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## Members of the Pensions Committee, Investment Managers, Advisors and Officers

**Committee Members**

| | |
|---|---|
| South Tyneside Council | Councillor R. S. Haws (Chair)<br>Councillor S. Stratford (Vice Chair)<br>Councillor T.A. Bamford<br>Councillor E. Battye<br>Councillor A. Frost<br>Councillor J.F. Harper<br>Councillor C. Tolson<br>Councillor E.M. Gibson |
| Gateshead Council | Councillor N. O'Neil<br>(substitute – Councillor K. Childs) |
| Newcastle City Council | Councillor G. Bell<br>(substitute – Councillor G. Douglas) |
| North Tyneside Council | Councillor K.I. Fairs<br>(substitute – Councillor M. Madden) |
| City of Sunderland Council | Councillor J. Heron<br>(substitute – Councillor P. Young) |
| Trades Union Representatives | G. Clements – UNISON<br>W. Flynn – UCATT<br>S. Forster – UNISON |
| **Investment Managers** | |
| Indexation | Legal and General Investment Management |
| Global Equities | Capital International |
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| Property Manager | Aberdeen Property Investors |
| Private Equity | HarbourVest |
| **AVC Providers** | The Prudential Assurance Company<br>Equitable Life Assurance Society |
| **Actuary and Investment Advisor** | Watson Wyatt Partners |
| **Executive Director Resources** | J. Alderson |
| **Head of Pensions** | S. Moore |
| **Head of Legal Services** | C.G.D. Bradley |
| **Pensions Manager** | D. Smith |
| **Loans and Investment Manager** | I. Bainbridge |

## 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, without a need for additional contributions from employers***
- ***employers and members tell us they are highly satisfied with the services we provide***
- ***we are recognised as being amongst the leading UK pension funds.***

## Introduction

We are pleased to present the 2002/03 Annual Report and Accounts for the Tyne and Wear Pension Fund.

The year proved to be a very difficult one for the pensions industry. Equity markets fell by about 30% as the global economy stalled and concern increased over the situation in Iraq. This was the third year in succession that equity markets had fallen.

Against this background, the Fund decreased in value from £2.220 billion to £1.870 billion. The investment return for the year was –17.7%, which was 0.7% below the Fund's own benchmark but 5.0% better than the average return for UK pension funds.

The five year return was –0.8% per annum, which was 0.8% per annum ahead of the Fund's benchmark and 2.0% per annum above the average return for UK pension funds.

Whilst these absolute returns are disappointing, the relative performance against other pension funds is satisfactory.

In order to advise employers of the effect that investment conditions have had on funding levels, an indicative interim valuation was carried out as at 31st December 2002. This showed that the overall funding level had fallen from 82% at the 2001 valuation to 67%. A further interim valuation will be undertaken in 2003 to assist employers to prepare their budgets for 2004/05 onwards.

In February 2003, the Fund introduced a new pensions administration system that will provide a sound platform to improve the service we provide. It was pleasing to note that our 2002 survey of active members showed that 93% of the 2,200 returns that we received stated that the member was satisfied with the service.

The pensions industry faces many challenges in the coming years. The Fund is determined to meet these challenges and enhance the service that is provided to employers and members.

**Councillor Robert Haws**
**Chair of Pensions Committee**

**Julie Alderson**
**Executive Director Resources**

## Assurance Statement

## Corporate Governance Statement

South Tyneside Council is responsible for ensuring that its business is conducted in accordance with law and proper standards, that public money is safeguarded and properly accounted for and used economically, efficiently and effectively. In discharging this accountability members and senior officers are responsible for putting into place proper arrangements for governance of the Councils affairs and the stewardship of resources at its disposal.

To this end at their meeting on 19th March 2003, the Cabinet, approved and adopted a local code of corporate governance which is consistent with the principles and reflects the requirements of the CIPFA/SOLACE framework, Corporate Governance in Local Government: A Keystone for Community Governance.

During the year, the Council has started to put into place improved management and reporting arrangements to enable it to satisfy itself that its approach to corporate governance is both adequate and effective in practice. Specifically it has introduced new Constitutional arrangements and adopted risk management and consultation strategies. The Head of Legal Services and Corporate Governance (this post is currently vacant) has been given responsibility for:

- Overseeing the implementation and monitoring of the code;
- Reviewing the operation of the code;
- Reporting annually to Cabinet and Resources and Corporate Development Scrutiny Committee on compliance with the code and any changes that may be necessary to maintain it and ensure its effectiveness in practice.

In addition, South Tyneside Council's Chief Internal Auditor has been given the responsibility to review independently and report to the Resources and Corporate Development Scrutiny Committee annually, to provide assurance on the adequacy and effectiveness of the code and the extent of compliance with it.

We propose over the coming year to take steps to further enhance our corporate governance arrangements and will review their implementation and operation as part of our next annual review.

**Councillor Paul Waggott**
**Leader of the Council**

**Irene Lucas**
**Chief Executive**

## Statement on the System of Internal Financial Control

This statement is given in respect of the statement of accounts for South Tyneside Council. I acknowledge our responsibility for ensuring that an effective system of internal financial control is maintained and operated in connection with the resources concerned.

The system of internal control can provide only reasonable and not absolute assurance that assets are safeguarded, that transactions are authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.

The system of internal financial control is based on a framework of regular management information, financial procedure rules, procedure manuals covering financial and administrative matters (including segregation of duties), management supervision, and a system of delegation and accountability. Development and maintenance of the system includes:

- A clear delegation scheme incorporated into the Council's Constitution.
- Performance agreements for Executive Directors and Heads of Service which address financial responsibilities.
- A Corporate Plan which explicitly sets out planned key actions and performance targets for the future.
- Comprehensive budgeting systems.
- A robust system of budgetary control including formal quarterly and annual financial reports which indicate financial performance against forecasts.
- Setting targets to measure financial and other performance.
- The preparation of regular financial reports at various levels within the Council which indicate actual expenditure against the forecasts.
- Clearly defined capital expenditure guidelines.
- Use of appropriate project management disciplines.
- Participation in the National Fraud Initiative and subsequent investigations.
- Maintenance of the Verification Framework for the administration of Council and Housing Benefit.

In addition, the Council approved its first Code of Corporate Governance in March 2003, closely following the framework, recommended by CIPFA/SOLACE. This Code has assessed the Council's arrangements for compliance with the three underpinning principles of corporate governance – openness and inclusivity, integrity and accountability – across the various dimensions of the Council's business. The Code demonstrates that the Council has the majority of documentary evidence; processes and measures to demonstrate sound arrangements are in place. Where further development to comply with the code is necessary action has been planned to address this.

In order to ensure independent review of the adequacy, or otherwise, of the system of internal financial control, the Council maintains an adequate and effective internal audit.

The Internal Audit Group is working towards meeting the ISO 9002 standard and complies with relevant professional standards.

The work of Internal Audit is based upon its three year Strategic Audit Plan that covers all areas of activity and the associated risk of each area.

As part of the Council's Constitution, the Internal Audit Group reports its performance to the Resources and Corporate Development Scrutiny Committee on a quarterly and annual basis.

The Chief Internal Auditor reports to the Executive Director Resources, as the Chief Finance Officer via the Head of Legal Services and Corporate Governance, this post is currently vacant, but in order to ensure independence the Chief Internal Auditor has direct access to the Chief Executive, Cabinet and the Resources and Corporate Development Scrutiny Committee.

The Chief Internal Auditor reports the findings of audits to Executive Directors and action is agreed to address these findings as necessary. An annual report on audit activity together with details of the performance of Internal Audit is made to the Resources and Corporate Development Scrutiny Committee. The Annual Internal Audit Report for 2002/2003 concluded that, based on the work undertaken, overall throughout the Council there are sound systems in place. The Resources and Corporate Development Scrutiny Committee, having considered the Annual Report agreed that, based upon the Internal Audit Groups' performance and the outcome of their work, that the Council has a sound control environment.

My review of the effectiveness of the system of internal financial control is informed by:

- The work of managers within the Council.
- The work of the internal auditors as described above.
- The external auditors in their annual audit letter and other reports.

Whilst the Internal Audit Group has concluded that, based on the work undertaken, overall throughout the Council there are sound systems in place, the internal financial control system can always be improved. In conjunction with the Council's Executive Directors I will ensure that any recommendations for improvement arising from findings from internal audits to the control system are implemented.

**Julie Alderson**
**Executive Director Resources**

# Fund Report

## Governance

South Tyneside Council is the administering authority for the local government pension fund for the Tyne and Wear County area. The Fund is set up in accordance with the provisions of the Local Government Pension Scheme.

The Council has established a Pensions Committee that is required to control and resolve all matters relating to the administration and investment of the Fund. The Committee consists of fifteen members. South Tyneside Council nominates eight of the members and the other four district councils within the County area nominate one member each. Three representatives nominated by the trades unions also attend Committee meetings.

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

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

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

## The Service Plan

The vision and aims of the Pension Fund are set out in the Service Plan. This is a three year rolling plan that is produced annually. It contains the challenges and actions that the Pensions Service must concentrate on to achieve the vision.

The Service Plan may be viewed on the Fund's website, for which the address is **www.twpf.info**

It is pleasing to report that the Pensions Service achieved Investors in People accreditation in 2003. We believe that this commitment to training will assist us to improve the service we offer.

## Membership

As at 31st March 2003, there were 107 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 County area. These organisations are listed on pages 16 and 17.

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.

Membership of the Fund has grown by 2927 over the year, as shown in the following table:

| | 2002/03 | 2001/02 |
|---|---|---|
| Contributors | 46,520 | 44,585 |
| Deferreds | 13,399 | 13,170 |
| Pensioners | 28,054 | 27,291 |
| **Total** | **87,973** | **85,046** |
| Employers | 107 | 101 |

## Legal Framework

The provisions of the Local Government Pension Scheme are contained in Regulations made by the Office of the Deputy Prime Minister. These Regulations apply nationally to all local authorities in England and Wales.

The Local Government Pension Scheme Regulations 1997, as amended, which were introduced with effect from 1st April 1998, set out the current rates of contribution and the method of calculation of benefits.

During the year, the 1997 Regulations were modified to bring certain provisions into line with other pensions legislation and to meet new circumstances. An amendment was introduced to allow employees transferring to Care Trusts to remain within the Scheme, as well as having admittance rights to the Health Service Pension Scheme.

The legal framework for the investment of the Fund 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 which can be made, which include company and government securities, property and unit trusts, and set out restrictions on the proportion of the Fund which can be held in certain types of investment. They also require that a Statement of Investment Principles be prepared and published. The Fund's Statement is shown on pages 42 to 52 of this Report.

An amendment was made to the 1998 Regulations in 2002 that requires an administering authority to revise its Statement of Investment Principles to set out the extent to which it complies with the ten principles of practice contained in the CIPFA document, "Principles for Investment Decision Making in the Local Government Pension Scheme". Comment on the extent of the Fund's compliance with the Principles is given on pages 24 and 25.

## Benefits

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

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

## Employees Contributions

The 1997 Regulations introduced a common contribution rate of 6% for all members. Manual workers who were members of the Scheme prior to 1st April 1998 have retained the right to pay 5% for as long as they remain in the Scheme in continuous employment and in the same capacity.

## Employers' Contributions and the 2001 Valuation

Employees' contributions and investment returns do not cover the total cost of benefits. Employers participating in the Fund meet the balance of the cost with their contributions. The Fund's Actuary must value the Fund every third year in order to assess each employer's share of the cost.

Employers' contributions for the 2002/03 year were set by the 2001 valuation. This valuation showed that the funding level was 81.7%. This represents the average funding level across the Fund as a whole: each employer has their own funding level calculated. The strategy adopted at the 2001 valuation is to make good this deficiency over the average future working lifetime of active members. For most employers this is a period of thirteen years.

The funding level of 81.7% is a fall of 5% since the previous valuation in 1998. This fall is attributable to an increase in early retirements, the improvement in life expectancy and the poor performance of investment markets. These negative factors were offset in part by the Fund's relatively good investment performance during the inter valuation period.

Regrettably, employers' contributions had to be raised at the 2001 valuation in order to recover this increased deficit. An increase was also required to the future service contribution rates due to changes in the actuarial assumptions.

The next triennial valuation of the Fund will take place as at 31st March 2004, with the resulting contribution rates taking effect from 1st April 2005.

Information on the actuarial position of the Fund and the employers' contributions is set out in the Actuary's Reports, which are on pages 28 to 29.

In April 2003, the Fund Actuary, Watson Wyatt, decided to withdraw from the local authority actuarial market with effect from no later than October 2003. Hewitt Bacon and Woodrow has been appointed as Fund Actuary from July 2003.

## Interim Valuation

The performance of investment markets in the period since the 2001 valuation has been significantly worse than was assumed in the valuation. This poor performance has further reduced the funding level.

An indicative interim valuation was carried out as at 31st December 2002 in order to advise employers of the effect that investment conditions have had on their funding level since the 2001 valuation. This interim valuation showed that the overall funding level had fallen to 67%. Individual funding levels, together with indicative contribution rates based upon those funding levels, were calculated for each employer. The Actuary presented the results to employers in January 2003 and also addressed the meeting on the factors affecting funding positions.

The results of the indicative interim valuation were, as the name suggests, provided purely to inform employers of an estimate of their funding position. Employers were under no obligation to adopt the higher employer contribution rates set out in the results. However, employers may voluntarily have chosen to pay a higher rate in order to reduce the likelihood of a significant increase at the 2004 valuation.

A further indicative interim valuation will be undertaken in 2003 in order to assist employers to prepare their budgets for 2004/05 onwards and to provide an indication of the outcome of the 2004 triennial valuation.

### Stocktake of the Scheme

In July 2001, Ministers authorised a review, or “Stocktake”, of the Scheme in order to ensure that it is operating effectively, efficiently, and that it continues to provide value for money. This Stocktake follows a similar exercise for the Principal Civil Service Pension Scheme.

In 2002, the Office of the Deputy Prime Minister published a paper aimed at fostering discussion of a range of options for the future of the Scheme. The aim is to provide local government and other relevant public sector employees with a scheme that is suitable for modern working trends.

The discussion paper suggests that the present Scheme is a reasonable one for many employees who stay in local government throughout their career, but that it does not serve the pension needs of others, such as part-timers, career break workers, low paid workers and contract workers, so well.

The paper makes it clear that the present Scheme is not being challenged and invites thoughts on a number of possible elements of change, such as:

- The scope for further simplification of the Scheme’s legal framework, particularly within the context of the recommendations that emerged from the Pickering Review on private sector pension legislation.
- An assessment of the options from which it may be possible to develop a more flexible benefit package for new employees from a future date.
- Establishment of measures to enhance the Scheme’s benefit administration capacity in order to ensure the cost-effective delivery of a quality service.
- Establishing new means to monitor all the factors which influence the Scheme’s on-going sustainability on a fund-by-fund basis.

The Fund hosted a meeting in February 2003 to consider the early issues raised by the Stocktake and also by the Government’s Green Paper on Pensions. All Fund employers were invited to the meeting, which was addressed by representatives of the Office of the Deputy Prime Minister. The meeting was well attended and a lively discussion resulted covering various aspects of the Stocktake.

The Local Government Pensions Committee is acting as the primary respondent for local government employers and administering authorities. The Office of the Deputy Prime Minister is encouraging participating employers and administering authorities to comment on an individual basis, and we are submitting our comments, as an administering authority, on the discussion papers.

We will continue to keep employers advised of progress on the Stocktake and encourage them to submit their views.

## Pension Rights for Part Timers

The Scheme offers membership to all employees regardless of the number of hours worked. However, prior to January 1993 some part time employees were excluded from membership.

The House of Lords has ruled that such employees suffered discrimination and can backdate their membership to the later of 8th April 1976 and the date of commencement of employment. This will only be permitted where the appropriate pension contributions are paid.

Any employees who cease their current employment, who believe that they are affected by this judgement and who would like to secure Scheme membership, have to pursue their claim through an Employment Tribunal. These tribunals have been stayed pending the outcome of a number of test cases.

The Employers Organisation for Public Sector employers has now agreed, in principle, the method of calculating arrears of contributions for those employees who have submitted a valid claim to an Employment Tribunal. A procedure is in place to take these cases forward for settlement. Appropriate guidance has been issued to employers.

It is important to note that this procedure only applies in respect of those cases where the claimant has lodged an Employment Tribunal claim. These cases represent a small minority of all potential claimants. Amendments to the Scheme Regulations are not necessary to grant retrospective access for those members who have submitted a valid Employment Tribunal claim. Those cases where a claim has not been submitted cannot be settled at this time and must await future amendments to the Regulations.

## Additional Voluntary Contributions

Whilst the Scheme provides an excellent benefits package, it is normally possible to increase benefits and thereby take full advantage of the tax relief which is available. This can be done either by purchasing added years of service within the Scheme or by paying into an Additional Voluntary Contributions (AVC) plan.

As well as allowing members to boost their pension up to the maximum allowed under Inland Revenue rules, an AVC plan can also be used to provide extra life assurance.

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.

## Equitable Life

The Fund also has an AVC plan with Equitable Life. Due to Equitable's well-publicised difficulties, this plan is no longer promoted by the Fund and does not receive investment contributions from our members.

Whilst Equitable remains solvent, it continues to experience financial difficulties. The Fund has closely monitored the position of our members' investments with Equitable and has taken investment and legal advice. We have sought to keep members aware of developments as these arise.

During 2003, the case for transferring assets out of the with-profits fund and accepting the financial penalty of doing so became stronger. Also, the case for transferring assets out of the unit-linked funds appeared stronger.

Legal advice received by the Fund confirmed that the decision on whether to transfer investments from one AVC provider to another must be made by the Fund and cannot be made by the individual members. The Fund has to base its decision on what is likely to secure benefits of reasonable value for the member.

Accordingly, the Fund has adopted the following broad policy:

- Investments in Equitable's With-Profits Fund have been transferred to The Prudential's With-Profits Fund where it is believed to be in each member's best interests. This has meant that investments for members who are near to retirement age, or possibly about to retire early, have not been transferred because the predicted future investment returns would not compensate for the early withdrawal penalty imposed by Equitable.
- All investments in Equitable's managed funds have been transferred to comparable funds managed by The Prudential.
- All investment contributions to Equitable have been stopped, with the exception of the life cover option, and redirected into an equivalent investment with The Prudential.

The Fund will continue to monitor the position on Equitable and keep our members informed.

## Replacement Pensions Processing System

In February 2002, the Pensions Committee approved the award of a contract to Comino for a new pensions administration system. The new system went live in February 2003. The launch was acknowledged as a success by both the Fund and Comino.

The introduction of the system will assist us to provide members and employers with the highest level of service. It provides a sound platform to improve our pension processing and to develop the service.

The Fund had to commit significant staffing resources to the development and introduction of the new system. Unfortunately, this has meant that we could not meet our service standards during the period around the launch date. We have a recovery programme in place to rectify this situation.

## Communications Strategy with Fund Members

The Fund aims to communicate with members in a clear, concise and informative manner. The major features of our strategy are outlined below:

- A dedicated telephone helpline.
- A Fund website.
- An annual benefit statement for active members, sent direct to their home address. These statements were produced for the fourth year running, accompanied by the Members Annual Report and a newsletter.

- In 2002 we sent our first annual mailshot to deferred members. This included the Members' Annual Report and a newsletter. We encouraged members to register with the Fund to receive an annual benefit statement in future years. Over 3,000 deferred members have registered to receive a benefit statement, starting from 2003.
- A letter to our pensioners detailing the annual increase to their pension. The Members Annual Report is also provided.
- Pensions seminars to groups of members, on request. Over 400 employees attended 20 seminars held at various employer locations throughout the year.
- A comprehensive range of information booklets. These are available in a variety of formats for people with special needs, such as large print, Braille and foreign languages.

The Fund is committed to continually improving communications with its members. As part of this process we issued customer surveys to all of our active members and asked them to comment on what we are doing. Over 2,200 members responded and we were pleased to find that 93% declared that they were satisfied with the service we provide.

In the coming year we intend to survey our deferred members and our pensioners to seek their views on the service.

## Communications Strategy with Employers

We aim to communicate effectively with the employers in the Fund. Our communications strategy includes the following:

- The Annual General Meeting.
- The provision of an Employers Guide to the administration of the Fund.
- Training courses that aim to educate and inform staff on pension matters and working procedures.
- The provision of a joint Memorandum of Understanding that sets out our respective roles and responsibilities.
- Regular mailshots and updates.
- The Fund website, which has a dedicated section for employers.
- Occasional meetings with liaison staff. We are working to develop a more regular programme of meetings for those employers that would value this service.

## Pension Fund Website

The Fund's website, **www.twpf.info** is increasingly important to our service delivery package. We are committed to continually developing and improving this means of communication.

The website contains the following information:

- Latest news and topical issues.
- Links to other useful websites.
- Pensions Committee agendas.
- Details on how to contact the Fund.
- Current and previous years' Annual Report and Accounts.
- The Statement of Investment Principles and Policy on Socially Responsible Investment.
- Information booklets.
- Pension payment dates and details of pension inflation proofing.
- General comment about the Fund.

During the year, improvements were made to the design and layout of the website to give it a fresher appearance and to make it easier to navigate through.

Employers may access a password protected secure area of the website. After an initial registration process, employers have access to:

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

The Fund is working to expand the interactive nature of the website. We intend to introduce systems that will allow members to view their personal record and calculate estimates of existing benefits and possible improvements to their benefits. We are also looking to introduce on-line automated data transmission and processing for employers.

## Organisations Participating in the Fund as at 31st March 2003

**District Councils**
Gateshead Council
Newcastle City Council
North Tyneside Council
South Tyneside Council
City of Sunderland Council

**Other Scheduled Bodies**
Birtley Town Council
City of Sunderland College
Former North East Regional Airport
Former Tyne and Wear County Council
Former Tyne and Wear Residuary Body
Gateshead College
Monkwearmouth College
Newcastle Education Action Zone
Newcastle College
Nexus
North Tyneside College
Northumbria Police Authority
Northumbria Probation and After Care Service
South Tyneside College
South Tyneside Education Action Zone
Sunderland Education Action Zone
Tyne and Wear Fire and Civil Defence Authority
Tyne and Wear Passenger Transport Authority
Tynemouth College
University of Northumbria at Newcastle
University of Sunderland
Wearside College

**Admitted Bodies**
Age Concern Newcastle
Assessment and Qualification Alliance
Association of North East Councils
Benton Grange School
Blue Square Trading
Bovis Lend Lease
Brunswick Young Peoples Project
Catholic Care North East
Disability North
Gateshead Law Centre
Gateshead Magistrates
Higher Education Funding Council for England
Hebburn Neighbourhood Advice Centre
Information North (Northern Regional Library System)
International Centre for Life Trust
Jarvis-Sandhill View
Learning World
National Glass Centre
Newcastle Community Law Centre
Newcastle Family Service Unit
Newcastle Healthy City Project
Newcastle Magistrates
Newcastle International Airport Company Limited
Newcastle Tenants Federation
Newcastle West End Partnership
Newcastle Youth Congress

## Organisations Participating in the Fund as at 31st March 2003

**Admitted Bodies**

Norcare
Norland Road Community Association
North East Innovation and Development Company Limited
North East Museums, Libraries and Archives Council
North East Regional Employers Organisation
Northern Arts Association
Northern Council for Further Education
Northern Counties School for the Deaf
Northern Informatics Application Agency
North Tyneside Child Care Enterprise
North Tyneside City Challenge
North Tyneside Disability Advice Centre
North Tyneside Magistrates
Northumbria Tourist Board
One North East
Ouseburn Trust
Park View Sports Complex
Passenger Transport Company
Port of Tyne Authority
Praxis Service
Raich Carter Sports Complex
Saint Mary Magdalene and Holy Jesus Charity
Scolarest
Search Project
Simonside Community Centre
South Tyneside Groundwork Trust
South Tyneside Magistrates
South Tyneside Victim Support
Stagecoach Travel Services (Busways)
Sunderland Arts Centre
Sunderland City Training and Enterprise Council
Sunderland Empire Theatre Trust Limited
Sunderland Enterprise Agency
Sunderland Housing Group
Sunderland Magistrates
Sunderland Outdoor Activities Association
Theatre Royal Trust Limited
The Hospital of Saint Mary the Virgin
The Ozanam House Probation Hostel Committee
Thomas Gaughan Community Centre
Tyne and Wear Development Company Limited
Tyne and Wear Development Corporation
Tyne and Wear Enterprise Trust Limited
Tyne and Wear Play Association
Tyne and Wear Small Business Service
Tyneside Deaf Youth Project
Tyneside Training and Enterprise Council
Tyne Theatre Trust (Northern Stage Company)
Tyne Waste Limited
Valley Citizens Advice Bureau
Wallsend Citizens Advice Centre
Wallsend Peoples Centre
Wellfield Middle School
Workshops for the Adult Blind (Palatine Products)

# Investment Report

## Investment Objectives

The formal 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 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 the regulations relating to the investment of local government pension funds.

## Strategic Investment Policy

The strategic investment policy is derived from an asset liability study that was first undertaken in 2000. This study examined the Fund's financial position, the profile of its membership, the nature of its liabilities and included an analysis of the expected returns from differing investment policies. The outcome of the initial study has been tested against updated market and liability data in 2001 and 2002 and has been found to remain appropriate, with the exception of a small adjustment in 2001 to the proportions allocated to certain Bonds asset classes. This ongoing exercise ensures that the Fund is properly invested in relation to its liabilities and to opportunities in investment markets.

The study has indicated that a diversified portfolio invested 65% in Equities and 35% in Bonds and Property represents a suitable strategic benchmark for the Fund. The benchmark is shown in the following table:

| **Asset Class** | **Strategic Benchmark %** |
|---|---|
| **UK Equities** | **30.00** |
| Overseas Equities | |
| - US | 9.75 |
| - Europe ex UK | 12.25 |
| - Japan | 6.50 |
| - Other Far East | 3.25 |
| - Emerging Markets | 3.25 |
| **Total Overseas Equities** | **35.00** |
| **Total Equities** | **65.00** |
| Fixed Interest | |
| - UK Gilts | 8.75 |
| - UK Index-Linked | 5.00 |
| - Sterling Non Government | 11.00 |
| - Overseas | 2.75 |
| **Total Fixed Interest** | **27.50** |
| **Property** | **7.50** |

The previous benchmark was the consensus asset allocation within the Russell/Mellon CAPS survey. This provided an appropriate benchmark for the Fund for a number of years but it became clear in 2000 that its suitability was diminishing.

The move to the new benchmark was largely completed by March 2002, although the final stages of the transition were not undertaken until after the 2001/02 year-end. The new benchmark was fully operational from 1st July 2002.

The new benchmark has not resulted in a significant change to the overall allocation to Equities. However, there was a move into UK Fixed Interest and

Overseas Equities at the expense of UK Equities, Overseas Fixed Interest and Cash. Over time, there will also be an increased allocation to Private Equity.

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

### Investment Management Structure

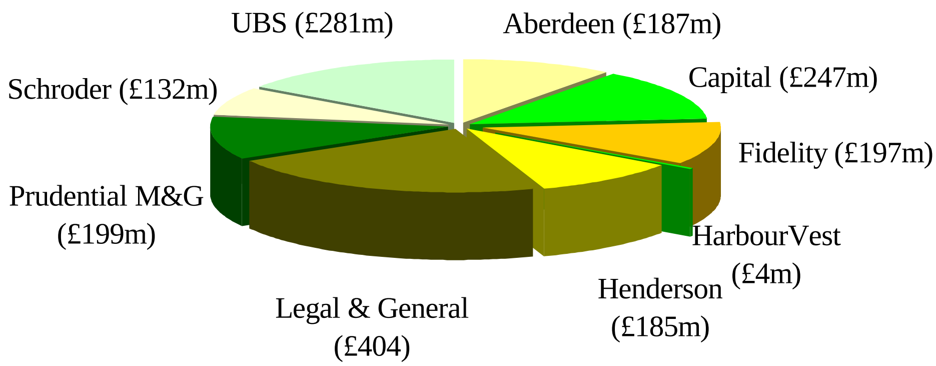
When the consensus asset allocation was used as the benchmark, half of the Fund was managed on a balanced basis and half on a specialist basis. The move to the new benchmark made it appropriate to review this structure.

A new structure has been introduced that employs nine specialist managers over a total of fourteen investment mandates. This broadly based structure ensures that investment returns are not overly influenced by the performance of any one manager.

The structure is set out in the following table:

| **Manager** | **Portfolio** |
|---|---|
| Legal and General | Indexation<br>- UK Equities<br>- US Equities<br>- Corporate Bonds<br>- UK Index-Linked |
| Capital | Global Equities<br>Emerging Market Equities |
| UBS | Pan European Equities |
| Fidelity | UK Equities |
| Schroder | Japanese Equities<br>Pacific Rim ex Japan Equities |
| Prudential M&G | Corporate Bonds |
| Henderson | Global Government Bonds |
| Aberdeen | Property |
| HarbourVest | Private Equity |

The value of assets with each manager at the year-end is shown below:



## Investment Managers' Objectives and Restrictions

The Pensions Committee has set objectives and restrictions for the investment mandates. These have been prepared with the aims of ensuring a prudent approach to investment and of 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 have also been set.

In addition to managing a range of indexed portfolios, Legal and General assists the Fund's Officers to maintain the asset allocation in line with the strategic benchmark.

Investment in Private Equity is made largely on a fund of funds basis. Whilst an outperformance target relative to quoted equity markets has been set, official measurement against this is not appropriate at this early stage of investment into this asset class.

The Property Portfolio, which is managed by Aberdeen Property Investors, has a target based on the Investment Property Databank (IPD) Index. Aberdeen is also responsible for advising the Committee on the proportion of the Fund's assets which should be invested in Property.

## Custodians

When appointing an investment manager, the Committee is prepared to appoint that manager's in-house or recommended custodian providing that criteria on security of assets and service standards can be met. Where a manager does not recommend a custodian, the Committee will make the appointment. Under the current management structure there are four investment managers who do not recommend a custodian. Consequently, the Fund appointed Northern Trust to act as custodian for these managers. The custodians for each manager are noted below:

| Manager | Custodian |
|---|---|
| Legal and General | Northern Trust |
| Capital | Northern Trust |
| UBS | UBS |
| Fidelity | Northern Trust |
| Schroder | Schroder |
| Prudential M&G | Boston Safe Deposit and HSBC |
| Henderson | Northern Trust |

## Developments during the Year

The Fund is continually looking at developing its investment management arrangements and the mechanisms used to monitor and control activity. During the year, the following initiatives have been put into place:

**Transaction Cost Monitoring**. Arrangements have been made to obtain an independent analysis of each manager's trading activity. The analysis for 2002/03 has shown a successful year in terms of overall trading performance, with the Fund's costs being less than the average costs revealed by the survey.

**Risk Measurement**. The Fund has appointed a risk measurement service provider to produce an in depth analysis of the risks being assumed in each manager's portfolio and at the Total Fund level. A review of the results for 2002/03 confirmed that the risk profiles of the Total Fund and of the individual portfolios were in line with expectations and no issues of concern were identified.

**Commission Recapture**. The Fund has implemented a Commission Recapture Scheme. It is estimated that this may generate annual income of approximately £200,000.

**Money Market Fund.** An off balance sheet money market fund has been introduced to assist with the management of the tactical holdings in cash and to improve the security of the cash balances.

## Investment Strategy

The asset allocation is maintained within pre-determined ranges around the strategic benchmark. When a range is breached, the Fund is rebalanced back to the benchmark weightings.

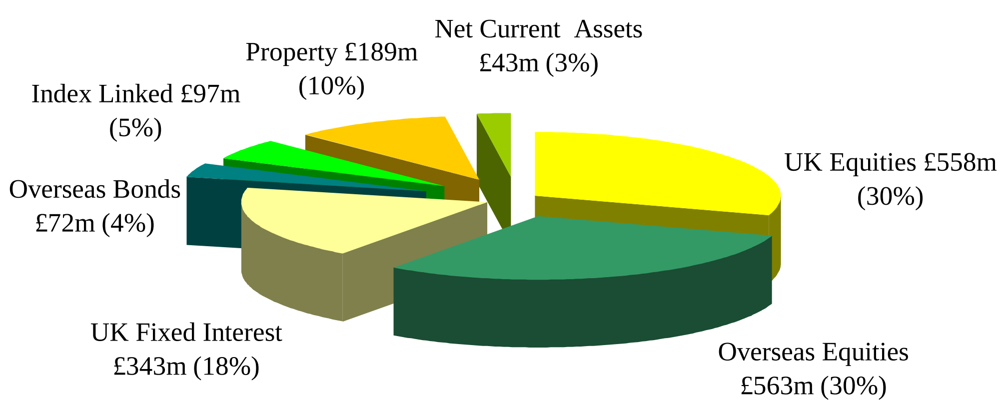
Equity and Bond managers that invest in more than one market are permitted to make tactical asset allocation decisions within their own portfolios. This does not impact on the Fund's overall strategy but provides additional scope for managers to outperform their targets.

The tactical allocation to Property is set by the Pensions Committee, based on recommendations from the Property Manager and advice from the Investment Advisor.

The change to the asset allocation during the year, including the impact of market movements, is illustrated in the following table:

| Asset Class | £m | % |
|---|---|---|
| UK Equities | -284 | -8 |
| Overseas Equities | -79 | +1 |
| UK Fixed Interest | -52 | +1 |
| Overseas Fixed Interest | +6 | +1 |
| Index-Linked | +73 | +4 |
| Property | +27 | +3 |
| Net Current Assets | -40 | -2 |

The actual asset allocation as at 31st March 2003 is shown below:



## Performance Measurement

2002/03 is the first full year for which performance has been measured against the new strategic benchmark. For longer periods ending on 31st March 2003, a hybrid benchmark is used. This is based on the median up to and including periods ending 31st January 2002 and on the strategic benchmark thereafter.

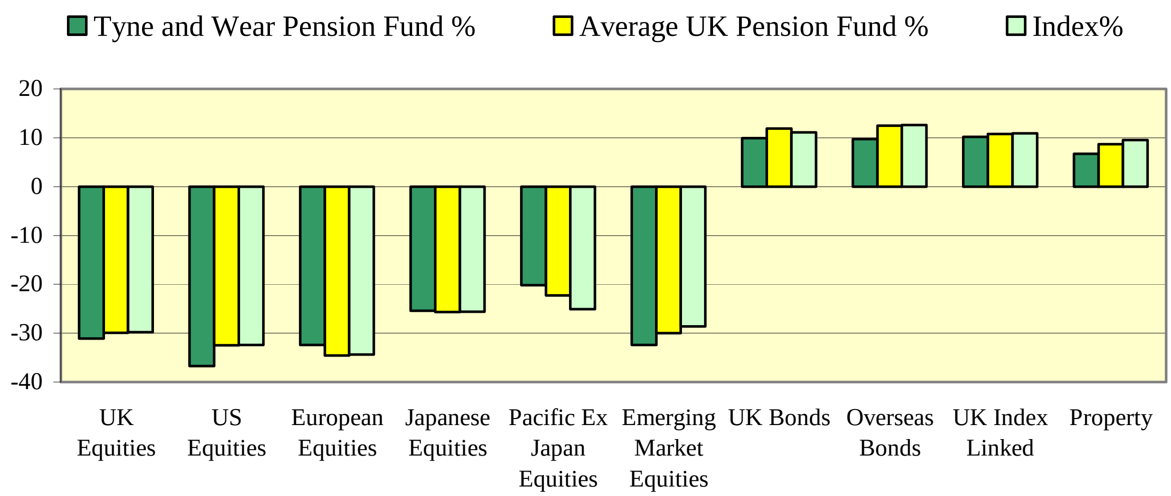
## Returns for 2002/03

The year saw a global economic slowdown and a difficult situation in the Middle East, culminating in a war in Iraq. In this environment, Equities fell significantly and posted negative returns for the third year in succession. In contrast, the defensive nature of Bonds and Property meant that they performed well.

The Fund's investment return for the year was –17.7%, which was 0.7% below the benchmark return of –17.0%. In general, the Fund was positioned for a recovery in Equity markets and this detracted from returns.

Whilst the Fund is no longer assessed against the median, it is interesting to see how it is performing against its peer group. The median return for the year was –22.7%. Therefore, whilst the Fund underperformed its benchmark, it comfortably outperformed the median. This is because the Fund's benchmark has a higher weighting in Bonds that protected it during a period of falling Equity markets.

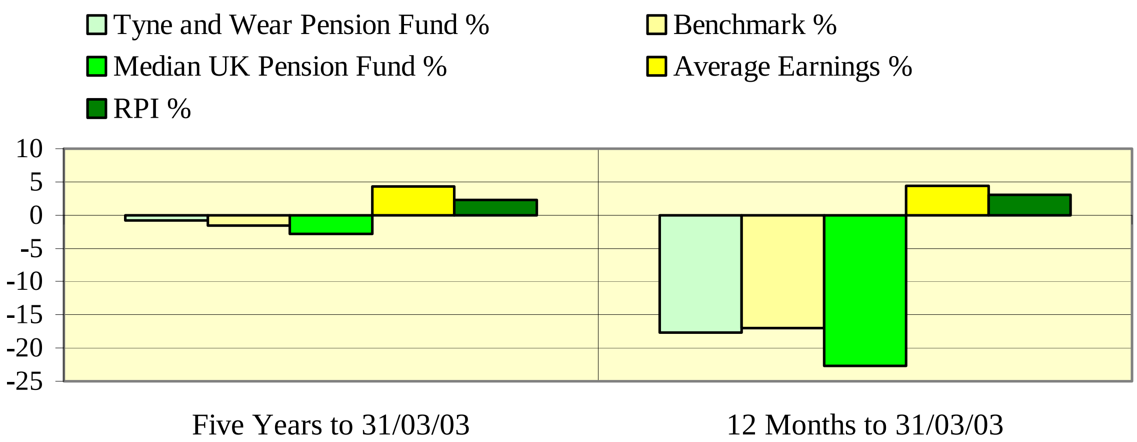
The chart below shows the Fund's return over the main investment markets for 2002/03 and compares it against the median and index returns.



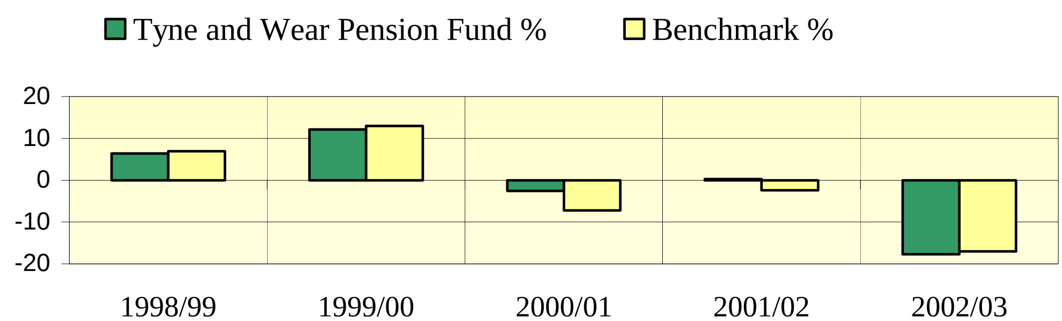

## Five Year Performance

In order to avoid taking too short term a view of investment performance, pension fund returns are generally assessed over five year periods. The Fund's annual return over the last five years has been –0.8% per annum. Whilst this negative return is disappointing, it is pleasing to note that it is above the benchmark return of –1.6% per annum and ahead of the median return of -2.8% per annum.

Because the five year return has fallen into negative territory, it now lags the rate of wages and inflation over the period, as shown below:




The annual performance, relative to benchmark, over the five year period is shown in the following chart




The chart shows that the Fund underperformed for the first two years of the period. This was mainly because the Fund had a defensive asset allocation that resulted largely from the investment views of UBS Global Asset Management, who managed a large balanced portfolio under the previous investment management structure. Financial markets performed very strongly during this two year period and the defensive stance detracted from returns. However, the market environment changed considerably in 2000/01 and Equity markets began to fall. This continued into 2001/02. The Fund and UBS performed well on a relative basis and more than reversed the losses of the earlier years.

Unfortunately, 2002/03 saw performance slip below the benchmark for the year, but performance remains above the benchmark for the five year period to 31st March 2003.

# Investment Policies

## 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.

One year later, on 6th March 2001, the "Myners Report" was produced. In October 2001, the Government published a Code of Investment Principles that reflected the proposals of the Myners 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 compliance.

Last year, the Fund was able to report full compliance with six of the ten Principles and partial compliance with a further three. This year, the Fund is fully compliant with eight Principles and partially compliant with two.

Progress towards full compliance includes the publication of a handbook for Committee Members, the implementation of transaction cost monitoring arrangements and the tendering of the actuarial services contract. The contract for investment advice will be tendered in 2003/04 and we will be considering an approach to assess formally the decisions taken by the Committee and its Investment Advisor.

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 and a Committee Members' handbook has been 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 annually in the light of changing market and liability data. |
| **Principle 4 –** Contracts for actuarial services and investment advice should be open to separate competition. | Partially Compliant. The actuarial services contract has been subject to tender in 2003. The investment advisory contract will be 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 have been put in place to monitor transaction costs. |
| **Principle 6** – The Fund should play an active role in Corporate Governance. | Fully Compliant. The Fund has an agreed 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. | Partially Compliant. An approach to the formal assessment of decisions taken by the Committee and the Advisor is under consideration. |
| **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 Myners. |
| **Principle 10** – The Fund should publish its Statement of Investment Principles (SIP) and the results of monitoring. | Fully Compliant. The Fund's SIP is published in the Annual Report and Accounts and is available on the Fund's website www.twpf.info. |

## The Statement of Investment Principles

The Pensions Committee first approved a Statement of Investment Principles (SIP) 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. With the introduction of the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999, the need to produce a SIP was extended to local government funds.

The Fund's SIP is a key document. It sets out the investment framework for the Fund and provides an up to date assessment of compliance with the Myners Principles. The document is reviewed as new developments take place and was last updated as at 31st March 2003.

The SIP sets out the following details:

- Who is taking which decisions and why this structure has been selected.
- The Fund's investment objective.
- The Fund's planned asset allocation strategy, 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 all advisors and managers and why this set of structures has been selected.
- The extent to which the Fund complies with the Myners Principles.

As would be expected, the contents of the SIP reflect the detail contained in this Annual Report and Accounts. A copy of the SIP is shown on pages 42 to 52.

## Corporate Governance and Voting

The Pensions Committee believes that good corporate governance and the informed use of voting rights are an integral part of the investment process which 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, the Committee believes that the Fund's investment managers are best placed to undertake it.

The Committee requires each manager 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.
- 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 Institutional Shareholder Committee (ISC) has recently drafted a Statement of Principles that sets out recommended practice for institutional shareholders in relation to their corporate governance responsibilities. The Fund's compliance with this has been reviewed and it has been concluded that many of the Principles are already included in the Fund's existing Policy. However, the Policy may need to be more prescriptive in a number of areas. This area is being reviewed with the investment managers.

## Socially Responsible Investment

The Fund's SIP covers the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. This area is known as Socially Responsible Investment (SRI).

The policy on SRI is combined with the policy on voting and corporate governance entitled "Policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance". It requires that each 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.

This policy was reviewed and updated by the Pensions Committee in June 2003. A copy is shown on pages 53 to 54.

SRI is an important issue and the Pensions Committee takes its responsibility in this area very seriously. Investment managers are required to report on the implementation of this policy in their quarterly performance report and it is on the agenda for meetings with investment managers.

## Actuarial Information

The Scheme Regulations require that a full actuarial valuation is carried out every third year. The purpose of this is to establish that the Fund is able to meet its liabilities to past and present contributors.

### Actuarial Position

1. Rates of contributions paid by the participating employers during 2002/03 were based on the actuarial valuation carried out as at 31st March 2001.

2. This valuation showed that the required level of contributions to be paid to the Fund by participating employers (in aggregate) with effect from 1st April 2002 was as set out below:

   - 210% of members' contributions to meet the liabilities arising in respect of service after the valuation date

   Plus

   - 125% of members' contributions over a period of 13 years (the members' average future service lifetime) to reflect the shortfall of the Fund's assets over 100% of its accrued liabilities, allowing, in the case of members in service, for future pay increases

   Less

   - 20% of members' contributions to reflect anticipated outperformance on the Fund's equity holdings.

3. The contributions actually required from each participating employer over the period 1st April 2002 to 31st March 2005 are set out in a certificate appended to a separate report on the actuarial valuation.

4. The market value of the Fund's assets at the valuation date was £2,190 million and this represented 81.7% of the Fund's accrued liabilities, allowing for future pay increases.

5. The contribution rates have been calculated using the projected unit actuarial method and the main actuarial assumptions were as follows:

| | |
|---|---|
| Discount rate for periods | |
| - after retirement: | 5.90% per annum |
| - before retirement: | 6.75% per annum |
| Rate of general pay increases: | 4.25% per annum |
| Rate of increases to pensions in payment | |
| (in excess of Guaranteed Minimum Pensions): | 2.50% per annum |
| Valuation of assets: | assets are taken at their market value. |

## Report of the Actuary for the Year Ended 31st March 2003

The last full actuarial investigation into the financial position of the Tyne and Wear Pension Fund in accordance with Regulation 77(1) of the Local Government Pension Scheme Regulations 1997 was completed as at 31st March 2001. The results showed that the financial position of the Fund had deteriorated since the previous valuation with the assets covering 81.7% of the liabilities, allowing for future pay increases in pensionable remuneration.

We recommended revised rates of contributions to be paid by the participating employers with effect from 1st April 2002. A formal Certificate of these contribution rates to be paid from 1st April 2002 was issued to the Director of Finance of South Tyneside Council as part of our formal report on the valuation of the Fund as at 31st March 2001.

Having regard to the results of the actuarial valuation as at 31st March 2001 and the rates of contribution in payment from 1st April 2002, together with the stepped increases recommended to apply in future years, the assets of the Fund as at 31st March 2003 will be sufficient, on the basis that the assumptions adopted for the valuation as at 31st March 2001 are borne out in practice (over the long-term starting from the valuation date), to meet the on-going liabilities of the Fund under the Regulations associated with both the accrued service and the currently accruing service, increasing levels of pensionable remuneration and increases to pensions both in payment and in deferment, taking into account the gradual amortisation of the deficiency disclosed by the valuation as at 31st March 2001. However, in the absence of enhanced future returns to offset the effects of equity market falls since 31st March 2001, employers' contributions would need to increase further in future.

The next actuarial valuation of the Pension Fund will be carried out as at 31st March 2004 and the results will be reported in the accounts for the year ending 31st March 2005, although the contribution rates found to be required as part of that valuation become effective from 1st April 2005.

**R. G. Ashurst**
**Fellow of the Institute of Actuaries**
**Watson Wyatt LLP**

## Financial Statements

## Fund Account

| 2001/02 £'000 | 2001/02 £'000 | | Note | 2002/03 £'000 | 2002/03 £'000 |
|---|---|---|---|---|---|
| | | **Contributions and Benefits** | | | |
| 133,414 | | Contributions Receivable | 4 | 165,416 | |
| 12,548 | | Transfers In | 5 | 14,251 | |
| | 145,962 | | | | 179,667 |
| 103,062 | | Benefits Payable | 6 | 111,693 | |
| 20,324 | | Leavers | 7 | 18,200 | |
| 1,925 | | Administrative Expenses | 8 | 2,445 | |
| | 125,311 | | | | 132,338 |
| | 20,651 | **Net Additions from Dealings with Members** | | | 47,329 |
| | | **Returns on Investments** | | | |
| 71,316 | | Investment Income | 9 | 43,816 | |
| -4,773 | | Non-Recoverable Tax | 9 | -2,332 | |
| -58,641 | | Change in Market Value of Investments | 10 | -434,978 | |
| -3,771 | | Investment Management Expenses | 11 | -4,342 | |
| | 4,131 | **Net Returns on Investments** | | | -397,836 |
| | 24,782 | **Net Increase/(Decrease) in the Fund during the Year** | | | -350,507 |
| | 2,195,451 | **Net Assets of the Fund at 1st April** | | | 2,220,233 |
| | 2,220,233 | **Net Assets of the Fund at 31st March** | | | 1,869,726 |

## Financial Statements

## Net Assets Statement

| 2001/02 £'000 | 2001/02 £'000 | | Note | 2002/03 £'000 | 2002/03 £'000 |
|---|---|---|---|---|---|
| | | **Investments** | 10 | | |
| 185,310 | | Fixed Interest Securities | | 186,300 | |
| 989,135 | | Equities | | 835,150 | |
| 24,275 | | Index-Linked Securities | | 29,839 | |
| 774,134 | | Managed and Unitised Funds | | 581,738 | |
| 158,800 | | Properties | | 188,975 | |
| 5,779 | | External AVCs | | 4,709 | |
| 67,454 | | Cash Deposits | | 33,053 | |
| 7,490 | | Other investment balances | | -1,222 | |
| | 2,212,377 | | | | 1,858,542 |
| | 7,856 | **Current Assets and Liabilites** | 12 | | 11,184 |
| | 2,220,233 | **Net Assets of the Fund at 31st March** | | | 1,869,726 |

# 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) and follow the 2002 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 28 and 29. The financial statements should be read in conjunction with the Actuary's statements.

## 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 2003.

Unitised securities have been included at the average of their bid and offer prices on 31st March 2003.

Other unquoted investments have been valued with regard to latest dealings and other appropriate financial information.

Overseas investments and foreign currency balances have been converted into Sterling at the closing exchange rates on 31st March 2003.

Properties are shown as valued at 31st December 2002. 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 2003 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 2003.

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 2003 is credited to the Fund Account.

Interest on cash deposits has been accrued up to 31st March 2003.

## Investment Management Expenses

Investment management expenses payable as at 31st March 2003 have been accrued.

## Debtors and Creditors

For Fund transactions, a system of income and converted payments is operated. Unless stated below, at the year-end, payments are converted to expenditure by the addition of unpaid creditors as at 31st March 2003. The accrual concept is in accordance with SSAP 24.

## Contributions

Contributions represent the amounts receivable from the organisations participating in the Fund; these may be district councils, other scheduled bodies or admitted bodies. Such amounts relate both to their own employer contributions and to those of their pensionable employees. The rate for employers is determined by the Actuary. Contributions due as at 31st March 2003 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 normally accounted for on a payments/receipts basis since not only do they frequently apply to several past years but, in the case of transfer values due, information is not available at the year end on which to make an accrual. However, where a transfer value has been agreed prior to the year end but the payment has not been made, this has been accrued.

## 3. Change to Accounting Policy

There have been two changes to the Accounting Policies used in the production of the 2002/03 report and accounts. Where this has affected amounts shown in the 2001/02 accounts the figures have been restated to allow a meaningful comparison between years to be undertaken.

### Treatment of Dividend Accruals and Recoverable Taxation

In previous accounts, the current assets and liabilities shown in note 12 have included amounts for dividend accruals and recoverable taxation. However, it has been decided that from 2002/03 these amounts should be included within investment debtors. This has affected figures in notes 10 and 14 which have also been restated.

### External Additional Voluntary Contributions

For 2002/03 the accounts include all amounts in relation to external additional voluntary contributions (AVCs). Whilst these are invested separately from the Fund's assets and do not form part of the Fund, the Statement of Recommended Practice (Financial Reports of Pension Schemes) requires that they are included in the Pension Fund's financial statements. Therefore notes 4, 5, 6, 7, 10 and 14 all now include a line for external AVCs.

Further details on the Fund's AVC arrangements are provided in note 13.

## 4. Contributions Receivable

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Employers | | |
| Normal | 73,861 | 64,753 |
| Additional | 51,821 | 31,155 |
| Members | | |
| Normal | 38,753 | 37,081 |
| In-House AVCs | 652 | 4 |
| External AVCs | 329 | 421 |
| | 165,416 | 133,414 |

## 5. Transfers In

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Individual Transfers From Other Schemes | 11,818 | 11,822 |
| External AVCs | 2,433 | 726 |
| | 14,251 | 12,548 |

## 6. Benefits Payable

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Pensions | 100,591 | 94,615 |
| Commutations and Lump Sum Retirement Benefits | 19,145 | 15,063 |
| Lump Sum Death Benefits | 1,961 | 2,356 |
| External AVCs | 428 | 298 |
| Less: Recharges | -10,432 | -9,270 |
| | 111,693 | 103,062 |

## 7. Payments to and on Account of Leavers

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Individual Transfers to Other Schemes | 15,203 | 19,716 |
| Refunds to Members Leaving Service | 613 | 436 |
| External AVCs | 2,384 | 172 |
| | 18,200 | 20,324 |

## 8. 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:

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Employee Expenses | 1,010 | 961 |
| Support Services Recharge | 754 | 721 |
| External ICT Costs | 344 | 102 |
| Printing/Publications | 74 | 40 |
| Actuarial Fees | 168 | 133 |
| Other Expenses | 170 | 73 |
| SIB Pension Review | -35 | -68 |
| Other Income | -40 | -37 |
| | 2,445 | 1,925 |

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

## 9. Investment Income

| | 2002/03<br>£'000 | 2001/02<br>£'000 |
|---|---|---|
| Fixed Interest Securities | 8,373 | 18,660 |
| Equities | 23,939 | 31,660 |
| Index-Linked Securities | 660 | 686 |
| Managed and Unitised Funds | 171 | 3,225 |
| Properties – Net Rents | 8,915 | 10,968 |
| Cash Deposits | 1,703 | 6,116 |
| Commission Recapture | 35 | 0 |
| Underwriting Commission | 20 | 1 |
| Sub-Total | 43,816 | 71,316 |
| Less: Non-Recoverable tax | -2,332 | -4,773 |
| Total Investment Income | 41,484 | 66,543 |

## 10. Investments

| | Value at 1.4.02 | Purchases at Cost | Sales Proceeds | Change in Market Value | Value at 31.3.03 |
|---|---|---|---|---|---|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| Fixed Interest Securities | 185,310 | 280,117 | -290,312 | 11,185 | 186,300 |
| Equities | 989,135 | 600,856 | -394,483 | -360,358 | 835,150 |
| Index-Linked Securities | 24,275 | 30,679 | -26,611 | 1,496 | 29,839 |
| Managed and Unitised Funds | 774,134 | 242,234 | -348,560 | -86,070 | 581,738 |
| Properties | 158,800 | 28,875 | 0 | 1,300 | 188,975 |
| External AVCs | 5,779 | 2,762 | -2,812 | -1,020 | 4,709 |
| | 2,137,433 | 1,185,523 | -1,062,778 | -433,467 | 1,826,711 |
| Cash Deposits | 67,454 | 1,704 | -35,807 | -298 | 33,053 |
| Other Investment Balances | 7,490 | 3,688 | -11,187 | -1,213 | -1,222 |
| | 2,212,377 | 1,190,915 | -1,109,772 | -434,978 | 1,858,542 |

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.

| | | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|---|
| **Fixed Interest Securities** | | | |
| UK Public Sector | | 69,106 | 69,036 |
| UK Other | | 47,598 | 49,848 |
| Overseas Public Sector | | 69,596 | 66,426 |
| Overseas Other | | 0 | 0 |
| | | 186,300 | 185,310 |
| **Equities** | | | |
| UK Quoted | | 341,765 | 415,793 |
| UK Unquoted | | 153 | 159 |
| Overseas Quoted | | 489,719 | 570,468 |
| Overseas Unquoted | | 3,513 | 2,715 |
| | | 835,150 | 989,135 |
| **Index-Linked Securities** | | | |
| UK Quoted | | 26,850 | 24,275 |
| Overseas Quoted | | 2,989 | 0 |
| | | 29,839 | 24,275 |
| **Managed and Unitised Funds** | | | |
| UK Managed Funds | - Other | 512,002 | 721,727 |
| Overseas Managed Funds | - Other | 63,223 | 42,986 |
| UK Unit Trusts | - Property | 2 | 3,100 |
| | - Other | 6,509 | 6,315 |
| Overseas Unit Trusts | - Other | 2 | 6 |
| | | 581,738 | 774,134 |
| **Properties** | | | |
| Freehold | | 154,325 | 124,050 |
| Long Leasehold | | 34,650 | 34,750 |
| | | 188,975 | 158,800 |
| **External AVCs** | | 4,709 | 5,779 |
| **Cash Deposits** | | | |
| Sterling | | 30,026 | 65,833 |
| Foreign Currency | | 3,027 | 1,621 |
| | | 33,053 | 67,454 |
| **Other Investment Balances** | | | |
| Currency Hedging | | -1,775 | 251 |
| Debtors | | 10,505 | 20,879 |
| Creditors | | -9,952 | -13,640 |
| | | -1,222 | 7,490 |

## 11. 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:

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Administration, Management and Custody | 4,162 | 3,549 |
| Performance Measurement Services | 98 | 43 |
| Other Advisory Fees | 65 | 154 |
| Audit Fees | 17 | 25 |
| | 4,342 | 3,771 |

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

## 12. Current Assets and Liabilities

| | 2002/03 £'000 | 2001/02 £'000 |
|---|---|---|
| Contributions and Recharges Due | 14,213 | 10,949 |
| Inland Revenue | -1,700 | -1,533 |
| Investment Management Expenses | -1,087 | -1,515 |
| Other | -242 | -45 |
| | 11,184 | 7,856 |

## 13. Additional Voluntary Contributions

The Fund offers two types of AVC arrangements.

Additional years of service 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.

Equitable Life has been experiencing significant financial difficulties over the past few years. The problems arose from some of its financial products that carry guaranteed returns. This has been compounded by poor stock market performance over the past three years which has reduced Equitable's reserves and forced significant bonus reductions.

The AVC funds provided by Equitable Life are now closed for business with the exception of the Life Assurance Fund. A significant proportion of investors in other funds operated by Equitable have had their balances transferred to The Prudential. The Fund continues to monitor the position of the remaining investors with Equitable and is trying to establish the best way forward.

## 14. Analysis of Investments over Managers

In addition to the two external AVC providers, the Fund employs external investment managers over a total of fourteen different 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/AVC provider were:

| As at 31st March 2002 | | | As at 31st March 2003 | |
|---|---|---|---|---|
| £'000 | % | | £'000 | % |
| | | **Investment Managers** | | |
| 161,137 | 7 | Aberdeen Property Investors | 187,119 | 10 |
| 5 | 0 | Barclays Global Investors | 4 | 0 |
| 302,152 | 14 | Capital International – Global Equities | 194,894 | 10 |
| 30,556 | 1 | Capital International – Emerging Mkts. | 51,808 | 3 |
| 287,555 | 13 | Fidelity Pensions Management | 197,442 | 11 |
| 2,715 | 0 | HarbourVest | 3,513 | 0 |
| 182,607 | 8 | Henderson Global Investors | 184,582 | 10 |
| 540,633 | 25 | Legal and General Investment Management | 404,328 | 22 |
| 226,180 | 10 | Prudential M&G | 199,832 | 11 |
| 134,752 | 6 | Schroder Investment Management | 132,378 | 7 |
| 298,646 | 14 | UBS Global Asset Management | 280,893 | 15 |
| 39,660 | 2 | Managed In-House | 17,040 | 1 |
| 2,206,598 | 100 | | 1,853,833 | 100 |
| | | **AVC Providers** | | |
| 4,893 | 0 | Equitable Life Assurance Society | 1,134 | 0 |
| 886 | 0 | The Prudential Assurance Company | 3,575 | 0 |
| 5,779 | 0 | | 4,709 | 0 |
| 2,212,377 | 100 | Total Investments | 1,858,542 | 100 |

## 15. Investment Performance

During the year, investment markets have fallen significantly and this has detracted from the returns of pension funds. In this environment, the Fund's investment return for the year was –17.7%. This was behind the Benchmark return of –17.0% but was better than the average return of UK pension funds, which was –22.7%.

To avoid taking too short term a view of investment performance, pension fund returns are generally assessed over five year periods. The Fund's average annual return for the five year period ended 31st March 2003 has been –0.8%. This was above both the Benchmark return of –1.6% and the average return of UK pension funds of –2.8%. The Fund's longer term performance is satisfactory in relative terms but the significant fall in markets has meant that the five year return has fallen into negative territory.

## 16. Taxation

### UK Tax

The Fund is an exempt approved fund and is not liable to income tax or capital gains tax.

The Fund is not registered separately from the Council for VAT and can therefore 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.

## 17. Derivatives

The Fund has used Forward Currency Contracts to hedge the currency exposure on certain overseas investments. As at 31st March 2003, the Fund held a range of positions which together showed an unrealised loss of £1.774 million. The positions showed an overall loss of £2.150 million when settled.

## 18. Underwriting

The Fund accepts a number of underwriting and placing propositions. As at 31st March 2003, no commitments were outstanding.

## 19. Significant Holdings

As at 31st March 2003, the Fund had two holdings which represented more than 5% of the Total Fund value. Both of these holdings are insurance contracts which provide access to a pool of underlying assets. These are:

- Legal and General Assurance (Pensions Management) Limited – Managed Fund – as at 31st March 2003 this was valued at £339.769 million and represented 18.2% of the total net assets of the Fund.

- Prudential Pensions Limited – Corporate Bond All Stocks Fund – as at 31st March 2003 this was valued at £158.482 million and represented 8.5% of the total net assets of the Fund.

## 20. Private Equity

As at 31st March 2003 the Fund had five outstanding commitments to Private Equity Investments:

- HarbourVest International Private Equity Partners IV – a total commitment of \$55.000 million has been made with three drawdowns to the value of \$6.600 million taking place. At the year end there was an outstanding commitment of \$48.400 million (£30.620 million, based on the exchange rate as at 31st March 2003).

- HarbourVest Partners VII Cayman Buyout Fund – a total commitment of \$30.000 million has been made with one drawdown to the value of \$0.300 million taking place. At the year end there was an outstanding commitment of \$29.700 million (£18.790 million, based on the exchange rate as at 31st March 2003).

- HarbourVest Partners VII Cayman Venture Fund – a total commitment of \$24.000 million has been made with one drawdown to the value of \$0.240 million taking place. At the year end there was an outstanding commitment of \$23.760 million (£15.032 million, based on the exchange rate as at 31st March 2003).

- HarbourVest Partners VII Cayman Mezzanine Fund – a total commitment of \$6.000 million has been made with one drawdown to the value of \$0.120 million taking place. At the year end there was an outstanding commitment of \$5.880 million (£ 3.720 million, based on the exchange rate as at 31st March 2003).

- Capital North East – a total commitment of £1.500 million has been made with one drawdown to the value of £0.150 million taking place. At the year end there was an outstanding commitment of £1.350 million.

## Statement of Investment Principles – Approved by Pensions Committee on 2nd September 2003

### Introduction

1. The Local Government Pension Scheme 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 Actuary and 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 a Pensions Committee that is required to control and resolve all matters relating to the administration and investment of the Fund. The Committee has fifteen members. The Council nominates eight members and the other four district councils within the County area nominate one member each. The trades unions 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 Resources and Corporate Development Scrutiny Committee to review and scrutinise the decisions and actions of the Pensions Committee.

9. A training programme is provided for members of both committees.

10. Hewitt Bacon and Woodrow has been appointed as Actuary.

11. Watson Wyatt 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 will result in a tendering process, as 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 business 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 initial study was undertaken in 2000. Having considered the outcome of this initial study, the Committee concluded that a diversified portfolio, of which about 65% is invested in UK and overseas equities and about 35% is invested in bonds and 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. This strategic benchmark was implemented from 1st July 2002.

22. The study is subject to periodic updating. The most recent update was carried out as at 30th September 2002 and was based upon the liabilities shown by the 2001 valuation, rolled forward eighteen months, together with adjustments to allow for asset changes and market conditions up to that date. The projected investment returns that were used in the update are shown in an appendix. It was concluded that the existing strategic benchmark continues to be suitable for the Fund.

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

24. 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

25.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.

26.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.

27.The structure includes discretionary mandates for the active management of UK equities, Pan European equities, Global equities, Far East equities, Emerging Market equities, Global bonds and Corporate bonds.

28.Following consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market, the Committee determined that 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.

29.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.

30.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.

31.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.

32.The Property portfolio is managed on an advisory basis. The manager is also responsible for advising on the tactical allocation to property, for which purpose the benchmark allocation is set at 7.5% of the Fund.

33.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.

34.An appendix is attached that sets out details of the individual mandates.

35.The managers are remunerated by way of ad valorem fees. Performance fees have received consideration but none have been adopted because the fee structures were not found to be satisfactory.

36. The Investment Advisor is remunerated by reference to the time and resources expended in that role.

37. 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

38. 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.

39. Within each asset category in each portfolio, the manager concerned is responsible for appropriate diversification.

40. The restrictions ensure that, at a stock selection level, the Fund avoids undue concentration.

### Suitability

41. The Committee has taken advice from the Actuary and Investment Advisor to ensure that the strategic asset allocation benchmark is suitable for the Fund, given its financial position, statutory status and liability profile.

42. 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

43. 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

44. 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 liasing 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

45. Responsibility for the selection, retention and realisation of investments is delegated to the managers.

46. 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.

47. 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.

48. 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

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

### Corporate Governance and Voting

50. 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, whilst the policy towards companies outside the UK should take account of the practices of the home nation.

51. 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.

52. Whilst it has not been made compulsory for the managers to vote, they are strongly urged to do so.

53. Each manager must continue to develop its policy and provide a quarterly report that sets out how it has been implemented.

### Additional Voluntary Contributions

54. 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. 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. The Fund's Officers monitor the returns obtained on members' AVC investment and the Committee reviews annually the suitability of the AVC providers used.

55. 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

56. The Fund complies with the Principles of Investment Practice, as set out in the document called CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme, except in the areas stated below:

- Contracts for actuarial and investment advice should be opened to separate competition (Principle 4).
- The formal assessment of decisions taken by the Committee and its advisors (Principle 8).

57. Consideration is being given to achieving compliance in these two areas.

## 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 September 2002.

| Asset class | 10 year median real return % pa |
|---|---|
| Global (ex UK) equities (unhedged) | 6.4 |
| UK equities | 5.9 |
| Property | 4.5 |
| Private equity | 6.2 |
| AA Sterling long-dated corporate bonds | 2.6 |
| Long-dated UK gilts | 1.9 |
| UK index-linked gilts | 2.1 |
| Foreign bonds (unhedged) | 2.5 |
| Cash | 1.5 |

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.

The returns shown above were those projected from 30th September 2002 and hence would not necessarily apply at any subsequent date.

## Strategic Benchmark

| Asset Class | Allocation % | Index |
|---|---|---|
| **UK Equities** | **30.00** | FTSE All Share |
| **Overseas Equities** | **35.00** | |
| - US | 9.75 | FTSE All World US |
| - Europe ex UK | 12.25 | FTSE World Europe ex UK |
| - Japan | 6.50 | FTSE All World Japan |
| - Other Far East | 3.25 | MSCI All Country Pacific Free ex Japan inc Malaysia |
| - Emerging Markets | 3.25 | MSCI Emerging Markets Free |
| **Fixed Interest** | **27.50** | |
| - UK Gilts | 8.75 | FTSE A All Stocks |
| - UK Index-Linked | 5.00 | FTSE A Over 5 Year IL |
| - Sterling Non Government | 11.00 | ML Sterling Non Gilt All Stocks |
| - Overseas | 2.75 | JPM Global (non UK) Traded Bond Index, hedged into Sterling |
| **Property** | **7.50** | CAPS Property |

### Note

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.

## Investment Mandates

| Manager | Mandate | Proportion of Fund % | Investment Objective |
|---|---|---|---|
| Fidelity | UK Equities | 13 | To to outperform the FTSE All Share Index by 1.5% p.a. over 3 year rolling periods with the return being no more than 4% below the Index in any one year. |
| UBS | Pan European Equities | 13 | To outperform the FTSE Europe (including UK) Index – Developed Series by 2% p.a. over 3 year rolling periods with the return being no more than 5% below the Index in any one year. |
| Capital International | Global Equities | 13 | To outperform the FTSE All World Index by 2% p.a. over 3 year rolling periods with the return being no more than 5% below the Index in any one year. |
| Capital International | Emerging Market Equities | 3 | To outperform the MSCI Emerging Markets Free Index |
| Schroders | Japanese Equities | 5 | To outperform the FTSE All World Japan Index by 2% p.a. over 3 year rolling periods with the return being no more than 4% below the Index in any one year. |
| Schroders | Pacific ex Japan Equities | 3 | To outperform the MSCI All Country Pacific Free ex Japan Index by 2% p.a. over 3 year rolling periods with the return being no more than 5% below the Index in any one year. |

| Manager | Mandate | Proportion of Fund % | Investment Objective |
|---|---|---|---|
| Various | Private Equity | Up to 5% of fund, to be topsliced from the equity allocation | Notionally, 5% above the returns on quoted equity. |
| Legal and General | UK Equities | 11 | To match the return on the FTSE All Share Index |
| Legal and General | US Equities | 3 | 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 | 4 | To match the return on the FTSE A Over 5 Year Index Linked Index |
| Legal and General | AAA Fixed Interest | 4 | To match the return on the iBoxx Sterling Non-Gilt AAA Index |
| Prudential M&G | Corporate Bonds | 11 | To outperform a composite benchmark by 0.75% p.a. over three year rolling periods with the return being no more than 2% below the Index in any one year.<br><br>The benchmark is:<br><br>80% Merrill Lynch Sterling Non Gilt All Stocks<br><br>15% FTSE A All Stocks<br><br>5% FTSE A Over 5 Year Index Linked |

| Manager | Mandate | Proportion of Fund % | Investment Objective |
|---|---|---|---|
| Henderson | Government Bonds | 9 | To outperform a composite benchmark by 0.75% p.a. over three year rolling periods with the return being no more than 2% below the Index in any one year.<br><br>The benchmark is:<br><br>37.5% FTSE A All Stocks<br><br>7.5% FTSE A Over 5 Year Index Linked<br><br>25% Merrill Lynch Sterling Non Gilt All Stocks<br><br>30% JP Morgan Global (Non UK) Traded Bond Index, hedged into Sterling. |
| Aberdeen Property Investors | Property | 8 | To outperform the IPD All Funds Universe by 0.5% p.a. over 3 year rolling periods. |

## Note

The column headed "Proportion of Fund" shows the approximate proportion of the Fund's assets that was placed in each mandate at inception. Over time, the actual proportion held in each mandate will change as a result of the capital injections and withdrawals that take place to maintain the strategic benchmark, and also due to differing investment returns.

# Policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance - Approved by Pensions Committee on 2nd June 2003

## 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.

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.

# Contacts

**Please contact us if you require any further information about the Tyne and Wear Pension Fund.**

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

**For information about investments please contact the Investments Office:**

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

***Web site*: www.twpf.info**

| Pensions Office | Investments Office |
|---|---|
| Helpline: 0191 424 4141 | Tel: 0191 424 4115 |
| Fax: 0191 427 4171 | Fax: 0191 483 8660 |
| Pensions@s-tyneside-mbc.gov.uk | Investments@s-tyneside-mbc.gov.uk |

Notes