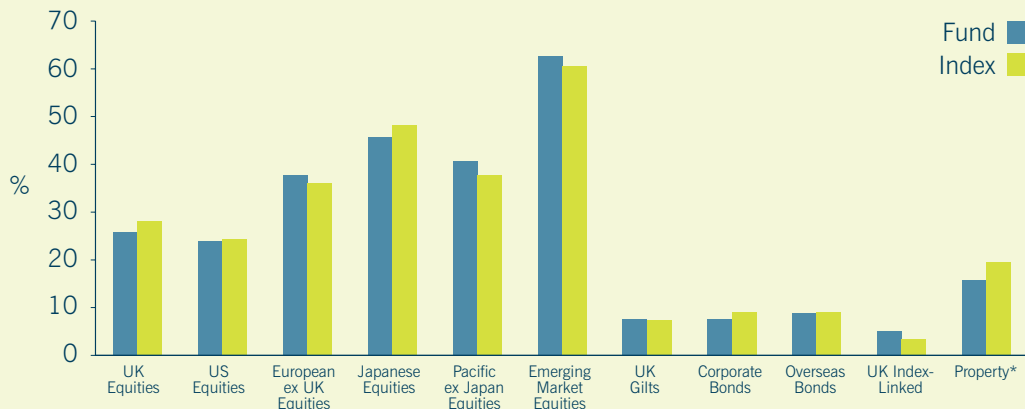
Property continued to perform strongly with a return of 19%, whilst UK bonds produced a return of over 7%.

In this environment, pension funds have been able to post good positive returns for the third year in succession.

The Fund's return for the year was 25.4%, which was 0.4% below the benchmark return of 25.8%.



The chart below shows the Fund's returns over the main investment markets for 2005/06.

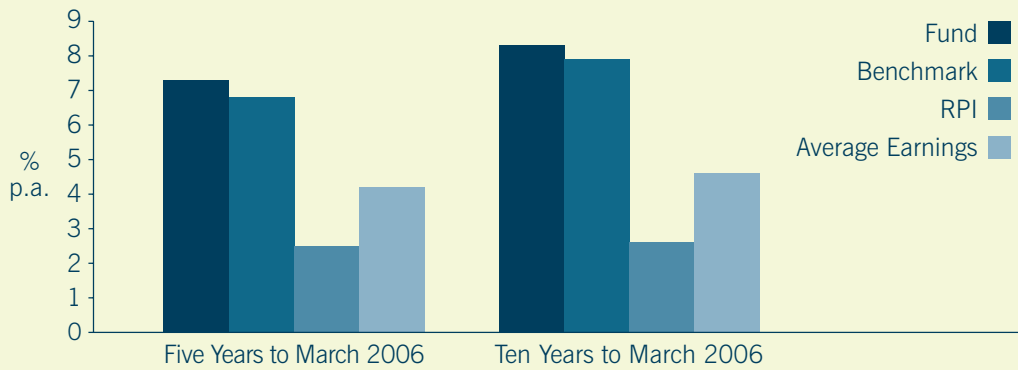


* Property performance is measured and shown on a calendar year basis to December 2005.

Longer Term Performance

In order to avoid taking too short term a view of investment performance, pension fund returns are generally assessed over at least five year periods.

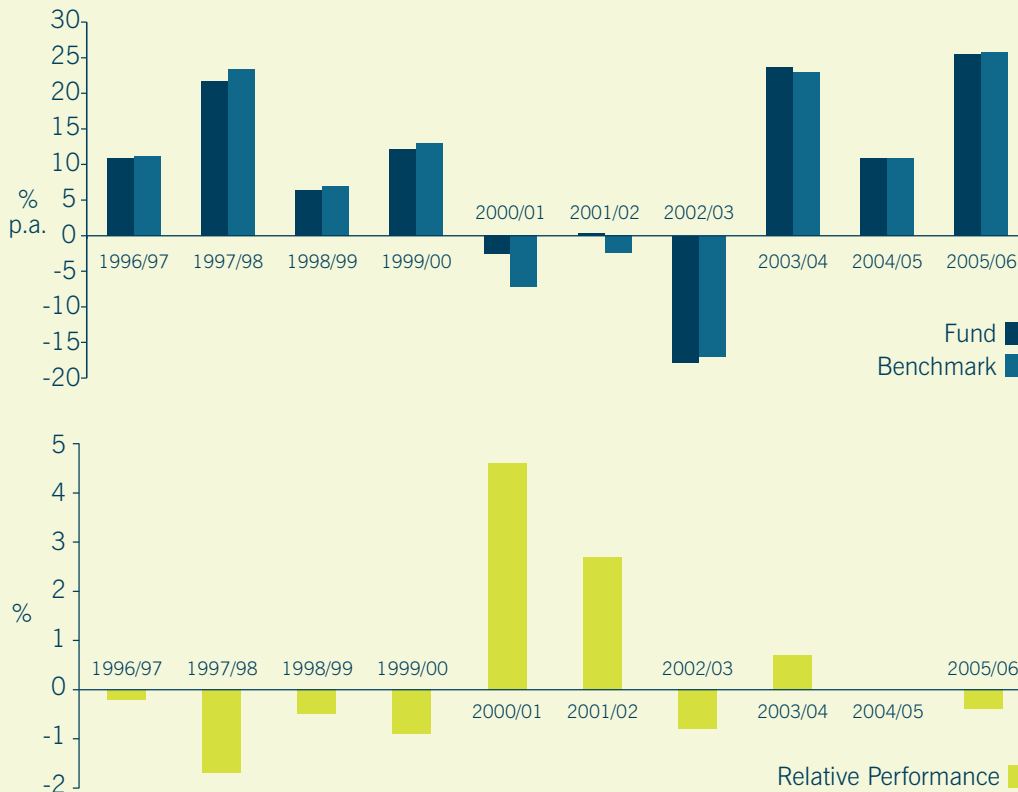
The chart below shows the Fund's annual return over five year and ten year periods.



The five year return is 7.3% per annum, which is 0.5% above the benchmark return of 6.8% per annum, whilst the ten year return is 8.3% per annum, which is 0.4% above the benchmark return of 7.9% per annum.

The returns for both periods are above both inflation and the increase in average earnings.

The annual performance of the Fund over ten years is shown in the following charts:



The charts show that the Fund's relative performance was poor in the mid to late 1990s. This was a time of strong equity markets and performance suffered because the Fund was positioned, overall, for a downturn in equity markets. Consequently, the Fund was appropriately positioned for the equity market correction that ran from 2000 to 2003.

Absolute returns have been strong in the last three years, whilst the relative performance has been slightly positive.

Myners Report

In March 2000, the Chancellor of the Exchequer commissioned a review into institutional investment in the UK. He invited Paul Myners of Gartmore Investment Management to lead the review.

The Myners' Report was produced in March 2001. In October 2001, the Government published a Code of Investment Principles that reflected the proposals contained in that Report. There are ten Principles contained in the Code and, whilst compliance is voluntary, legislation requires local government pension funds to state the extent of their compliance.

In December 2004, the Treasury published a consultation document that reviewed the progress of pensions funds' compliance with the Principles. This review concluded that the voluntary approach to seeking improvements was working, but further progress was needed. Some amendments to the Principles were proposed.

Further Myners-related change has come through in guidance issued by the National Association of Pension Funds, the Financial Services Authority and the Institutional Shareholders Committee.

A further review of progress is to be carried out in 2007.

2005/06 is the third year that the Fund has been able to report full compliance with the Principles.



A summary of the Principles and the Fund's compliance is shown below:

Principle 1	Decisions should only be taken by those with sufficient expertise.	Fully Compliant. An Investment Panel provides increased focus and scrutiny over investment decisions. A comprehensive training programme is in place for Pensions Committee Members. A Committee Members Handbook is issued.
Principle 2	Clear investment objectives should be set.	Fully Compliant. The Fund has set formal investment objectives.
Principle 3	Strategic asset allocation decisions should receive sufficient attention.	Fully Compliant. The Fund has undertaken an asset liability study and tests the results in the light of changing market and liability data. Risk budgeting and modelling work was undertaken in 2005/06.
Principle 4	Contracts for actuarial services and investment advice should be open to separate competition.	Fully Compliant. The actuarial services contract and the investment advisory contract were separately tendered in 2003/04.
Principle 5	An explicit written mandate should be agreed between the Fund and the investment managers and transaction related costs should be monitored.	Fully Compliant. Written mandates have been agreed with all investment managers and arrangements are in place to monitor transaction costs and foreign exchange costs.
Principle 6	The Fund should play an active role in Corporate Governance.	Fully Compliant. The Fund has a policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance.
Principle 7	The Fund should set appropriate investment benchmarks.	Fully Compliant. Investment benchmarks have been set for the Total Fund and for individual investment mandates.
Principle 8	Arrangements should be made to measure the performance of the Fund, the Committee, Advisors and Managers.	Fully Compliant. A service provider has been appointed to measure the risk and return of the Total Fund and of individual managers. A formal assessment of the effectiveness of decisions taken by the Committee, the Advisor and the Officers takes place. The decision making process is subject to independent review.
Principle 9	The Statement of Investment Principles should be strengthened.	Fully Compliant. The Fund's Statement of Investment Principles has been expanded to include all of the areas required by the Myners' Report.
Principle 10	The Fund should publish its Statement of Investment Principles and the results of monitoring.	Fully Compliant. The Fund's SIP is published in the Report and Accounts and is available on the Fund's website.

The Statement of Investment Principles

The Pensions Committee first approved a Statement of Investment Principles in October 1997. At this time, the legal requirement to have such a document applied only to private sector schemes, but it was considered to be good practice for local government funds to prepare one. The legal requirement to produce a SIP was extended to local government funds in 2000. The SIP is a key document. It sets out the investment framework and provides an up to date assessment of compliance with the Investment Principles. The document is reviewed as new developments take place and was last updated as at 6th June 2006.

The SIP sets out:

- Who is taking which decisions and why this structure has been selected.
- The investment objectives.
- The asset allocation, including projected investment returns on each asset class, and how the strategy has been arrived at.
- The mandates given to all advisors and managers.
- The nature of the fee structures in place for advisors and managers and why this set of structures has been selected.
- The extent to which the Fund complies with the Investment Principles.

A copy of the SIP is shown on pages 49 to 55.

Corporate Governance and Voting

The Committee believes that good corporate governance and the informed use of voting rights are an integral part of the investment process that should improve the long term performance of the companies in which the Fund is invested. Voting rights are regarded as an asset that needs managing with the same duty of care as any other asset. The use of these rights is essential to protect the interests of the organisations participating in the Fund and the beneficiaries of the Fund.

It is important that this process is carried out in an informed manner and, for this reason, it is believed that the investment managers are best placed to undertake it. Each manager is required to prepare a document that sets out their policy on corporate governance and on the use of voting rights.

This policy has to provide for:

- The approach towards UK quoted companies to take account of the strong guidance offered by the Combined Code produced by the Hampel Committee and by the Responsibilities of Institutional Shareholders and Agents – Statement of Principles, that was first prepared by the Institutional Shareholders Committee in 2002 and then updated in 2005.
- The approach towards companies outside the UK to take account of the practices of the home nation.
- The approach towards unquoted companies to be consistent with the approach adopted for quoted companies, to the extent that this is practicable.
- Voting rights to be exercised in a manner that establishes a consistent approach to both routine and exceptional issues, in order that company directors fully understand the manager's views and intentions.

Whilst the Committee requires each manager to exercise voting rights in accordance with their individual policy, it retains the right to direct the manager in respect of any particular issue should such action be considered appropriate.

Each manager is required to:

- Report any material change to their policy immediately.
- Provide an annual report that sets out their policy and the manner in which it has been implemented.
- Provide a quarterly report that sets out their voting record.

The voting record of the investment managers is monitored and recorded. The Fund currently votes on a global basis for all segregated equity holdings. The holdings in UK companies in pooled funds are voted at the discretion of the manager concerned, but this is subject to any direction by the Fund.

An analysis of the Fund's global and UK only voting record (including the UK pooled funds) for 2005/06 is shown in the table below:

	Global	UK Only
Annual general meetings	1,280	913
Extraordinary general meetings	339	248
Resolutions	15,950	11,206
Votes for management	13,754	10,872
Votes against management	228	144
Abstentions	47	7
Resolutions where no vote was cast	1,921	183

The table shows that the Fund supported the vast majority of resolutions.

A number of resolutions were opposed or an abstention was cast. The most common reasons for this were overly generous executive compensation packages for mediocre performance, the length of directors' contracts, lack of independence of non-executive directors and auditors, and the level of non-audit fees paid. Most of these issues are covered in the Combined Code. It is believed that improvements are coming through in companies' practices as fewer votes were cast against management than in previous years.

The table shows that there are resolutions where votes were not cast. The main reasons for this are:

- Shareblocking, whereby shares cannot be sold until after the annual meeting if a vote has been cast by a shareholder. Therefore, shareholders are understandably reluctant to vote on non-contentious issues if this will prevent them from selling at any time. Such resolutions remain subject to review before a decision is taken on whether to vote. It should be noted that this practice does not occur in the UK.
- Securities lending, where the Fund has lent its stock to a third party, and with it, the right to vote at any meetings. The Fund has the right to request the return of stock, which happens if a resolution is considered to be contentious. This accounts for all instances where votes were not cast in the UK.
- An occasional breakdown in communication between an investment manager and the voting agent.

In 2004, the Fund joined the Local Authority Pension Fund Forum. The Forum is comprised of around forty local authority pension funds with total assets of £70 billion. The Forum is committed to actively encouraging companies to comply with good practice on corporate governance and Socially Responsible Investment issues. By doing so, it believes that shareholder value is improved over the medium and longer term. The Forum also believes that a coordinated approach with other local authority funds will increase the level of effectiveness when seeking change.

Socially Responsible Investment

The Fund's SIP covers the extent to which social, environmental and ethical considerations are taken into account in the selection, retention and realisation of investments. This area is known as Socially Responsible Investment (SRI). SRI is an important issue and the Committee takes its responsibility in this area very seriously. The approaches to SRI, voting and corporate governance are combined into a single policy. This was last reviewed and updated by the Committee on 6th June 2006. A copy is shown on pages 56 to 57.

Each investment manager must:

- Develop and co-ordinate policies on SRI, corporate governance and voting.
- When buying and selling investments, take into account how SRI factors might affect their value.
- For each company in which they invest, review that company's approach to social, environmental and ethical factors and, where necessary, approach company management to seek improvements.

Investment managers are required to report on the implementation of this policy in their quarterly performance report. The subject is regularly covered in meetings with managers.

Financial Statements

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Fund Account

2004/05 £m		Note	2005/06 £m
	Contributions and Benefits		
(138.222)	Contributions Receivable – Employers	3	(164.798)
(45.464)	Contributions Receivable – Members	3	(48.784)
(21.355)	Transfers In	4	(17.147)
(205.041)			(230.729)
118.568	Benefits Payable	5	129.783
18.845	Payments to and on Account of Leavers	6	23.200
2.097	Administrative Expenses	7	2.031
139.510			155.014
(65.548)	Net Additions from Dealings with Members		(75.736)
	Returns on Investments		
(52.842)	Investment Income	8	(64.710)
3.386	Non-Recoverable Tax	8	3.797
(209.139)	Change in Market Value of Investments	9	(614.600)
5.275	Investment Management Expenses	10	6.057
(253.320)	Net Returns on Investments		(669.456)
(318.851)	Net (Increase) / Decrease in the Fund During the Year		(745.171)
2,355.676	Net Assets of the Fund as at 1st April		2,674.527
2,674.527	Net Assets of the Fund as at 31st March		3,419.698

Net Assets Statement

As at 31st March 2005 £m	Net Assets Statement	Note	As at 31st March 2006 £m
	Investments	9	
244.432	Fixed Interest Securities		223.091
1,296.384	Equities		1,637.892
17.450	Index-Linked Securities		23.359
854.595	Pooled Investment Vehicles		1,162.568
207.479	Properties		306.170
36.539	Cash Deposits		88.238
4.636	Other Investment Balances		(34.979)
2,661.515	Total Investments		3,406.339
13.012	Current Assets and Liabilities	11	13.359
2,674.527	Net Assets of the Fund as at 31st March		3,419.698

Notes to the Financial Statements

1 Basis of Preparation

The financial statements have been prepared in accordance with the main recommendations of the Statement of Recommended Practice (Financial Reports of Pension Schemes) (Revised November 2002) and subject to note 5 follow the 2005 Code of Practice on Local Authority Accounting issued by the Chartered Institute of Public Finance and Accountancy.

The financial statements summarise the transactions of the Fund and deal with the net assets at the disposal of the Council. They do not take account of obligations to pay pensions and benefits that fall due after the end of the Fund year. The actuarial position of the Fund, which does take account of such obligations, is dealt with in statements prepared by the Actuary, which are shown on pages 16 and 17. The financial statements should be read in conjunction with the Actuary's statement.

2 Accounting Policies

Acquisition Cost of Investments

The acquisition cost of investments is based on the purchase price plus any additional costs associated with the purchase.

Valuation of Investments

Quoted securities have been valued at their mid-market closing price on 31st March 2006. Pooled investment vehicles have been included at the average of their bid and offer prices on 31st March 2006 as valued by the investment manager responsible for such vehicles. Other unquoted investments have been valued with regard to latest dealings and other appropriate financial information as provided by the investment manager responsible for these investments. The value of fixed income investments excludes interest earned but not paid over at the year-end. The interest earned has been accrued within investment income.

Overseas investments and foreign currency balances have been converted into Sterling at the closing exchange rates on 31st March 2006.

Futures have been valued on the basis of associated economic exposure as at 31st March 2006. This associated economic exposure has been incorporated into the value of the relevant asset class.

Properties are shown as valued at 31st December 2005, with the exception of six properties purchased after that date which have been valued at cost. The valuers are Fellows of the Royal Institute of Chartered Surveyors from Lambert Smith Hampton.

Investment Transactions

Investment transactions that were not settled as at 31st March 2006 have been accrued.

Investment Income

Investment income has been credited to the Fund on the ex-dividend date and is grossed up to allow for recoverable and non-recoverable tax. Non-recoverable tax has been shown as an expense.

Foreign income received during the year has been converted into Sterling at the exchange rate at the date of transaction. Amounts outstanding at the year-end have been valued at the closing exchange rates on 31st March 2006. With regard to property rental income payable quarterly in advance, only the proportion of each payment attributable to the Fund from the due date to the 31st March 2006 is credited to the Fund Account. Interest on cash deposits has been accrued up to 31st March 2006.

Investment Management Expenses

Investment management expenses payable as at 31st March 2006 have been accrued.

Debtors and Creditors

The accounts have been prepared on an accruals basis. The exception to this practice is transfer values.

Contributions

Contributions represent the amounts received from the organisations participating in the Fund; these may be district councils, other scheduled bodies, resolution bodies or admitted bodies. Such amounts relate both to their own employer contributions and to those of their pensionable employees. The Actuary determines the rate for employers. Contributions due as at 31st March 2006 have been accrued.

Benefits and Refunds

Benefits and refunds are accounted for in the year in which they become due for payment.

Transfer Values

Transfer values are accounted for on a payments/receipts basis.

3 Contributions Receivable

2004/05 £m	Contributions Receivable	2005/06 £m
	Employers	
(86.105)	Normal	(115.047)
(52.117)	Additional	(49.751)
(138.222)		(164.798)
	Members	
(44.820)	Normal	(48.074)
(0.644)	In-House Additional Voluntary Contributions	(0.710)
(45.464)		(48.784)
(183.686)	Total Contributions Receivable	(213.582)

The contributions can be analysed by type of member body as follows:

2004/05 £m	Member Body	2005/06 £m
(20.967)	South Tyneside Council (Administering Authority)	(22.902)
(115.066)	Other Metropolitan Councils	(131.170)
(28.339)	Other Scheduled Bodies	(34.483)
(6.361)	Resolution Bodies	(8.930)
(12.953)	Admitted Bodies	(16.097)
(183.686)	Total Contributions Receivable	(213.582)

4 Transfers In

During the year, individual transfers in from other schemes amounted to £17.147m (£21.355m in 2004/05). There were no group transfers during 2005/06 or 2004/05.

5 Benefits Payable

2004/05 £m	Benefits Payable	2005/06 £m
111.029	Pensions	118.003
15.314	Commutations and Lump Sum Retirement Benefits	19.175
2.116	Lump Sum Death Benefits	3.355
(9.891)	Less: Recharges	(10.750)
118.568	Total Benefits Payable	129.783

The analysis of benefits by type of member body is not available. In this respect the accounts do not comply with the 2005 Code of Practice on Local Authority Accounting.

6 Payments to and on Account of Leavers

2004/05 £m	Payments to and on Account of Leavers	2005/06 £m
18.142	Individual Transfers to Other Schemes	22.719
0.509	Refunds to Members Leaving Service	0.297
0.194	State Scheme Premiums	0.184
18.845	Total Payments to and on Account of Leavers	23.200

There were no group transfers during 2005/06 or 2004/05.

7 Administration Expenses

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 permit costs incurred in connection with the administration of the Fund to be charged against the Fund. A breakdown of the costs is set out below.

2004/05 £m	Administration Expenses	2005/06 £m
1.195	Employee Expenses	1.312
0.638	Support Services Recharge	0.514
0.034	Audit Fees	0.040
0.040	External ICT Costs	0.021
0.100	Printing/Publications	0.100
0.132	Professional Fees	0.057
0.055	Other Expenses	0.048
(0.097)	Income	(0.061)
2.097	Total Administration Expenses	2.031

Employee expenses have been charged to the Fund on a time basis. Office expenses and other overheads have also been charged.

8 Investment Income

2004/05 £m	Investment Income	2005/06 £m
(8.515)	Fixed Interest Securities	(10.492)
(32.498)	Equities	(39.239)
(0.360)	Index-Linked Securities	(0.663)
(0.067)	Pooled Investment Vehicles	(0.073)
(9.263)	Properties – Net Rents	(11.760)
(1.696)	Cash Deposits	(1.910)
(0.166)	Securities Lending	(0.394)
(0.277)	Commission Recapture	(0.170)
-	Underwriting Commission	(0.009)
(52.842)	Sub-Total	(64.710)
3.386	Less: Non-Recoverable Tax	3.797
(49.456)	Total Investment Income	(60.913)

9 Investments

Investments	Value as at 1st April 2005 £m	Purchases at Cost £m	Sales Proceeds £m	Change in Market Value £m	Value as at 31st March 2006 £m
Fixed Interest Securities	244.432	598.213	(623.608)	4.054	223.091
Equities	1,296.384	699.210	(739.143)	381.441	1,637.892
Index-Linked Securities	17.450	49.958	(45.849)	1.800	23.359
Pooled Investment Vehicles	854.595	288.763	(186.702)	205.912	1,162.568
Properties	207.479	91.718	(13.100)	20.073	306.170
	2,620.340	1,727.862	(1,608.402)	613.280	3,353.080
Cash Deposits	36.539	52.096	-	(0.398)	88.238
Other Investment Balances	4.636	62.185	(103.517)	1.717	(34.979)
Total Investments	2,661.515	1,842.143	(1,711.919)	614.600	3,406.339

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

As at 31st March 2005 £m	Investments	As at 31st March 2006 £m
	Fixed Interest Securities	
130.116	UK Public Sector	101.290
-	UK Gilt Futures	13.956
42.663	UK Other	48.115
71.653	Overseas Public Sector	36.556
-	Overseas Bond Futures	23.174
244.432	Total Fixed Interest Securities	223.091
	Equities	
479.083	UK Quoted	554.094
817.301	Overseas Quoted	1,080.911
-	Overseas Unquoted	2.887
1,296.384	Total Equities	1,637.892
	Index-Linked Securities	
17.450	UK Quoted	23.359
17.450	Total Index-Linked Securities	23.359
	Pooled Investment Vehicles	
7.414	Unit Trusts	58.426
718.115	Unitised Insurance Policies	876.760
129.066	Other Managed Funds	227.382
854.595	Total Pooled Investment Vehicles	1,162.568
	Properties	
186.269	Freehold	278.250
21.210	Long Leasehold	27.920
207.479	Total Properties	306.170
	Cash Deposits	
26.154	Sterling	68.947
10.385	Foreign Currency	19.291
36.539	Total Cash Deposits	88.238
	Other Investment Balances	
-	Cash Backing Fixed Interest Futures	(37.130)
2.075	Currency Hedging	(0.154)
20.261	Debtors	18.547
(17.700)	Creditors	(16.242)
4.636	Total Other Investment Balances	(34.979)
2,661.515	Total Investments	3,406.339

10 Investment Management Expenses

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 permit costs incurred in connection with the investment of the Fund to be charged against the Fund. A breakdown of the costs is set out below:

2004/05 £m	Investment Management Expenses	2005/06 £m
5.099	Administration, Management and Custody	5.923
0.060	Performance and Risk Measurement Services	0.055
0.116	Other Advisory Fees	0.079
5.275	Total Investment Management Expenses	6.057

Administration includes employee expenses that have been charged to the Fund on a time basis. Office expenses and other overheads have been charged.

11 Current Assets and Liabilities

As at 31st March 2005 £m	Current Assets and Liabilities	As at 31st March 2006 £m
3.836	Contributions and Recharges Due – Employees	4.136
13.760	Contributions and Recharges Due – Employers	14.609
(2.047)	Inland Revenue	(1.592)
(1.233)	Investment Management Expenses	(1.996)
(1.304)	Other	(1.798)
13.012	Total Current Assets and Liabilities	13.359

12 Additional Voluntary Contributions

The Fund offers two types of AVC arrangements.

Additional periods of membership may be purchased within the Local Government Pension Scheme, with the contributions being invested as a part of the Fund's assets. In addition, the Pensions Committee has appointed Equitable Life Assurance Society in 1989 and The Prudential Assurance Company in 2001 for the investment of other AVCs specifically taken out by Fund members. Contributions to these external providers are invested separately from the Fund's own assets on a money purchase basis. Equitable Life has been experiencing significant financial difficulties over recent years. The problems arose from some of its financial products that carry guaranteed returns.

With the exception of existing life cover policies, the Fund has closed its AVC plan with Equitable Life to new members contributions from existing members and transfers. A significant proportion of investors in funds operated by Equitable Life have had their balances transferred to The Prudential. The Fund continues to monitor the position of the remaining investors with Equitable Life. As at 31st March 2006 the AVC funds provided by The Prudential were valued at £6.073m (£5.097m as at 31st March 2005) and the funds operated by Equitable Life were valued at £1.080m (£1.207m as at 31st March 2005). The funds are valued by each of the providers and take no account of accruals.

13 Analysis of Investments Over Managers

The Fund employs ten specialist external investment managers over a total of fifteen investment mandates. Each manager is a specialist in the market in which they invest. This broadly based management structure ensures that investment returns are not overly influenced by the performance of any one manager.

The market values of investments in the hands of each manager were:

As at 31st March 2005		Analysis of Investment Managers	As at 31st March 2006	
£m	%		£m	%
		Investment Managers		
205.530	8	Arlington Property Investors	304.185	9
-	-	Barclays Global Investors	22.725	1
290.524	11	Capital International – Global Equities	386.672	11
73.496	3	Capital International – Emerging Markets	98.496	3
301.039	11	Fidelity Pensions Management	382.565	11
231.639	9	Henderson Global Investors	246.118	7
574.566	21	Legal and General Investment Management	642.666	19
269.205	10	Prudential M&G	289.951	9
-	-	Record Currency Management	23.162	1
215.503	8	Schroder Investment Management	322.766	10
468.825	18	UBS Global Asset Management	619.843	18
24.770	1	Private Equity	50.278	1
6.418	-	Managed In-House	16.912	-
2,661.515	100	Total Investments	3,406.339	100

14 Taxation

UK Tax

The Fund is an exempt approved fund and is not liable to income tax or capital gains tax. It is not registered separately from the Council for VAT and therefore can recover its input tax. All investment income in the accounts has been shown gross of UK income tax and the non-recoverable element has been shown as an expense.

Overseas Tax

The Fund is subject to withholding tax in certain overseas countries. In all such cases, the investment income has been grossed up and non-recoverable tax has been shown as an expense.

15 Derivatives

The Fund has used a number of futures instruments as part of its investment strategy and to assist with efficient portfolio management.

As at 31st March 2006 the Fund held 125 June 2006 long gilt futures contracts which, when valued on the basis of the associated economic exposure, had a book value of £14.150m and a market value of £13.956m. The net variation margin paid to 31st March 2006 was £0.194m.

As at 31st March 2006 the Fund held 211 June 2006 US bond futures contracts which, when valued on the basis of the associated economic exposure, had a book value of £12.921m and a market value of £12.831m. The net variation margin paid to 31st March 2006 was £0.090m.

As at 31st March 2006 the Fund held 91 June 2006 Euro bond futures contracts which, when valued on the basis of the associated economic exposure, had a book value of £7.185m and a market value of £7.082m. The net variation margin paid to 31st March 2006 was £0.103m.

As at 31st March 2006 the Fund held 5,000 Japanese bond futures contracts which, when valued on the basis of the associated economic exposure, had a book value of £3.286m and a market value of £3.261m. The net variation margin paid to 31st March 2006 was £0.025m.

The Fund has used forward currency contracts to hedge the currency exposure on certain overseas investments. As at 31st March 2006, the Fund held a range of positions that together showed an unrealised loss of £0.154m. Of the twenty seven positions open as at 31st March 2006, six have been settled showing an overall profit of £0.139m. At the time of finalising the accounts twenty one of these positions remained open. As at 31st May 2005 these positions were showing an unrealised profit of £1.414m.

16 Securities Lending

The Fund operates a securities lending programme through its custodian, Northern Trust. Securities totalling £295.969m were out on loan as at 31st March 2006, against collateral of £315.075m. The breakdown of securities on loan as at 31st March 2006 is set out below:

As at 31st March 2005 £m	Securities Lending	As at 31st March 2006 £m
92.834	Fixed Interest Securities	57.447
6.813	Index-Linked Securities	75.423
33.099	UK Equities	9.350
34.794	Overseas Equities	153.749
167.540	Total Securities Lending	295.969

The value of collateral against which the securities were lent out as at 31st March 2006 is set out below:

As at 31st March 2005 £m	Securities Lending – Collateral	As at 31st March 2006 £m
17.146	Cash	19.011
128.794	Fixed Interest	212.503
29.855	Equities	83.561
175.795	Total Collateral	315.075

17 Underwriting

The Fund accepts a number of underwriting and placing propositions. As at 31st March 2006, no commitments were outstanding.

18 Significant Holdings

As at 31st March 2006, the Fund had two holdings that represented more than 5% of the total Fund value. Both of these holdings are without-profit insurance contracts which provide access to a pool of underlying assets. The values have been determined by reference to the underlying assets using price feeds from markets. These holdings are:

- Legal and General Assurance (Pensions Management) Limited – Managed Fund. As at 31st March 2006 this was valued at £642.666m and represented 18.8% of the total net assets of the Fund. This insurance contract can be split into four individual funds, representing four different asset classes, as follows:

	£m
UK Equities	296.009
North American Equities	166.808
AAA Fixed Interest	91.143
Index-Linked Gilts	88.706

- Prudential Pensions Limited – Corporate Bond All Stocks Fund. As at 31st March 2006 this was valued at £232.079m and represented 6.8% of the total net assets of the Fund.

19 Outstanding Commitments

As at 31st March 2006 the Fund had fourteen outstanding commitments to investments:

Name of Fund	Initial Commitment		As at 31st March 2006		
	Year	Value	Drawdowns Made	Commitment Outstanding	
HarbourVest International Private Equity Partners IV	2002	\$55.0m	\$31.9m	\$23.1m	£13.3m
HarbourVest Partners VII Cayman Buyout Fund	2002	\$46.0m	\$13.1m	\$32.9m	£19.0m
HarbourVest Partners VII Cayman Mezzanine Fund	2002	\$8.0m	\$1.5m	\$6.5m	£3.7m
HarbourVest Partners VII Cayman Venture Fund	2002	\$28.0m	\$7.4m	\$20.6m	£11.9m
Capital North East	2002	£1.5m	£0.9m	£0.6m	£0.6m
HarbourVest Partners 2004 Direct Fund	2004	\$30.0m	\$14.6m	\$15.4m	£8.9m
Capital International Private Equity Fund IV	2004	\$18.0m	\$7.0m	\$11.0m	£6.3m
HarbourVest International Private Equity Partners V – Partnership	2005	€48.0m	€2.9m	€45.1m	£31.5m
HarbourVest International Private Equity Partners V – Direct	2005	€20.0m	€1.0m	€19.0m	£13.3m
Pantheon Asia Fund IV	2005	\$10.0m	\$0.0m	\$10.0m	£5.8m
Pantheon Europe Fund IV	2005	€25.0m	€1.9m	€23.1m	£16.1m
Pantheon USA Fund VI	2005	\$30.0m	\$2.8m	\$27.2m	£15.7m
Lexington Capital Partners VI-B	2005	\$30.0m	\$1.4m	\$28.6m	£16.5m
Henderson PFI Secondary Fund II	2005	£15.0m	£0.0m	£15.0m	£15.0m
Total Outstanding Commitments					£177.6m

The Sterling figures for the commitment outstanding as at 31st March 2006 are based on the exchange rates at the close of business on that date.

20 Related Party Transactions

Under FRS8 “Related Party Disclosures”, it is a requirement that material transactions with related parties, not disclosed elsewhere, should be included in a note to the financial statements.

Examinations of returns completed by elected members of the Pensions Committee and senior officers involved in the management of the Pension Fund have not identified any cases where disclosure is required.

During 2005/06 South Tyneside Council charged the Tyne and Wear Pension Fund £0.783m (£0.917m in 2004/05) in respect of services provided, primarily financial, legal and information technology. Tyne and Wear Pension Fund charged South Tyneside Council £0.047m (£0.056m in 2004/05) in respect of treasury management.

There were no material contributions due from employer bodies outstanding at the year end.

Statement by the Appointed Auditor to South Tyneside Council (the Authority)

Responsibilities of the Authority

The Authority is required:

- To make arrangements for the proper administration of the Authority's financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Head of Finance.
- To manage the Authority's affairs to secure economic, efficient and effective use of resources and safeguard its assets.

Responsibilities of the Head of Finance

The Head of Finance is responsible for the preparation of the Authority's Statement of Accounts which, in terms of the CIPFA Code of Practice on Local Authority Accounting in Great Britain (the Code of Practice), is required to present fairly the financial position of the Authority, including the Pension Fund, at the accounting date and its income and expenditure for the year ended 31st March 2006.

In preparing the Statement of Accounts, he has:

- Selected suitable accounting policies and then applied them consistently.
- Made judgements and estimates that were reasonable and prudent.
- Complied with the Code of Practice.

The Head of Finance has also:

- Kept proper accounting records which were up to date.
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

Responsibilities of the Auditor

PricewaterhouseCoopers LLP has been appointed by the Audit Commission under s2 of the Audit Commission Act 1998 to undertake the audit of the Statement of Accounts of the Authority, which includes a summary of the financial statements of the Pension Fund. As a result, the audit opinion on the Authority's Statement of Accounts, includes an opinion on the Pension Fund financial statements and is provided in the audit report issued on the Authority's Statement of Accounts. Our audit report is made solely to the Authority in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 54 of the Statement of Responsibilities of Auditors and of Audited Bodies, prepared by the Audit Commission.

Statement by the Appointed Auditor

We have examined pages 38 to 47 of the annual report of the Pension Fund, which have been prepared by its Head of Finance. In our opinion, these pages of the annual report are consistent with the Statement of Accounts of the Authority on which we have issued an unqualified opinion.

PricewaterhouseCoopers LLP

Newcastle

29 September 2006

Statement of Investment Principles

Approved by Pensions Committee on 6th June 2006

Introduction

- 1 The Local Government Pension Scheme Regulations (the Regulations) require an administering authority to prepare, maintain and publish a written statement of the principles that govern their decisions about investment. This document forms that statement.
- 2 In the course of preparing this statement, the Pensions Committee (the Committee) has sought advice from the Fund's Investment Advisor.
- 3 The Committee reviews the Statement annually, or more frequently if required.
- 4 The Statement is provided to the Fund's investment managers, who are required to follow the principles that it sets out and to report showing how they have done so.

Governance

- 5 South Tyneside Council (the Council) is the administering authority of the local government pension fund set up for the Tyne and Wear County area.
- 6 The Council has set up the Committee and has required it to control and resolve all matters relating to the administration and investment of the Fund. The Committee has eighteen members. The Council nominates eight members and the other four district councils within the County area nominate one member each. The trades unions and the employers (excluding the district councils) each nominate three members, who sit in an advisory capacity.
- 7 The local authority members are remunerated in accordance with each council's scheme of allowances.
- 8 The Council has set up a Regeneration and Resources Scrutiny Committee that reviews and scrutinises the decisions and actions of the Committee.
- 9 A training programme is provided for members of both committees.
- 10 Hewitt Bacon and Woodrow has been appointed as Actuary.
- 11 Hymans Robertson has been appointed as Investment Advisor.
- 12 The Committee meets quarterly to consider investment matters. It sets the investment objectives and policy, whilst responsibility for tactical asset allocation and for the selection, retention and realisation of specific investments has been delegated to external investment managers.
- 13 The performance of the managers is measured by independent external agencies.
- 14 The detailed formal monitoring of the investment of the Fund is undertaken by an Investment Panel, which is comprised of three Committee members, two of the Fund's officers and the Investment Advisor. The Panel meets quarterly to consider the investment objectives and policy and each manager's performance and process. It reports to the Committee on its findings and makes recommendations on any action that is required.
- 15 If the Committee accepts a Panel recommendation to review and change the investment objectives or policy, or the management structure, or a manager's appointment, the Committee will require the Panel to implement that change. If a formal review of a manager's appointment is required, this may result in a tendering process, where required by law.
- 16 The Fund's officers undertake the day to day monitoring of the investment of the Fund.
- 17 The Fund has a service plan that sets out in detail the development of the structure and processes that govern the investment of the Fund.

Investment Objectives and Policy

18 The investment objectives of the Fund are:

- To maintain securely a portfolio of assets of appropriate liquidity which will generate income and capital growth which, together with employer and employee contributions, will meet the cost of current and future benefits which the Fund provides, as set out in the statutory documentation.
- To minimise the long term costs of the Fund by maximising the return on the assets, whilst having regard to the objective stated above.
- To comply with the regulations relating to the investment of local government pension funds.

19 In order to assist in setting the Fund's strategic investment policy, an asset liability modelling study is carried out. This study examines the Fund's financial position, the profile of its membership, the nature of its liabilities and includes an analysis of the expected ranges of outcomes from differing investment policies.

20 The current strategic asset allocation is based upon a study carried out as at 30th November 2004 by Hymans Robertson, based upon the liabilities shown by the 2004 valuation. The projected investment returns that were used in this study are shown in an appendix. Having considered the outcome of this initial study, the Committee concluded that a diversified portfolio, of which about 67.5% is invested in UK and overseas equities, 22.5% in bonds and 10% in property, represented a suitable strategic asset allocation benchmark for the Fund. The degree and nature of risks attaching to such a portfolio, when taken in conjunction with the expected returns, were considered by the Committee to be appropriate for the Fund.

21 An appendix is attached that sets out the detail of the strategic benchmark.

22 The Committee will continue to monitor the suitability of this policy in the light of the Fund's developing liabilities and finances.

The Investment Management Structure

23 The Committee considers that the Fund must have an investment management structure that provides exposure to a suitably diversified, but complementary, range of investment styles and processes.

24 It is the view of the Committee that the strategic benchmark is best implemented by investing the entire Fund on a specialist basis, using passive asset allocation and a combination of active and passive stock selection.

25 The structure includes discretionary mandates for the active management of UK equities, pan European equities, global equities, pacific equities, emerging market equities, global bonds, corporate bonds and currencies.

26 Following consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market, the Committee determined that up to about 25% of the Fund should be managed on a passive basis. The passive mandate includes a proportion of the total allocation to UK equities, US equities and UK government bonds.

27 It is intended that up to 5% of the Fund is to be invested in private equity. This position will be built up over a period of years, largely by investment in funds of funds. The allocation will be top-sliced from the allocation to quoted equities.

28 Up to 3% of the Fund is invested in actively managed currency funds.

29 The Fund's officers monitor the overall allocation of the Fund's assets, relative to the strategic benchmark, with assistance from the passive manager. In the light of this monitoring, the actual asset allocation is maintained within agreed margins around the strategic benchmark by the direction of cash flow or by the reallocation of assets between portfolios, as appropriate.

30 Independent custodians have been appointed to take responsibility for the safe keeping of the assets within each of the Fund's stock market portfolios. The Fund's officers monitor the operation of the custodians.

31 The property portfolio is managed on an advisory basis.

- 32 The Committee's expectations in respect of returns from the Fund's investments are expressed through achievable and prudent objectives and restrictions that have been set for each mandate. The objectives and restrictions have been discussed and agreed with each manager with the aims of ensuring a prudent approach to investment and of allowing each manager to implement their natural investment style and process. The use of any financial instruments is not prohibited, except where such prohibition is required by legislation or where it has been agreed with a manager that its use is inappropriate.
- 33 An appendix is attached that sets out details of the individual mandates.
- 34 The majority of the managers are remunerated by way of ad valorem fees. Performance fees receive consideration but have only been adopted where there is no ad valorem alternative.
- 35 The Investment Advisor is remunerated by reference to the time and resources expended in that role.
- 36 The managers are permitted to use soft commission arrangements within their broking transactions where the Committee believes this practice to be a satisfactory approach for the manager to access resources in the most cost efficient way to the Fund.

Diversification

- 37 The strategic asset allocation benchmark and the investment objectives and restrictions placed upon the managers are designed to ensure that the Fund's investments are adequately diversified.
- 38 Within each asset category in each portfolio, the manager concerned is responsible for appropriate diversification.
- 39 The restrictions ensure that, at a stock selection level, the Fund avoids undue concentration.

Suitability

- 40 The Committee has taken advice from the Investment Advisor to ensure that the strategic asset allocation benchmark is suitable for the Fund, given its financial position, statutory status and liability profile.
- 41 Within each of the Fund's portfolios, and within each asset category in those portfolios, the manager concerned is responsible for the suitability of individual investments.

Realisation of Assets

- 42 The Fund maintains sufficient investment in liquid or readily realisable assets to meet the payment of benefits, together with a margin for unexpected cashflow requirements so that, whenever possible, the realisation of assets will not disrupt the overall investment policy. When the Committee requires assets to be realised out of a portfolio in order to meet cashflow requirements or to reinvest the proceeds elsewhere, the realisation of individual holdings is at the discretion of the manager of the portfolio.

Risk

- 43 The Committee recognises that there are a number of risks involved in the investment of the assets. The policy is to minimise these risks as far as possible, consistent with earning a satisfactory return on investments. In particular:
- Solvency risk and mismatching risk is controlled through the asset allocation strategy and through ongoing triennial actuarial valuations.
 - Liquidity risk is controlled by estimating the annual net benefit outgo or inflow and liaising with the managers to ensure that sufficient cash balances are available.
 - Manager risk is controlled through the investment objectives and restrictions set out in each manager's agreement and through the ongoing monitoring of the managers.
 - Custodian risk is controlled through the restrictions set out in each custodian's agreement and through the ongoing monitoring of the custodial arrangements.
 - Position, currency and political risks are controlled through the approach to diversification.
 - Counterparty risk is controlled through the restrictions followed by the managers with respect to the trading of securities and cash management.

Socially Responsible Investment

- 44 Responsibility for the selection, retention and realisation of investments is delegated to the managers.
- 45 The Committee has reviewed and will continue to review from time to time the policies operated by each of the Fund's managers in respect of social, environmental or ethical considerations. Having done so, the policy of the Committee is that the extent to which such considerations are taken into account in investment decisions is at the discretion of each manager. However, active managers must take such considerations into account where they may have a financial impact on the portfolio. The passive manager is not required to take account of such considerations in the selection, retention and realisation of investments.
- 46 Each manager is urged to pursue a policy of engagement with companies and to take account of such considerations in its corporate governance and voting policy.
- 47 Each manager must continue to develop its policy and provide a quarterly report that sets out how it has been implemented.

Rights Attaching to Investments

- 48 Responsibility for the exercising of rights, including voting rights, attaching to investments is delegated to the managers.

Corporate Governance and Voting

- 49 Each manager is required to prepare and implement a policy on corporate governance and voting. The policy towards UK quoted companies should take account of the principles contained in the Combined Code and of the guidance offered by relevant organisations, including that contained in "The Responsibilities of Institutional Shareholders and Agents – Statement of Principles", that was first prepared by the Institutional Shareholders Committee in 2002 and then updated in 2005. The policy towards companies outside the UK should take account of the practices of the home nation.
- 50 Voting rights must be exercised in a manner that establishes a consistent approach to both routine and exceptional issues in order that company directors fully understand the manager's views and intentions.
- 51 Whilst it has not been made compulsory for the managers to vote, they are strongly urged to do so.
- 52 Each manager must continue to develop its policy and provide a quarterly report that sets out how it has been implemented.

Additional Voluntary Contributions

- 53 The Fund provides a facility for members to pay additional voluntary contributions (AVCs) to enhance their benefits. Members have a choice between buying added years of service or accumulating their AVCs to purchase benefits on a money purchase basis.
- 54 Investment of money purchase AVCs is undertaken through the Prudential Assurance Company. The Committee's intention is to offer a range of funds that are intended to provide a suitable long-term return for members, consistent with the degree of risk accepted. A socially responsible fund is included within the range on offer.
- 55 The Committee reviews the suitability of the AVC arrangements annually, or more frequently if required, based upon advice provided by Hewitt Bacon and Woodrow.
- 56 The Fund also has an AVC facility with Equitable Life. Due to Equitable's well publicised difficulties, this facility is no longer promoted by the Fund and does not receive new investment contributions.

Compliance with Principles of Investment Practice

57 The Fund complies with all of the Principles of Investment Practice, as set out in the “CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme”.

Limits on Investment in Partnerships

58 The Regulations contain the following limits on the percentage of a pension fund that may be invested into a partnership:

- 2% in respect of all contributions into any single partnership.
- 5% in respect of all contributions into partnerships.

59 The limits apply at the time that an investment is made.

60 The regulations provide for the limits to be raised as follows, subject to certain requirements being met:

- 5% in respect of all contributions into any single partnership.
- 15% in respect of all contributions into partnerships.

61 Up to 5% of the Fund is to be invested in private equity. This position will be built up over a period of years and the allocation will be top-sliced from that to quoted equities.

62 At its meeting on 27th February 2006, the Committee resolved that the limits applicable to the Fund be raised in order to accommodate the commitments that would be made in respect of this investment, as follows:

- The limit in respect of all contributions into any single partnership be raised from 2% to 3%.
- The limit in respect of all contributions into partnerships be raised from 5% to 15%.

63 The Committee has taken proper advice in respect of this investment from the Investment Advisor, Hymans Robertson, and from the Fund’s officers.

64 This decision will apply for the period for which the Fund’s strategic investment benchmark includes a 5% allocation to private equity, unless investment considerations require an earlier review.

65 No date has been set for an earlier review.

66 This decision is compliant with the Regulations.

Limits on Stock Lending

67 The Regulations contain a limit of 25% on the value of the securities of a pension fund that may be transferred (or agreed to be transferred) under stock lending arrangements.

68 The Regulations provide for the limit to be raised to 35%, subject to certain requirements being met.

69 At its meeting on 28th November 2005, the Committee resolved that the limit be raised to 35%.

70 The Committee has taken proper advice in respect of this decision from the Investment Advisor, Hymans Robertson, and from the Fund’s officers.

71 This decision has been taken to allow greater flexibility within the stock lending arrangement and to provide the potential for additional income.

72 This decision will apply for as long as the stock lending arrangement operates, unless an earlier review is required.

73 No date has been set for an earlier review.

74 This decision is compliant with the Regulations.

Asset Liability Study

Projected Investment Returns

The asset liability modelling study involves ten year projections of the Fund's liabilities and of returns from the various asset classes, over a large number of scenarios. Implicit within that process is a distribution of expected returns for each asset class over the ten year period. The table below shows the median real returns (i.e. returns in excess of price inflation) from the distributions in respect of the main asset classes, as used in the update of the study carried out as at 30th November 2004.

Asset class	10 year median real return % per annum
Global (ex UK) Equities (unhedged)	4.6
UK Equities	4.8
Property	2.9
AA Sterling long-dated Corporate Bonds	2.0
Long-dated UK Gilts	1.3
UK index-linked Gilts	0.8
Foreign Bonds (unhedged)	2.0

The returns shown above were those projected from 30th November 2004 and hence would not necessarily apply at any subsequent date.

The results of the asset liability modelling study reflect not only these median returns, but also more complex factors such as:

- The volatility of returns from each asset class.
- The degree to which returns from one asset class are linked to returns from other classes.
- The relationship between movements in assets and movements in liabilities.

Inflation has been assumed at 2.8%.

Strategic Benchmark

Asset Class	Allocation %	Index
UK Equities	27.50	FTSE All Share
Overseas Equities	40.00	
- US	12.50	FTSE All World US
- Europe ex UK	13.50	FTSE World Europe ex UK
- Japan	7.00	FTSE All World Japan
- Other Far East	3.50	MSCI All Country Pacific Free ex Japan inc Malaysia
- Emerging Markets	3.50	MSCI Emerging Markets Free
Fixed Interest	22.50	
- UK Gilts	7.00	FTSE – A British Govt All Stocks
- UK Index-Linked	4.00	FTSE – A British Govt Over Five Year Index-Linked
- Sterling Non Government	9.00	ML Sterling Non Gilt All Stocks
- Overseas	2.50	JPM Global (non UK) Traded Bond Index, hedged into Sterling
Property	10.00	IPD Monthly Index

Notes

Up to 5% of the Fund is to be invested in private equity. This position will be built up over a period of years and will be top-sliced from the allocation to quoted equities.

Up to 3% of the Fund is invested in actively managed currency funds, which are contained within the allocation to passively managed US equities.

Management Structure

Manager	Mandate	Objective
Fidelity	UK Equities	To aim to outperform the FTSE All Share Index by 2.0% per annum over three year rolling periods. To aim not to underperform the FTSE All Share Index by more than 5.5% over any rolling 12 month period.
UBS	Pan European Equities	To outperform the FTSE Europe (including UK) Index – Developed Series by 2% per annum over three year rolling periods with the return being no more than 5% below the Index in any one year.
Capital International	Global Equities	To outperform the FTSE All World Index by 2% per annum over three year rolling periods with the return being no more than 5% below the Index in any one year.
Capital International	Emerging Market Equities	To outperform the MSCI Emerging Markets Free Index.
Schroder	Japanese Equities	To outperform the FTSE All World Japan Index by 2% per annum over three year rolling periods with the return being no more than 4% below the Index in any one year.
Schroder	Pacific ex Japan Equities	To outperform the MSCI All Countries Pacific Free ex Japan Index by 2% over three year rolling periods with the return being no more than 5% below the Index in any one year.
Legal and General	UK Equities	To match the return on the FTSE All Share Index.
Legal and General	US Equities	To track the total return of the FTSE World North America Index within expected tolerances of +/-0.5% in two years out of three.
Legal and General	UK Index-Linked	To match the return on the FTSE – A British Government Over Five Years Index-Linked Index.
Legal and General	AAA Fixed Interest	To match the return on the iBoxx Sterling AAA All Stocks Index.
Various	Private Equity	5% above the returns on quoted equity.
Prudential M&G	Corporate Bonds	To outperform a composite benchmark by 0.75% per annum over three year rolling periods with the return being no more than 2% below the Index in any one year. The benchmark is: <i>80% iBoxx Non Gilt All Stocks</i> <i>10% FTSE – A British Government All Stocks</i> <i>10% FTSE – A British Government Over Five Years Index-Linked</i>
Henderson	Government Bonds	To outperform a composite benchmark by 1% per annum over three year rolling periods. To maintain an estimated ex-ante tracking error of no more than 2.5% per annum and which is typically in a range of 0.5% to 2%. The benchmark is: <i>27.5% FTSE – A British Government All Stocks</i> <i>7.5% FTSE – A British Government Over Five Years Index-Linked</i> <i>25% Merrill Lynch Sterling Non Gilt All Stocks</i> <i>30% JP Morgan Global (Non UK) Traded Bond Index, hedged into Sterling</i> <i>10% BBA 3 Month Sterling LIBOR</i>
Arlington Property Investors	Property	To outperform the IPD All Funds Universe by 0.5% per annum over three year rolling periods.
Barclays Global Investors	Currency	Absolute return.
Record	Currency	Absolute return.

Policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance

Approved by Pensions Committee on 6th June 2006

Introduction

- 1 This document sets out the Fund's policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance.
- 2 The Pensions Committee reviews the policy annually, or more frequently if required.
- 3 The Committee provides copies of this document to the Fund's investment managers, who are required to follow the principles that it sets out and to report showing how they have done so.

Development of a Manager's Policy

- 4 Each manager must prepare and implement a policy on Socially Responsible Investment, corporate governance and the principles that govern the way in which voting rights are exercised.
- 5 If a manager's policy is inconsistent with the requirements set out in this document, the issues will be discussed with the manager and an approach will be agreed.
- 6 Each manager must continue to develop its policy and report change as soon as practicable.

Socially Responsible Investment

- 7 Responsibility for the selection, retention and realisation of investments is delegated to the managers, who are required to act within specified guidelines and restrictions.
- 8 The extent to which social, environmental or ethical considerations are taken into account in this decision is at the discretion of each manager.
- 9 However, active managers must take such considerations into account where they may have a financial impact on a portfolio.
- 10 Part of the Fund's assets are invested on a passive basis. The passive manager is not required to take account of such considerations in the selection, retention and realisation of investments.
- 11 Each manager is urged to pursue a policy of engagement with companies and to take account of such considerations in its corporate governance and voting policy.

Rights Attaching to Investments

- 12 Responsibility for the exercising of rights, including voting rights, attaching to investments is delegated to the managers.

Corporate Governance

- 13 The policy towards UK quoted companies should take account of the principles contained in the Combined Code and of the guidance offered by relevant organisations, including that contained in "The Responsibilities of Institutional Shareholders and Agents – Statement of Principles", that was first prepared by the Institutional Shareholders Committee in 2002 and then updated in 2005.
- 14 The policy towards companies outside the UK should take account of the practices of the home nation.
- 15 The policy towards unquoted companies should be consistent with the approach adopted for quoted companies, to the extent that this is practicable.

Voting Rights

- 16 Voting rights should be exercised in an informed manner. Therefore, in general, the managers are most appropriately placed to undertake this task.
- 17 Voting rights are regarded as an asset that needs managing with the same duty of care as any other asset. Exercising the rights attached to shares is essential to protect the interests of the organisations participating in the Fund and the beneficiaries of the Fund.
- 18 Whilst it has not been made compulsory for the managers to vote, they are strongly urged to do so.
- 19 Voting rights must be exercised in a manner that establishes a consistent approach to both routine and exceptional issues in order that company directors fully understand the manager's views and intentions.
- 20 Whilst the responsibility is delegated to each manager to exercise voting rights in accordance with its own policy, the Committee retains the right to direct each manager in respect of any issue.
- 21 Prior to voting, each manager is required to use reasonable endeavours to consider whether, in their opinion, any issue could become controversial for the Fund or the organisations participating in the Fund. If this is the case, the issue should be referred to the Fund's officers for discussion and possibly direction. It is considered that this will happen infrequently. Whilst each manager should exercise their own discretion as to what may fall into this category, examples may be:
 - Where the manager intends to vote against directors on a major issue.
 - Matters affecting the local economy.
 - Political donations.

Review and Reporting Arrangements

- 22 Each manager's policy will be reviewed and its impact monitored on a regular basis.
- 23 Policy changes must be reported as soon as practicable.
- 24 Each manager must provide a quarterly report that sets out how its policies have been implemented.
- 25 The quarterly report must include:
 - The proportion and numbers of votes which were cast.
 - A summary and explanation of instances where:
 - Voting rights were exercised in a manner that was inconsistent with the normal policy.
 - Voting rights were exercised against management.
 - The manager abstained from voting.
 - Voting rights were not exercised.

How to contact us

If you require any further information about the Tyne and Wear Pension Fund please contact us at:



Tyne and Wear Pension Fund
Civic Centre Campbell Park Road
Hebburn Tyne and Wear NE31 2SW



Web www.twpf.info

For information about investments please contact the Investments Office.



Tel 0191 424 4115



Fax 0191 483 8660



Email investments@twpf.info

For information about contributions or benefits please contact the Pensions Office.



Tel 0191 424 4141



Fax 0191 424 4171



Email pensions@twpf.info

Our information is available in other ways on request.

We can provide information in other languages, Braille formats, large print.

We also have access to audio aids and BSL interpretation services.