



Croydon Pension Scheme

ANNUAL REPORT 2005/2006

Management & Advisers

Croydon Council Pension Fund Governance Policy

Pensions Sub-Committee:

As an administrating pension authority the Council discharges its duties in respect of maintaining the Pension Fund in the form of the Pensions Sub-Committee. Its terms of reference are to deal with all matters relating to the investment of the Council Pension Fund. The Pensions Sub-Committee is made up of six voting Members of the Council, a non-voting pensioner representative and a non-voting employee representative.

Councillors during the 2005/06 Municipal Year:

Councillors Ian Payne, Raj Rajendran, Peter Hopson, Brenda Kirby, Dudley Mead and Derek Millard
(Chair) – Councillor Ian Payne
(Vice Chair) – Councillor Raj Rajendran

Current Councillors in 2006/07 Municipal Year:

Councillors Derek Millard, Dudley Mead, Tim Pollard, Enley Taylor, Simon Hall and Raj Rajendran
(Chairman) – Councillor Derek Millard
(Vice Chairman) – Councillor Dudley Mead

Non-voting members:

Staff Representatives – Alan O'Brien
Pensioners' Representative – Peter Howard

In addition the Sub-Committee is supported by officers and external advisers.

External Advisers to the Sub-Committee:

J N Sykes – Mercer Investment Consulting
V Furniss – Independent Adviser

Actuary: J Livesey – Mercer Human Resource Consulting

The Sub-Committee sets the long term objectives and strategy for the Fund. It also oversees all matters relating to investment strategy of the Fund including the appointment of managers, advisers and custodians.

The Sub-Committee meetings are held on at least a quarterly basis, the agenda and minutes from previous meetings are circulated to the Members of the Sub-Committee within 5 days of the next meeting.

The agendas and minutes of Sub-Committee meetings are available on the Council's website.

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Foreword

I was delighted to accept the position of Chairman of the Pensions Sub-Committee in June 2006 following the Local Government elections in May.

I was first elected to the Council in a by-election in November 1986. As a retired Actuary, Stockbroker and Merchant Banker I have always had a very keen interest in the pension industry and have been a member of the Pensions Sub-Committee for many years, taking an extremely active role in the management of the Council's Pension Fund. I believe my experience both in investment and as a Councillor of many years standing has provided me with a valuable knowledge of the Pension industry and I am committed in continuing to bring this experience to the Fund.

2005/06 proved to be another busy year for the Sub-Committee which met on five separate occasions. During 2005/06 the Sub-Committee was chaired by Councillor Ian Payne and his Vice Chair was Councillor Raj Rajendran, the other members being Councillors Peter Hopson, Brenda Kirby, Dudley Mead and myself. At these meetings we considered a range of investment and administrative issues. These included the continuing review of the future investment strategy of the Fund with the aim of identifying the best mix of investments to provide the Fund with an acceptable level of return. As a consequence it was agreed that the Fund should move away from its previous 100% stance in equities.

During the year the Fund held its inaugural Pensions Open Day to which all members of the Fund were invited. The Fund Managers attended as well as a representative from the Local Government Employers Organisation, Irene Vass and the Head of Pensions of the Department of Communities and Local Government, Terry Crossley. Each of the attendees gave a summary of their key areas of involvement in respect of the Croydon Pension Fund and the Local Government Pension Scheme in general. The day provided an excellent opportunity for staff to be informed of the benefits of the Fund, and how it is managed. It was a great success and will be a forerunner for similar events to facilitate increased awareness of pension issues and to encourage a greater take-up in the Pension Scheme.

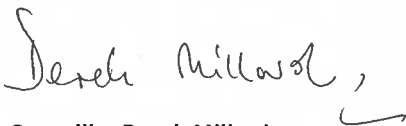
I am pleased to report that the Fund achieved a positive return of 27.9% compared to the Local Authority average return of 24.9%. The Fund was the 5th best performing Fund in 2005/06 and over the last 3 years was the top performing Local Authority Fund. The Fund's assets increased to over £501m, which was an excellent performance and I am keen to build on this success and set investment objectives accordingly. I am extremely pleased to report that the hard work of members and officers of the Pension Sub-committee was externally recognised and the Council's Pension Fund won the prestigious award of Pension Fund of the Year.

As I am sure you will be very aware, the pension industry is currently going through a period of major change. The Department of Communities and Local Government, formally the Office of the Deputy Prime Minister, introduced a number of major new pension regulations during the year, including changes to the 85 year rule, which will impact on the Local Government Pension Scheme. These are detailed in this Report.

The Croydon scheme remains a vibrant statutory scheme and my role as Chairman of the Committee will be to work to develop the investment and management of the Fund. I will also work with colleagues to increase the percentage of employees in the Pension Scheme ensuring that all staff are aware of the benefits that they will receive as a member of the scheme.

I should like to stress that the benefits payable to members and the future of the Fund is guaranteed by statute and my aim, with colleagues of the Sub-Committee, will be to ensure that the Pension Fund continues to provide benefits to both existing Pensioners and other members of the Pension Fund at an affordable cost.

Finally as Chairman of the Sub-Committee I look forward over the years ahead to the future development of the Pension Fund and of ensuring the continued successful investment of the Fund.



Councillor Derek Millard
Chairman of the Pensions Sub-Committee



Good investment performance is important since it will restrict the call that the Fund makes on the local taxpayers.

Introduction

The following pages provide you with an overview of Scheme benefits that may be received and how we have invested your contributions and other Pension Fund income during 2005/2006.

If, after reading this booklet, you would like further information regarding the investments of the Fund, please contact the Pensions and Treasury team who will be pleased to answer any questions you may have.

Security of Funds

The Local Government Pension Scheme is a scheme regulated by Act of Parliament. The benefits payable to members are therefore not dependent directly on the investment performance of the Fund. However, the Council has to make good any deficit that might arise in the Fund at regular intervals.

Socially Responsible Investment and Corporate Governance

Socially responsible investment is investment where moral, social and ethical considerations are taken into account. Corporate governance is the system by which companies are run and the means by which they are responsive to their shareholders, employees and other stakeholders. The Council's policy is outlined within the Statement of Investment Principles on page 14.

The Council is at the forefront of the developments within the UK pensions industry to persuade companies to pursue socially responsible policies consistent with good performance.

The Pensions Sub-Committee have adopted a corporate governance voting policy in accordance with which the UK investment managers are required to vote at company meetings. Most of the votes relate to best practice in the conduct of company management but separate votes are also cast in connection with companies' stances on environmental issues.

There is no doubt that pressure to take account of socially responsible issues in the investment process will increase. The Council, whilst recognising as paramount its responsibilities to its members and taxpayers, will play its part in taking the matter forward.

Membership 2005/2006

During the year the Scheme's total membership has grown from 15,002 to 15,332. Changes in membership during the year were as follows:

Employees

Number at 31 March 2005		6,556
Add	Employees joining during year	436
		6,992
Less	Members leaving during year:	
	Normal retirements (including redundancies etc)	128
	Ill-health retirements	10
	Deaths in service	8
	Transfers to other funds/schemes	1
	Refunds of contributions	33
	Deferred pensions	205
		385
Number at 31 March 2006		6,607

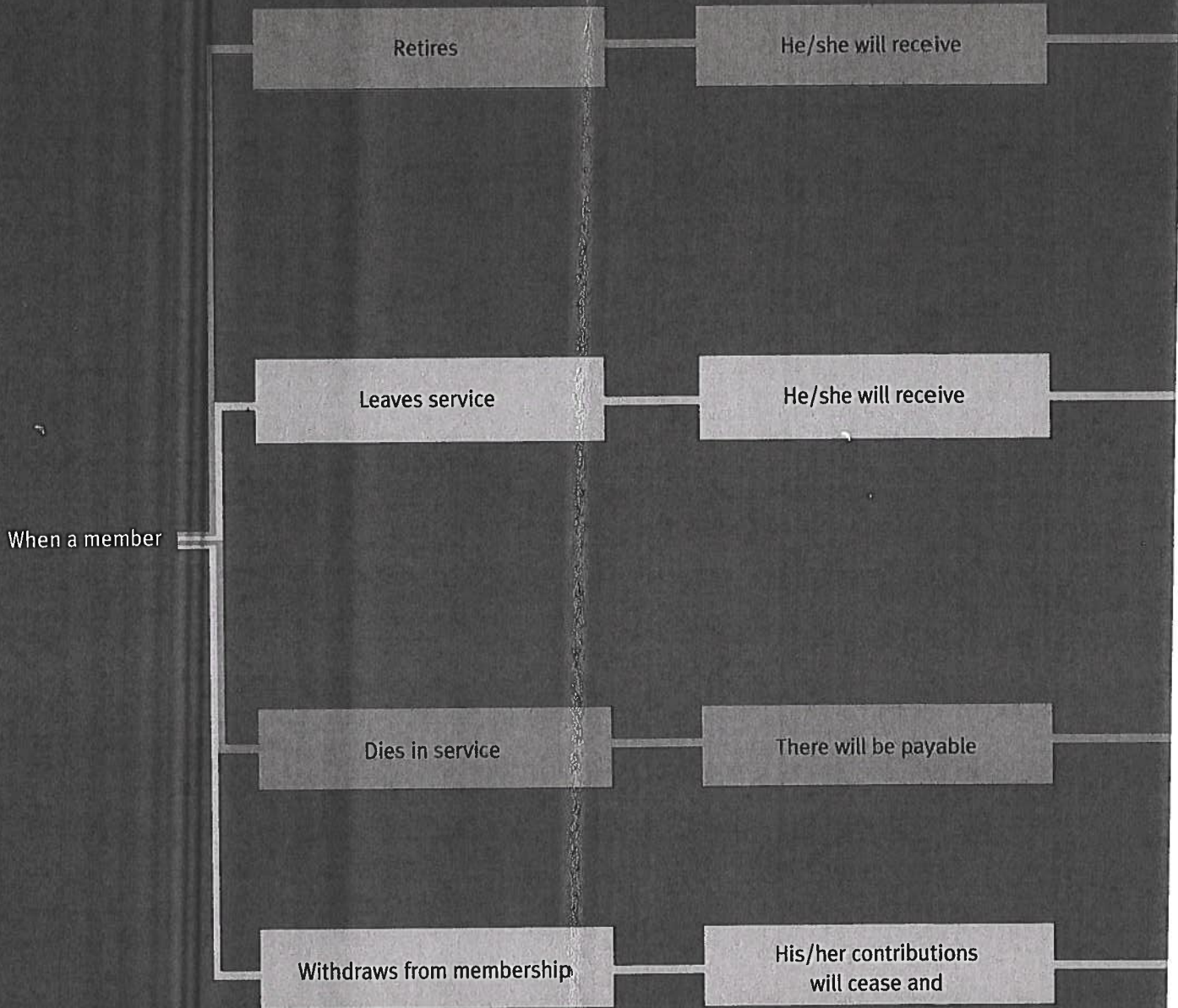
Pensioners

Number at 31 March 2005		4,964
Add	New pensioners during year:	
	Normal retirements (including redundancies etc)	128
	Ill-health retirements	10
	Dependants' pensions	49
	Deferred pensions becoming payable	83
		270
		5,234
Less	Deaths/dependants ceasing to be eligible	46
Number at 31 March 2006		5,188

Deferred Pensioners

Number at 31 March 2005		3,482
Add	New deferred pensioners during year	178
		3,660
Less	Transfers to other funds/schemes	33
	Deferred benefits becoming payable	83
	Back to active status	3
	Deaths	4
		123
Number at 31 March 2006		3,537
Total Membership at 31 March 2006		15,332

Summary of Benefits



Notes

1. This chart covers the main features of the Scheme - it does not include full details of all benefits.
2. Local Government Pension Scheme pensions and deferred pensions are increased annually in line with the increase in the Retail Price Index.
3. Exchanging part of your pension for extra lump sum - If you draw your benefits on or after 6 April 2006 you will be able to commute up to 25% of the capital value of your pension benefits to receive a tax free lump sum. The current lump sum automatically paid on retirement roughly equates to 15% of the capital value. Any amount you take above the current lump sum would be achieved by exchanging part of your annual pension for a one off tax-free cash payment at a rate of £12 lump sum for each £1 of pension surrendered.

A **pension** of one eightieth and a tax free **lump sum** of three eightieths of final pensionable pay for each year of membership (please see note 3 for options)

and on death

Subject to qualifying conditions the **spouse** and **Civil Partners** under the Civil Partnership Act 2004 will receive a pension of up to one half of the pension being paid to the member

With less than 3 months membership - a **refund** of contributions less a deduction to cover the cost of buying back into the State Scheme and tax on the balance

or

A **transfer payment** of the cash equivalent value of the accrued rights may be made to another approved pension arrangement

With more than 3 months membership - **deferred benefits** payable from normal retirement date based on total period of membership and pensionable pay at the date of leaving

A **lump sum** death grant of twice pensionable pay

plus

The **spouse** and **Civil Partners** will receive a pension of up to one half of the pension the member would have received had he/she retired due to ill-health on the date of death

A **refund**, or a **transfer payment**, or **deferred benefits** may be paid in a similar way to the benefits payable on leaving the service (There are restrictions on re-entry to the Scheme)

in addition

The employee will be required to contribute to the State Second Pension Scheme, or to a personal pension plan or stakeholder pension scheme.

Telephone enquiries about pension scheme benefits should be made as follows:

Enquiries from current scheme members - ☎ 020 8666 9919

Pension payroll enquiries - ☎ 020 8666 9935

Written enquiries should be addressed to:

Croydon Pensions Team, Liberata UK Limited, PO Box 1598, Croydon CR0 0ZW

National Local Government Pension Scheme Web Site

The address is www.lgps.org.uk

The national Local Government Pension Scheme web site enables all members, potential members and beneficiaries of the Scheme to access Scheme information 24 hours a day, 365 days a year.

The site has a comprehensive range of Scheme information, which includes:

<i>All About Your Pension Scheme:</i>	A new employees' guide to the Scheme
<i>All About Your Preserved Benefits:</i>	A guide to benefits provided if you leave before retirement age
<i>All About Your Retirement Benefits:</i>	A guide to retirement benefits
<i>Increasing your Benefits:</i>	How to purchase additional periods of membership
<i>A "FAQ" section:</i>	Frequently asked questions

Additional Voluntary Contributions

The Council has appointed Prudential as the Scheme's provider for additional voluntary contributions investment services.

If you would like more information all you have to do is call "The Pension Connection" helpline on 0845 607 0077.

AVC's are an opportunity for all employees to pay additional contributions into an external scheme which will enhance income on retirement

Statement Of Investment Principles

1. INTRODUCTION

The elected Members of Croydon Council, acting through the Pensions Sub-Committee, have drawn up this Statement of Investment Principles to comply with The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations as they relate to the Pensions Act 1995 in its requirements of occupational pension schemes and the London Borough of Croydon Pension Fund ('the Fund'). The Council has consulted suitably qualified persons and has obtained written advice from Mercer Investment Consulting. Overall investment policy falls into two parts:

- The strategic management of the assets is the responsibility of the Pensions Sub-Committee, who delegate many of their functions to the officers and act on advice of the investment consultant and the independent Fund adviser.
- The remaining elements of policy are part of the day-to-day management of the assets, which are delegated to professional investment managers as described in Section 3.

2. INVESTMENT OBJECTIVES, STRATEGY AND RISK

2.1 Investment Objectives

To guide them in their strategic management of the assets and control of the various risks to which the Fund is exposed, Croydon Council have adopted the following objectives:

- Overall investment policy is to maximise the return on investments, within the risk parameters set for the Fund.
- Investment policy is guided by an overall objective of achieving, over the long term, a return on investments to meet all the Fund's liabilities, after taking into account employer and employee contributions, which is consistent with the long-term assumptions used by the Actuary in determining the funding of the Fund.
- The objective is to achieve a return in line with the mandates (see paragraph 3.1).
- Promote a Socially Responsible Investment Strategy consistent with maximising the return on the Fund.

2.2 Investment Strategy

During the 2005/06 Financial Year the Pensions Sub-Committee received a number of reports dealing with the issue of risk versus return in relation to the Investment Strategy. It was agreed that the Pension Funds medium term strategy should be an allocation of 75% in equities phased over the period 2005-2008. The balance of non-equity assets are to be held in bonds, property and cash. The proposed allocations are as shown in the table overleaf.

Assets	Target Allocations		
	2005/6 %	2006/7 %	2007/8 %
UK Equities	61	51	42
Overseas Equities	28	28	29
Private Equity	2	3	4
Bonds	7	12.5	17
Property	0.5	4	7
Cash	1.5	1.5	1
Total	100	100	100

Preparation for a tender process is in progress to meet the proposed asset allocations.

In order for the Council's exposure to pooled vehicles and unit trust schemes to be brought into line with the new target allocations, the Council, having taken appropriate advice, has decided that the increased limits for units of shares of the investments subject to the trusts of unit trust schemes managed by any one body should be adopted. This is for an unlimited period of time, is consistent with the Council's Investment Strategy and the increase complies with the Local Government Scheme (Management and Investment of Funds) (Amendment) Regulations 2003, and therefore the Sub-Committee is required to formally agree the following:

That all investments in units or other shares of the investment subject to the trusts of unit trust schemes managed by one body can be invested up to a maximum of 35% (of the total fund value).

All investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by any one body can be invested up to a maximum of 35% (of the total fund value).

That all investments in units or other shares of the investments subject to the trusts of unit trust schemes and all investments in open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body can be invested up to a maximum of 35% (of the total fund value).

That any single insurance contract investment can be made up to a maximum of 35% (of the total fund value).

Investment strategy will continue to be kept under constant review.

2.3 Risk

There are various risks to which any pension scheme is exposed. The Council has considered the following risks:

- The primary risk is that arising through a mismatch between the Fund's assets and its liabilities.
- The risk of deterioration in the Fund's ongoing funding level.
- The risk of a shortfall of assets, relative to the liabilities as determined if the Fund were to be wound up.
- The risk that the day-to-day management of the assets will not achieve the rate of investment return required to meet accrued and future liabilities as quantified by the Actuary to the Fund.
- The risk of active managers underperforming their benchmarks.

The potential risk concerning underperformance is relatively low given that the majority of the Fund's holdings are in passive tracker funds.

In addition, the Council recognises the different types of risk and seeks to minimise them as far as possible by regular monitoring of the performance of all fund managers. It also seeks advice from the Actuary and investment advisors on the suitability of the assets with regard to the Fund's liabilities and ensuring the portfolio is suitably diversified.

3. DAY TO DAY MANAGEMENT OF THE ASSETS

3.1 Main Assets

The Council invests the main assets of the Fund according to the agreed allocation of assets in a series of portfolios as follows:

- UK Index-Tracking (passive) Equities (segregated portfolio)
- UK Index Tracking (passive) Bonds portfolio (pooled)
- Overseas (Passive) Equities (fixed weight, pooled funds)
- Private Equity (limited partnership)

The Council employs more than one manager to limit the risk to the Fund as a whole should any one manager under-perform. The Council's policy on apportioning assets is also to seek further diversity of risk by maintaining a spread of equity portfolios. Assets are currently distributed within set parameters and a target distribution for 2005/6 was as follows:

Investment Manager	Investment Mandate	% of Fund
Hermes Investment Management	Passive UK Equities	59.0
	Passive UK Bonds	7.0
F & C Asset Management	Ethical UK Equities	2.0
UBS Global Asset Management	Passive Overseas Equities	28.0
Pantheon Ventures	Private Equity	2.0
Not decided	Active Property Fund	0.5
In-house	Cash LIBID 7 day notice	1.5

3.2 Asset Allocation Guidelines

The main investment managers have been set the following benchmarks:

Hermes Investment Management

Asset	Weighting %	Benchmark
UK Equities- Passive	100	FTSE 350
UK Bonds - Passive	100	FTSE Gilt Edged All Stocks

F&C Asset Management

Asset	Weighting %	Benchmark
Ethical UK Equities	100	70% FTSE Allshare (exFTSE 100; Investment Trusts 30% FTSE 100)

This holding has subsequently been sold.

UBS Global Asset Management (UK) Ltd

Asset	Weighting %	Benchmark
North America	34	FTSE AW USA
Europe ex UK	34	FTSE Europe (ex UK) Index-Developed Series
Japan	14	FTSE AW Japan
Pacific ex Japan	18	FTSE AW Pacific (ex Japan) Index- Developed Series

In order for the Council's overseas equities exposure to be brought into line with the target allocation, the Council, having taken appropriate advice, decided to increase its holdings with UBS Asset Management. This is for an unlimited period of time, is consistent with the Council's Investment Strategy and the increase complies with the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2003, and resulting from this the Sub-Committee has formally agreed to increase the allowable limit for any single insurance contract to 35%.

Pantheon Ventures

Asset	Weighting %	Benchmark
Private Equity	100	No specific benchmark

3.3 Investment Performance Benchmark

The managers' performances are compared to the relevant benchmarks.

The performance objective for each manager is: -

Hermes Investment Management: For the UK equity index-tracking fund, to replicate the returns on the benchmark index within a maximum tracking error of plus or minus 0.2%.

For the UK Bonds index-tracking fund, to replicate the return on the FTSE All Stock Gilt Index within a maximum tracking error of plus or minus 0.15%.

UBS Global Asset Management (UK) Ltd: The Fund to replicate the return on specific benchmark indices within a tracking error of plus or minus 0.25% for USA and Japan, and plus or minus 0.5% for Pacific ex Japan and Europe ex UK.

Pantheon Ventures: It is expected that over the long term it will outperform the All-Share Index.

F & C Asset Management: Out-perform the benchmark by 1% p.a.

Property: Fund Manager and objective to be agreed.

3.4 Fees

Fees for the investment managers are related to the assets under management. In the case of the Pantheon Ventures there is also a performance-related element to the fee, again based on the assets under management.

3.5 Additional Assets

Assets in respect of members' additional voluntary contributions are held in various separate investments administered by Prudential Assurance Company Limited.

3.6 Realisation of Investments

In general, the Fund's investment managers have discretion in the timing of realisations of investments and in considerations relating to the liquidity of those investments.

The Fund's investment managers have responsibility for generating cash for investment in new assets and shortfalls in revenue expenditure of the Fund as may be required from time to time. The Council decides (with the advice from its investment managers and investment advisers) on how investments should be realised for cash.

3.7 Monitoring the Investment Managers

Performance of the investment managers is measured by The WM Company. The Council's officers meet the investment managers regularly to review their actions together with the reasons for investment performance. Managers are invited to attend the Pensions Sub-Committee meetings on a regular basis. Mercer Investment Consulting and the Fund's independent adviser are retained to assist the Council in fulfilling its responsibility for monitoring the investment managers.

The Sub-Committee meets on a quarterly basis to review and monitor performance with one of the managers attending on a rota basis; the officers and advisers also meet with managers on a regular basis to review progress and performance.

3.8 Sub-Committee Arrangements

As an administering pension authority, the Council discharges its duties in respect of maintaining the Pension Fund in the form of the Pensions Sub-Committee. Its terms of reference are to deal with all matters relating to the investment of the Council's Pension Fund.

The Pensions Sub-Committee is made up of six voting Members of the Council, a non-voting pensioner representative and a non-voting employee representative. In addition, officers and the Council's external advisers support the meeting. The Sub-Committee is scheduled to meet on at least four occasions during the 2006/07 Municipal Year and formal minutes are taken and acted on accordingly.

4. CUSTODY

For the additional security of the invested assets, the Council employs The Bank of New York as an independent custodian for its segregated UK equity holdings. J P Morgan acts as the independent custodian for the overseas equities held by UBS Global Asset Management Limited. The other holdings of the Fund are in pooled arrangements where the custodian is determined by the investment manager.

5. SOCIALLY RESPONSIBLE INVESTMENT AND CORPORATE GOVERNANCE

The Council recognises the need for a policy of socially responsible investment. To this end officers intend to include a section in the equity tender questionnaire relating to Corporate Governance and Engagement issues. The quality of responses from prospective fund managers will form part of the scoring criteria for each tenderer.

In addition there will be a requirement that the fund manager complies with the Institutional Shareholders Committee Statement of Principles which identifies in some detail how they should discharge their responsibilities.

The Fund is also a member of the Local Authority Pension Fund Forum (LAPFF). A major aim of the LAPFF is to further extend and influence corporate governance issues. Membership of the Forum allows the Council to maximise its influence as a shareholder, in a shared approach with other authorities, in issues such as board structures, remuneration, shareholder rights and audit in a way that would not otherwise be possible.

It is the view of officers and the advisers that this is an extremely cost effective way of fulfilling part our commitment to activism.

Allied to shareholder activism is the need to ensure that the Pension Fund has a comprehensive voting policy, which reflects the socially responsible investment issues, supported recommend the votes cast by the Sub-Committee. To this end the Sub-Committee has appointed PIRC (Pensions Investment Research Consultants), to recommend the votes cast on the Council's behalf according to their voting guidelines. It is the view of officers that, as a consequence of membership of PIRC, the Council's voting policy is probably one of the most comprehensive of local authorities in the country.

The Council has determined that dialogue and a proactive engagement with companies is the most effective way of influencing companies in relation to social, environmental and business policies whilst at the same time achieving financial returns compatible with the fund's longer term financial objectives.

The Council requires the UK investment manager to vote on the shares attached to their holdings whenever possible. Guidance as to voting policy has been given to the managers, via PIRC, which reflect the latest approach to corporate governance issues; this is reviewed on a regular basis.

6. EXPECTED RETURN ON INVESTMENTS

The Council made a decision in 2005/6 to move towards an equity/non equity split of 75% equities and the balance being bonds and property, the detail of which can be found in paragraph 2.2 of this statement. The asset allocation of the Fund will, however, be kept under constant review and may be changed from time to time, and any major changes will be reflected in an updated version of this Statement.

7. PRINCIPLES FOR INVESTMENT DECISION MAKING

Detailed below is the extent of the Council's compliance with the ten investment principles contained in the CIPFA document "Principles for Investment Decision-Making in the Local Government Pension Scheme in the UK."

Within these Principles, the term "Trustee" is used from time to time.

When considering advice and determining investment policy, the Council's Pensions Sub-Committee are effectively acting as Trustees. As such, they have responsibilities additional to those carried out as elected members of the Council. Their duties as "Trustees" are to manage the Fund in accordance with the Local Government Pension Regulations and to do so prudently and impartially.

Typically, Members discharge their duty by ensuring that they have a systematic and clear way of agreeing their investment policy with the managers and advisers they employ.

8. COMPLIANCE WITH THIS STATEMENT

The Council will monitor compliance with this Statement annually.

9. REVIEW OF THIS STATEMENT

The Council will review this Statement in response to any material changes to any aspects of the Fund, its liabilities, finances and the attitude to risk which they judge to have a bearing on the stated investment policy.

This review will also occur no less frequently than every three years to coincide with the actuarial valuation. Any such review will again be based on written expert investment advice.

Statement of Compliance – Myners’ Investment Principles

Principle 1 - Effective Decision Making

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part No			
✓		<p>Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.</p>	<p>All investment decisions are taken either by the Pensions Sub-Committee which is responsible for the ‘Management of the Council’s Pension Fund’ or by the Director of Finance and Resources under his delegated powers.</p> <p>In addition to the Director of Finance and Resources, the Sub-Committee is advised by experienced Council officers and external advisers (one being appointed by Mercer Investment Consulting and the other entirely independent).</p> <p>All voting members of the Sub-Committee are Councillors with a wide range of expertise including investment and accountancy. In addition to the Councillors, the Sub-Committee also includes representatives of the staff and pensioners. Collectively, the Sub-Committee has all the skills necessary to properly carry out their investment responsibilities.</p> <p>Councillors, officers and advisers are given training opportunities, to ensure that their expertise remains up to date. Several members of the Sub-Committee have attended specific training seminars.</p>	<p>Training will continue to be offered to all members of the Pensions Sub-Committee. Training requirements will be assessed during the year.</p>
✓		<p>Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.</p>	<p>None of the Fund’s assets are managed in-house and current staffing levels are sufficient in number and qualifications to support the Sub-Committee in their investment responsibilities.</p> <p>The voting members of the Sub-Committee are in receipt of agreed allowances for Councillors.</p>	
✓		<p>It is good practice for trustee boards to have an investment sub-committee to provide appropriate focus.</p>	<p>The London Borough of Croydon has appointed a Pensions Sub-Committee whose terms of reference are the “Management of the Council’s Pension Fund”.</p> <p>Whilst considering some benefits and administration issues, the Sub-Committee spends almost all its time considering investment matters.</p> <p>The Sub-Committee meets 4/5 times per year and the structure and processes are appropriate for carrying out their role effectively.</p>	

Principle 1 - Effective Decision Making (continued)

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
	✓		Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively.	All voting members of the Sub-Committee are Councillors with a wide range of expertise including investment, accountancy, actuarial and administration of benefits. Collectively, the Sub-Committee has all the skills necessary to carry out their investment responsibilities properly with training.	Training will be provided to new members of the Sub-Committee.
✓			They should draw up a forward-looking business plan.	There has always existed a forward-looking Business Plan as regards monitoring performance and the management of the pension section. A three year rolling business plan is agreed on an annual basis.	

Principle 2 - Clear Objectives

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
✓			Trustees should set out an overall investment objective for the Fund that:	See section 2 of the Statement of Investment Principles (SIP).	
✓			<ul style="list-style-type: none"> Represents their best judgement of what is necessary to meet the Fund's liabilities, given their understanding of the contributions likely to be received from employer(s) and employees; and 	See section 2.1 of the SIP.	
✓			<ul style="list-style-type: none"> Takes account of their attitude to risk, specifically their willingness to accept under performance due to market conditions. 	See section 2.3 of the SIP.	
✓			<ul style="list-style-type: none"> Objectives for the overall Fund should not be expressed in terms which have no relationship to the Fund's liabilities, such as performance relative to other Pension Funds, or to a market index. 	See sections 2 and 3 of the SIP. The Fund's objectives are reviewed annually, during the review of the Statement of Investment Principles.	

Principle 3 - Focus on Asset Allocation

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
✓			Strategic asset allocation decisions should receive a level of attention (and, where relevant, advisory or management fees) that fully reflect the contribution they can make towards achieving the Fund's investment objective	At both the Pensions Sub-Committee and the Advisers/ Officers level, strategic asset allocation is discussed, either in the context of performance monitoring or arising from a specific Officer report. The full range of investment opportunities is considered.	Continue to consider and review asset allocation policy.
✓			Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity. Asset allocation should reflect the Fund's own characteristics, not the average allocation of other Funds.	Since the last Annual Report was published, the Pensions Sub-Committee has continued to consider the issue of risk versus performance in respect of the Pension Fund's ongoing 100% equity stance. It has agreed that the medium term investment strategy of the Fund should be a median of 75% equities, with the balance allocated to bonds and property. This strategy is being phased over the period 2005-2008. As part of this review, the Pensions Sub-Committee have considered all major asset classes including bonds and property and further investment in private equities.	The review of all asset types will continue.

Principle 4 - Expert advice

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
✓			Contracts for actuarial services and investment advice should be opened to separate competition.	The Council appointed William M Mercer Limited to provide both actuarial services and investment advice. The two services were tendered as a package but Officers and Members were satisfied that the services offered separately were individually the best available. The services are now provided by two totally separate specialist teams of William M Mercer – Mercer Investment Consulting and Mercer Human Resource Consulting. Officers are satisfied that there is no conflict of interest between the providers of the two services. The Fund pays sufficient fees to attract interest from all the major actuarial/investment practices and to ensure that a high quality service continues to be provided. In addition, the Council has appointed Mr Valentine Furniss as an independent adviser. Mr Furniss has a wealth of experience in the investment field and is an adviser to several other local authority Pension Funds.	
✓			The Fund should be prepared to pay sufficient fees for each service to attract a broad range of kinds of potential providers.		

Principle 5 - Explicit mandates

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future	
Full	Part	No			
✓			Trustees should agree with both internal and external investment managers an explicit written mandate covering agreement between trustees and managers on:	Investment guidelines are included in the investment management agreements which include investment objectives, restrictions and performance measurement.	
✓			An objective, benchmark(s) and risk parameters that together with all the other mandates are coherent with the Fund's aggregate objective and risk tolerances;	These are included in investment management agreements and are consistent with the Fund's aggregate objectives and risk tolerances.	
✓			The manager's approach in attempting to achieve the objective; and	Assessed at tender stage and reviewed as appropriate	
✓			Clear timescale(s) of measurement and evaluation, such that the mandate will not be terminated before the expiry of the evaluation timescale for under performance alone.	Performance evaluation is based on a long term basis reflecting the volatility of equities. Managers are given sufficient time to meet the required performance standards.	
✓			The mandate and trust deed and rules should not exclude the use of any set of financial instruments, without clear justification in the light of the specific circumstances of the Fund.	Permissible financial instruments are governed by legislation.	
✓			Trustees, or those to whom they have delegated the task, should have a full understanding of the transaction-related costs they incur, including commissions. They should understand all the options open to them in respect of these costs, and should have an active strategy – whether through direct financial incentives or otherwise – for ensuring that these costs are properly controlled without jeopardising the Fund's other objectives.	UBS and Hermes have provided Level One disclosures (a statement of transaction practices) and Level Two disclosures (client specific data).	To continue to monitor disclosure adherence by the Fund Managers.
✓			Trustees should not without good reason permit "soft commissions" to be paid in respect of their Fund's transactions.	No "soft commissions" are paid.	

Principle 6 - Activism

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No		
	✓		<p>The Council's external Fund Managers have been advised of the Sub-Committee's revised voting policy and are expected to adhere to it. They are also expected to follow the principle of the Bulletin which has now, in effect, been superseded by the "The Responsibilities of Institutional Shareholders in Action".*</p> <p>Hermes and UBS have provided Statements of their Corporate Governance and Voting Policies. Most UK shares are voted on. In respect of overseas equities, in most instances UBS vote on the Pension Fund's investments in accordance with their voting policies.</p>	<p>The Council's voting policy will continue to be reviewed to ensure that current developments in corporate governance are considered.</p>
	✓		<p>Trustees should also ensure that managers have an explicit strategy, elucidating the circumstances in which they will intervene in a company; the approach they will use in doing so; and how they measure the effectiveness of this strategy.</p>	<p>The Council's policy on Social Responsible investment is identified in paragraph 5 of the SIP. The voting guidelines were reviewed during the year to keep in line with current corporate governance issues. The UK Fund Manager for the tracker fund is required to provide details of voting on a quarterly basis. Hermes and UBS confirm that they act in accordance with the requirements of "The Responsibilities of Institutional Shareholders in Action" *.</p>

Principle 7 - Appropriate Benchmarks

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No		
	✓		<p>Full consideration has been given to index benchmarks and their impact on investment strategies. The benefits to be gained from active or passive management are regularly considered and, where active management has been chosen, targets and risk controls have been set to reflect the potential to achieve higher returns. This is currently being done through private equity funds.</p> <p>The agreed benchmarks are stated in Section 3 of the Statement of Investment Principles.</p>	<p>The Fund Strategy has been reviewed and the Pensions Sub-Committee will be agreeing revised asset allocations during the current year.</p>

Principle 7 - Appropriate Benchmarks (continued)

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No		
✓				
		<p>Consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned; and</p> <p>Where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving managers the freedom to pursue genuinely active strategies.</p>	<p>Where active management has been chosen, targets and risk controls have been set to reflect the potential to achieve higher returns. This is currently being done through private equity funds.</p>	

Principle 8 – Performance Measurement

Compliance		Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No		
✓				
		<p>Trustees should arrange for measurement of the performance of the Fund and make formal assessment of their own procedures and decisions as trustees.</p> <p>They should also arrange for a formal assessment of performance and decision-making delegated to advisers and managers.</p>	<p>The Fund's managers provide full reports on performance on a quarterly basis. The managers' performance and the Fund's overall performance are measured quarterly and annually by The WM Company and reported regularly to the Pensions Sub-Committee.</p> <p>An assessment was formerly undertaken in 2004/05 and a detailed report was submitted to the Pensions Sub-Committee.</p>	<p>A similar review will be undertaken on an ongoing basis in future years.</p>

Principle 9 – Transparency

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
✓			<p>A strengthened Statement of Investment Principles should set out:</p> <ul style="list-style-type: none"> • Who is taking which decisions and why this structure has been selected; <p>The Fund's investment objective;</p> <ul style="list-style-type: none"> • The Fund's planned asset allocation strategy, including projected investment returns on each asset class, and how the strategy has been arrived at; • The mandates given to all advisers and managers; and • The nature of the fee structures in place for all advisers and managers, and why this set of structures has been selected. 	<p>See the Statement of Investment Principles on pages 9 to 15 of this report.</p>	<p>The Council's Statement of Investment Principles is reviewed on an annual basis and amended with any significant changes.</p>
✓					
✓					

Principle 10 - Regular reporting

Compliance			Principle	How the Principle is Met	Plans to meet the Principle in the future
Full	Part	No			
✓			<p>Trustees should publish their Statement of Investment Principles and the results of their monitoring of advisers and managers. They should send key information from these annually to members of these Funds, including an explanation of why the Fund has chosen to depart from any of these principles.</p>	<p>The Statement of Investment Principles, key performance information and comments on strategy are included in the Annual Scheme Report, a copy of which is sent to all Scheme members. It is also available on the Council's website.</p>	

* "The Responsibilities of Institutional Shareholders and Agents – Statement of Principles" has been drawn up by the Institutional Shareholders' Committee (members – ABI, NAPF and IMA) to set out best practice for institutional shareholders and/ or agents to identify their responsibilities in respect of investee companies. The Fund Managers appointed by the Council have been appointed to act on its behalf.

Fund Investment Commentary & Performance

General

During 2005/06, local authority pension funds enjoyed an average gain in value of 24.9%. This was well above CPI inflation and average earnings growth of 1.8% and 3.8% respectively.

2005/06 was a good year for equities in the major markets including returns of 28% in the UK, 36% in Europe, 48% in Japan and 24% in North America. Equity returns were significantly above the UK bonds positive return of 7.4%.

Strategy

During the year, the Fund began its phased movement towards a 75% equity 25% non-equity split of investments. The major change was to move 4.7% of funds from UK equities into UK Gilts. The investment in UK equities of 64% of the Fund's value showed a decrease compared with the previous year. The 29% invested in overseas equities is higher than the 2003/04 figure. The intention is to move towards a target of 60% in the UK and 40% overseas when suitable market conditions arise.

As described in paragraph 2.2 of the Statement of Investment Principles, the Pensions Sub-Committee agreed the medium term investment strategy of the Fund should be a median of 75% in equities with a move to this strategy to be phased over the period 2005-2008.

Performance

The Fund's performance is compared with the Council's own customised benchmarks. It is also compared to the average return from 88 local authority pension funds with a combined asset value of £118bn.

Whilst local authority funds as a whole saw the value of their investments increase significantly during the year, the performance of the Council's Fund was particularly encouraging. The excellent positive return of 27.9% was above the average return of 24.9%. This is the third year in a row that the Council's Fund has outperformed the average.

This good performance was due to the decision to remain with the Fund's bias towards holding equities at a time when equity markets have been rising. The result was that the Fund was again one of the best performers of all Local Authority Pension Funds in the country.

The disappointing returns in past years is one of the factors (together with the greater life expectancy of pensioners) to have had an impact on the funding position of the Fund. However, the performance during 2005/06 has resulted in an improvement compared to the corresponding figures published last year. Over the last 3 years the Fund has now returned 22.9% per year which is ahead of the local authority average of 19.9%

The assets of the Fund have grown over the last 10 years from £280m to £501m, an increase of 79%.

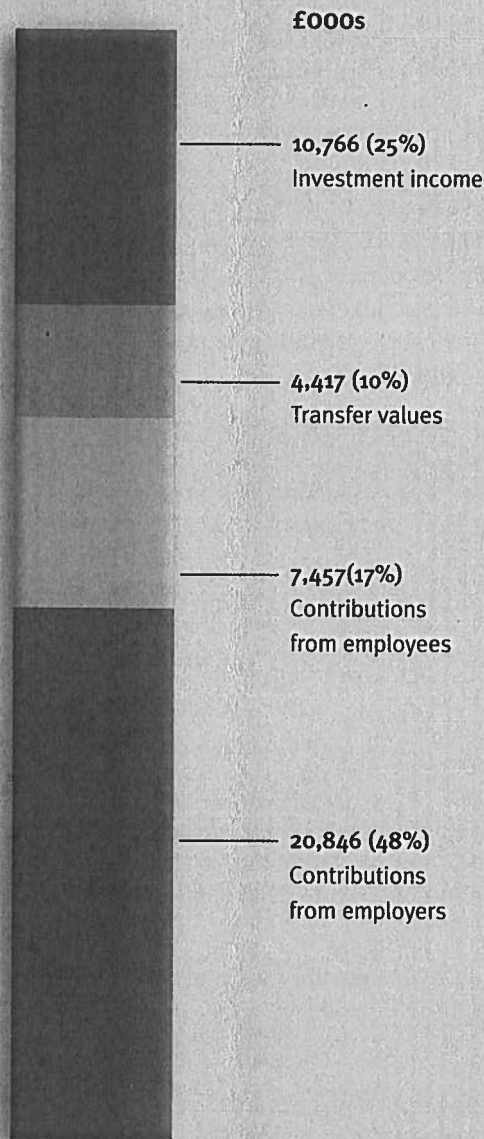


Nathan Elvery, Director of Finance and Resources, receiving the Pension Fund of the Year Award 2005

Income and Expenditure

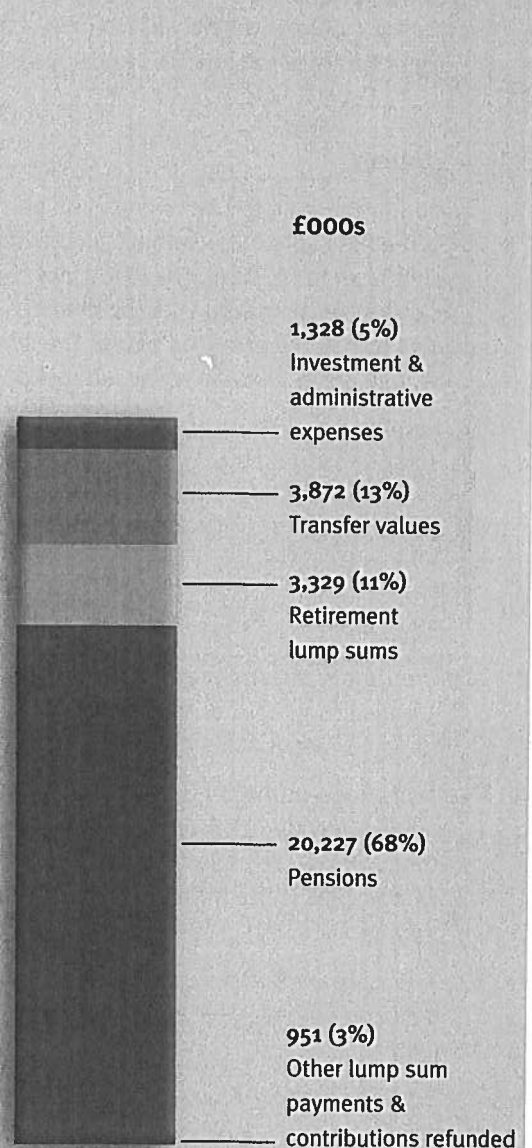
Income

Income during the year
totalled **£43.5 m**



Expenditure

Expenditure during the year
totalled **£29.7 m**



There was a net cash inflow during the year of **£13.8m**.

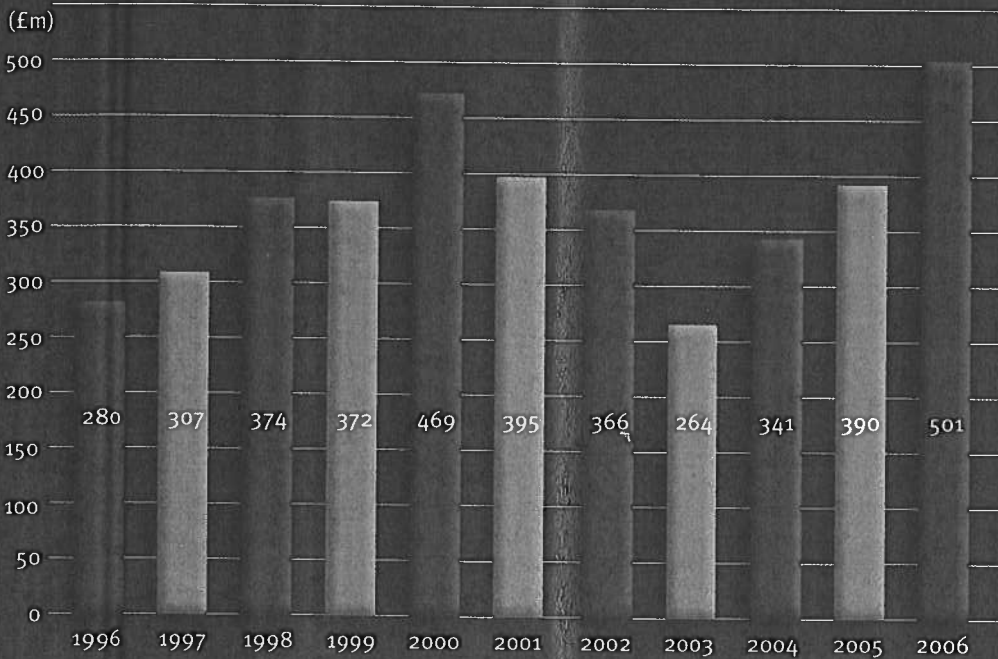
Employee and employer contributions to the Scheme during the year were:

- Employee contributions - 6% of contributory pay, although some employees retain the right to contribute at 5% of earnings;
- Employer contributions - 17.5% of contributory pay for the major employer.

Pensions are increased each April and are based on the movements in the RPI for the twelve months ending the previous September. For April 2005, this was 3.1%, and for the current year, it is 2.7%.

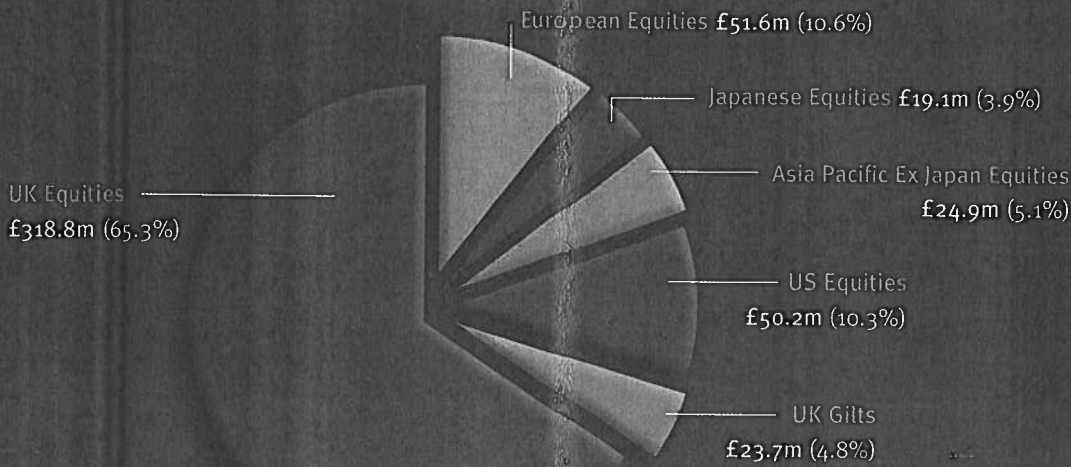
Movement of Fund

The net assets of the Fund at 31 March 2006 were £501 million compared with £280 million at 31 March 1996. The chart below shows the growth of the Fund's assets over the past ten years.



Investments

As at 31 March 2006 the market value of the equity and gilts investments held was £488 million. An analysis of these investments is shown below:



	£m	%
Market Value of Investments	488.3	97.4
Add Net Current Assets	12.9	2.6
Net Assets	501.2	100.0

Statistics 2005/2006

Fig 1. Returns 2005/2006

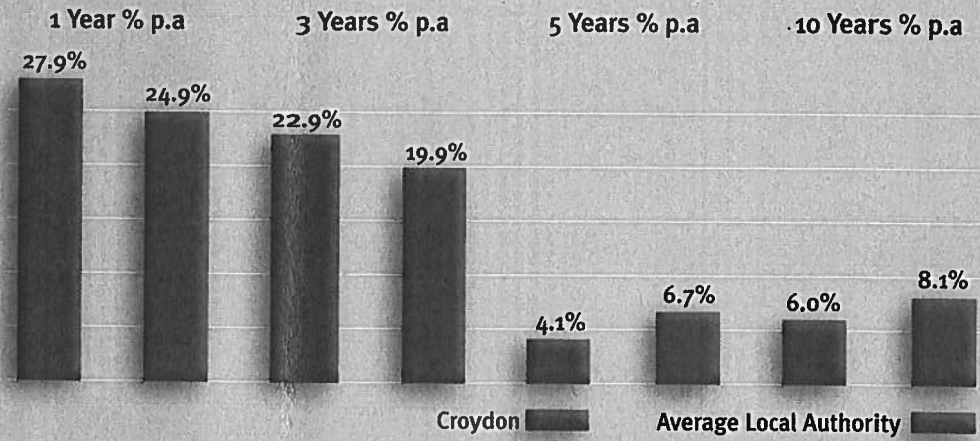


Fig 2. Markets 2005/2006

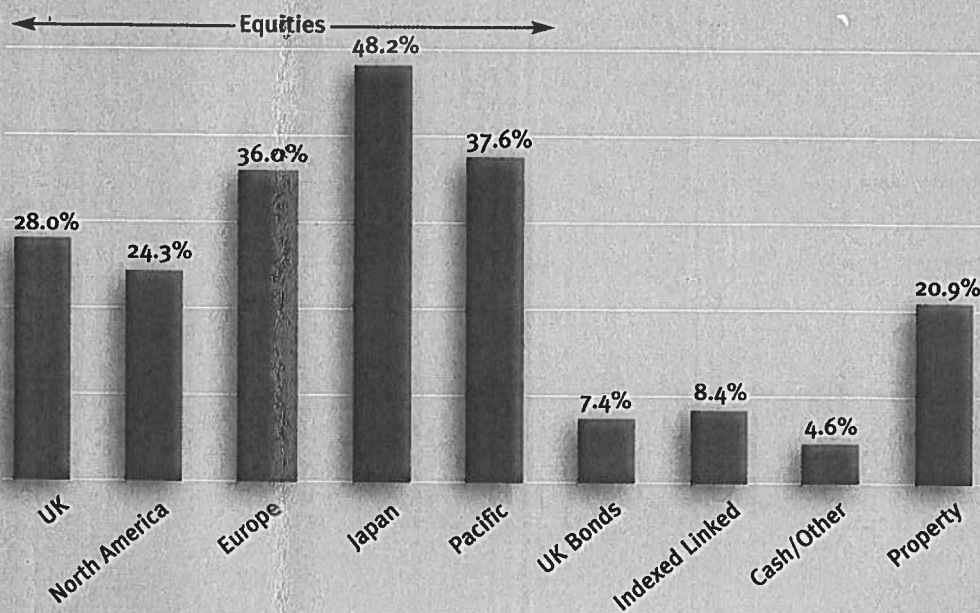
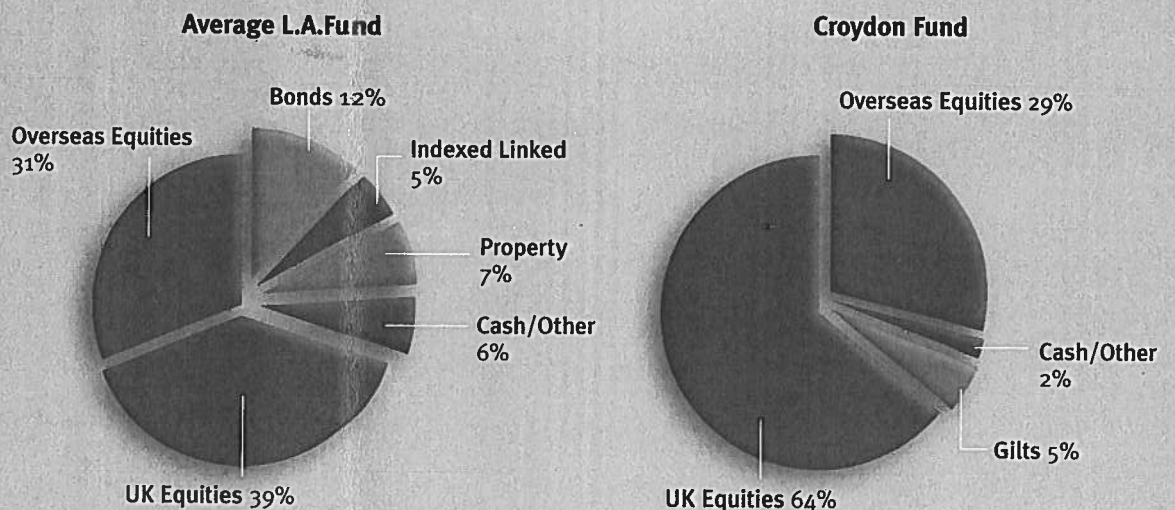


Fig 3. Asset Distribution



Data Source: WM Company/Annual Accounts

Top 25 UK Holdings

	Market Value at 31 March 2006	% of Total U.K. Equity Investment
	£'000	%
BP	24,699	7.7
ROYAL DUTCH SHELL	22,280	7.0
HSBC HOLDINGS	19,828	6.2
GLAXOSMITHKLINE	15,746	4.9
VODAFONE GROUP	13,396	4.2
ROYAL BANK OF SCOTLAND	10,831	3.4
ASTRAZENECA	8,381	2.6
BARCLAYS	7,826	2.5
HBOS	6,727	2.1
ANGLO AMERICAN PLC	5,958	1.9
RIO TINTO	5,672	1.8
LLOYDS TSB GROUP	5,524	1.7
DIAGEO	5,124	1.6
BHP BILLITON	4,733	1.5
TESCO	4,668	1.5
BG GROUP	4,589	1.4
AVIVA	3,443	1.1
STANDARD CHARTERED	3,387	1.1
BT GROUP	3,372	1.1
UNILEVER	3,092	1.0
PRUDENTIAL	2,915	0.9
NATIONAL GRID	2,801	0.9
RECKITT BENCKISER	2,642	0.8
BAE SYSTEMS	2,433	0.8
SABMILLER PLC	2,296	0.7
	192,363	60.4

Fund Account

For the year ended 31 March 2006

	2005/06	2004/05
	£'000	£'000
Balance at 1 April at cost	317,394	300,109
Net income plus net realised gains for the year	28,247	17,297
Accumulated unrealised gains	155,573	72,100
Balance at 31 March at market value	501,214	389,506

Net Assets Statement

At 31 March 2006

	2005/06	2004/05
	£'000	£'000
Investments		
UK gilts	23,738	-
UK equities	318,769	268,047
Overseas equities (including unquoted limited partnerships)	145,773	108,718
	488,280	376,765
Current Assets		
Debtors	2,933	3,150
Bank balances	12,815	11,152
	15,748	14,302
Less Current Liabilities		
Creditors	2,814	1,561
Net current assets	12,934	12,741
Market value of Fund	501,214	389,506

A full set of the audited pension fund accounts are available on request from the Pensions and Treasury Management Section at Croydon Council on 020 8760 5768 (extn 62892).

Changes to the Local Government Pension Scheme Regulations 2006

Several changes have been made to the Local Government Pension Scheme with effect from April 2006.

People are generally living longer and receiving their pensions for longer. This is great news but it means that the cost of the Local Government Pension Scheme (LGPS) has risen.

The Government has, therefore, made changes to ensure that the scheme can remain affordable whilst still providing a good level of pension benefits for current and future employees.

Also, the tax rules that govern pension schemes have changed from 6 April 2006, allowing the LGPS to relax many of the contribution and benefit limits that previously applied.

The main changes are as follows:

Phasing out the '85 year rule'

The Government's legal advice is that the '85 year rule' will be in breach of Age Discrimination legislation which comes into force on 1 October 2006. For this reason the 85-year rule has been removed, but only in respect of benefits you build up in the future. The pension rights you have banked up to 30 September 2006 (or up to 31 March 2016 if you will be aged 60 or over by then) will not be affected and will continue to be calculated in the same way as if the changes had not been made.

The change to the 85 year rule will not affect you if you draw your pension at age 65, if you are retired on the grounds of permanent ill health at any age, or if you are retired on or after age 50 on the grounds of redundancy or efficiency of the service. Pension benefits in these circumstances continue to be paid at an unreduced rate.

Flexible retirement for employees from age 50

Flexible retirement is to be permitted at or after age 50, linked to a reduction in hours or grade agreed by the employer. Pensions paid will generally be actuarially reduced.

Exchanging part of your pension for extra lump sum

Taking AVCs as cash

If you pay additional AVC's via the LGPS you may elect to take up to 100% of the accumulated fund as a tax free lump sum providing you draw it at the same time as your LGPS benefits

Removal of 15% limit on employee contributions

You are able to purchase extra years of membership in the Scheme by paying additional pension contributions. However, the number of extra years that can be purchased is limited to 6 $\frac{2}{3}$ rd years.

Other changes

- you can join the scheme and remain in the Scheme up to two days before your 75th birthday.
- if you defer drawing your pension beyond age 65, your pension benefits will be actuarially increased.
- the ability to give up part of your pension to provide a dependant's benefit over and above the standard spouse's, civil partner's or child's pension has been removed.
- children's pensions coming into payment after 5th April 2006 for non-incapacitated children who are continuing in full time education or training will have to cease by age 23.
- the ability to convert some or all of the tax free lump sum paid to you on retirement into additional taxable pension is removed.

Further details can be obtained from the Pensions and Treasury Management Section at Croydon Council.

Further Information

1. **The Pensions Regulator**

Napier House
Trafalgar Place
Brighton
East Sussex BN1 4DW

Telephone Number: 0870 606 3636 (Monday to Friday 09.00-17.00)

Website: www.thepensionsregulator.gov.uk

The role of the Pensions Regulator has been set out by Parliament, and is to:

- Protect the benefits of members of work-based pension schemes;
- Promote the good administration of work-based pension schemes;
- Reduce the risk of situations arising which may lead to claims for compensation from the Pensions Protection Fund.

2. **The Pensions Advisory Service (TPAS)**

11 Belgrave Road
London SW1V 1RB

Telephone Number: 0845 601 2923

Website: www.opas.org.uk

TPAS is available to assist members of pension schemes with any difficulties that they are unable to resolve with their scheme administrators.

3. **The Pensions Ombudsman**

at the same address as TPAS

Telephone Number: 020 7834 9144

Website: www.pensions-ombudsman.org.uk

The Pensions Ombudsman can investigate and determine any complaint or disputes between scheme members and administrators, involving maladministration, or matters of fact or law.

4. **Pension Tracing Service**

The Pension Service
Tyneview Park, Whitley Road
Newcastle-upon-Tyne NE98 1BA

Telephone Number: 0845 600 2537

Website: www.pensionservice.gov.uk

The Pension Tracing Service can help ex-members of pension schemes, who may have lost touch with their previous employers, to trace their pension entitlements.

Scheme members should note that any enquiries or complaints can be sent in the first instance to Liberata, at the address shown on page 7.

If you are experiencing difficulties receiving information from your local scheme, these bodies will help you.

Queries relating to the Pension Fund investments can be made to the Pensions and Treasury Management Section at Croydon Council on 020 8760 5768 (ext 62892).