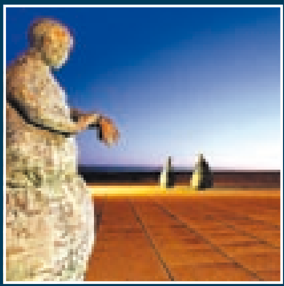




# Tyne and Wear
## Pension Fund

# Report and Accounts 2006/07

Administered by
South Tyneside Council

# Contents

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

## Committee Members

| | |
|---|---|
| South Tyneside Council | Councillor S. Stratford (Chair)<br>Councillor E. Leask (Vice Chair)<br>Councillor B. Brady<br>Councillor G.R.W. Elsom<br>Councillor G.H. Finch<br>Councillor E.M. Gibson<br>Councillor J.N. McKie<br>Councillor O. Punchion |
| Gateshead Council | Councillor J.I. Mearns<br>(substitute – Councillor K. Dodds) |
| Newcastle City Council | Councillor D. Slesenger<br>(substitute – Councillor B. Renton) |
| North Tyneside Council | Councillor M. Green<br>(substitute – Councillor C. Gambling) |
| 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 |
| Employers' Representatives | J. Fenwick – National Probation Service - Northumbria<br>G. Foster – Northumbria University<br>D. Scott – Stagecoach Travel Services |

## Investment Managers

| | |
|---|---|
| Indexation | Legal and General Investment Management |
| Global Equities | Capital International |
| Emerging Market Equities | Capital International |
| Pan European Equities | UBS Global Asset Management |
| UK Equities | Fidelity Pensions Management |
| Far East Equities | Schroder Investment Management |
| Corporate Bonds | Prudential M&G |
| Global Government Bonds | Henderson Global Investors |
| Property | Goodman Property Investors |

## Additional Voluntary Contributions

The Prudential Assurance Company
Equitable Life Assurance Society

## Advisors

| | |
|---|---|
| Actuary | Hewitt Bacon and Woodrow Limited |
| Investment Advisor | Hymans Robertson Consultants and Actuaries |

## Officers

| | |
|---|---|
| Executive Director Regeneration and Resources | D. Slater |
| Head of Pensions | S. Moore |
| Head of Corporate Governance | B.T. Scott |
| Pensions Manager | D. Smith |
| Investment Manager | I. Bainbridge |

# Review of the Year

## We are pleased to present the 2006/07 Report and Accounts for the Tyne and Wear Pension Fund.

**The Fund's programme of work has continued to be heavily influenced by legislative change. There have been amendments to Scheme benefits and several consultation exercises, including those for the new scheme that will take effect from 1st April 2008. We also brought in the single tax regime from April 2006.**

We have introduced two new policy statements, for Governance and Communications. These set out arrangements that we already had in place.

The efficiency of our pensions processing is heavily dependent on our systems. We have worked with our payroll provider to introduce a new payroll system. This has involved system changes, staff training and the communication of these changes to members and employers.

We considered the future provision of a pensions administration software system and decided to renew the contract with our current provider, Civica. Work has started on implementing an updated system that will allow us to improve the service to members and employers and will be compliant with the new scheme. It is planned that this system will go live when the new scheme comes into force from 1st April 2008.

We are committed to continually improving the services we offer. We regularly seek the views of members and employers to assist with this. In 2006/07, we issued surveys to our active and retired members and to employers. We were pleased to see that 97% of our active members and 98% of our retired members who responded stated that they were satisfied with the service we provide, as did 91% of the employers who responded.

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

The contributions paid by employers in 2006/07 were set by the 2004 valuation. The average future service rate is 240% of employees' contributions, whilst the contribution to address the funding deficit is 105%. The total rate of contribution is 345%.

The contributions had to be increased at the 2004 valuation, largely due to a material fall in the Fund's assets in the equity bear market from 2000 to 2003.

The Fund used a number of measures to assist employers to manage this level of contributions, the most significant being an increase in the deficit recovery period for employers with a suitably strong covenant. The recovery periods were set within a range from twenty five years for employers with the strongest covenant to average future working lifetime of active members, which is generally around thirteen years, for some employers with a weaker covenant.

**Preparations are in hand for the March 2007 valuation, which will lead to revised employer contributions from April 2008.**

The Fund has monitored the estimated movements in the funding level since the 2004 valuation. The funding level has improved because actual investment returns have exceeded the returns assumed at the 2004 valuation. However, there is upward pressure on contribution rates from inflation and improvements in mortality.

The strategy for the 2007 valuation will take account of the new scheme and will use updated financial, inflation and salary assumptions. The mortality assumptions will be revised in the light of new national data and the Fund's own experience.

The investment strategy is derived from an asset liability study undertaken in 2005, using the liability data from the 2004 valuation. The study determined that the optimal strategy is 67.5% in equities, 22.5% in bonds and 10% in property.

During 2006/07, research has been undertaken on improving the efficiency of the strategy and on potential new areas of investment.

A number of changes have been made to the investment management structure. These include investment into an infrastructure fund, enhancements to a bonds mandate and substantial commitments into a range of private equity funds in order to achieve the targeted level of investment of 5%. A follow on investment of £60 million was made into active currency funds following a risk modelling exercise that concluded that this had the potential to reduce risk and enhance returns.

The service provided by our global custodian, Northern Trust, was market tested. It was concluded that the service was satisfactory and competitive.

**We are undertaking a review of investment strategy and the management structure in 2007/08. This will include an update of the asset liability study, using data from the 2007 valuation.**

With regard to investment returns, property has continued to perform strongly and was the best performing asset class in 2006/07 with a return of nearly 16%. However, bond markets generally struggled in an environment where interest rates were rising.

Global equity markets fell on two occasions during the year, with falls being triggered firstly by rising interest rates and then by a downturn in the Chinese market. Markets recovered on both occasions, helped by strong earnings and bid speculation.

The returns from equity markets were mixed. Whilst Pacific Rim ex Japan, Europe ex UK and UK equities all produced strong returns of between 11% and 13%, US equities were marginally negative and Japanese equities fell by 10%.

Pension funds were able to post positive returns for the fourth year in succession, although the returns were more modest than those seen in the earlier years.

The Fund's return for the year was 6.4%. This is 0.2% below the benchmark return of 6.6%, but above inflation, as measured by the Retail Price Index, and average earnings.

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

The five year return is 8.5% per annum, which is 0.2% below the benchmark return of 8.7% per annum. The ten year return is 7.9% per annum, which is 0.4% above the benchmark return of 7.5% per annum. The returns for both periods are above both inflation and the increase in average earnings.

The weaker returns relative to benchmark in recent years are attributable to poor performance from certain active equity managers. The Pensions Committee is closely monitoring this position.

**Looking forward, the next year will be an extremely busy one for the Fund. As shown above, we will be implementing a new pensions administration system, introducing the new scheme and reviewing the investment strategy and structure.**

**Councillor Eileen Leask**
Chair Of Pensions Committee

**David Slater**
Executive Director Regeneration and Resources

# Governance Arrangements

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

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

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

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

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

The Committee meets quarterly to consider pension matters. Additional meetings are called should any matter require an in-depth review.

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

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

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

# Service Plan and Vision Statement

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

**The Pensions Committee approved the 2007 to 2010 Service Plan on 27th February 2007. The Service Plan may be viewed on the Fund's website.**

# Vision Statement

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

## We will:

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

## We will know we are succeeding when:

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

# Legal Framework

## Introduction

The Department for Communities and Local Government (CLG) sets out the framework for the scheme in regulations that apply in England and Wales.

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

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

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

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

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

## The Stocktake

A review, or "Stocktake", of the Scheme commenced in 2001 to ensure that it operates effectively and efficiently and that it provides value for money.

CLG has published a number of discussion papers inviting comment on possible changes to the Scheme. The Local Government Pensions Committee acts as the primary respondent for local government employers.

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

The first changes, most of which were relatively minor, became effective from April 2004. The more significant changes were requirements for:

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

Further changes became effective from April 2006, with the more significant being:

- The introduction into the Scheme of the single tax regime.
- The removal of the Rule of 85 voluntary early retirement provision, with limited protection for members close to retirement.

- A provision for retiring members and some deferred beneficiaries to increase the amount of their benefits package taken as a lump sum to a maximum of 25% of the value of the package. The conversion rate is twelve pounds of lump sum for every pound of pension given up.

**The New Scheme**

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

In November 2006, it was announced that the new scheme will start in April 2008 and will include the following provisions:

- A normal retirement age of 65 for the release of unreduced benefits.
- The earliest age for release of pension is to be 55, except on grounds of ill-health. This will come into effect in 2010 for current members.
- Early release from age 55 on grounds of redundancy or business efficiency.
- A final salary pension based on 1/60th of salary for each year of pensionable service.
- Pensions are to be based upon the best actual pensionable pay in the last three years, or an averaging of three financial years within the last ten before early retirement.
- A permanent ill-health retirement package with no review system. There are two levels, a 25% enhancement where there is a prospect of return to gainful employment and a higher enhancement of benefits for total incapacity.
- An option to commute pension at the rate of one pound of annual pension for twelve pounds of lump sum, up to a maximum tax free lump sum of 25% of the value of the benefits package.
- Survivor benefits for life payable to spouses, civil partners and nominated dependant partners (opposite and same sex) at a 1/160th accrual rate.
- Survivor benefits payable to children. The accrual rates vary according to status.
- Pensions are indexed in line with the Retail Price Index and must come into payment before the 75th birthday.
- A death-in-service tax-free lump sum of three times salary.
- Tiered employee contribution rates with 5.5% payable on the first £12,000 of pensionable pay, and 7.5% paid on the excess over £12,000, to be increased in line with the RPI.

Regulations that set out the benefits, transitional and administrative arrangements for the new scheme are being issued in 2007.

There are a number of new administrative provisions, including:

- A requirement to publish a governance compliance statement that demonstrates compliance against a set of best practice principles that are to be issued by CLG.
- A power to prepare and publish a local administration strategy.
- A power to allow an administering authority to recover costs that have resulted from an employer's poor performance.
- Requirements concerning the publication and content of annual reports.

# Additional Voluntary Contributions

## Introduction

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

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

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

From April 2007, in general, members can contribute up to half of their pay as additional voluntary contributions. These contributions must now be deducted from pay. Prior to this change, members could contribute an amount equal to all of their pay.

**The Prudential**

The Fund has an AVC plan arranged with The Prudential that offers a comprehensive range of funds, including lifestyle options.

We carry out an annual review of AVC provision. The 2006/07 review was carried out with the assistance of Hewitt Bacon and Woodrow and it was concluded that The Prudential should remain as the sole provider. This review also led to the removal of with-profits investments as a fund choice for new investors and the introduction of a bespoke lifestyle option to reflect the recent changes to the Scheme rules. A wider review of the fund range is ongoing.

**Equitable Life**

The Fund has closed its AVC plan with Equitable Life to new members and transfers.

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

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

The position of these members was re-examined in 2006. This resulted in more members' investments being moved to The Prudential.

The Fund continues to keep those members who remain with Equitable Life informed of their position.

# Employers' Contributions and the Valuation Process

**Introduction**

The Scheme benefits are paid from investment returns, employees' contributions and employers' contributions. The employees' contributions are set by regulations, whilst employers' contributions are adjusted in triennial valuations to ensure that the Fund will have sufficient assets to meet its liabilities.

**Funding Level**

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

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

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

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

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

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

**Employers' Contributions**

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

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

**Valuation Strategy**

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

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

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

- Some employers directly guarantee the deficit of certain admission bodies and transferee admission bodies.
- If an employer without a guarantee closes and does not meet any deficit for financial, legal or other reasons, all employers in the Fund are required to pay increased contributions to meet the shortfall.

However, not extending a recovery period could impose an additional financial pressure on an employer that might, in extreme cases and for non-statutory bodies, lead to a wind up. This could lead to a loss of the service provided by that employer and leave the Fund with a deficit that cannot be recovered for financial reasons.

Information supplied by employers in response to the Fund's annual employer survey was taken into account in setting recovery periods. All employers were then asked for their views as part of the consultation exercise on the Funding Strategy Statement.

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

For most contractors, the recovery period did not exceed the maximum of the remainder of the contract period.

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

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

**The 2007 Valuation**

Preparations are in hand for the March 2007 valuation, which will lead to revised employer contributions from April 2008.

The Fund has monitored the estimated movements in the funding level since the 2004 valuation. The funding level has improved because actual investment returns have exceeded the returns assumed at the 2004 valuation. However, there is upward pressure on contribution rates from inflation and from improvements in mortality.

The strategy for the 2007 valuation will take account of the new scheme and use updated financial, inflation and salary assumptions. The mortality assumptions will be revised in the light of new national data and the Fund's own experience.

# Statement of the Actuary

**Introduction**

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

**Actuarial Position**

1. Rates of contributions paid by the participating employers during 2006/07 were based on the actuarial valuation carried out as at 31st March 2004.
2. The valuation as at 31st March 2004 showed that the financial position of the Fund had deteriorated since the previous valuation with the market value of the Fund's assets of £2,355.7m, after application of a smoothing adjustment, covering 64% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable remuneration.
3. The valuation also showed that the required level of contributions to be paid to the Fund by participating employers (in aggregate) with effect from 1st April 2005 was as set out below:
   - 240% of members' contributions to meet the liabilities arising in respect of service after the valuation date.

   **Plus**

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

   **Less**

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

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

   The majority of employers participating in the Fund pay different rates of contributions depending on their past experience, their current staff profile, and the recovery period agreed with the Administering Authority.

   If the assumptions are borne out in practice, the rate of contribution for each employer would increase at the end of three years, due to the cessation of the short term additional investment income. It would then continue at the resultant level for the balance of the relevant recovery period before reverting to the relevant long term rate. In practice, contribution rates will be reviewed at the next valuation which is being carried out as at 31st March 2007, and consideration is being given to making further assumptions concerning short term investment returns.
4. The rates of contributions payable by each participating employer over the period 1st April 2005 to 31st March 2008 are set out in a certificate dated 30th March 2005 which is appended to our report of the same date on the actuarial valuation.

5. The contribution rates certified in our valuation as at 31st March 2004 were based on the benefit structure of the Fund as indicated by Regulations as at the date of signing our certificate. However new Regulations, backdated to 1st April 2005, were subsequently issued which increased the theoretical cost of Fund benefits relative to those on which the certificate was based. No adjustment was made to contribution rates in respect of that change as it was indicated by the Government that further changes would occur which would offset these additional costs. Further Regulations have since been issued which brought in various changes including:
   - allowing commutation of pension for additional lump sum,
   - extending the retention of the Rule of 85 age provisions to 31st March 2008, and the transitional protections, but only for existing members at 30th September 2006.

   More recently the Government issued regulations setting out a new benefit structure to be introduced from 1st April 2008.

   The impact of all of these changes will be taken into account at the Fund valuation as at 31st March 2007.
6. The contribution rates were calculated using the projected unit actuarial method and taking account of the Fund's funding strategy as described in the Funding Strategy Statement. The main actuarial assumptions were as follows:

| | |
|---|---|
| Discount rate for periods<br>In service<br>Left service | <br>6.2% a year<br>5.2% a year |
| Rate of general pay increases | 4.4% a year |
| Rate of increases to pensions in payment | 2.9% a year |
| Short term return on shares/property | 6.45% a year |
| Short term return on other assets | 5.2% a year |
| Valuation of assets | smoothed market value. |

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

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

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

**Hewitt Bacon and Woodrow Limited**

June 2007

# Membership of the Fund

**As at 31st March 2007, there were 124 employers participating in the Fund. This includes the five district councils and a wide range of other organisations that provide a public service within the Tyne and Wear County area.**

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

The Fund had 101,019 members as at the 31st March 2007. The table below shows an increase of 3,583 in the membership of the Fund over the year:

| Membership of the Fund | | | |
|---|---|---|---|
| | 31st March 2006 | 31st March 2007 | Increase / (Decrease) over the year |
| Actives | 48,986 | 48,647 | (339) |
| Deferred Members | 18,887 | 21,151 | 2,264 |
| Pensioners | 29,563 | 31,221 | 1,658 |
| **Total Membership** | **97,436** | **101,019** | **3,583** |

## Employers in the Fund and their members as at 31st March 2007:

| District Councils | Actives | Deferreds | Pensioners |
|---|---|---|---|
| City of Sunderland Council | 8,637 | 3,967 | 5,637 |
| Gateshead Council | 6,921 | 3,421 | 4,902 |
| Newcastle City Council | 9,026 | 3,682 | 6,788 |
| North Tyneside Council | 5,964 | 2,670 | 3,878 |
| South Tyneside Council | 5,287 | 2,328 | 3,461 |
| **Sub Totals** | **35,835** | **16,068** | **24,666** |

| Other Scheduled Bodies | Actives | Deferreds | Pensioners |
|---|---|---|---|
| City of Sunderland College | 456 | 161 | 59 |
| Former North East Regional Airport | 0 | 0 | 33 |
| Former Tyne and Wear County Council | 0 | 89 | 278 |
| Former Tyne and Wear Residuary Body | 0 | 5 | 30 |
| Gateshead College | 212 | 140 | 62 |
| Gateshead Housing Company | 337 | 48 | 12 |
| Monkwearmouth College | 0 | 1 | 5 |
| National Probation Service, Northumbria Area | 676 | 170 | 285 |
| Newcastle College | 752 | 286 | 187 |
| Newcastle Education Action Zone | 0 | 3 | 2 |
| North Tyneside College | 8 | 68 | 57 |
| Northumbria Magistrates Court | 0 | 43 | 82 |
| Northumbria Police Authority | 2,080 | 699 | 939 |
| Northumbria University | 1,428 | 701 | 704 |
| South Tyneside College | 284 | 105 | 119 |
| South Tyneside Education Action Zone | 0 | 2 | 0 |
| South Tyneside Homes | 604 | 4 | 13 |
| Sunderland Education Action Zone | 0 | 0 | 1 |
| Tyne and Wear Fire and Civil Defence Authority | 294 | 95 | 186 |
| Tyne and Wear Passenger Transport Authority | 98 | 31 | 83 |
| Tyne Metropolitan College | 183 | 41 | 10 |
| Tynemouth College | 5 | 27 | 7 |
| University of Sunderland | 823 | 516 | 392 |
| Wearside College | 0 | 4 | 10 |
| Your Homes Newcastle | 663 | 58 | 43 |
| **Sub Totals** | **8,903** | **3,297** | **3,599** |

| Resolution Bodies | Actives | Deferreds | Pensioners |
|---|---|---|---|
| Birtley Town Council | 0 | 4 | 4 |
| Blakelaw and North Fenham Parish Council | 0 | 0 | 0 |
| Blue Square Trading | 9 | 5 | 1 |
| Learning World | 0 | 9 | 0 |
| Nexus | 972 | 445 | 1,403 |
| **Sub Totals** | **981** | **463** | **1,408** |

| Admitted Bodies | Actives | Deferreds | Pensioners |
|---|---|---|---|
| Age Concern Newcastle | 52 | 33 | 24 |
| Assessment and Qualification Alliance (AQA) | 0 | 3 | 12 |
| Association of North East Councils | 35 | 11 | 6 |
| Balfour Beatty | 24 | 0 | 0 |
| Baltic Arts Flour Mills Visual Arts Trust | 5 | 4 | 0 |
| Benton Grange School | 0 | 0 | 9 |
| Benwell Young Peoples' Development Group | 2 | 0 | 0 |
| Bovis Lend Lease (BLL) | 9 | 0 | 0 |
| Brunswick Young Peoples' Project | 3 | 2 | 0 |
| Catholic Care North East | 0 | 20 | 26 |
| CBS Outdoor Limited | 1 | 1 | 0 |

| Admitted Bodies | Actives | Deferreds | Pensioners |
|---|---|---|---|
| Community Action on Health | 7 | 0 | 0 |
| Compass Group UK and Ireland Limited | 6 | 0 | 0 |
| Disability North | 15 | 19 | 5 |
| Gateshead Law Centre | 7 | 7 | 1 |
| Hebburn Neighbourhood Advice Centre | 5 | 1 | 0 |
| Higher Education Funding Council for England | 0 | 2 | 8 |
| Information North (Northern Regional Library System) | 0 | 0 | 3 |
| International Centre for Life | 14 | 6 | 2 |
| Jarvis Accommodation Services Limited | 6 | 0 | 0 |
| Jarvis-Sandhill View | 5 | 1 | 1 |
| Kenton Park Sports Centre | 6 | 4 | 0 |
| Managed Business Space Limited | 2 | 0 | 1 |
| Mitie Cleaning (North) Limited | 0 | 1 | 0 |
| Mitie PFI (Boldon) | 8 | 0 | 0 |
| Mitie PFI Limited | 1 | 0 | 0 |
| Morrison Facilities Services Limited 1 | 62 | 4 | 2 |
| Morrison Facilities Services Limited 2 | 322 | 7 | 4 |
| Museums Libraries and Archives North East | 21 | 6 | 3 |
| National Car Parks Limited | 6 | 2 | 3 |
| National Glass Centre | 1 | 1 | 1 |
| Newcastle Family Service Unit | 0 | 4 | 3 |
| Newcastle Healthy City Project | 18 | 5 | 0 |
| Newcastle International Airport Company Limited | 216 | 266 | 302 |
| Newcastle Law Centre | 8 | 3 | 2 |
| Newcastle Tenants Federation | 5 | 2 | 1 |
| Newcastle Theatre Royal Trust Limited | 51 | 22 | 14 |
| Newcastle West End Partnership | 0 | 2 | 0 |
| Newcastle Youth Congress | 0 | 2 | 0 |
| No Limits Theatre | 2 | 0 | 0 |
| Norcare | 0 | 1 | 1 |
| Norland Road Community Centre | 0 | 1 | 0 |
| North East Innovation Centre Company Limited | 0 | 19 | 13 |
| North East Regional Employers' Organisation | 7 | 1 | 5 |
| Northern Arts Association | 0 | 34 | 12 |
| Northern Council for Further Education | 0 | 15 | 12 |
| Northern Counties School | 2 | 21 | 22 |
| Northern Grid For Learning | 9 | 0 | 0 |
| North Tyneside Child Care Enterprise | 3 | 15 | 1 |
| North Tyneside City Challenge | 0 | 4 | 1 |
| North Tyneside Disability Advice Centre | 0 | 0 | 1 |
| Northumbria Tourist Board | 0 | 30 | 9 |

| Admitted Bodies | Actives | Deferreds | Pensioners |
|---|---|---|---|
| One North East | 0 | 2 | 7 |
| Ouseburn Trust | 0 | 1 | 0 |
| Passenger Transport Company | 0 | 0 | 95 |
| Percy Hedley Foundation | 28 | 0 | 1 |
| Port of Tyne Authority | 0 | 0 | 5 |
| Praxis Service | 1 | 3 | 0 |
| Raich Carter Sports Complex | 32 | 14 | 0 |
| Saint Mary Magdalene and Holy Jesus Trust | 8 | 6 | 3 |
| Saint Mary the Virgin Estate Management Charity | 0 | 0 | 1 |
| Scolarest | 27 | 0 | 2 |
| Search Project | 2 | 1 | 2 |
| Simonside Community Centre | 1 | 0 | 0 |
| South Tyne Football Trust | 1 | 0 | 0 |
| South Tyneside Groundwork Trust | 4 | 3 | 3 |
| South Tyneside Victim Support | 0 | 2 | 0 |
| Southern Electric Contracting Limited | 30 | 1 | 3 |
| Stagecoach Travel Services (Busways) | 230 | 208 | 544 |
| Sunderland City Training and Enterprise Council | 0 | 45 | 23 |
| Sunderland Empire Theatre Trust Limited | 0 | 7 | 5 |
| Sunderland Housing Group | 1,442 | 280 | 157 |
| Sunderland Outdoor Activities Association | 0 | 3 | 0 |
| Sunderland Streetlighting Limited | 58 | 7 | 5 |
| The Ozanam House Probation Hostel Committee | 21 | 16 | 6 |
| Thomas Gaughan Community Association | 2 | 0 | 0 |
| Tyne and Wear Development Company Limited | 11 | 12 | 4 |
| Tyne and Wear Development Corporation | 0 | 27 | 23 |
| Tyne and Wear Enterprise Trust Limited | 16 | 15 | 12 |
| Tyne and Wear Play Association | 1 | 0 | 0 |
| Tyne and Wear Small Business Service | 34 | 8 | 8 |
| Tyneside Deaf Youth Project | 0 | 3 | 0 |
| Tyneside Training and Enterprise Council | 0 | 44 | 30 |
| Tyne Waste Limited | 0 | 10 | 11 |
| Valley Citizens' Advice Centre | 0 | 2 | 0 |
| Walker Profiles (North East) Limited | 31 | 0 | 0 |
| Wallsend Citizens' Advice Centre | 0 | 2 | 1 |
| Wallsend People's Centre | 2 | 2 | 2 |
| Workshops for the Adult Blind (Palatine Products) | 0 | 17 | 85 |
| **Sub Totals** | **2,928** | **1,323** | **1,548** |

| Grand Totals | 48,647 | 21,151 | 31,221 |
|---|---|---|---|

# Working with Members and Employers

## Introduction

**The provision of a statutory pensions service to our 101,000 members and 124 employers is a substantial task. This service is provided by the Pensions Office, which is organised into five teams of experienced officers who are encouraged to obtain a recognised professional qualification.**

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

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

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

**Events During the Year**

This has been another very demanding year for the Pensions Office. There have been a number of regulatory consultation exercises, Scheme amendments to put in place and preparations for the new scheme.

We introduced the single tax regime, known as A-Day, and worked with our payroll provider to introduce a new payroll system. This has involved system changes, staff training and the communication of these changes to members and employers.

We considered the future provision of our pensions administration system and decided to renew the contract with our current provider, Civica. Work has started on implementing a system that will be compliant with the new scheme. It is planned that this system will go live when the new scheme comes into force on 1st April 2008.

## Communications Policy

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

The Fund has a Communications Policy Statement that sets out the services we provide to members, prospective members and employers. The Statement outlines:

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

The Statement is available on the website.

## Surveys

We are committed to continually improving the services we offer. We regularly seek the views of members and employers to assist with this. In 2006/07, we issued surveys to our active and retired members and to employers. We were pleased to see that 97% of our active members and 98% of our retired members who responded stated that they were satisfied with the service we provide, as did 91% of the employers who responded.

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

## Services to Members

The main services that we provide to our members are:

- We maintain a website.
- We provide a helpline that allows members to request leaflets and information, change certain personal and bank details, and track progress of payments and transfers. The helpline managed 48,000 calls in 2006/07.
- We welcome personal callers and, last year, were visited by 565 members. An appointment is not necessary.
- We provide combined pension forecasts for our active members and annual benefit statements for our deferred members. Pensioners receive an annual update and details of their pensions increase. These are sent directly to the member's address, accompanied by a member's annual report.
- We provide newsletters to keep members informed of changes to the Scheme.
- On request, we provide seminars to members covering topics such as induction, midlife and pre-retirement planning.
- We provide a comprehensive range of leaflets that are available from our website or on request from the helpline.

We adopt the principles of plain English in our documents and are pleased to see that our recent surveys show that:

- 96% of members who responded found their annual benefit statement easy to understand.
- 95% of members who responded found the annual report easy to understand.

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

Members can register to receive all future information in their required format when they join the Fund.

## Annual Benefit Statements

We have produced annual benefit statements for our active members that set out their current and projected Scheme benefits since 1999. Statements for deferred members have been provided since 2003.

The employers supply most member information and we work with them to ensure that members' records are up to date. In 2006, we were able to provide 98% of active members with a complete benefit statement.

We issue benefit statements to every deferred member for whom we hold a current address. Should we lose touch with a member, we use the Department of Work and Pensions (DWP) bulk letter forwarding service to update the address we hold.

## Combined Pension Forecasts

We work in partnership with the DWP to provide combined pension forecasts for our active members. These statements include information on the current and projected state pension entitlement. Combined forecasts will not be available in 2007 due to possible future changes to the state pension.

We will continue to provide statements that set out members' LGPS benefits and provide contact details for the DWP, should a member wish to obtain further information on the future of the State Scheme.

## Services to Employers

The main services that we provide to employers are:

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

## Our Website and Electronic Communications

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

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

Through our website, members have access to:

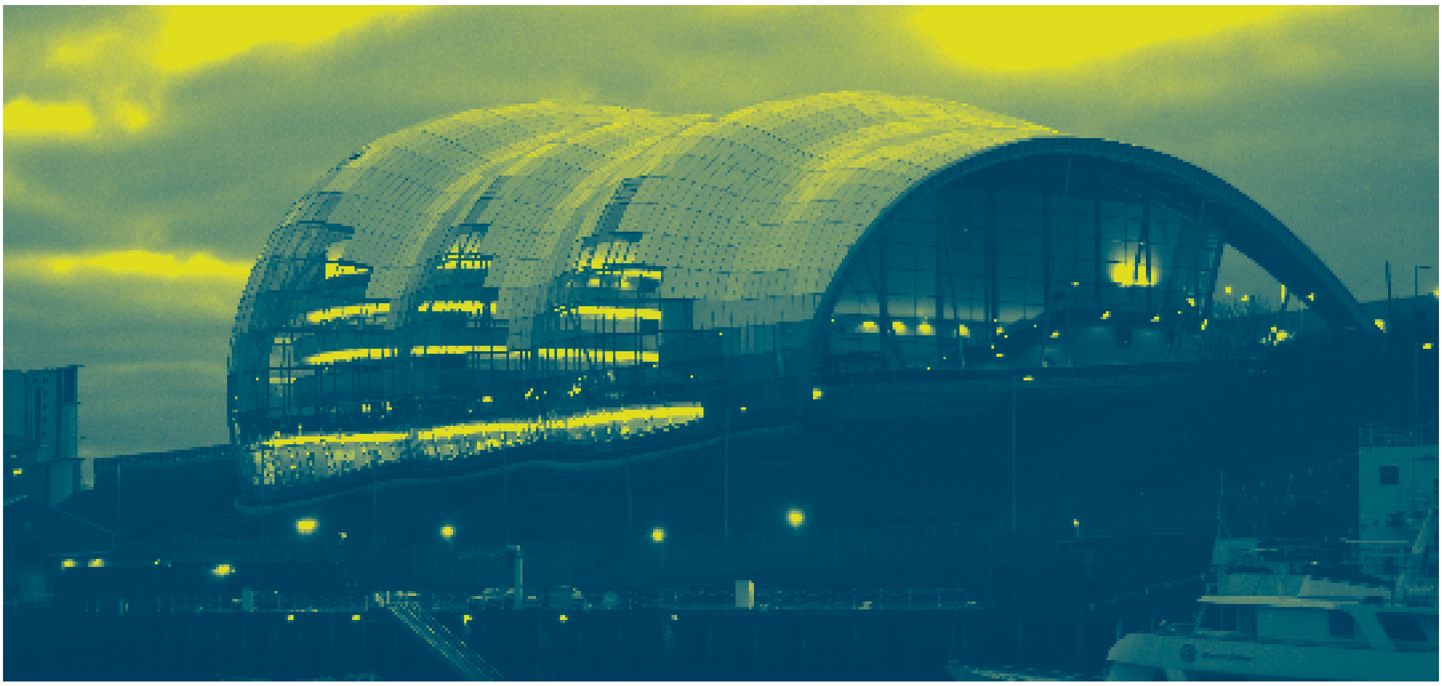
- Details on how to contact the Fund.
- Latest news and topical issues.
- Our range of leaflets.
- Pension payment dates and details of pension inflation proofing.
- Links to other useful websites.
- The Report and Accounts.
- The Fund's main policies, including the Funding Strategy Statement, the Communications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

In addition to the main website, there is a password-protected area for employers. So far, forty seven employers have registered to use this service which provides access to:

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

We have developed an email alert facility to provide important news and latest information to employers. Almost all of our mailshots are now sent out electronically. This facility has greatly improved the efficiency of keeping employers informed and allows them to distribute information within their own organisation.

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



# Investment Report

**Introduction**

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

The formal objectives are:

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

**Strategy**

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

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

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

An allocation to active currency management was introduced.

The move to this strategy, which is summarised below, took place during 2005/06.

| Asset Class | Strategy % |
|---|---|
| **UK Equities** | **27.50** |
| Overseas Equities | |
| - US | 12.50 |
| - Europe ex UK | 13.50 |
| - Japan | 7.00 |
| - Other Far East | 3.50 |
| - Emerging Markets | 3.50 |
| **Total Overseas Equities** | **40.00** |
| **Total Equities** | **67.50** |
| | |
| Fixed Interest | |
| - UK Gilts | 7.00 |
| - UK Index-Linked | 4.00 |
| - Sterling Non Government | 9.00 |
| - Overseas | 2.50 |
| **Total Fixed Interest** | **22.50** |
| | |
| **Property** | **10.00** |

**Developments during 2006/07**

Research has been undertaken on improving the efficiency of the strategy and on new areas of investment.

A number of changes have been made to the investment management structure. These are summarised below:

| Date | Activity |
|---|---|
| May 2006 | Top up commitment of €10 million to the HarbourVest Private Equity Partners V Direct Fund, which invests directly in companies in Western Europe and the US. The total commitment to this fund is €30 million. |
| May 2006 | Top up commitment of €52 million to the HarbourVest Private Equity Partners V Partnership Fund, which sources opportunities outside the US. The total commitment to this fund is €100 million. |
| May 2006 | Commitment of $112 million to HarbourVest Partners VIII Cayman Buyout Fund, which sources opportunities in the US. |
| May 2006 | Commitment of $56 million to HarbourVest Partners VIII Cayman Venture Fund, which sources opportunities in the US. |
| June 2006 | Enhancements made to the Henderson Global Government Bond Portfolio to allow greater freedom to invest in high yield and emerging market debt, take cross currency positions and allow greater use of pooled funds. The benchmark was adjusted to include an allocation to cash. The outperformance target was increased from 0.75% per annum to 1.0% per annum, over rolling three year periods. |
| June 2006 | Further investment of £30 million into the active currency fund managed by Record. |
| July 2006 | Commitment of €35 million to Pantheon Europe Fund V. |
| July 2006 | Commitment of $35 million to Pantheon USA Fund VII. |
| August 2006 | Commitment of $30 million to Coller International Partners V, which sources secondary investments in private equity on a global basis. |
| September 2006 | Further investment of £30 million into the active currency fund managed by BGI. |
| December 2006 | £14 million drawn down from an earlier £15 million commitment to the Henderson PFI Secondary Fund II, which invests in infrastructure assets in the UK and Europe. |
| March 2007 | Commitment of $35 million to Capital International Private Equity Fund V, which invests directly in companies in emerging markets. |
| March 2007 | Commitment of €30 million to Partners 2006 Direct Fund, which invests directly in companies on a global basis. |

The increased investment in active currency followed on from a risk modelling exercise that concluded that further investment had the potential to reduce risk and enhance returns.

### Development Work in 2007/08

At the time of writing, the Fund is undertaking its triennial actuarial valuation as at 31st March 2007. The liability data from this valuation will be used to update the asset liability model, following which there will be a wide ranging review of strategy and the management structure.

### Investment Management Structure

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

The structure is set out in the following table:

| Manager | Portfolio |
|---|---|
| Legal and General | Indexation<br>- UK Equities<br>- US Equities<br>- UK Gilts<br>- Corporate Bonds<br>- UK Index-Linked Gilts |
| Capital International | 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 Bonds |
| Goodman | Property |

### Active Currency

The Fund has allocated 3% to active currency strategies. This is invested in funds managed by Barclays Global Investors and Record Currency Management.

The allocation is equitised against US equities and therefore forms part of the exposure to that asset class.

### Private Equity

The objective is to have a 5% allocation to private equity, financed out of the allocation to the quoted equity markets.

The Fund initiated its private equity programme in 2002. Initially, it was comprised largely of investment into fund of funds managed by HarbourVest.

In order to diversify this exposure and to speed up progress towards attaining the target weighting, commitments have been made to fund of funds managed by Pantheon Ventures, secondary funds managed by Lexington Partners and Coller Capital and direct funds with HarbourVest, Capital International and Partners Group. These additional providers complement the fund of funds programme offered by HarbourVest.

The process of increasing the actual investment in private equity to the required level will continue. Commitments totalling £210 million have been made in 2006/07.

As at March 2007, £113 million, equal to 3% of the Fund, was invested in private equity. This represents an increase of £60 million, or 1.6% of the Fund, over the previous year end.

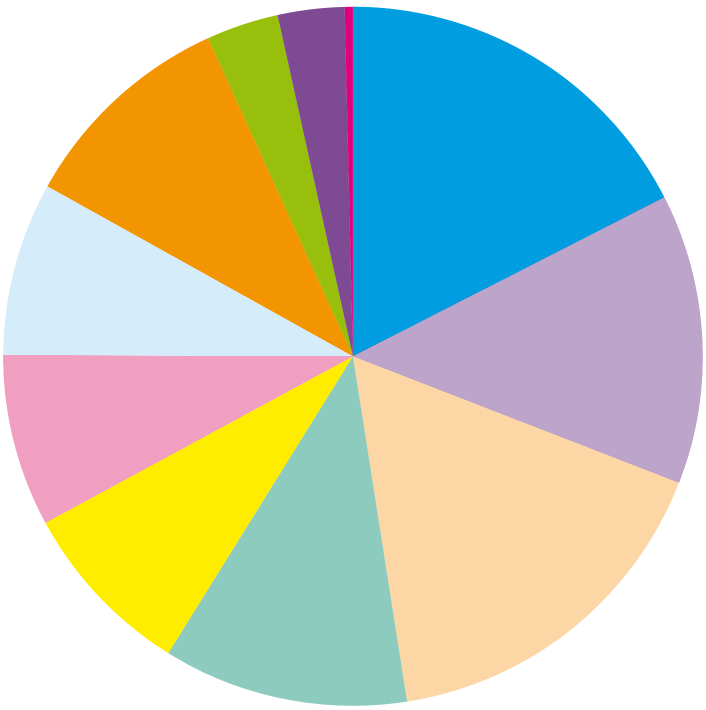
Our projections show that the Fund should achieve its target level of investment of 5% in 2008/09.

## Infrastructure Investments

In December 2006, £14 million was drawn down from an earlier £15 million commitment to the Henderson PFI Secondary Fund II, which invests in infrastructure assets in the UK and Europe. This is a new area of investment for the Fund and it is intended that the allocation will be increased.

## Assets Under Management

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



| | £m |
|---|---|
| Legal and General | 646.1 |
| Capital | 495.5 |
| UBS | 614.6 |
| Fidelity | 418.6 |
| Schroder | 304.6 |
| Prudential M&G | 294.3 |
| Henderson | 296.7 |
| Goodman | 373.7 |
| Active Currency | 123.5 |
| Private Equity | 113.9 |
| Infrastructure | 13.9 |

## Investment Managers' Objectives and Restrictions

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

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

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

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

The performance targets for the active currency funds are based on an agreed level of outperformance relative to the Standard and Poors 500 Index, against which the exposure is equitised.

An outperformance target of 5%, net of fees, over the FTSE All World Index has been set for private equity.

## Custody

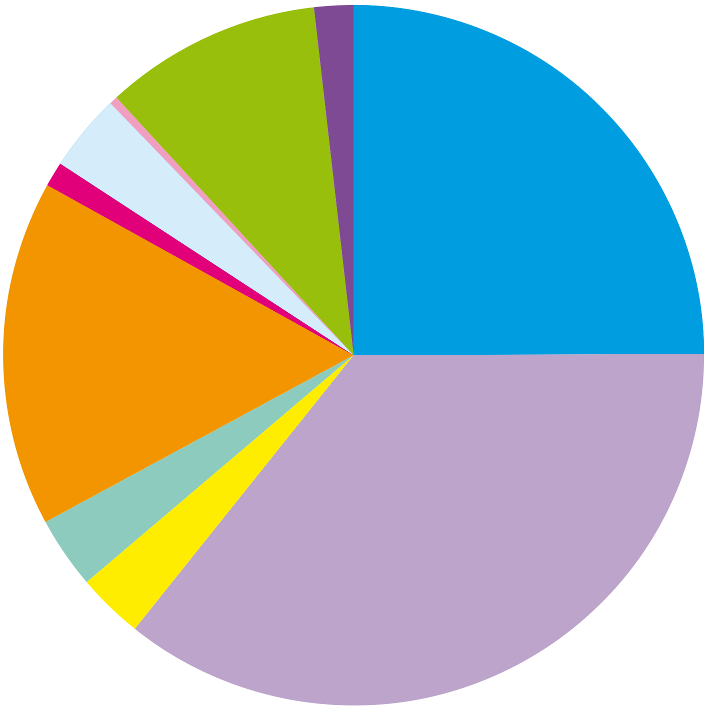
Northern Trust was appointed in 2002 to provide custody services for four segregated mandates. In early 2005, the remit was widened to cover the remainder of the segregated assets in the Fund. The service was market tested in 2006 and it was concluded that it was satisfactory and competitive. As at March 2007, Northern Trust was providing custody for approximately £1,900 million of assets held in seven mandates.

## Asset Allocation

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

The active managers that invest in more than one market are permitted to take tactical asset allocation decisions within their portfolios. This provides additional scope for managers to outperform their targets.

The asset allocation as at March 2007 is shown below:



| | £m |
|---|---|
| UK Equities | 929.4 |
| Overseas Equities | 1,333.7 |
| Private Equity | 113.9 |
| Active Currency | 123.5 |
| UK Fixed Interest | 595.1 |
| Overseas Fixed Interest | 42.5 |
| Index-Linked | 133.3 |
| Infrastructure | 13.9 |
| Property | 373.7 |
| Net Current Assets | 67.5 |

## Performance Measurement

The Fund has used a fund specific benchmark for performance measurement since January 2002. A hybrid benchmark is used for periods that extend earlier than this date. This is based on a median up to and including periods ending on January 2002 and on the strategic benchmark thereafter.

## Returns for 2006/07

The returns from global equity markets were mixed during the year. Pacific Rim ex Japan, Europe ex UK and UK equities all produced strong returns of between 11% and 13%. US equities were marginally negative, whilst Japanese equities fell by approximately 10%.

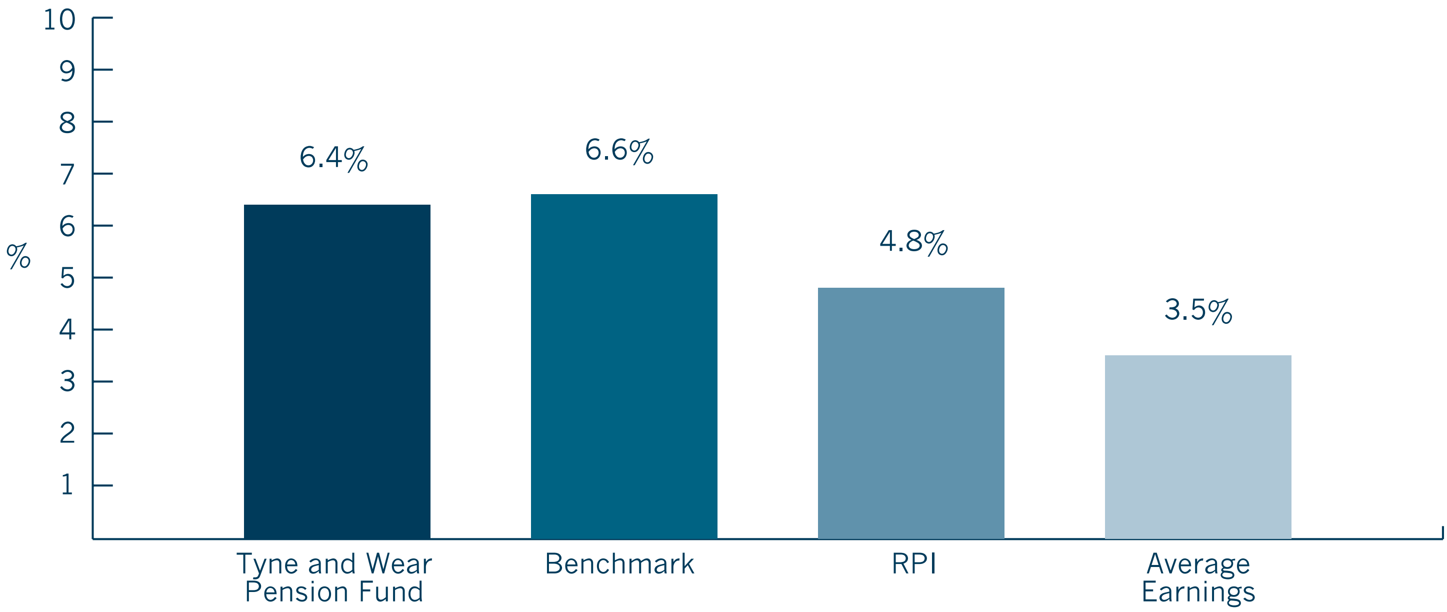
Global equity markets fell on two occasions during the year. The first fall was in May 2006 when investors became concerned about a rise in interest rates. The second fall was in February 2007 and was triggered by a downturn in the Chinese market. Markets recovered on both occasions, helped by strong earnings and bid speculation.

Property has continued to perform strongly and was the best performing asset class with a return of nearly 16%.

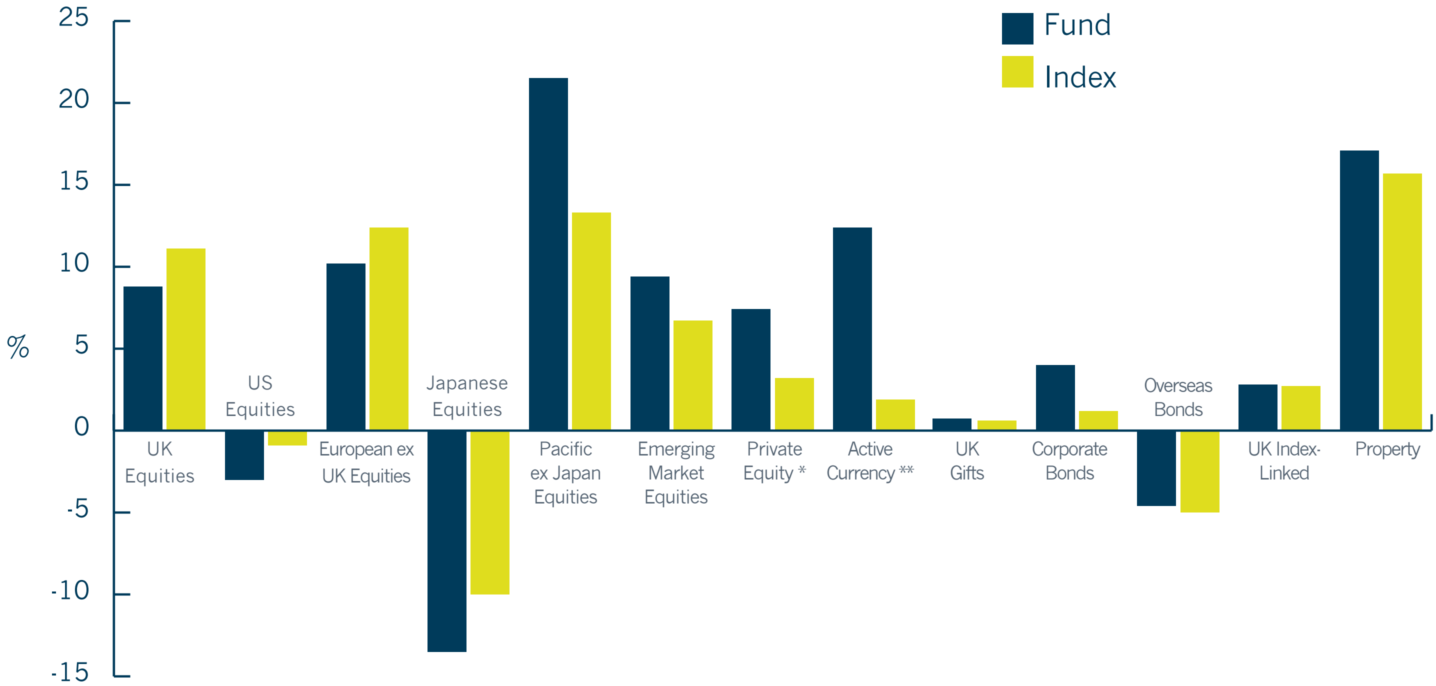
Bond markets generally struggled in an environment where interest rates were rising.

Overall, pension funds were able to post positive returns for the fourth year in succession.

The Fund's return for the year was 6.4%, which was 0.2% below the benchmark return of 6.6%, but above inflation, as measured by the Retail Price Index (RPI) and average earnings.




The chart below shows the Fund's returns over the main investment markets for 2006/07.

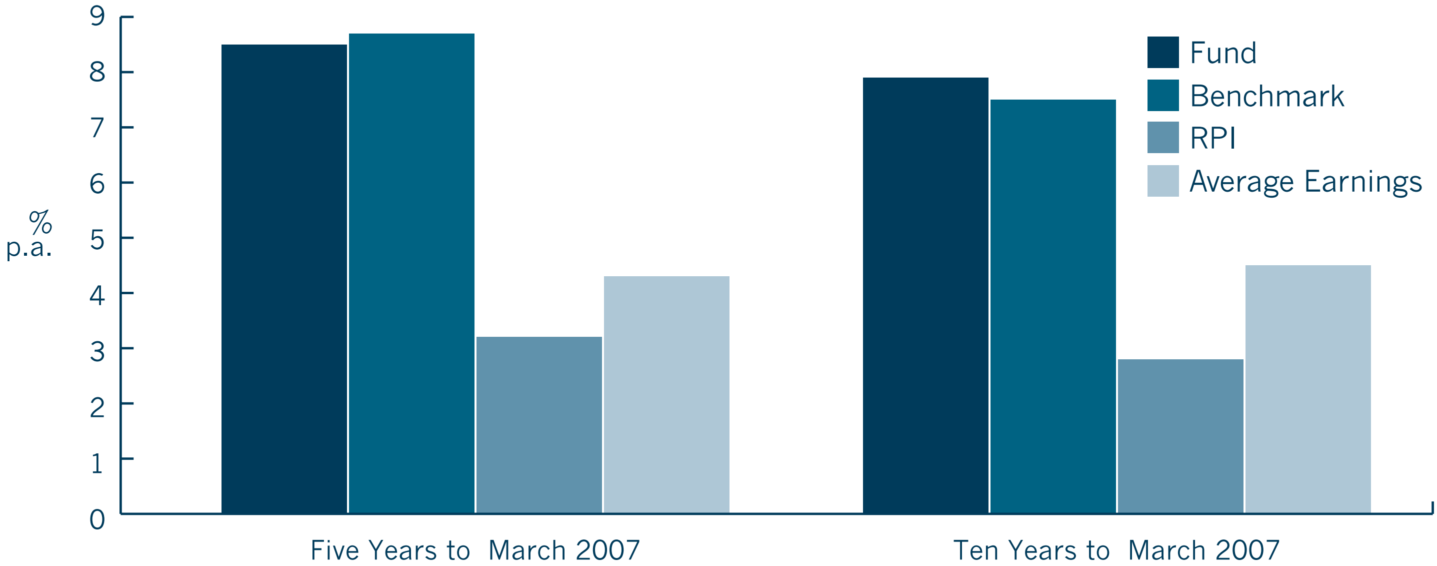



* The return for private equity is shown relative to the FTSE All World Index
** The return for active currency is shown relative to a partially hedged S&P 500 Index

## Longer Term Performance

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

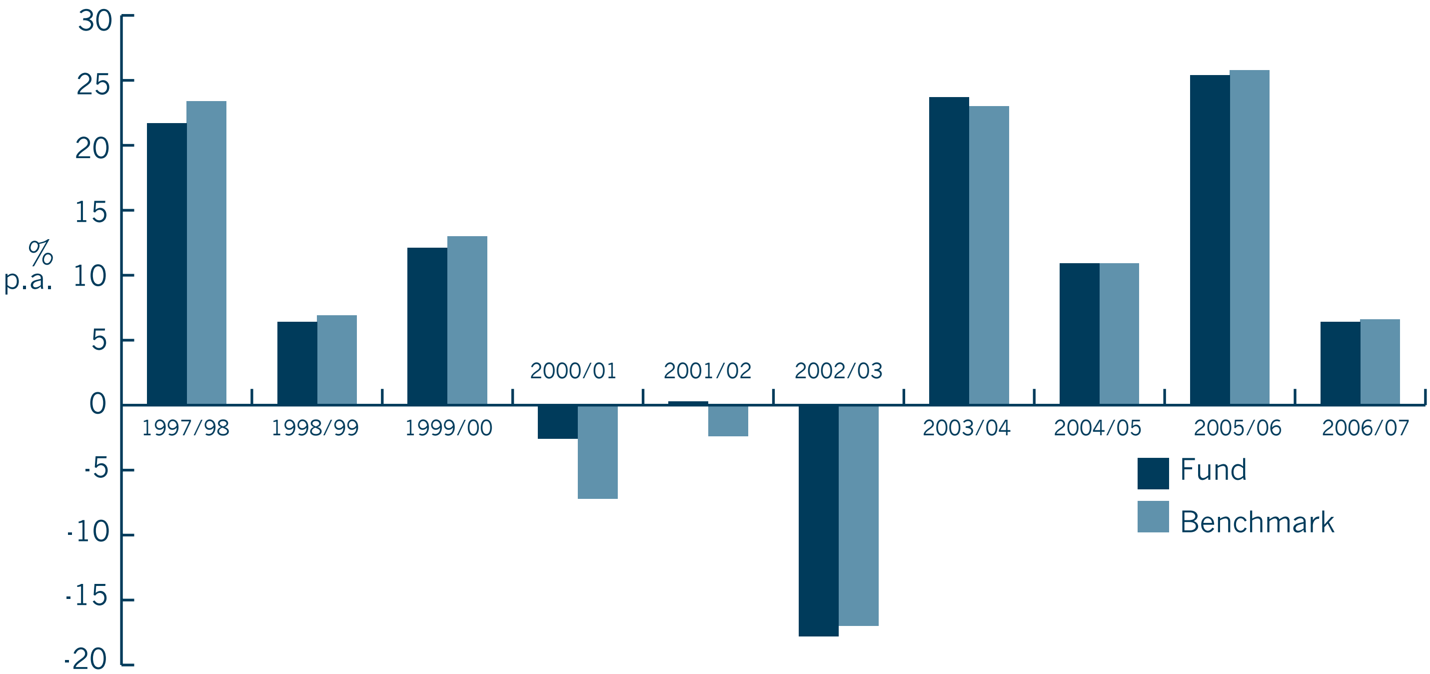
The chart below shows the Fund's annual return over five year and ten year periods.



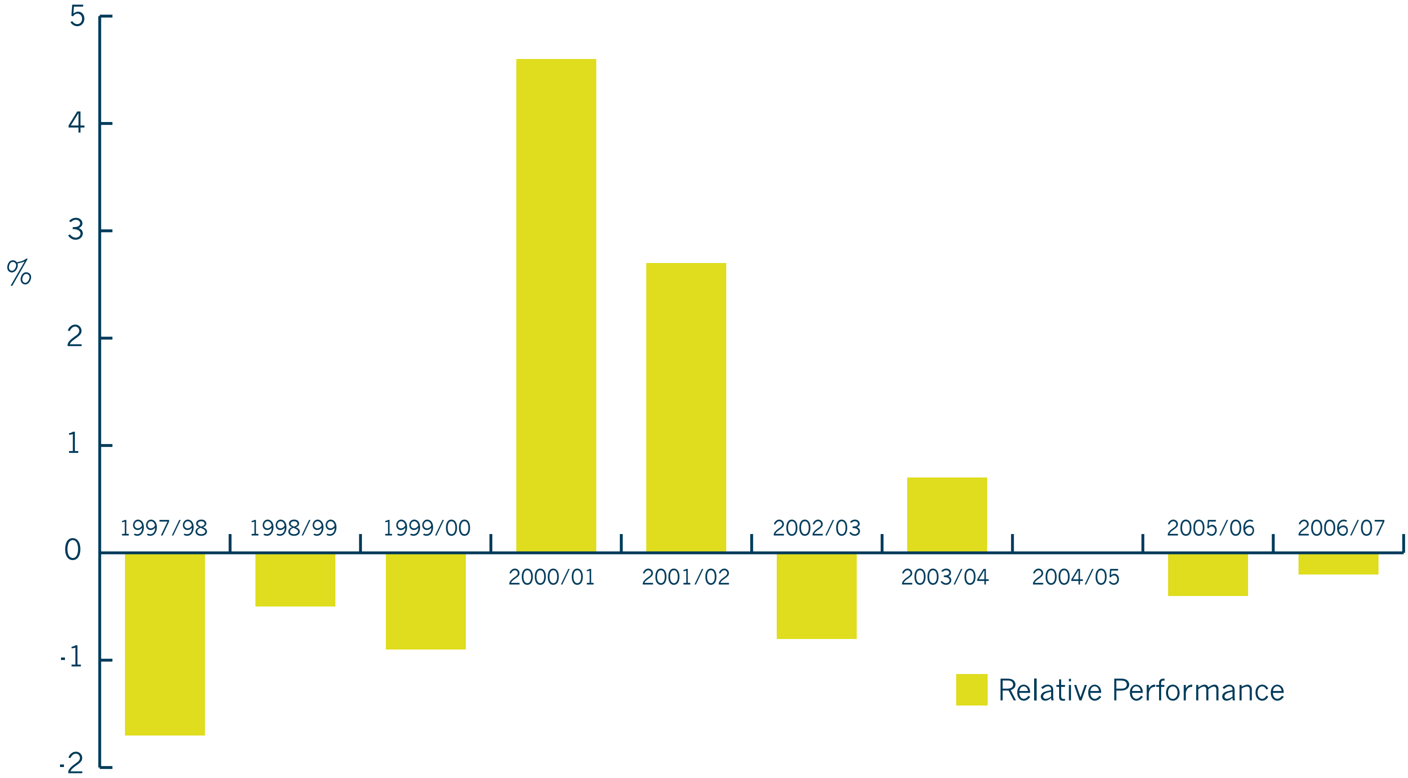

The five year return is 8.5% per annum, which is 0.2% below the benchmark return of 8.7% per annum. The ten year return is 7.9% per annum, which is 0.4% above the benchmark return of 7.5% per annum.

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

The annual performance of the Fund over ten years, against its benchmark, is shown in the following chart:



The next chart shows the relative performance over the ten year period:




The charts show that the Fund's relative performance was poor in the late 1990s. This was a time of strong equity markets and performance suffered because the Fund was positioned for a downturn in equity markets.

When markets corrected in 2000 through to 2003, the Fund benefited from its defensive positioning and outperformed strongly for two years, although performance in 2002/03 was negative.

As equity markets recovered and started to rise from 2003 onwards, the Fund initially outperformed. However, performance has been slightly negative for the last two years due to poor performance from certain active equity managers.

# Investment Principles

**Myners Report**

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

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

A follow up review initiated in 2004 concluded that the voluntary approach to seeking improvements was working, but further progress was needed.

At the request of HM Treasury, the National Association of Pension Funds is undertaking a further review in 2007. The Fund has responded to a discussion paper and has attended a round table. The Government will consider the need for policy action in the light of the evidence and recommendations from this review.

The Fund has been fully compliant with the Principles since 2003/04.

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 the Pensions Committee. A Committee Handbook is issued.

**Principle 2** – Clear investment objectives should be set.

**Fully Compliant.** The Fund has set formal investment objectives.

**Principle 3** – Strategic asset allocation decisions should receive sufficient attention.

**Fully Compliant.** The Fund has undertaken an asset liability study and tests the results in the light of changing market and liability data. Risk budgeting and modelling work has also been undertaken.

**Principle 4** – Contracts for actuarial services and investment advice should be open to separate competition.

**Fully Compliant**. The actuarial services contract and the investment advisory contract were separately tendered in 2003/04.

**Principle 5** – An explicit written mandate should be agreed between the Fund and the investment managers and transaction related costs should be monitored.

**Fully Compliant**. Written mandates have been agreed with all investment managers and arrangements are in place to monitor transaction costs and foreign exchange costs.

**Principle 6** – The Fund should play an active role in corporate governance.

**Fully Compliant.** The Fund's approach to corporate governance is covered in the Statement of Investment Principles and there is a further policy on Socially Responsible Investment, the Exercise of Rights and Corporate Governance. The Fund is a member of the Local Authority Pension Fund Forum, which promotes corporate governance and corporate social responsibility.

**Principle 7** – The Fund should set appropriate investment benchmarks.

**Fully Compliant.** Investment benchmarks have been set for the Fund and for individual investment mandates.

**Principle 8** – Arrangements should be made to measure the performance of the Fund, the Committee, Advisors and Managers.

**Fully Compliant.** The risk and return of the Fund and of individual managers is measured. A formal assessment of the effectiveness of decisions taken by the Committee, the Investment Advisor and the Officers takes place. The decision making process is subject to independent review.

**Principle 9** – The Statement of Investment Principles should be strengthened.

**Fully Compliant.** The Fund's Statement of Investment Principles has been expanded to include all of the areas required by the Myners' Report.

**Principle 10** – The Fund should publish its Statement of Investment Principles and the results of monitoring.

**Fully Compliant**. The Fund's Statement is published in the Report and Accounts and is available on the Fund's website.

# Investment Policies

## The Statement of Investment Principles

The Pensions Committee first approved a Statement of Investment Principles in October 1997. At this time, the legal requirement to have such a document applied only to private sector schemes, but it was considered to be good practice for local government funds to prepare one. The legal requirement to produce a SIP was extended to local government funds in 2000.

The SIP is a key document. It sets out the investment framework and provides an up to date assessment of compliance with the Investment Principles. The document is reviewed as new developments take place and was last updated as at 5th June 2007.

**The SIP sets out:**

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

A copy of the SIP is shown on pages 50 to 59.

## Corporate Governance and Voting

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

It is important that this process is carried out in an informed manner and, for this reason, it is believed that the investment managers are best placed to undertake it.

Each manager is required to prepare a document that sets out their policy on corporate governance and on the use of voting rights.

**This policy has to provide for:**

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

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

**Each manager is required to:**

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

The voting record of the investment managers is recorded and monitored. The Fund votes globally for its segregated equity holdings. The holdings in companies in pooled funds are voted at the discretion of the manager concerned, subject to any direction by the Fund.

**An analysis of the Fund's global and UK only voting record (including the UK pooled funds) for 2006/07 is shown below:**

| | Global | UK Only |
|---|---|---|
| Annual general meetings | 1,296 | 893 |
| Extraordinary general meetings | 411 | 328 |
| Resolutions | 16,852 | 11,987 |
| Votes for management | 15,443 | 11,698 |
| Votes against management | 322 | 149 |
| Abstentions | 35 | 12 |
| Resolutions where no vote was cast | 1,052 | 128 |

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

A resolution was opposed or an abstention was cast in just over 350 cases. The most common reasons for this were:

- Overly generous executive compensation packages for mediocre performance.
- The length of directors' contracts.
- The lack of independence of non-executive directors and auditors.
- Voting for shareholder resolutions that improved corporate governance.

Most of these issues are covered in the Combined Code.

The table shows that there were about 1,000 resolutions where votes were not cast. The main reasons for this were:

- Shareblocking, whereby shares cannot be sold until after the annual meeting if a vote has been cast by a shareholder. Therefore, shareholders are understandably reluctant to vote on non-contentious issues if this will prevent them from selling at any time. This accounts for nearly 70% of the instances for votes not being cast. Such resolutions remain subject to review before a decision is taken on whether to vote. It should be noted that this practice does not occur in the UK.
- Securities lending, where the Fund has lent its stock to a third party and, with it, the right to vote at any meetings. In such cases, the Fund will request the return of stock and vote if a resolution is considered to be contentious. This accounts for 17% of the reasons for votes not being cast. It accounts for all instances where votes were not cast in the UK.
- Some of the managers' voting policies provide only for voting on contentious issues or those where there is a sizeable interest in the company. This practice accounts for just over 10% of the non-voting total. It only occurs in overseas markets, such as those in the Far East, where it is difficult to vote.
- An occasional breakdown in communication between a manager and the voting agent. Only 3% of the votes not cast are due to this issue. This is a significant reduction from previous years.

The Fund is a member of the Local Authority Pension Fund Forum. The Forum is comprised of around forty local authority funds with total assets of more than £70 billion. The Forum is committed to actively encouraging companies to comply with good practice on corporate governance and socially responsible investment issues. By doing so, it believes that shareholder value is improved over the medium and longer term. The Forum also believes that a co-ordinated approach between funds will increase the level of effectiveness when seeking change.

**Socially Responsible Investment**

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

SRI is an important issue and the Committee takes its responsibility in this area very seriously.

The approach to SRI, voting and corporate governance is set out in a policy which was last reviewed and updated by the Committee on 5th June 2007. A copy is shown on pages 60 to 61.

The Fund's policy requires each manager to:

- Develop and co-ordinate its 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 it invests, review that company's approach to social, environmental and ethical factors and, where necessary, approach company management to seek improvements.

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

# Financial Statements

## Fund Account

| 2005/06 £m | | Note | 2006/07 £m |
|---|---|---|---|
| | **Contributions and Benefits** | | |
| (164.798) | Contributions Receivable – Employers | 3 | (180.298) |
| (48.784) | Contributions Receivable – Members | 3 | (50.929) |
| (17.147) | Transfers In | 4 | (10.398) |
| **(230.729)** | | | **(241.625)** |
| 129.783 | Benefits Payable | 5 | 142.255 |
| 23.200 | Payments To and On Account of Leavers | 6 | 11.760 |
| 2.031 | Administrative Expenses | 7 | 2.260 |
| **155.014** | | | **156.275** |
| **(75.715)** | **Net Additions from Dealings with Members** | | **(85.350)** |
| | **Returns on Investments** | | |
| (64.710) | Investment Income | 8 | (83.802) |
| 3.797 | Non-Recoverable Tax | 8 | 4.881 |
| (614.600) | Change in Market Value of Investments | 9 | (150.525) |
| 6.057 | Investment Management Expenses | 10 | 7.989 |
| **(669.456)** | **Net Returns on Investments** | | **(221.457)** |
| **(745.171)** | **Net (Increase) / Decrease in the Fund During the Year** | | **(306.807)** |
| **2,674.527** | **Net Assets of the Fund at 1st April** | | **3,419.698** |
| **3,419.698** | **Net Assets of the Fund at 31st March** | | **3,726.505** |

## Net Assets Statement

| As at 31st March 2006 £m | Net Assets Statement | Note | As at 31st March 2007 £m |
|---|---|---|---|
| | **Investments** | **9** | |
| 223.091 | Fixed Interest Securities | | 194.175 |
| 1,637.892 | Equities | | 1,656.063 |
| 23.359 | Index-Linked Securities | | 36.057 |
| 1,162.568 | Pooled Investment Vehicles | | 1,426.838 |
| 306.170 | Properties | | 373.675 |
| 88.238 | Cash Deposits | | 57.347 |
| (34.979) | Other Investment Balances | | (31.665) |
| **3,406.339** | **Total Investments** | | **3,712.490** |
| **13.359** | **Current Assets and Liabilities** | **11** | **14.015** |
| **3,419.698** | **Net Assets of the Fund at 31st March** | | **3,726.505** |

# Notes to the Financial Statements

1. **Basis of Preparation**

The financial statements have been prepared in accordance with the main recommendations of the Statement of Recommended Practice (Financial Reports of Pension Schemes), revised November 2002, and subject to note 5 follow the 2006 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 a statement prepared by the Actuary, which is shown on pages 16 and 17. The financial statements should be read in conjunction with the Actuary's statement.

2. **Accounting Policies**

**Acquisition Cost of Investments**

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

**Valuation of Investments**

Quoted securities have been valued at their mid-market closing price on 30th March 2007. The 31st March was a non business day and therefore the valuations are based on the closing price on the last business day of the reporting period.

Pooled investment vehicles have been included at the average of their bid and offer prices on 30th March 2007 as valued by the Investment Manager responsible for such vehicles.

Other unquoted investments have been valued with regard to latest dealings and other appropriate financial information as provided by the Investment Manager responsible for these investments.

The value of fixed income investments excludes interest earned but not paid over at the year-end. The interest earned has been accrued within investment income.

Overseas investments and foreign currency balances have been converted into Sterling at the closing exchange rates on 30th March 2007.

Futures have been valued on the basis of associated economic exposure as at 30th March 2007. This associated economic exposure has been incorporated into the value of the relevant asset class.

Properties are shown as valued at 31st March 2007. The valuers are Fellows of the Royal Institute of Chartered Surveyors from Colliers CRE.

**Investment Transactions**

Investment transactions that were not settled as at 31st March 2007 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 30th March 2007.

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 2007 is credited to the Fund Account.

Interest on cash deposits has been accrued up to 31st March 2007.

**Investment Management Expenses**
Investment management expenses payable as at 31st March 2007 have been accrued.

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

**Contributions**
Contributions represent the amounts received from the organisations participating in the Fund; these may be district councils, other scheduled bodies, resolution bodies or admitted bodies. Such amounts relate both to their own employer contributions and to those of their pensionable employees. The Actuary determines the rate for employers. Contributions due as at 31st March 2007 have been accrued.

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

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

## 3. Contributions Receivable

| 2005/06 £m | Contributions Receivable | 2006/07 £m |
|---|---|---|
| | **Employers** | |
| (115.047) | Normal | (121.323) |
| (49.751) | Additional | (58.975) |
| **(164.798)** | | **(180.298)** |
| | **Members** | |
| (48.074) | Normal | (50.207) |
| (0.710) | In-House Additional Voluntary Contributions | (0.722) |
| **(48.784)** | | **(50.929)** |
| **(213.582)** | **Total Contributions Receivable** | **(231.227)** |

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

| 2005/06 £m | Member Body | 2006/07 £m |
|---|---|---|
| (22.902) | South Tyneside Council (Administering Authority) | (22.661) |
| (131.170) | Other Metropolitan Councils | (139.579) |
| (34.483) | Other Scheduled Bodies | (37.541) |
| (8.930) | Resolution Bodies | (9.435) |
| (16.097) | Admitted Bodies | (22.011) |
| **(213.582)** | **Total Contributions Receivable** | **(231.227)** |

## 4. Transfers In

During the year, individual transfers in from other schemes amounted to £10.398m (£17.147m in 2005/06). There were no bulk transfers in during 2006/07 or 2005/06.

## 5. Benefits Payable

| 2005/06 £m | Benefits payable | 2006/07 £m |
|---|---|---|
| 118.003 | Pensions | 123.713 |
| 19.175 | Commutations and Lump Sum Retirement Benefits | 27.289 |
| 3.355 | Lump Sum Death Benefits | 2.009 |
| (10.750) | Less: Recharges | (10.756) |
| **129.783** | **Total Benefits Payable** | **142.255** |

The analysis of benefits by type of member body is not available. In this respect the accounts do not comply with the 2006 Code of Practice on Local Authority Accounting.

## 6. Payments To and On Account of Leavers

| 2005/06 £m | Payments To and On Account of Leavers | 2006/07 £m |
|---|---|---|
| 22.719 | Individual Transfers to Other Schemes | 11.323 |
| 0.000 | Bulk Transfers to Other Schemes | 0.329 |
| 0.297 | Refunds to Members Leaving Service | 0.105 |
| 0.184 | State Scheme Premiums | 0.003 |
| **23.200** | **Total Payments To and On Account of Leavers** | **11.760** |

## 7. Administration Expenses

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

| 2005/06 £m | Administration Expenses | 2006/07 £m |
|---|---|---|
| 1.312 | Employee Expenses | 1.456 |
| 0.514 | Support Services Recharge | 0.473 |
| 0.040 | Audit Fees | 0.043 |
| 0.021 | External ICT Costs | 0.085 |
| 0.100 | Printing/Publications | 0.131 |
| 0.057 | Professional Fees | 0.072 |
| 0.048 | Other Expenses | 0.052 |
| (0.061) | Income | (0.052) |
| **2.031** | **Total Administration Expenses** | **2.260** |

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

## 8. Investment Income

| 2005/06 £m | Investment Income | 2006/07 £m |
|---|---|---|
| (10.492) | Fixed Interest Securities | (8.898) |
| (39.239) | Equities | (50.067) |
| (0.663) | Index-Linked Securities | (0.714) |
| (0.073) | Pooled Investment Vehicles | (3.335) |
| (11.760) | Properties – Net Rents | (17.707) |
| (1.910) | Cash Deposits | (2.476) |
| (0.394) | Securities Lending | (0.567) |
| (0.170) | Commission Recapture | (0.033) |
| (0.009) | Underwriting Commission | (0.005) |
| **(64.710)** | **Sub Total** | **(83.802)** |
| 3.797 | Less: Non-Recoverable tax | 4.881 |
| **(60.913)** | **Total Investment Income** | **(78.921)** |

## 9. Investments

| Investments | Value at 1st April 2006 £m | Purchases at Cost £m | Sales Proceeds £m | Change in Market Value £m | Value at 31st March 2007 £m |
|---|---|---|---|---|---|
| Fixed Interest Securities | 223.091 | 602.882 | (619.982) | (11.816) | 194.175 |
| Equities | 1,637.892 | 735.167 | (749.970) | 32.974 | 1,656.063 |
| Index-Linked Securities | 23.359 | 24.961 | (11.876) | (0.387) | 36.057 |
| Pooled Investment Vehicles | 1,162.568 | 459.955 | (274.029) | 78.344 | 1,426.838 |
| Properties | 306.170 | 39.013 | (18.392) | 46.884 | 373.675 |
| **Sub Total** | **3,353.080** | **1,861.978** | **(1,674.249)** | **145.999** | **3,686.808** |
| Cash Deposits | 88.238 | 0.000 | (30.024) | (0.867) | 57.347 |
| Other Investment Balances | (34.979) | 348.332 | (350.411) | 5.393 | (31.665) |
| **Total Investments** | **3,406.339** | **2,210.310** | **(2,054.684)** | **150.525** | **3,712.490** |

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.

| 31st March 2006 £m | Investments | 31st March 2007 £m |
|---|---|---|
| | **Fixed Interest Securities** | |
| 101.290 | UK Public Sector | 107.312 |
| 13.956 | UK Gilt Futures | 50.347 |
| 48.115 | UK Other | 0.000 |
| 36.556 | Overseas Public Sector | 51.454 |
| 23.174 | Overseas Bond Futures | (14.938) |
| **223.091** | **Total Fixed Interest Securities** | **194.175** |
| | **Equities** | |
| 554.094 | UK Quoted | 610.861 |
| 1,080.911 | Overseas Quoted | 1,034.723 |
| 2.887 | Overseas Unquoted | 10.479 |
| **1,637.892** | **Total Equities** | **1,656.063** |
| | **Index-Linked Securities** | |
| 23.359 | UK Quoted | 30.422 |
| 0.000 | Overseas Quoted | 5.635 |
| **23.359** | **Total Index-Linked Securities** | **36.057** |
| | **Pooled Investment Vehicles** | |
| 58.426 | Unit Trusts | 130.852 |
| 876.760 | Unitised Insurance Policies | 873.666 |
| 227.382 | Other Managed Funds | 422.320 |
| **1,162.568** | **Total Pooled Investment Vehicles** | **1,426.838** |
| | **Properties** | |
| 278.250 | Freehold | 342.875 |
| 27.920 | Long Leasehold | 30.800 |
| **306.170** | **Total Properties** | **373.675** |
| | **Cash Deposits** | |
| 68.947 | Sterling | 40.725 |
| 19.291 | Foreign Currency | 16.622 |
| **88.238** | **Total Cash Deposits** | **57.347** |
| | **Other Investment Balances** | |
| (37.130) | Cash Backing Fixed Interest Futures | (35.409) |
| (0.154) | Currency Hedging | 0.000 |
| 18.547 | Debtors | 18.047 |
| (16.242) | Creditors | (14.303) |
| **(34.979)** | **Total Other Investment Balances** | **(31.665)** |
| **3,406.339** | **Total Investments** | **3,712.490** |

## 10. Investment Management Expenses

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

| 2005/06 £m | Investment Management Expenses | 2006/07 £m |
|---|---|---|
| 5.923 | Administration, Management and Custody | 7.781 |
| 0.055 | Performance and Risk Measurement Services | 0.075 |
| 0.079 | Other Advisory Fees | 0.133 |
| **6.057** | **Total Investment Management Expenses** | **7.989** |

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

## 11. Current Assets and Liabilities

| 31st March 2006 £m | Current Assets and Liabilities | 31st March 2007 £m |
|---|---|---|
| 4.136 | Contributions and Recharges Due - Employees | 4.277 |
| 14.609 | Contributions and Recharges Due - Employers | 16.065 |
| (1.592) | Inland Revenue | (0.918) |
| (1.996) | Investment Management Expenses | (2.653) |
| (1.798) | Other | (2.756) |
| **13.359** | **Total Current Assets and Liabilities** | **14.015** |

## 12. Additional Voluntary Contributions (AVCs)

The Fund offers two types of AVC arrangements.

Additional periods of membership can be purchased within the Local Government Pension Scheme, with the contributions being invested as a part of the Fund's assets.

In addition, the Pensions Committee has appointed Equitable Life Assurance Society in 1989 and The Prudential Assurance Company in 2001 for the investment of other AVCs specifically taken out by Fund members. Contributions to these external providers are invested separately from the Fund's own assets on a money purchase basis. In accordance with the Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended) these amounts are not credited to the Pension Fund and as such are excluded from the Fund's accounts.

Equitable Life has been experiencing financial difficulties in recent years, which arose from some of its financial products that carry guaranteed returns. With the exception of existing life cover policies, the Fund has closed its AVC plan with Equitable Life to new members, contributions from existing members and transfers. A significant proportion of investors in funds operated by Equitable Life have had their balances transferred to The Prudential. The Fund continues to monitor the position of the remaining investors with Equitable Life.

During 2006/07, £0.813m of contribution income was received into the AVC funds provided by The Prudential (£0.6m during 2005/06). As at 31st March 2007 these funds were valued at £6.776m (£6.073m as at 31st March 2006).

During 2006/07, £0.005m of contribution income was received into the AVC funds operated by Equitable Life (£0.006m during 2005/06). As at 31st March 2007 these funds were valued at £0.743m (£1.080m as at 31st March 2006).

The funds are valued by each of the providers and take no account of accruals.

## 13. Analysis of Investments Over Managers

The Fund employs eight specialist external investment managers over a total of fourteen 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.

In addition to the appointment of investment managers investments have been made in active currency funds, private equity and infrastructure funds.

The market values of these investments analysed across managers is as follows:

| 31st March 2006 | | Analysis of Investment Managers | 31st March 2007 | |
|---|---|---|---|---|
| £m | % | | £m | % |
| | | **Investment Managers** | | |
| 304.185 | 9 | Goodman Property Investors | 373.675 | 10 |
| 386.672 | 11 | Capital International – Global Equities | 385.103 | 10 |
| 98.496 | 3 | Capital International – Emerging Markets | 110.417 | 3 |
| 382.565 | 11 | Fidelity Pensions Management | 418.582 | 11 |
| 246.118 | 7 | Henderson Global Investors | 296.736 | 8 |
| 642.666 | 19 | Legal and General Investment Management | 646.103 | 18 |
| 289.951 | 9 | Prudential M&G | 294.324 | 8 |
| 322.766 | 10 | Schroder Investment Management | 304.518 | 8 |
| 619.843 | 18 | UBS Global Asset Management | 614.599 | 17 |
| 45.887 | 1 | Active Currency | 123.515 | 3 |
| 50.278 | 1 | Private Equity | 113.907 | 3 |
| 0.000 | 0 | Infrastructure | 13.949 | 0 |
| 16.912 | 1 | Managed In-House | 17.062 | 1 |
| **3,406.339** | **100** | **Total Investments** | **3,712.490** | **100** |

## 14. Taxation

### UK Tax

The Fund is an exempt approved fund and is not liable to income tax or capital gains tax.
It is not registered separately from the Council for VAT and therefore can recover its input tax.

All investment income in the accounts has been shown gross of UK income tax and the non-recoverable element has been shown as an expense.

### Overseas Tax

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

## 15. Derivatives

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

As at 31st March 2007 the Fund held 467 June 2007 Long Gilt Futures contracts which, when valued on the basis of the associated economic exposure, had a book value of £50.710m and a market value of £50.347m. The net variation margin paid on these outstanding contracts as at 31st March 2007 was £0.363m.

As at 31st March 2007 the Fund held 228 June 2007 Short US Bond Futures contracts which, when valued on the basis of the associated economic exposure, had a book value of -£12.643m and a market value of -£12.569m. The net variation margin received on these outstanding contracts as at 31st March 2007 was £0.074m.

As at 31st March 2007 the Fund held 96 June 2007 Short Euro Bond Futures and 60 June 2007

Long Euro Bond Futures contracts which, when valued on the basis of the associated economic exposure, had a book value of -£2.367m and a market value of -£2.369m. The net variation margin paid on these outstanding contracts as at 31st March 2007 was £0.002m.

The Fund has used Forward Currency Contracts to hedge the currency exposure on certain overseas investments. As at 31st March 2007, the Fund held a range of positions that together showed no unrealised profit or loss. Of the seventy eight positions open as at 31st March 2007, seventy four have been settled showing an overall loss of £0.401m. As at 31st May 2007 four of these positions remained open and were showing an unrealised profit of £1.217m.

## 16. Securities Lending

The Fund operates a securities lending programme through its custodian, Northern Trust. Securities totalling £236.700m were out on loan as at 31st March 2007, against collateral of £249.579m. The breakdown of securities on loan as at 31st March 2007 is set out below:

| 31st March 2006 £m | Securities Lending | 31st March 2007 £m |
|---|---|---|
| 57.447 | Fixed Interest Securities | 80.229 |
| 9.350 | Index-Linked Securities | 3.003 |
| 75.423 | UK Equities | 103.720 |
| 153.749 | Overseas Equities | 49.748 |
| **295.969** | **Total Securities Lending** | **236.700** |

The value of collateral against which the securities were lent out as at 31st March 2007 is set out below:

| 31st March 2006 £m | Securities Lending - Collateral | 31st March 2007 £m |
|---|---|---|
| 19.011 | Cash | 39.005 |
| 212.503 | Fixed Interest | 150.584 |
| 83.561 | Equities | 59.990 |
| **315.075** | **Total Collateral** | **249.579** |

## 17. Underwriting

The Fund accepts a number of underwriting and placing propositions. As at 31st March 2007 no commitments were outstanding.

## 18. Significant Holdings

As at 31st March 2007 the Fund had two holdings that represented more than 5% of the total Fund value. Both of these holdings are without-profit insurance contracts that provide access to a pool of underlying assets. The values have been determined by reference to the underlying assets using price feeds from the markets. These holdings are:

- Legal and General Assurance (Pensions Management) Limited – Managed Fund. As at 31st March 2007 this was valued at £646.103m and represented 17.3% of the total net assets of the Fund. This insurance contract can be split into four individual funds, representing four different asset classes, as follows:

| Fund Type | £m |
|---|---|
| UK Equities | 329.035 |
| North American Equities | 127.473 |
| UK Gilts | 35.994 |
| AAA Fixed Interest | 56.402 |
| Index-Linked Gilts | 97.199 |

- Prudential Pensions Limited – Corporate Bond All Stocks Fund. As at 31st March 2007 this was valued at £227.563m and represented 6.1% of the total net assets of the Fund.

## 19. Outstanding Commitments

As at 31st March 2007 the Fund had twenty one outstanding commitments to investments:

| | Initial Commitment | | As at 31st March 2007 | | |
|---|---|---|---|---|---|
| **Name of Fund** | **Year** | **Value** | **Drawdowns Made** | **Commitment Outstanding** | |
| HarbourVest International Private Equity Partners IV | 2002 | \$55.0m | \$44.5m | \$10.5m | £5.4m |
| HarbourVest Partners VII Cayman Buyout Fund | 2002 | \$46.0m | \$24.8m | \$21.2m | £10.8m |
| HarbourVest Partners VII Cayman Mezzanine Fund | 2002 | \$8.0m | \$3.4m | \$4.6m | £2.3m |
| HarbourVest Partners VII Cayman Venture Fund | 2002 | \$28.0m | \$13.0m | \$15.0m | £7.6m |
| Capital North East | 2002 | £1.5m | £1.2m | £0.3m | £0.3m |
| HarbourVest Partners 2004 Direct Fund | 2004 | \$30.0m | \$24.0m | \$6.0m | £3.1m |
| Capital International Private Equity Fund IV | 2004 | \$18.0m | \$14.7m | \$3.3m | £1.7m |
| HarbourVest International Private Equity Partners V – Partnership | 2005 | €100.0m | €19.5m | €80.5m | £54.6m |
| HarbourVest International Private Equity Partners V – Direct | 2005 | €30.0m | €14.2m | €15.8m | £10.7m |
| Pantheon Asia Fund IV | 2005 | \$20.0m | \$2.4m | \$17.6m | £9.0m |
| Pantheon Europe Fund IV | 2005 | €25.0m | €6.0m | €19.0m | £12.9m |
| Pantheon USA Fund VI | 2005 | \$30.0m | \$8.1m | \$21.9m | £11.2m |
| Lexington Capital Partners VI-B | 2005 | \$30.0m | \$6.4m | \$23.6m | £12.0m |
| Henderson PFI Secondary Fund II | 2005 | £15.0m | £14.1m | £0.9m | £0.9m |
| HarbourVest Partners VIII Cayman Buyout Fund | 2006 | \$112.0m | \$11.2m | \$100.8m | £51.4m |
| HarbourVest Partners VIII Cayman Venture Fund | 2006 | \$56.0m | \$1.7m | \$54.3m | £27.7m |
| Pantheon Europe Fund V | 2006 | €35.0m | €0.0m | €35.0m | £23.8m |
| Pantheon USA Fund VII | 2006 | \$35.0m | \$2.5m | \$32.5m | £16.6m |
| Coller International Partners V | 2006 | \$30.0m | \$1.5m | \$28.5m | £14.5m |
| Capital International Private Equity Fund V | 2007 | \$35.0m | \$0.0m | \$35.0m | £17.8m |
| Partners Group 2006 Direct Fund | 2007 | €30.0m | €0.0m | €30.0m | £20.4m |
| **Total Outstanding Commitments** | | | | | **£314.7m** |

The Sterling figures for these outstanding commitments are based on the exchange rate at the close of business on 30th March 2007 which was the last business day prior to the 31st March 2007.

## 20. Related Party Transactions

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

Examinations of returns completed by Elected Members of the Pensions Committee and Senior Officers involved in the management of the Pension Fund have not identified any cases where disclosure is required.

During 2006/07 South Tyneside Council charged the Tyne and Wear Pension Fund £0.725m (£0.783m in 2005/06) in respect of services provided, primarily financial, legal and information technology. Tyne and Wear Pension Fund charged South Tyneside Council £0.048m (£0.047m in 2005/06) in respect of treasury management.

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

## 21. Audit

The accounts are presented subject to audit.

# Statement of Investment Principles

## Approved by Pensions Committee on 5th June 2007

### Introduction

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

### Governance

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

16. The Fund's officers undertake the day to day monitoring of the investment of the Fund.
17. The Fund has a service plan that sets out in detail the development of the structure and processes that govern the investment of the Fund.

**Investment Objectives and Policy**

18. The investment objectives of the Fund are:
    - To maintain securely a portfolio of assets of appropriate liquidity which will generate income and capital growth which, together with employer and employee contributions, will meet the cost of current and future benefits which the Fund provides, as set out in the statutory documentation.
    - To minimise the long term costs of the Fund by maximising the return on the assets, whilst having regard to the objective stated above.
    - To comply with the regulations relating to the investment of local government pension funds.
19. In order to assist in setting the Fund's strategic investment policy, an asset liability modelling study is carried out. This study examines the Fund's financial position, the profile of its membership, the nature of its liabilities and includes an analysis of the expected ranges of outcomes from differing investment policies.
20. The current strategic asset allocation is based upon a study carried out as at 30th November 2004 by Hymans Robertson, based upon the liabilities shown by the 2004 valuation. The projected investment returns that were used in this study are shown in an appendix. Having considered the outcome of this initial study, the Committee concluded that a diversified portfolio, of which about 67.5% is invested in UK and overseas equities, 22.5% in bonds and 10% in property, represented a suitable strategic asset allocation benchmark for the Fund. The degree and nature of risks attaching to such a portfolio, when taken in conjunction with the expected returns, were considered by the Committee to be appropriate for the Fund.
21. An appendix is attached that sets out the detail of the strategic benchmark.
22. The Committee will continue to monitor the suitability of this policy in the light of the Fund's developing liabilities and finances.

**The Investment Management Structure**

23. The Committee considers that the Fund must have an investment management structure that provides exposure to a suitably diversified, but complementary, range of investment styles and processes.
24. It is the view of the Committee that the strategic benchmark is best implemented by investing the entire Fund on a specialist basis, using passive asset allocation and a combination of active and passive stock selection.
25. The structure includes discretionary mandates for the active management of UK equities, pan european equities, global equities, pacific equities, emerging market equities, global bonds, corporate bonds and currencies.
26. Following consideration of the efficiency, liquidity and level of transaction costs likely to prevail within each market, the Committee determined that up to about 25% of the Fund should be managed on a passive basis. The passive mandate includes a proportion of the total allocation to UK equities, US equities and UK government bonds.
27. It is intended that 5% of the Fund is to be invested in private equity. This position will be built up over a period of years, largely by investment in funds of funds. The allocation will be top-sliced from the allocation to quoted equities.
28. An allocation of 3% of the Fund is invested in actively managed currency funds.
29. Allocations, each of up to 1% of the Fund, are being made into infrastructure funds. These are top-sliced from the allocation to gilts.

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.
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 majority of the managers are remunerated by way of ad valorem fees. Performance fees receive consideration but have only been adopted where there is no ad valorem alternative.
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 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 liaising with the managers to ensure that sufficient cash balances are available.
    - Manager risk is controlled through the investment objectives and restrictions set out in each manager's agreement and through the ongoing monitoring of the managers.
    - Custodian risk is controlled through the restrictions set out in each custodian's agreement and through the ongoing monitoring of the custodial arrangements.
    - Position, currency and political risks are controlled through the approach to diversification.
    - Counterparty risk is controlled through the restrictions followed by the managers with respect to the trading of securities and cash management.

## Socially Responsible Investment

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, including that contained in "The Responsibilities of Institutional Shareholders and Agents - Statement of Principles", that was first prepared by the Institutional Shareholders Committee in 2002 and then updated in 2005. The policy towards companies outside the UK should take account of the practices of the home nation.
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.
55. Investment of money purchase AVCs is undertaken through the Prudential Assurance Company. The Committee's intention is to offer a range of funds that are intended to provide a suitable long-term return for members, consistent with the degree of risk accepted. A socially responsible fund is included within the range on offer.
56. The Committee reviews the suitability of the AVC arrangements annually, or more frequently if required, based upon advice provided by Hewitt Bacon and Woodrow.
57. 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

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

## Limits on Investment in Partnerships

59. The Regulations contain the following limits on the percentage of a pension fund that may be invested into a partnership:
    - 2% in respect of all contributions into any single partnership.
    - 5% in respect of all contributions into partnerships.
60. The limits apply at the time that an investment is made.
61. The regulations provide for the limits to be raised as follows, subject to certain requirements being met:
    - 5% in respect of all contributions into any single partnership.
    - 15% in respect of all contributions into partnerships.
62. Up to 5% of the Fund is to be invested in private equity. This position will be built up over a period of years and the allocation will be top-sliced from that to quoted equities.
63. At its meeting on 27th February 2006, the Committee resolved that the limits applicable to the Fund be raised in order to accommodate the commitments that would be made in respect of this investment, as follows:
    - The limit in respect of all contributions into any single partnership be raised from 2% to 3%.
    - The limit in respect of all contributions into partnerships be raised from 5% to 15%.
64. The Committee has taken proper advice in respect of this investment from the Investment Advisor, Hymans Robertson, and from the Fund's officers.
65. This decision will apply for the period for which the Fund's strategic investment benchmark includes a 5% allocation to private equity, unless investment considerations require an earlier review.
66. No date has been set for an earlier review.
67. This decision is compliant with the Regulations.
68. The investment in infrastructure funds is also through limited partnerships. These investments will be taken into account against the increased limits referred to above.

## Limits on Stock Lending

69. The Regulations contain a limit of 25% on the value of the securities of a pension fund that may be transferred (or agreed to be transferred) under stock lending arrangements.
70. The Regulations provide for the limit to be raised to 35%, subject to certain requirements being met.
71. At its meeting on 28th November 2005, the Committee resolved that the limit be raised to 35%.

72. The Committee has taken proper advice in respect of this decision from the Investment Advisor, Hymans Robertson, and from the Fund's officers.
73. This decision has been taken to allow greater flexibility within the stock lending arrangement and to provide the potential for additional income.
74. This decision will apply for as long as the stock lending arrangement operates, unless an earlier review is required.
75. No date has been set for an earlier review.
76. This decision is compliant with the Regulations.

# Asset Liability Study

### Projected Investment Returns

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

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

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

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

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

Inflation has been assumed at 2.8%.

# Strategic Benchmark

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

**Notes**

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

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

Allocations, each of up to 1% of the Fund, are being made into infrastructure funds. These are top-sliced from the allocation to gilts.

## Management Structure

**Manager:** Fidelity

**Mandate:** UK Equities

**Objective:** To aim to outperform the FTSE All Share Index by 2.0% per annum over three year rolling periods. To aim not to underperform the FTSE All Share Index by more then 5.5% over any rolling twelve month period.

**Manager:** UBS

**Mandate:** Pan European Equities

**Objective:** To outperform the FTSE Europe (including UK) Index – Developed Series by 2% per annum over three year rolling periods with the return being no more than 5% below the Index in any one year.

**Manager:** Capital International

**Mandate:** Global Equities

**Objective:** To outperform the FTSE All World Index by 2% per annum over three year rolling periods with the return being no more than 5% below the Index in any one year.

**Manager:** Capital International

**Mandate:** Emerging Market Equities

**Objective:** To outperform the MSCI Emerging Markets Free Index.

**Manager:** Schroder

**Mandate:** Japanese Equities

**Objective:** To outperform the FTSE All World Japan Index by 2% per annum over three year rolling periods with the return being no more than 4% below the Index in any one year.

**Manager:** Schroder

**Mandate:** Pacific ex Japan Equities

**Objective:** To outperform the MSCI All Countries Pacific Free ex Japan Index by 2% per annum over three year rolling periods with the return being no more than 5% below the Index in any one year.

**Manager:** Legal and General

**Mandate:** UK Equities

**Objective:** To match the return on the FTSE All Share Index.

**Manager:** Legal and General

**Mandate:** US Equities

**Objective:** To track the total return of the FTSE World North America Index within expected tolerances of +/-0.5% in two years out of three.

**Manager:** Legal and General

**Mandate:** UK Index-Linked

**Objective:** To match the return on the FTSE-A British Government Over Five Years Index-Linked Index.

**Manager:** Legal and General

**Mandate:** AAA Fixed Interest

**Objective:** To match the return on the iBoxx Sterling AAA All Stocks Index.

**Manager:** Legal and General

**Mandate:** UK Gilts

**Objective:** To match the return on the FTSE-A British Government All Stocks Index.

**Manager:** Various

**Mandate:** Private Equity

**Objective:** 5% net of fees above the returns on quoted equity.

**Manager:** Prudential M&G

**Mandate:** Corporate Bonds

**Objective:** To outperform a composite benchmark by 0.75% per annum over three year rolling periods with the return being no more than 2% below the benchmark in any one year.

The benchmark is:
80% iBoxx Non Gilt All Stocks.
10% FTSE-A British Government All Stocks.
10% FTSE-A British Government Over Five Years Index-Linked.

**Manager:** Henderson

**Mandate:** Government Bonds

**Objective:** To outperform a composite benchmark by 1% per annum over three year rolling periods, whilst maintaining an estimated ex-ante tracking error of no more than 2.5% per annum and which is typically in a range of 0.5% to 2%.

The benchmark is:
27.5% FTSE-A British Government All Stocks.
7.5% FTSE-A British Government Over Five Years Index-Linked.
25% Merrill Lynch Sterling Non Gilt All Stocks.
30% JP Morgan Global (Non UK) Traded Bond Index, hedged into Sterling.
10% BBA three Month Sterling LIBOR.

**Manager:** Goodman Property Investors

**Mandate:** Property

**Objective:** To outperform the IPD All Funds Universe by 0.5% per annum over three year rolling periods.

**Manager:** BGI and Record

**Mandate:** Currency

**Objective:** Absolute return.

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

## Approved by Pensions Committee on 5th June 2007

**Introduction**

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

**Development of a Manager's Policy**

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

**Socially Responsible Investment**

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

**Rights Attaching to Investments**

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

## Corporate Governance

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

## Voting Rights

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

## Review and Reporting Arrangements

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

# How to contact us

Our information is available in other ways on request.
We can provide information in other languages, Braille or large print.
We also have access to audio aids and BSL (British Sign Language) interpreters.

There are a number of ways you can get in touch with us.
If you need further information on the LGPS, please contact us at:

Postal Address
Tyne and Wear Pension Fund
PO Box 143
HEBBURN NE31 2WT

Pensions Helpline
**Tel 0191 424 4141**

**Fax 0191 424 4171**

**Email pensions@twpf.info**

**Web www.twpf.info**

## Personal callers

You can visit us during office hours at the Civic Centre, Campbell Park Road, Hebburn, Tyne and Wear, NE31 2SW. You don't need to make an appointment.

## Office hours

Monday to Thursday 8.30am to 5.00pm Friday 8.30am to 4.30pm.

Please quote your National Insurance Number and your Membership ID Number so we can quickly trace your records.

**Tyne and Wear** Pension Fund
Administered by South Tyneside Council