Strathclyde Pension Fund

ANNUAL REPORT & ACCOUNTS
FOR THE YEAR TO 31st MARCH 2004

www.spfo.org.uk

- Strathclyde Pension Fund is a pool into which employees' and employers' contributions and income from investments are paid, and from which pensions and other lump sum benefits are paid out in accordance with the provisions of the Local Government Pension Scheme.
- The Fund services the 12 Unitary Authorities in the west of Scotland together with over 200 other public sector bodies, large and small.
- Fund administration is carried out by the Strathclyde Pension Fund Office, for both the No.1 Fund (the main Fund) and also the No.3 Fund (Strathclyde Buses Fund). The Pension Fund was previously administered by Strathclyde Regional Council and was not subject to disaggregation on local government reorganisation, but transferred intact to Glasgow City Council at 1st April 1996.
- The investment assets of the Fund are externally managed.
- Investment policy and strategy are the responsibility of the Strathclyde Pension Fund Panel who take advice from the Investment Advisory panel and from the Fund's external consultants.

These are the 12 unitary authorities covering the Strathclyde area.

Argyll & Bute Council
East Ayrshire Council
East Dunbartonshire Council
East Renfrewshire Council
Glasgow City Council
Inverclyde council
North Ayrshire Council
North Lanarkshire Council
Renfrewshire Council
South Ayrshire Council
South Lanarkshire Council
West Dunbartonshire Council

Contents

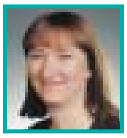
The Strathclyde Pension Fund Sub-Committee is a subsidiary panel of Glasgow City Council's Financial Services Committee.

The SPF Sub-Committee is responsible for all decisions concerning Pensions and Pension Fund Policy and Strategy.

The SPF Sub-Committee performs a role similar to that of the Trustee Board of a private sector pension fund.

SPF Sub-Committee Members

Councillor
Ruth Simpson
Convener



Councillor
Aileen Colleran

Councillor
Malcolm Cunning

Councillor
Eamon Fitzgerald

Councillor
John Lynch

Councillor
Robert MacBean

Councillor
John McKenzie

Bailie
Malcolm McLean

Councillor
James McNally

Councillor
John Mason

Councillor **Ruth Simpson**

Convener, Strathclyde Pension Fund Sub-Committee

Having assumed the convenership of the Sub-Committee immediately after the Council elections in May 2003 it has been my good luck to preside, so far, over a period of recovery in the fortunes of the Fund.

But having served on the committee throughout the previous three years of the bear market, I am acutely aware of the legacy which that period has left, both in terms of pressure on the funding position, and damaged public confidence in the pensions industry.

The funding position is heavily influenced by the state of the markets. But market direction is of course outwith our control. So, whilst short-term market performance forms the context against which we operate, the focus of our operations is on those elements we can control. On the investment side, the main focus of the Sub-Committee's attention during the year was the conclusion of the Fund's three-yearly review of investment strategy and structure. The "headline" changes agreed as the culmination of the review were not radical: a modest reduction in equity exposure within the strategy; and one new manager within the structure. But the review process was extremely rigorous and thorough, and with a large amount of fine-tuning within the details of the mandates.

The effectiveness of these decisions may not be clear for some time, so what must be clear is that they have been taken properly. The 2001 Myners report set new standards for pension fund decision-making. The Strathclyde fund has always endeavoured to conform with best practice in this and other areas. With the adoption in the current year of a formal "Trustee" Training Plan and Business Plan, the fund now complies with all of the Myners principles. As a result of recent difficulties, it is likely that governance will continue to be a burning issue for the pensions industry and will remain high on the agenda of the sub-committee. Working with the Director of Financial Services we will ensure that the Strathclyde fund's governance continues to develop and that the highest standards, processes and levels of transparency are maintained.

Investment Advisory Panel Members

Neil Hood CBE: Professor of Business Policy at Strathclyde University
Angus Mathieson: Director + Chairman of Strathaird Investments
Ronnie Bowie: Senior Partner, Hymans Robertson
Caroline Burton: Investment Adviser

The Investment Advisory Panel is responsible for monitoring the performance of the Fund and each of its investment managers.

Investment Managers

Legal & General
Schroders
Gartmore
Genesis
Baillie Gifford
Pantheon Private Equity Specialists
Capital International
Henderson Global Investors
Aberdeen Property Investors
JPMorgan Fleming Asset Management
Western Asset

Other Service Providers

Actuaries

Hymans Robertson

Solicitors

Glasgow City Council - Legal Services

Nabarro Nathanson

Advisers

Hymans Robertson

Valuers

Colliers CRE

Auditors

Audit Scotland

Global Custodian

Northern Trust

Performance Measurement

WM Co.
Northern Trust
Investment Property Databank

AVC Provider

Prudential

Lynn Brown

Director of Financial Services

Joining Glasgow in September 2003 as director of Financial Services, it was immediately apparent that it was, to say the least, a very interesting point at which to take responsibility for one of the UK's largest pension funds.

On a positive note, equity markets had been rising for six months and continued to do so for the remainder of the year, having finally broken out of the downward spiral into which they had been locked for three years. The impact on the Fund of this market recovery was very significant: the most salient feature of this year's accounts is a gain in market value of over £1 billion. Full details are in the investment report.

Against this background, the main investment activity during the year was the implementation of various changes agreed by the Fund's Sub-Committee as the culmination of the Fund's three-yearly review of investment strategy and structure. Implementation took the form of a major transition exercise which involved trading more than 1,800 lines of stock in 23 countries and with an aggregate value of £1.7 billion. The process was completed quickly and at minimal cost with the use of a specialist transition manager working alongside the Fund's appointed investment managers.

Away from the vicissitudes of the investment markets, the administration functions of the Strathclyde Pension Fund Office tend to operate against a more stable background. Change is currently afoot, however, as the last year has seen the Pensions Bill and the "Stocktake" review of the Local Government Pension Scheme progress towards new legislation and regulation respectively. We have participated actively in all stages of the debate and consultation surrounding the "Stocktake" review. As it moves towards its conclusion, and the likely amendments to the Scheme regulations become clearer, we have been busy assessing the implications of the SPFO itself and for Scheme members. As such we have, through the various strands of our Communications Strategy, endeavoured to ensure that members are made aware of the prospective changes as early as possible.

Again, whilst the context for Scheme administration may be changing, our attentions have remained focused on the job in hand. The performance figures in the Administration Report may seem less dramatic than the investment returns, but the story they tell is no less compelling. Operational performance has been rising for years and showed further significant improvement in all key measurables this year. Combined with our commitment to staff training, we are confident that both the efficiency and the quality of the service which we deliver to scheme members are currently higher than they have ever been.

Pension funds continue to operate in a very difficult environment. And challenges remain. But progress made in the last year means that the Strathclyde Pension Fund is well placed to rise to them from a position of relative strength.

Lynn Brown

Administration Report

Introduction

Strathclyde Pension Fund Office (SPFO) is a division of Glasgow City Council's Financial Services department. SPFO administers The Local Government Pension Scheme (LGPS) on behalf of the twelve unitary authorities situated in the former Strathclyde area, and for over 200 other employing bodies. In addition, SPFO administers the Police and Fire Pension Schemes on behalf of Strathclyde Police Force and Strathclyde Fire Brigade and pays Teachers Compensation payments under the Scottish Teachers Superannuation Scheme in conjunction with the Scottish Public Pensions Agency.

The LGPS is a traditional final salary scheme where benefits are generally related to the member's length of scheme membership and average pay during the final year of membership.
Scheme benefits are defined by statute and are not dependent on investment performance or prevailing market conditions, therefore providing a secure pension scheme with little or no risk to members' benefits. As part of the ongoing "Stocktake" review of the Local Government Pension Scheme, the Government has reaffirmed its commitment to the LGPS remaining as a final salary scheme.

Membership

As at 31st March 2004, membership of the Fund comprised over 87,000 active members, almost 21,000 deferred members, and a pension payroll which consisted of almost 57,000 LGPS pensioners and dependants. A full reconciliation of LGPS member numbers is presented in the table on page 8. In addition, SPFO pays almost 15,000 Police, Fire and Teachers Scheme pensions.

Service Delivery Update

In the drive to continually improve the level of service delivery to members, dependants, employers and all other stakeholders, the following actions have been undertaken in the year to 31st March 2004.

ADMINISTRATION SECTIONS: The three administration sections within the Pension Fund Office deliver the full range of benefit calculation services to the membership of the Local Government, Police and Fire Pension schemes. The statistics in the operational performance table highlight the performance improvements achieved by these sections during the year 2003/04. In addition, the performance of these sections provides the basis for the data used in the PALS and CIPFA benchmarking clubs in which SPFO participates. Draft results from the CIPFA benchmarking club are covered in the performance section.

COMMUNICATIONS SECTION: The Communications Section is responsible for implementing the Communications Strategy, with the objectives of ensuring member access to all necessary information, raising awareness of the LGPS among employees and employers, and encouraging employees to consider the importance of long term financial planning in relation to pension provision. Details of Communications activities are contained in the Communications Report.

TECHNICAL SECTION: The Technical Section provides systems support and maintenance - ensuring that new system developments are tested and implemented, that system integrity and availability is maintained and that pensions legislation is interpreted and implemented.
The section is anticipating a substantial increase in workload associated with amendments to the Local Government Pension Scheme scheduled for April 2005 and April 2006 and a major update to the pensions administration software due in 2004/05.

PENSIONS PAYROLL: Continuity of income from employment to retirement for members has always been a priority for the Fund, and the Pensions Payroll Section is committed to ensuring that members receive prompt and accurate payment of pension and lump sum benefits. During the year to 2004 pensions payroll has been preparing for Electronic Data Interchange (EDI) as part of the drive by the Inland Revenue to accept data electronically. It is anticipated that this exercise will be completed in 2004/05.

Staff Development

In pursuit of continuous improvement in service delivery through the development of knowledgeable and skilled staff, Strathclyde Pension Fund remains committed to ensuring that all staff gain a nationally recognised qualification in pensions administration as an assessment of competence.

As at 31st March 2004 thirteen members of staff had gained a Diploma in Pensions Management from the Institute of Payroll and Pensions Management (IPPM). A further five staff were currently studying to gain this qualification. In addition, thirty-four staff had gained the IPPM Advanced Certificate in Pensions Administration, with a further twenty-three staff currently undertaking this course.

Administration Developments

BENEFIT STATEMENTS: During 2003/04 the planned issue of Benefit Statements to one-third of the LGPS membership on a three-year rolling basis continued with the issue of statements to the employees of the following:-

Argyll & Bute Council, East Ayrshire Council, North Ayrshire Council, South Ayrshire Council, West Dunbartonshire Council, East Dunbartonshire Council, Inverclyde Council and also Scottish Enterprise, Scottish Water Strathclyde Police, Strathclyde Fire.

Amendments to the Local Government Pension Scheme, applicable from April 2005, will require administering authorities to issue Benefit Statements to live and deferred members on an annual basis. In preparation for this amendment it is intended that a Benefit Statement will be issued to all live scheme members towards the end of 2004 and thereafter to both live and deferred members on an annual basis.

DOCUMENT IMAGING: Strathclyde Pension Fund has completed the process of scanning all live and deferred member files onto its Document Image Processing System (DIPS). Work on transferring approximately 72,000 pensioner member files is due to commence during 2004/05.

OPERATIONAL PERFORMANCE: Work within SPFO is managed and monitored through the Task Management Workflow System, a subsystem of the AXISe pensions administration system.

Operational performance is monitored and reported at several levels within SPFO from Team through to Senior Management level. Performance also forms the basis of a quarterly report to the Pension Fund Sub-Committee. SPFO also participates in the PALS and CIPFA benchmarking clubs to compare its own operational performance with that of other local authority funds and large private sector schemes. Performance within the PALS group has been very satisfactory - results for 2003/04, once available, are expected to continue this trend. 2003/04 results form the CIPFA benchmarking club are similarly satisfactory. The “headline” unit cost figure for Strathclyde Pension Fund at £14.75 per member is significantly below the average cost of £21.38 per member across all participating funds. Service standards also reported as part of the benchmarking exercise demonstrate that SPFO’s target turnaround times are amongst the most challenging within the club, and attainment against target compares favourably against all other participants.

A summary of performance for the main operational activities, including comparison with 2002/03, is presented in the table below.

Comparison of the total number of processes logged through the administration system over the previous three years demonstrates a significant increase in the workload of the office as shown in the table below.

PROCESSES COMPLETED		
2001/02	2002/03	2003/04
44,504	62,788	82,665

TABLE OF OPERATIONAL PERFORMANCE

Activity	Volume 2003/04	(2002/03)	Average Days[1]	(2002/03)	Work in Progress[2]	(2002/03)
Retirals	1,456	(1,557)	3.39	(5.67)	5	(0)
Estimates	3,076	(2,877)	4.98	(9.12)	25	(50)
Deferred Benefits	2,558	(2,178)	2.11	(3.21)	9	(3)
Refunds	2,910	(2,516)	4.98	(6.4)	5	(5)
Transfer Out Quotes	708	(873)	3.86	(9.51)	7	(10)
Transfers Inward Actuals	2,273	(1,734)	1.17	(6,62)	0	(2)
Transfers Inward Quotes	2,577	(2,154)	3.09	(8.79)	11	(25)
New Start Administration	10,190	(8,736)	16.71	(17.37)	5	(33

1. The average days shown is the turnaround time for the completion of procedures.

2. Work in progress shows the volume of outstanding cases per procedure as at 31st March 2004.

MEMBERSHIP OF THE FUND Analysis of Movements	Contributors	Pensioners	Dependants	Deferred
As at 1st April 2003	81,584	46,400	10,734	20,443
New Contributors	9,408	-	-	-
New Pensioners	-1,125	1,468	-	-343
Deferred Membership	-1,470	-	-	1,470
Became Dependants	-	-	811	-
Rejoined Scheme	313	-	-	-313
Left Scheme	-1,411	-	-46	-391
Died	-111	-1,806	-637	-35
Membership as at 31st March 2004	**87,188**	**46,062**	**10,862**	**20,831**
Police, Fire + Teachers Pensioners			14,682	

Future Developments

Looking forwards, there are a number of imminent developments in the pensions field that will impact significantly on Strathclyde Pension Fund Office. Some of the changes are of a statutory nature whilst others result from internal measures to continuously improve service delivery to the scheme membership. The principal developments are as follows.

1. "Stocktake" Phase One changes to the Local Government Pension Scheme which will be effective from April 2005 and will involve changes to internal working practices and scheme documentation.

2. Preparation for Phase Two changes to the LGPS scheduled for implementation in April 2006. Both phases of amendments to the LGPS will involve intensive communications exercises.

3. Participation in the final stage of the "Stocktake" review of LGPS - the development of a new Final Salary Scheme for Local Government for implementation from 2008.

4. Participation in the National Fraud Initiative exercise being carried out by Audit Scotland during 2004/05.

5. Review of various elements of work and systems configuration within SPFO to ensure continuing improvement to service delivery and efficiency.

Summary of Benefits

When the member

Leaves service or withdraws from membership
under 2 years qualifying service

There will be payable

A refund of contributions

Or

A transfer payment of actuarial value of the deferred pension may be made to another approved pension arrangement

In addition

Continuing employees will be required to contribute to either the State Earnings Related Pension Scheme or to a Pension Plan

Leaves service or withdraws from membership
over 2 years qualifying service

He/she will receive

A pension payable from age 60 based on reckonable service and pensionable pay at the date of leaving

Plus

A tax-free lump sum payable at age 60 of 3 times the initial annual level of pension

Or

A transfer payment of the actuarial value of the deferred pension may be made to another approved pension arrangement

Retires

He/she will receive

A pension of one eightieth of final pensionable pay for each year of reckonable pay

Plus

A tax-free lump sum of 3 times the initial annual level of pension

And on death

The spouse will receive one half of the pension being paid to the member

Dies in service

There will be payable

A lump sum of 2 times pensionable pay depending on service and contributions

Plus

If a member had at least 2 years' reckonable service a spouse's pension of one half of the pension the member would have received had he/she retired due to ill health on the date of death.

Market Report

The Market Report was provided by Schroder Investment Management.

Schroders

2003 Review

Equity markets recovered in 2003 following three consecutive years of negative returns. Markets fell initially, then rallied sharply from their lows as geopolitical concerns started to diminish and risk appetites increased. The rally was sustained as signs of a synchronized global economic recovery began to emerge in the second half of the year and corporate profitability increased significantly, driven by earlier cost cutting and margin expansion. Cyclical stocks and sectors that had performed particularly poorly in the highly risk averse market environment of the past few years produced the strongest gains in 2003, while more defensive sectors were left behind.

The **US** dollar continued to depreciate against all major currencies in the year, driven by increasing concern over the twin budget and current account deficits. The euro bore the brunt of dollar weakness amid substantial intervention from Asian central banks to curb the appreciation of their currencies. Dollar weakness contributed to the comparatively weak return of the US equity market to sterling-based investors.
The US economy recovered sharply, boosted by expansionary monetary and fiscal policies, and corporate profits trends improved, although relatively high valuations limited the market's gains in the year.

Continental **European** equities rebounded vigorously as risk aversion subsided, and outperformed in sterling terms as a result of the appreciation of the euro. The expectation that the region would benefit from improving global growth supported performance as recovery in the euro area remained subdued. Weak domestic demand and restrictive fiscal and monetary conditions, as euro strength effectively tightened policy despite further interest rate cuts, increased the region's reliance on export growth.
Leading economic indicators suggested activity in the euro area would begin to accelerate, however, and the effective suspension of the Stability and Growth Pact towards the end of 2003 provided greater scope for governments to loosen their fiscal policy in 2004.

UK economic performance was unexpectedly resilient, in marked contrast to the euro area. Strong government and consumer spending provided the impetus for the UK economy as manufacturing activity remained subdued, to the benefit of stocks and sectors sensitive to domestic growth. Small and mid-cap stocks outperformed larger, more defensive companies in the year as a whole, although this pattern was reversed slightly towards the end of the year as the Bank of England raised interest rates.

Japanese equities lagged the global rally in its initial stages as a result of some heavy selling pressure by domestic pension funds and banks. However, rising inflows from international investors encouraged by attractive relative valuations, ongoing corporate restructuring and improving global growth, underpinned stronger performance in the second half of the year.
High quality companies with strong balance sheets and reliable earnings growth were largely overlooked as cyclically sensitive stocks considered to have significant recovery potential led the market higher. Elsewhere in Asia, Hong Kong and Singapore benefited from their sensitivity to improving global growth and links with China, where the domestic economy remained extremely robust. In addition, their economies started to recover, supported by various stimulative measures adopted to counteract the economic impact of the outbreak of SARS. The more defensive markets of Australia and New Zealand were comparatively weak, although currency appreciation boosted their returns in sterling terms.

Emerging markets continued to outperform developed markets in an environment of rising global growth, stronger commodity prices and abundant global liquidity.

Bonds significantly underperformed equities in an environment of improving global growth and higher risk appetites. Even so, bonds produced positive returns, supported by further monetary easing in the first half of the year, fears of deflation and as interest rates in general stayed low. Bond markets were surprisingly resilient towards the end of the year as economic data and growth expectations started to improve. Higher interest rates were not considered an immediate threat as inflation remained low, and Asian central banks' efforts to prevent significant appreciation of their currencies relative to the US dollar by buying US Treasuries also supported the market. Conventional government bonds underperformed index-linked gilts and corporate bonds in the year. Corporate bonds benefited from strong risk appetites and the improving corporate outlook, and credit spreads narrowed substantially in the year.

UK **property** continued to produce reasonable returns and outperformed bonds, although underperformed the FTSE All-Share Index. Strong demand for investment property supported performance in an environment of weak rental growth. There was marked divergence in sector returns, with the strongest returns from the retail sector and the weakest performance in the office sector.

Investment Report

Performance Measurement

In 2003 the Fund appointed Northern Trust as provider of independent investment performance measurement. This role complements their existing functions as the Fund's global custodian.

Previously (in fact since 1976), performance measurement had been carried out by the WM Company, an Edinburgh based subsidiary of State Street bank. The Fund has maintained a relationship with WM Co. to provide an annual investment report including comparison with the WM Universes which capture performance data from up to 1,000 UK pension funds.

The analysis presented in the following sections comprises:

- fund and benchmark returns as calculated by Northern Trust;
- Universe comparisons as provided by WM Co.; and
- property returns calculated by the Investment Property Databank (IPD).

All returns are total gross investment return figures expressed in percentage terms.

In line with the industry norm, the Fund's principal investment review is presented on a calendar year basis for 2003. Figures for the financial year - 1st April 2003 to 31st March 2004 - are also available and are shown in the Local Authority Review.

Background

The early part of 2003 remained overshadowed by the now 3 year old bear market. The first quarter saw further negative returns and a new low was reached during March. This seemed to mark a turning point, however, and for the remainder of the year equity markets rose strongly boosted by the speedy end of official hostilities in Iraq, improvements in economic data and the implications of $350 billion of tax cuts in the US. This ensured that 2003 went on record as a year of significant recovery for pension funds and other investors. (See the Market Report for a more detailed analysis.)

2003 RESULTS	
Fund Return	19.9%
Benchmark Return	20.9%
Average Fund Return	17.0%

The Strathclyde Pension Fund's asset structure - as a result of its customised benchmark - differs from that of the average UK fund. A higher exposure to equities and lower allocation to bonds had been detrimental in the previous 3 years of falling equity markets but was very beneficial as markets recovered in 2003.

The Fund's return was -1.0% behind its own benchmark, largely as a result of being overweight in property and underweight in equities. This same features had had a positive performance impact in the preceding 2 years. There was also some marginal impact from investment manager underperformance and from the process of restructuring portfolios at the end of the year.

The Fund's returns by asset class were as follows.

ASSET CLASS	Fund Return	Benchmark Return
UK Equities	22.1%	20.9%
Overseas Equities		
US	19.5%	16.4%
Europe	28.5%	29.7%
Japan	23.3%	23.0%
Pacific	35.2%	31.4%
Emerging Markets	37.9%	40.5%
UK Bonds	5.8%	4.7%
Overseas Bonds	6.1%	3.0%
UK Index Linked	7.6%	7.0%
Cash	0.6%	-
UK Property	14.1%	10.1%
TOTAL FUNDS	**19.9%**	**20.9%**

Investment Report

Review

LONG TERM PERFORMANCE											Annualised		
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	3yr	5yr	10yr
Retail Prices	2.9%	3.2%	2.5%	3.6%	2.8%	1.8%	2.9%	0.7%	2.9%	2.8%	2.1%	2.2%	2.6%
Average Earnings	4.4%	2.9%	4.9%	4.7%	4.1%	6.2%	4.5%	2.1%	4.1%	3.3%	3.2%	4.0%	4.1%
Fund Benchmark	-	-	-	-	-	28.3%	-4.3%	-10.0	-16.5%	20.9%	-3.1%	1.8%	-
Fund Return	-3.6%	16.9%	10.4%	14.8%	13.0%	28.2%	-2.5%	-9.7%	-15.4%	19.9%	-2.9%	2.7%	6.3%
WM All Funds	-3.9%	19.1%	10.7%	16.8%	14.0%	21.3%	-1.3%	-8.9%	-13.9%	17.0%	-2.8%	1.9%	6.4%
Fund Ranking (/100)*	18	91	68	73	57	7	64	43	35	18	29	16	50

*percentile ranking within the WM ALL Funds Universe of UK pension funds

The strong recovery in 2003 was of course extremely welcome. But it was not sufficient to undo all of the damage of the three preceding years. As a result the middle term returns remain very depressed. The 3 year annualised return is negative. And even over 5 years returns have failed to keep up with either price or earnings inflation. But the Fund has outperformed both its own benchmark (introduced in 1998) and the average UK fund over this period.

The longer term record is better in absolute terms. The 10 year annualised return of +6.3% per annum comfortably outstrips inflation and is close to the expected long-term return on assets. Relative performance suffered in the mid-1990's as a result of investment manager underperformance, but even so, performance is in line with the average UK fund over 10 years.

The Fund ranks in the top half of the WM Universe over 3, 5 and 10 years.

Local Authority Review

WM Co. produce a Local Authority Review on an accounting year (to 31st March) basis. The Fund's performance on this basis is shown in the table below.

Investment Arrangements

Following the actuarial valuation in 2002, a review of the Fund's investment arrangements was carried out during 2003.
Revised arrangements were agreed during a series of meetings of the Strathclyde Pension Fund Sub-Committee during August 2003, and implemented towards the end of the year.

LOCAL AUTHORITY REVIEW						Annualised		
	1999/00	2000/01	2001/02	2002/03	2003/04	3yr	5yr	10yr
Fund Return	18.7%	-8.6%	-0.2%	-20.8%	26.6%	0.0%	1.7%	6.9%
Local Authority Average	13.6%	-6.3%	-0.5%	-19.5%	23.4%	-0.4%	1.0%	6.7%
Fund Ranking (/100)*	3	74	29	62	10	-	-	-

*percentile ranking within the WM ALL Funds Universe

Investment Strategy

The Fund's investment strategy was revised as follows.

		Existing		Revised
UK Equity		46%		38%
Small Companies		4%		3%
Overseas Equity		28%		29%
North America	6.8%		9.75%	
Europe (ex UK)	7.7%		9.75%	
Japan	5.3%		3.25%	
Pacific	5.0%		3.25%	
Emerging Markets	3.2%		3.0%	
Private Equity		3.0%		5.0%
Total Equity		81%		75%
Property		8.0%		10.0%
Index Linked		4.0%		3.0%
UK Gilts		2.5%		3.0%
Corporate Bonds		2.5%		6.0%
Overseas Bonds		2.0%		3.0%
TOTAL FUNDS		**100%**		**100%**

The principal features were an increased allocation to property and corporate bonds, and a consequent reduction in equity exposure. Within the equity allocation there was a further shift from UK to overseas, consistent with previous revisions to the Fund's strategy.

Structure

As part of the investment review the Fund tendered a number of large investment mandates during the year. The appointments subsequently made represented a significant step towards more specialist management.

A newly created global bond portfolio was awarded to **Western Asset**, a dedicated bond house with its origins, and much of its present operations, in California. The Western mandate will be a little more aggressive than the fund's existing specialist bond mandate for which **Henderson Global Investors** were retained. Both mandates represent around 5% of total fund assets.

An equity manager search concluded with three appointments. **Baillie Gifford**, **Capital International** and **Schroder** were all awarded global equity mandates but with different regional allocations. Each mandate represents around 15% of total Fund value. All three managers were already running mandates for the Fund.

The Fund retained **Legal & General** as its passive manager together with **JP Morgan Fleming** and **Gartmore** (small companies), **Aberdeen** (property), **Pantheon** (private equity) and **Genesis** (emerging markets).

A multi-asset portfolio managed by **JP Morgan Fleming** was deleted from the Fund's structure.

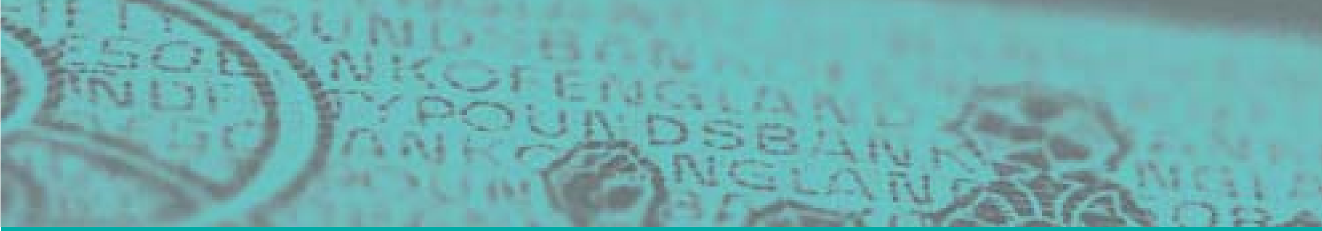
Other Developments

During the year the Fund adopted a Business Plan and an Elected Member Training plan to ensure compliance with all of the Myners Principles for investment decision-making.

Angus Mathieson decided to stand down from the Fund's Investment Advisory Panel at the end of 2003 having made a very significant contribution to the work of the Panel over a 10 year period.

Dick Barfield was subsequently recruited to the Panel. Dick spent a large part of his career at Standard Life where he was Chief Investment Manager from 1988 until his departure in 1996.Since then he has undertaken a varied portfolio of directorships and consultancy assignments for a variety of UK companies, pension funds and investment trusts.

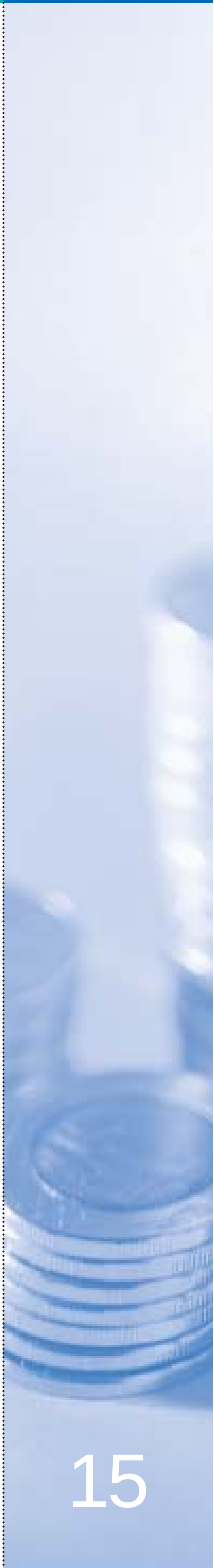
The Fund's internal resource was increased with the creation of a new post of Chief Pensions Officer (Investments) within the staffing structure.



No.1 Fund

FUND ACCOUNT

2002/03 £000		2003/04 £000	£000
	CONTRIBUTIONS		
73,019	Contributions Receivable from Employees	79,460	
159,913	Contributions Receivable from Employers	181,888	
15,093	Additional Contributions from Employers	15,534	
24,859	Transfers In	41,121	
301	Other Income	219	
273,185			318,222
	BENEFITS		
	Benefits Payable		
186,473	Pensions	192,325	
33,760	Lump Sums	31,344	
	Payments to and on account of leavers		
791	Refund of Contributions	1,548	
14,275	Transfers Out	25,272	
2,696	**Administrative and Other Expenses borne by the scheme**	2,728	
237,995			253,217
35,190	**Net Addition from dealings with members**		**65,005**
	RETURNS ON INVESTMENTS		
138,334	Investment Income	163,690	
	Less:		
(8,494)	Investment Management Expenses	(9,889)	
(1,289)	Overseas Tax	(1,313)	152,488
128,551			
(1,379,550)	Change in Market Value of Investments		1,125,545
(1,250,999)	**Net Returns on Investments**		**1,278,033**
(1,215,809)	**Net (Decrease)/Increase in the fund during the year**		**1,343,038**
6,039,199	**Opening Net Assets of the Scheme**		**4,823,390**
4,823,390	**Closing Net Assets of the Scheme**		**6,166,428**
(1,215,809)	**Asset Movement during the year**		**1,343,038**



No.1 Fund

NET ASSETS STATEMENT

2002/03 £000		2003/04 £000	£000
	INVESTMENT ASSETS AT MARKET VALUE		
	Listed Investments		
1,440,698	- UK Equities	1,435,590	
89,894	- UK Fixed Interest (Public Sector)	100,838	
132,772	- UK Fixed Interest (Others)	180,485	
778,802	- Overseas Equities	1,403,772	
141,425	- Overseas Fixed Interest	259,489	
190,196	- Index Linked	45,248	3,425,422
	Unlisted Investments		
440,668	- Property (Freehold)	393,126	
57,028	- Property (Long Lease)	45,067	
103,505	- Venture Capital	108,514	546,707
958,548	**Managed Funds**		1,531,505
	Unit Trusts		
77,107	- Property		90,130
211,294	- Other		276,314
4,621,937			**5,870,078**
	Current Assets		
215,102	Sundry Debtors	312,041	
61,215	Advances to Loans Fund	34,959	
114,162	Bank	251,473	598,473
390,479			
	Less: Current Liabilities		
(189,026)	Sundry Creditors	(302,123)	
201,453	Net Current Assets		296,350
4,823,390	**Net Assets**		**6,166,428**
	STATEMENT OF MOVEMENT IN NET ASSETS		
6,039,199	Fund Balance as at 1st April 2003		4,823,390
(123,511)	Surplus/(Deficit) for Year	391,950	
287,252	Less: Realised Gains/Add: Realised Losses	(174,457)	
			217,493
(1,379,550)	Change in Market Value of Investments		1,125,545
4,823,390	**Net Assets at 31st March 2004**		**6,166,428**

Notes to the Accounts

Accounting Policies

- The accounts have been prepared on an accruals basis to 31st March 2004, in accordance with CIPFA's Accounting Code of Practice.
- The Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end.
- Valuations of the investments have been carried out by each of the fund managers at mid market prices at 31st March 2004. Items denominated in foreign currencies have been translated into sterling at the closing foreign exchange rate at 31st March 2004.
- Valuation of the property portfolio was carried out at 31st December 2003 by an independent valuer. Property values have been trended to show the estimated value as at 31st March 2004.

Other

- The Fund had contractual commitments totalling £146.7million as at 31st March 2004 within its Private Equity portfolio.
- There were no transactions with related parties during the year other than the balance with the city council's loans fund, which is disclosed in the net assets statement.

Fund Management

The investment assets of the Fund are externally managed. An investment review carried out during 2003/04 resulted in :

- the appointment of Western Asset to manage a specialist global bond mandate
- termination of JP Morgan Fleming from a multi-asset mandate
- significant changes to a number of other mandates

Investment management arrangements as at 31st March 2004 are shown below.

Cash balances are managed by the Fund's Global Custodian, Northern Trust.

- Value of purchases and sales in the year were £5.9 billion and £5.6 billion respectively.
- The Fund participates in a stocklending programme managed by Northern Trust. As at 31st March 2004 the total amount of stock released by the Fund under this arrangement was £538 million.

FUND MANAGEMENT

Asset Class	Fund Manager	% Under Management
Multi Asset - Passive	Legal & General	25.9%
Global Equity	Baillie Gifford	16.0%
Global Equity	Capital International	15.8%
Global Equity - Active	Schroder	14.2%
Specialist - Property	Aberdeen PI	10.7%
Specialist - Bonds	Henderson	4.9%
Specialist - Bonds	Western	4.9%
Equities - UK Small Companies	Gartmore	2.1%
Equities - Overseas Small Companies	JP Morgan Fleming	2.1%
Specialist - Venture Capital	Pantheon	1.9%
Specialist - Emerging Markets	Genesis	1.5%
		100%

No.3 Fund

Membership

The No.3 Fund was established on 19th February 1993 in order to preserve the pension benefits of those remaining employees of Strathclyde Buses who had transferred from the service of Strathclyde Regional Council upon the implementation of the Transport Act 1985, in October 1986. Strathclyde Buses was subsequently subsumed into First Glasgow, a subsidiary of First Group, who remain the sole employer contributing to the Fund.

Actuarial Valuation

In accordance with Regulation 76 of the Local Government Pension Scheme (Scotland) Regulations (1998), an actuarial valuation of the Strathclyde Pension (No.3) Fund was carried out as at 31st March 2002. Results of the valuation were confirmed during February 2003 and are summarised as follows.

Funding Level

As at 31st March 2002 the funding position was as follows.

FUNDING LEVEL	
Fund Assets	£71.5m
Fund Liabilities	£73.3m
Surplus/(Deficit)	(£1.8m)

This implies a funding level of 98% (reduced from 101% at the last valuation in 1999).

Post Valuation Events

The actuary stressed that the funding position had deteriorated significantly between the valuation date and completion of the valuation process, as investment markets fell throughout the remainder of 2002.

Future Service Funding Rate

The Future Service Funding Rate is the cost to employers of pension benefits which will be earned after the valuation date. The actuary calculated the Future Service Funding Rate as 400% of employee contributions (390% in 2002).

Employer Contribution Rates

The following common contribution rates for the employer were agreed.

Year to	**Rate** (as % of employees' contributions)
31st March 2004	370%
31st March 2005	400%
31st March 2006	400%

The employer paid additional contributions of £0.5m in 2003/04, and will pay a further £0.5m in 2004/05 and 2005/06.

Method

The valuation was carried out by consulting actuaries Hymans Robertson. As in previous valuations, the method used was the Attained Age Method, which is appropriate for a fund closed to new members. Assets were valued at their market value as at 31st March 2002.

Assumptions

DEMOGRAPHIC: Demographic assumptions cover rates of mortality, retirement and withdrawal. The actuary is able to draw on a wide experience of local government funds in conjunction with published tables to set assumptions which reflect best estimates of future trends.

At this valuation the actuary incorporated revised mortality tables for both existing pensioners and current employee members. Some adjustment to the tables was made to reflect local experience.

FINANCIAL: The key financial assumptions used in the 2002 valuation were as follows.

FINANCIAL ASSUMPTIONS	**Nominal** (% p.a.)	**Real** (% p.a.)
Rate of Return on Investments		
Equities	6.5%	
Bonds	5.2%	
Discount Rate	6.2%	3.6%
Pay Increase	4.1%	1.5%
Price Inflation/Pension Increases	2.6%	0.0%

Fund Membership Profile

At the 2002 actuarial valuation, the membership profile of the No.3 Fund was as follows.

No.3 FUND	Members	Liabilities	
Active Members	562	£35.3m	48%
Deferred Pensioners	225	£7.0m	10%
Pensioners	520	£31.0m	42%
Total	**1,307**	**£73.3m**	**100%**

FUND ACCOUNT

2002/03 £000		2003/04 £000	£000
	CONTRIBUTIONS		
413	Contributions Receivable from Employees	392	
1,425	Contributions Receivable from Employers	1,449	
5	Additional Contributions from Employers	504	
1,843			2,345
	BENEFITS		
	Benefits Payable		
2,235	Pensions	2,336	
722	Lump Sums	616	
	Payments to and on account of leavers		
267	Transfers Out	37	
41	**Administrative and Other Expenses borne by the scheme**	26	
3,265			3,015
(1,422)	**Net Reduction from Dealing with Members**		**(670)**
	Returns on Investments		
2,035	Investment Income	2,293	
	Less :		
(163)	- Investment Management Expenses	(152)	
(15)	- Overseas Tax	(14)	2,127
(14,715)	Change in Market Value of Investments		11,755
(12,858)	**Net Returns on Investments**		**13,882**
(14,280)	**Net Decrease in the fund during the year**		**13,212**
71,546	**Opening Net Assets of the Scheme**		**57,266**
57,266	**Closing Net Assets of the Scheme**		**70,478**
(14,280)	**Asset Movement during the year**		**13,212**

No.3 Fund

NET ASSETS STATEMENT			
2002/03		**2003/04**	
£000		£000	£000
	INVESTMENT ASSETS AT MARKET VALUE		
	Listed Investments		
20,897	- UK Equities	27,543	
1,991	- UK Fixed Interest (Public Sector)	2,483	
1,871	- UK Fixed Interest (Others)	1,101	
6,781	- Overseas Equities	8,960	
2,301	- Overseas Fixed Interest	3,668	
3,214	- Index Linked	2,471	
			46,226
	Unit Trusts		
7,915	- Property	7,718	
10,519	- Others	15,028	22,746
55,489			**68,972**
	Current Assets		
2,287	Sundry Debtors	1,247	
312	Advances to Loans Fund	791	
1,061	Bank	242	
3,660			2,287
	Less :Current Liabilities		
1,883	Sundry Creditors		774
1,777	Net Current Assets		1,506
57,266	**Net Assets**		**70,478**
	STATEMENT OF MOVEMENT IN NET ASSETS		
71,546	Fund Balance as at 1st April 2003		57,266
(2,226)	Surplus for Year	1,965	
2,661	Less: Realised Gains/Add: Realised Losses	508	
			1,457
(14,715)	Change in Market Value of Investments		11,755
57,266	**Net Assets at 31st March 2004**		**70,478**

Notes to the Accounts

Accounting Policies

- The accounts have been prepared on an accruals basis to 31st March 2004, in accordance with CIPFA's Accounting Code of Practice.
- The Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end.
- Valuations of the investments have been carried out by the fund manager at mid market prices at 31st March 2004. Items denominated in foreign currencies have been translated into sterling at the closing foreign exchange rate at 31st March 2004.

Other

- There were no transactions with related parties during the year other than the balance with the City Council's loans fund, which is disclosed in the net assets statement.

Fund Management

The investment assets of the Fund are externally managed by Schroder Investment Management.

Cash balances are managed by the Fund's Global Custodian, Northern Trust.

- Value of purchases and sales in the year were £44.8 million and £43 million respectively.
- The Fund participates in a stocklending programme managed by its Global Custodian, Northern Trust. As at 31st March 2004 the total amount of stock released by the Fund under this arrangement was £10.2 million.

Actuarial Valuation

In accordance with Regulation 76 of the Local Government Pension Scheme (Scotland) Regulations 1998 an actuarial valuation of the Strathclyde Pension Fund was carried out as at 31st March 2002. Results of the valuation were confirmed during February 2003, and a copy of the valuation report was issued to all participating employers. The report is summarised as follows.

Results

FUNDING LEVEL

As at 31st March 2002 the funding position was as follows.

FUNDING LEVEL	
Fund Assets	£6,050m
Fund Liabilities	£5,594m
Surplus	£456m

This implies a funding level of 108%, broadly unchanged from the last valuation in 1999 when the Fund also had a surplus of around 8%.

POST VALUATION EVENTS

The actuary was at pains to stress that the funding position had deteriorated significantly between the valuation date and completion of the valuation process, as investment markets fell throughout the remainder of 2002.

FUTURE SERVICE FUNDING RATE

The Future Service Funding Rate is the cost to employers of pensions benefits which will be earned after the valuation date. The actuary calculated the Future Service Funding Rate as 245% of employee contributions. This had reduced a little from the 1999 valuation when the Future Service Rate was 260%.

EMPLOYER CONTRIBUTION RATES

Ordinarily, the existence of a surplus at the valuation date would allow actual employer contribution rates to be set below the Future Service Funding Rate. However, because of the post-valuation fall in the funding level, the actuary recommended that no account should be taken of the surplus. (Reliance on the surplus could have a severe negative impact if investment markets failed to recover before the next valuation in 2005).

This implied that employers should pay the Future Service Rate. The actuary proposed that the resultant increase should be phased over the period to the next valuation. The following common contribution rates for employers were agreed.

Year to	**Rate** (as % of employees' contributions)
31st March 2004	230%
31st March 2005	240%
31st March 2006	250%

Method

The valuation was carried out by consulting actuaries Hymans Robertson.
As in previous valuations, the method used was the Projected Unit Method.
Assets were valued at their market value as at 31st March 2002.

Assumptions

DEMOGRAPHIC

Demographic assumptions cover rates of mortality, retirement and withdrawal. The actuary is able to draw on a wide experience of local government funds in conjunction with published tables to set assumptions which reflect best estimates of future trends.

At this valuation the actuary incorporated revised mortality tables for both existing pensioners and current employee members. Some adjustment to the tables was made to reflect local experience.

For illustration, the table below shows the expectation of life implied by the old and new tables for pensioners retiring at age 60.

	1999	2002
Non Pensioners		
Males	19.5	23.5
Females	24.2	26.5
Pensioners		
Males	19.5	21.7
Females	24.2	24.6

Financial

The key financial assumptions used in the 2002 valuation were as follows.

FINANCIAL ASSUMPTIONS	Nominal (% p.a.)	Real (% p.a.)
Rate of Return on Investments		
Equities	6.5%	
Bonds	5.1%	
Discount Rate	6.2%	3.6%
Pay Increase	4.1%	1.5%
Price Inflation/Pension Increases	2.6%	0.0%