

INTRODUCTION

Welcome to the Annual Report and Accounts for the Durham County Council Pension Fund for the financial year ended 31st March 2006.

These are the key issues;

- Contributing members increased by 0.84% to 18,905
- 27.6% return on the Fund's investments
- Market value of the Fund's assets increased from £1,013m to £1,334m.

The Report provides further information on these issues and on the activities and management of the Fund during the year.

I hope this report provides some useful information on your Pension Fund. However, it is important to try to improve the quality and suitability of information provided within the report and feedback is welcomed. Details of contact points for further information on the Fund are provided at the end of the report.

S. D. CROWE, C.P.F.A.
County Treasurer

MANAGEMENT STRUCTURE (AS AT 31ST MARCH 2006)

ADMINISTERING AUTHORITY:

Durham County Council

PENSION FUND COMMITTEE:

Durham County Council Members:

Councillor N. Martin (Chairman)
Councillor A. Fenwick (Dec'd 12.06.06) (Vice Chairman)
Councillor A. Barker
Councillor D. Coates
Councillor E. Foster
Councillor Mrs. E. Hunter
Councillor K. Manton
Councillor R. Ord
Councillor D. Ross (Dec'd 20.03.06)
Councillor Mrs. C. Vasey
Councillor B. Walker

Darlington Borough Council Members:

Councillor D. Bristow
Councillor I. G. Haszeldine

District Council Members Nominated by the Durham County District Councils' Association:

Councillor G Mowbray	Durham City Council
Councillor D Jackson	Wear Valley District Council
Councillor G. K. Robinson	Teesdale District Council
Councillor R. Todd	District of Easington

COUNTY COUNCIL OFFICERS:

M Lloyd MBA	Chief Executive
A. North, LLB	Director of Corporate & Legal Services
S. D. Crowe, CPFA	County Treasurer

INVESTMENT MANAGERS:

Baring Asset Management Limited, Bishopsgate, London.
Legal and General Investment Management Limited,
Queen Victoria Street, London.
Morley Fund Management Limited, Poultry, London.

INDEPENDENT ADVISERS:

P. J. Williams, Herts.
PSolve Asset Solutions, Jermyn Street, London

SCHEME AUDITORS

Audit Commission

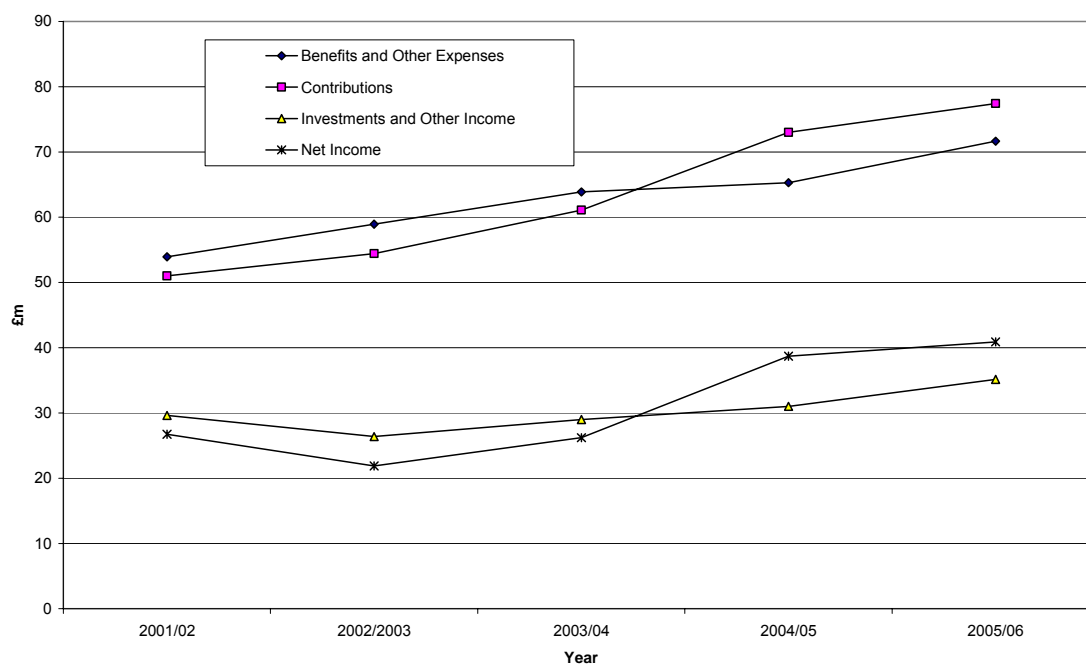
STAFF OBSERVERS:

F. C. Fox	UNISON
D. Little	GMB

FINANCIAL SUMMARY

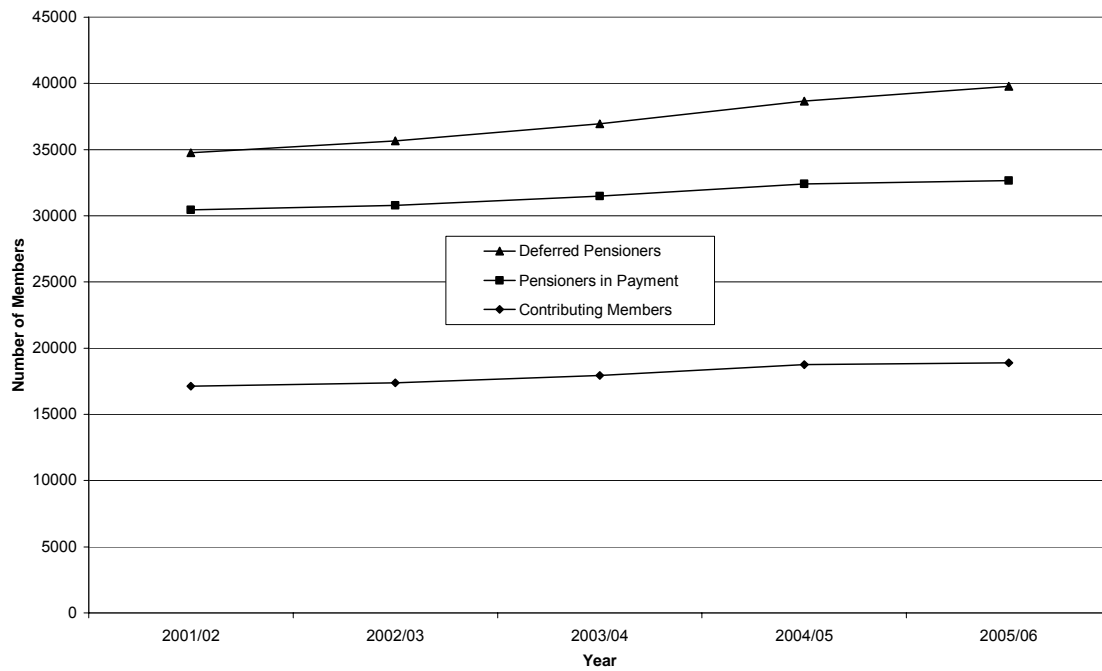
(1)	*2001/02 (2)	*2002/03 (3)	2003/04 (4)	2004/05 (5)	2005/06 (6)
	£000	£000	£000	£000	£000
INCOME					
Contributions	51,016	54,426	61,099	72,995	77,419
Investment and other income	29,631	26,379	29,694	30,999	35,133
TOTAL INCOME	80,647	80,805	90,793	103,994	112,552
LESS:					
Benefits and other expenses	53,921	58,924	63,899	65,298	71,647
Net income (a)	26,726	21,881	26,894	38,696	40,905
ADD:					
Increase/decrease(-) in market value of investments (b)	-43,214	-220,557	159,830	77,614	279,513
Increase/decrease(-) in Fund during year (a + b)	-16,488	-198,676	186,724	116,310	320,418
Net assets at 31st March <i>(Investments included at market value)</i>	*908,924	*710,248	896,972	1,013,282	1,333,700

*restated for change in Accounting Policy related to Additional Voluntary Contributions



MEMBERSHIP SUMMARY

(1)	2001/02 (2)	2002/03 (3)	2003/04 (4)	2004/05 (5)	2005/06 (6)
Contributing Members	17,142	17,366	17,935	18,748	18,905
Pensioners in Payment	13,308	13,353	13,537	13,669	13,758
Pensioners Deferred	4,323	4,891	5,477	6,236	7,124



MANAGEMENT REPORT

THE SCHEME

The Local Government Pension Scheme is statutorily based and is governed by the Local Government Pension Scheme Regulations 1997 and subsequent amendment regulations.

MEMBERSHIP

The Durham County Council Pension Fund is administered by Durham County Council. It was established in 1974 to cover the future pension entitlement of all eligible employees of the County Council and District Councils. The Fund excludes provision for teachers, police officers and fire-fighters, for whom separate arrangements exist.

A number of other bodies also participate in the Scheme. These include Parish and Town Councils, Further Education Colleges and civilian staff from the Police and Fire Authorities. Admitted Bodies are those which, under the Regulations, are able to apply for membership of the Scheme. If the Fund Committee agree to the application, an Admission Agreement is drawn up admitting the body into the Scheme.

Those organisations with employees currently participating in the Scheme are shown in Appendix 1.

During 2005/06 the number of contributing members within the Scheme increased from 18,748 to 18,905, an increase of 0.84%. The numbers continue to increase as a result of legislation permitting all employees to join the Scheme and the figure is expected to rise still further.

In summary, the number of members contributing to the Scheme is:

As at 31st March 2005		As at 31st March 2006
9,539	Durham County Council	9,863
2,573	Darlington Borough Council	2,620
3,592	District Councils	3,584
216	Town/Parish Councils	209
111	Fire and Rescue Authority	110
997	Colleges	930
821	Police Authority	823
274	Probation Service	284
625	Others	482
18,748		18,905

The number of pensioners in receipt of payments from the Fund increased by 0.65% to 13,758.

A further analysis of these figures is shown in Appendix 2.

MANAGEMENT REPORT

ADMINISTRATION OF THE SCHEME

Durham County Council is the Administering Authority and the Scheme administration is the responsibility of the County Treasurer. The costs of administering the Scheme are charged to the Pension Fund.

HOW THE SCHEME WORKS

The Local Government Pension Scheme is required to be funded whereby Scheme funds, currently surplus to immediate pension benefit requirements, are invested in approved securities. The Pension Fund so created must be sufficient to sustain the future pension entitlements of both past and present members. The Fund is financed by contributions from members, employers and earnings from investments.

An independent actuarial valuation of the Fund is carried out every three years to review the assets and liabilities of the Fund and to determine the rate of contributions which the employers must make to the Fund. The most recent valuation applicable to the period covered by the report was undertaken as at 31st March 2004 and a report of the actuary is provided on page 16.

From 1st April 1998 all new contributors to the scheme are required to pay 6% of their pensionable wage or salary to the Fund. Certain employees who were paying at a rate of 5% prior to 1st April 1998 are protected on this rate. Employee contributions qualify for income tax relief. Since April 1988 a member may have additional voluntary contributions (AVC) deducted from pay (subject to certain maxima) and paid into a personal fund.

Employees can invest their AVC's with any of the following companies:-

Standard Life
Prudential or
HECM (providing funds through Clerical Medical and Equitable Life)

Members who leave may transfer their accrued benefits to other approved schemes.

Members who leave with less than three months membership may alternatively take a refund of their contributions (less income tax and a payment to SERPS - the State Earnings Related Pension Scheme).

New members may transfer benefits accrued with other schemes into the Fund.

MANAGEMENT REPORT

The Local Government Pension Scheme is classified as a “*Final Salary Scheme*” which means that the annual pension and retirement grant are paid based on the period of membership and, usually, the final twelve months pay.

Full details of the benefits payable from the Scheme to former employees are shown in Appendix 3.

PENSION INCREASES

Mandatory increases in pensions and deferred benefits are made in accordance with annual statutory Pension Increase (Review) Orders to help protect pensions against inflation. The pension increase effective from April each year is based on the Retail Price Index as at the previous September. The table below shows the pension increases over the last six years:

Effective Date	Increase
	%
10 th April 2000	1.1
9 th April 2001	3.3
8 th April 2002	1.7
7 th April 2003	1.7
12 th April 2004	2.8
11 th April 2005	3.1
10 th April 2006	2.7

The pensioners must be over the age of fifty-five or have retired on ill-health grounds to receive the increase. Those in receipt of a widow's, widower's or dependant's benefit receive the increase regardless of age.

REVIEW OF LEGISLATION ETC.

The Local Government Pension Scheme (Amendment) Regulations 2005 were issued in July 2005. These regulations revoked the regulations issued in December 2004 that had removed the 'rule of 85' from the scheme and increased the earliest retirement age from 50 to 55. The 'rule of 85' was reinstated and the earliest retirement age in the Scheme (other than in cases of ill-health) was returned to age 50.

The Local Government Pension Scheme and Management and Investment of Funds (Amendment) Regulations 2005 were also issued in July 2005. These regulations made some minor amendments to the Local Government Pension Scheme Regulations and also made some changes to the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998. The

regulations allow administering authorities to increase the limit on their investments in securities transferred by the authority under stock lending arrangements from 25% to 35% of the total of their pension fund investments.

The Local Government Pension Scheme (Civil Partnership) (Amendment) (England and Wales) Regulations 2005 were issued in November 2005. These regulations introduced survivor benefits for same sex partners of Local Government Pension Scheme members or eligible persons where the same sex partners have registered a civil partnership under the terms of the Civil Partnership Act 2004. Survivor pensions for civil partners are based only on service after 5 April 1988.

The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2005 were also issued in November 2005. These regulations introduced a requirement for administering authorities to issue a governance policy statement and a communications policy by 1 April 2006. Durham County Council's governance policy statement and communication policy are available on Durham County Council's website (www.durham.gov.uk).

The Local Government Pension Scheme (Amendment) Regulations 2006 were issued in March 2006. These regulations introduced a number of significant changes to the Scheme to take advantage of the new pension tax regime that came into force from 6 April 2006. The changes included:

- Allowing membership up to age 75
- Lifting the restriction on member contributions – individuals can now theoretically pay 100% of their earnings into the Scheme (through payment of Additional Voluntary Contributions (AVCs))
- Removing the old limits on benefits (e.g. overall pension benefits can not exceed $\frac{2}{3}$ final pay)
- Allowing individuals the opportunity to draw their pension benefits whilst carrying on working provided they reduce their hours or their grade and have employer consent (flexible retirement)
- Setting an age limit of 23 for the payment of children's pensions where children are continuing to receive a pension because they are continuing in education (only applies to children's pensions that come into payment after 5 April 2006)

The regulations also removed the 'rule of 85' from the Scheme with effect from 1 October 2006 with protections for those individuals who would be 60 by 31 March 2013. Later regulations have (for existing members at 1 October 2006) delayed the removal of the 'rule of 85' until 31 March 2008 and have extended the protections available. The 'rule of 85' is the provision in the scheme that allows someone who retires before age 65 to have no early retirement reductions applied to their benefits provided their age plus qualifying service (both in complete years) add up to at least 85.

Tripartite negotiations between the unions, employers and the Government took place during the year on the subject of the removal of the 'rule of 85', the protections against its removal and the long term future of the Scheme. No consensus was reached during the negotiations.

MANAGEMENT REPORT

The regulations included limited protection for existing members – anyone already aged 50 by 1 April 2005 would still potentially be able to retire before age 55 and anyone who reached 60 before 1 April 2013 would not be affected by the removal of the ‘rule of 85’. Nevertheless the regulations were controversial and led to a threat of strike action, which in turn led to the government promising to revoke the regulations at the earliest parliamentary opportunity.

The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2004 were eventually revoked with retrospective effect in August 2005.

The main objective behind the scheme changes was to control costs against a background of improving mortality rates and a changed investment environment. The 31 March 2004 valuation of the Fund took into account the proposed changes to the Scheme. Revoking the regulations has increased the liabilities on the Fund beyond those taken into account by the actuary at the valuation. However, when promising to revoke the regulations the ODPM also promised to put in place further regulations that would ensure the cost of revocation would not fall on the employers or on the government. Consequently, employer contributions have not been re-assessed following the revocation although the situation may be reviewed depending on the eventual format of any future regulations.

In March 2004 the ODPM announced the setting up of a tripartite committee comprising representatives from government, the unions and the employers. The committee’s aim is to consider the long-term future of the Local Government Pension Scheme with “nothing ruled in or ruled out”. At the time of writing no agreed proposals have come from the committee.

The Pensions Act 2004 received royal assent in November 2004. Much of the act is concerned with areas that will not affect the Local Government Pension Scheme, such as the establishment of a Pension Protection Fund (PPF) to provide some protection for members of schemes whose employer becomes insolvent and where there are insufficient assets to pay all the promised benefits. The Local Government Pension Scheme along with other public sector schemes is specifically excluded from benefiting from the PPF and from paying levies to it.

One area of the Pensions Act 2004 that has direct relevance to the Local Government Pension Scheme is the introduction of a new Pensions Regulator with a different set of statutory objectives to the previous regulator. One of the Regulator’s objectives is to promote the good administration of work-based pension schemes and there is a new legal requirement for pension scheme administrators to consider reporting any breaches of regulations connected with the administration of their scheme to the Pensions Regulator. We have put in place a breaches log and a procedure for considering making reports to the Regulator.

INVESTMENTS

INVESTMENT POWERS AND DUTIES

The principal powers to invest are contained within the Local Government Pension Scheme Regulations 1997 which permit a wide range of investments, including equities, fixed interest and other bonds, and property, in the UK and overseas markets.

The main restrictions placed on investments include a limit of 10% of the total value of the Fund in any single holding, or deposits with a single bank or institution, or investments in unlisted securities.

The income to the Fund is primarily from the contributions of the Fund members and their employers and from the interest and dividends received from investments. Income to the Fund which is not required to pay pension and other benefits must be invested, having regard to the need for a suitably diversified portfolio of investments and to the advice of appropriately qualified advisers.

INVESTMENT MANAGEMENT

The Durham County Council Fund is split into three parts, each of which is managed by external investment managers. For the year ended 31st March 2006 approximately one third was managed actively by Baring Asset Management Limited, one third managed actively by Morley Fund Management and approximately one third was managed passively by Legal and General Investment Management Limited.

STATEMENT OF INVESTMENT PRINCIPLES

With effect from 4th January 2000 there is a statutory requirement for administering authorities to prepare and maintain a Statement of Investment Principles. This is a document which provides details of the principles that govern a pension fund's decision about investment. The most recent statement for the Durham Fund was approved by the Fund Committee on 25th July 2005 and this meets the statutory requirements. A copy of the Statement of Investment Principles is included as Appendix 4. The Statement is now under review.

FUNDING STRATEGY STATEMENT

The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 provide the statutory framework from which administering authorities are required to prepare a Funding Strategy Statement (FSS) by 31st March 2005.

The FSS provides a means of managing ongoing employers' pension costs and the decision processes of administering authorities. It raises the level of transparency and accountability, and provides a helpful context for adopting higher levels of communication with scheme employers. A copy of the FSS is available on Durham County Council's website (www.durham.gov.uk).

INVESTMENTS

INVESTMENT MONITORING AND PERFORMANCE STATISTICS

The performance of the investment managers is monitored and reported to the Pension Fund Committee on a quarterly basis. At the quarterly meetings of the Committee, the investments are reviewed and advice is given by independent advisers. The Managers submit reports to the meetings giving detailed information on transactions, views on the economy and investment strategy, including any proposed changes in asset allocation, and a valuation of the investments and cash under management as at the quarter end.

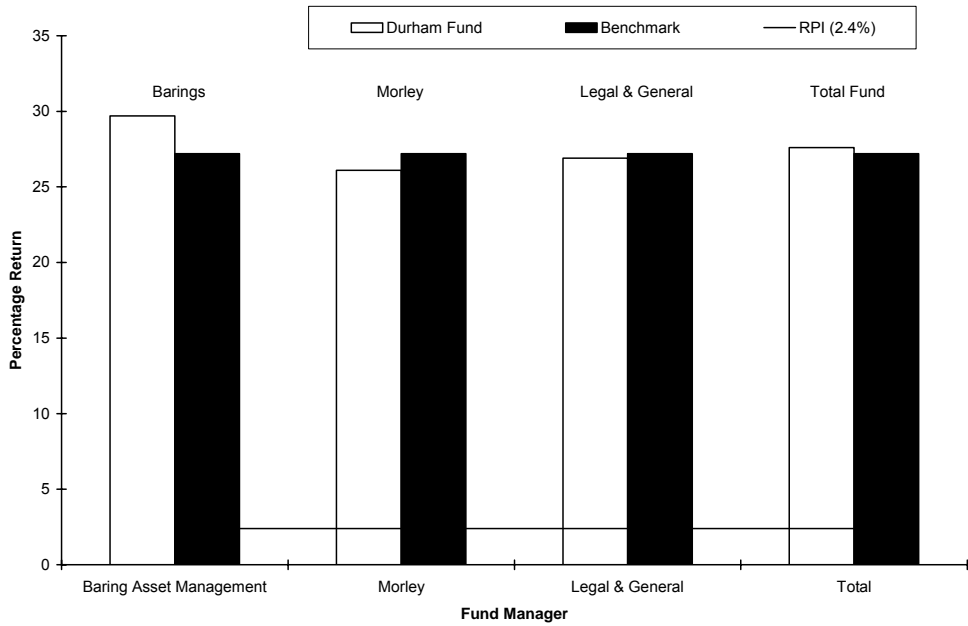
The performance of the investment managers was measured against the Russell Mellon Combined Actuarial Performance Service (CAPS) which provides a comparison with returns from other pension funds.

The median return for the year ended 31st March 2006, based on all funds participating in the CAPS survey, was 27.2%. By comparison, the Durham County Council Fund return was 27.6%.

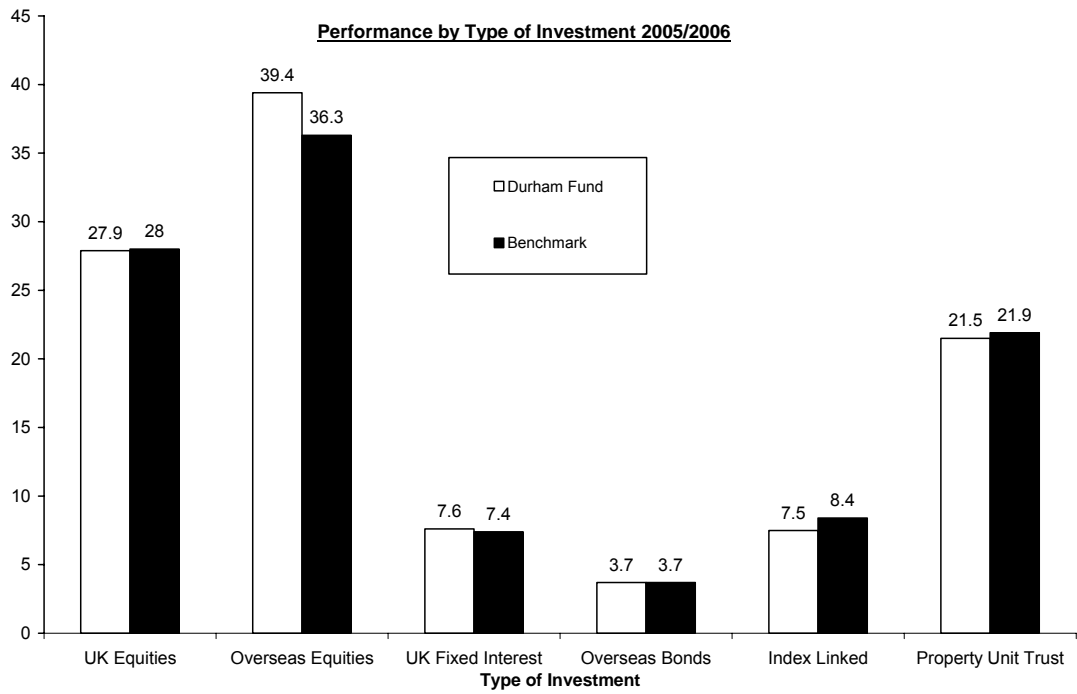
The following charts illustrate various aspects of Fund performance by comparing investment returns to a benchmark of the CAPS median return and increases in the Retail Price Index (RPI).

The CAPS Median is no longer available from 31st December 2003 and since this time the Fund has been measured against a CAPS Median “rolled forward” to 31st March 2006. This benchmark is under review by the Pension Fund Committee.

Performance of Fund Managers-2005/2006

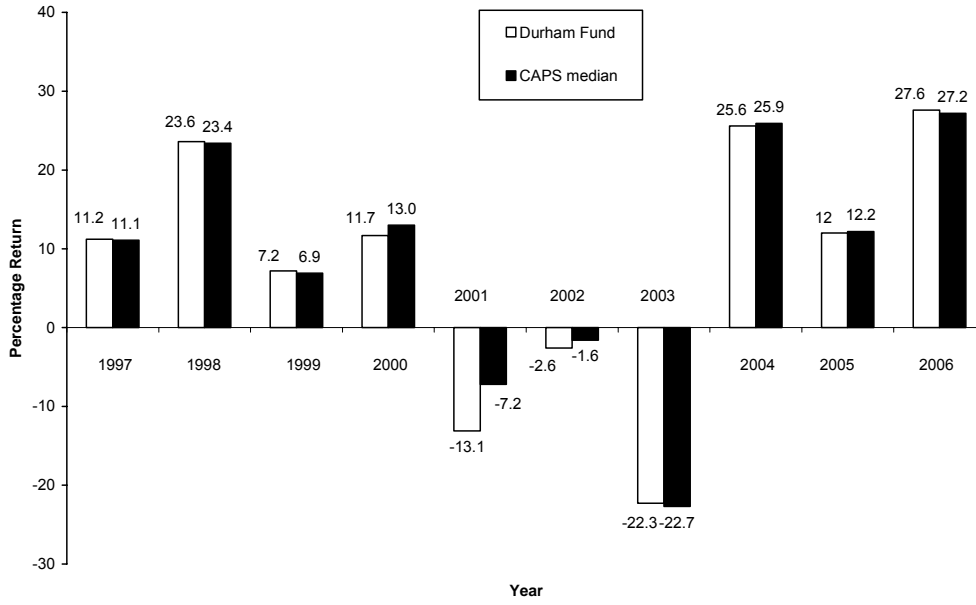


Performance by Type of Investment 2005/2006

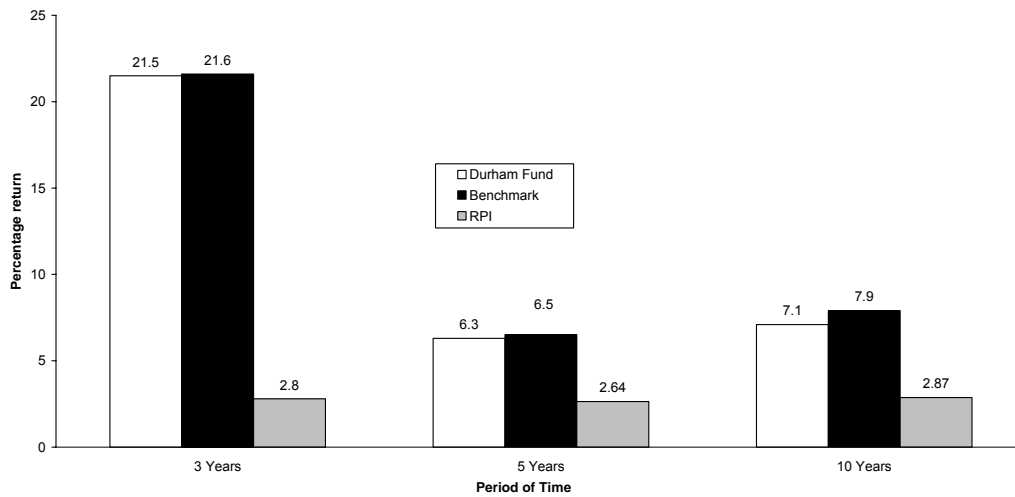


INVESTMENTS

Annual Performance of The Fund for each of the last 10 years



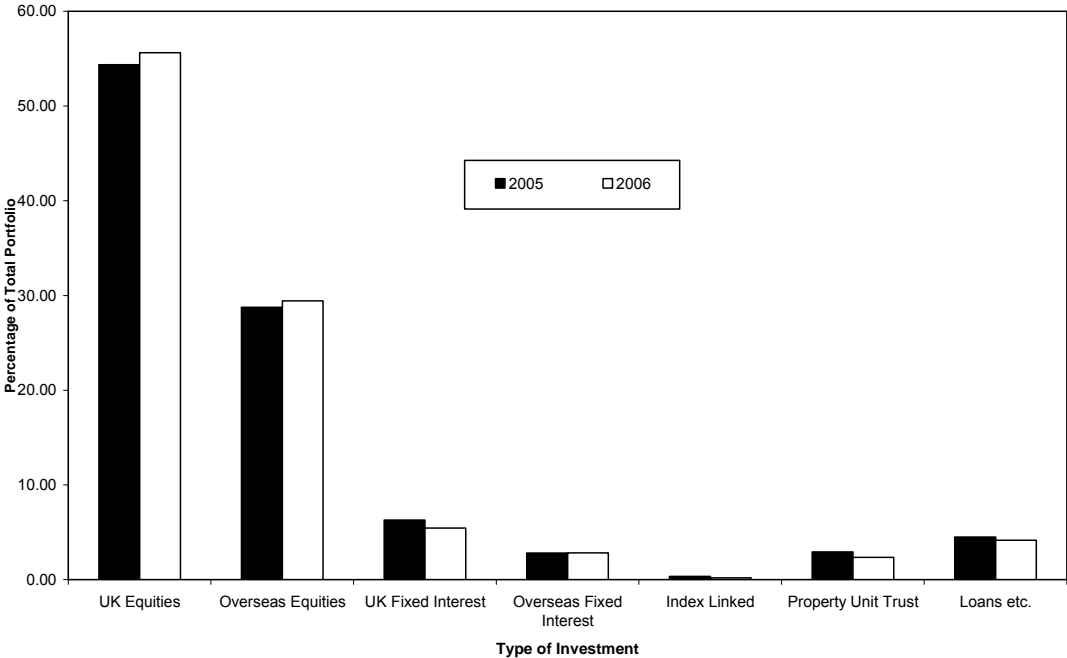
Long term performance of the Fund



INVESTMENTS

DISTRIBUTION OF INVESTMENTS

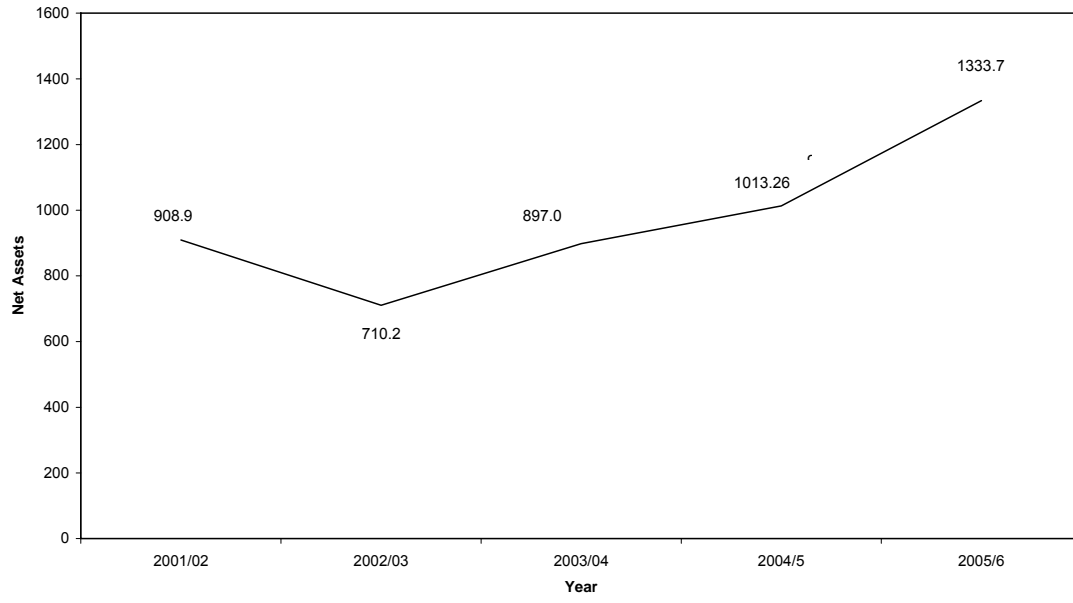
The following graph shows the distribution of Fund investments (by market value) at the beginning and end of the year. Further details of the distribution are shown in Appendix 5.



NET ASSETS OF THE FUND

The graph overleaf shows how the net assets of the Fund have changed over the last five years:

Net Assets of the Fund (£m)



ACTUARIAL VALUATION - REPORT OF ACTUARY

Introduction

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

Actuarial Position

1. Rates of contributions paid by the participating Employers during 2004/05 were based on the actuarial valuation carried out as at 31 March 2001.
2. That valuation showed that the required level of contributions to be paid to the Fund by participating Employers (in aggregate) with effect from 1 April 2002 was as set out below:
 - 210% of members' contributions to meet the liabilities arising in respect of service after the valuation date.
Plus
 - 120% of members' contributions to restore the assets to 100% of the liabilities in respect of service prior to the valuation date, over a recovery period of 13 years.
Less
 - 30% of members' contributions in respect of higher assumed investment income over the short term.
3. The valuation as at 31 March 2004 showed that the financial position of the Fund had deteriorated since the previous valuation with the market value of the Fund's assets of £897.0m, after application of a smoothing adjustment, covering 61% of the liabilities allowing, in the case of current contributors to the Fund, for future increases in pensionable remuneration.
4. The valuation also showed that the required level of contributions to be paid to the Fund by participating Employers (in aggregate) with effect from 1 April 2005 was as set out below:
 - 230% of members' contributions to meet the liabilities arising in respect of service after the valuation date.
Plus
 - 190% of members' contributions to restore the assets to 100% of the liabilities in respect of service prior to the valuation date, over a recovery period of 22 years.

Less

- 105% of members' contributions in respect of higher assumed investment income over the short term.

These figures were based on the Regulations that applied at the time of signing the valuation report, and in particular allowed for the changes in the Regulations that were effective from 1 April 2005, but these have since been revoked. The government has promised further compensating changes to apply from April 2006.

5. The majority of Employers participating in the Fund pay different rates of contributions depending on their past experience, their current staff profile, and the recovery period agreed with the Administering Authority. For many employers where the valuation indicated a significant increase in contributions from 1 April 2005, the Administering Authority has agreed with employers that the increase can be stepped over a period not exceeding 3 years.

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

6. The rates of contributions payable by each participating Employer over the period 1 April 2005 to 31 March 2008 are set out in a certificate dated 24 March 2005 which is appended to our report of the same date on the actuarial valuation.
7. The contribution rates were calculated using the projected unit actuarial method and taking account of the Fund's funding strategy as described in the Funding Strategy Statement.

The main actuarial assumptions were as follows:

Discount rate for periods

In service	6.2% per annum
Left service	5.2% per annum
Rate of general pay increases	4.4% per annum
Rate of increases to pensions in payment (in excess of Guaranteed Minimum Pensions)	2.9% per annum
Return over the three years following the valuation on equities/property	7.7% per annum
other assets	5.2% per annum
Valuation of assets	smoothed market value.

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

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

Hewitt Bacon & Woodrow does not accept any responsibility or liability to any party other than our client, Durham County Council, in respect of this statement.

Hewitt Bacon & Woodrow Limited
October 2005

PENSION FUND ACCOUNTS

FUND ACCOUNT

31 st March 2005			31 st March 2006	
£000	£000		£000	£000
72,995		CONTRIBUTIONS AND BENEFITS	77,419	
11,778		Contributions receivable (see Note 3)	12,629	
	84,773	Individual Transfers in		90,048
54,534		Benefits payable (see Note 4)	57,182	
8,400		Payments to and on account of Leavers (see Note 5)	12,031	
1,146		Administrative expenses (see Note 6)	1,122	
	64,080			70,335
	20,693	Net additions or withdrawals(-) from dealings with members		19,713
		RETURNS ON INVESTMENTS		
19,221		Investment income (see Note 7)	22,504	
77,614		Change in market value of investments (see Note 8)	279,513	
-1,218		Investment management expenses (see Note 9)	-1,312	
	95,617	NET RETURNS ON INVESTMENTS		300,705
	116,310	NET INCREASE IN THE FUND DURING THE YEAR		320,418
	896,972	NET ASSETS OF THE FUND AT 1ST APRIL		1,013,282
	1,013,282	NET ASSETS OF THE FUND AT 31ST MARCH		1,333,700

NET ASSETS STATEMENT

As at 31 st March 2005			As at 31 st March 2006	
£000	£000		£000	£000
51,247		INVESTMENTS (see Note 8)	64,845	
440,505		Fixed interest securities	629,29	
		Equities	1	
2,500		Index linked securities	1,241	
473,407		Managed and unitised funds	582,86	
			2	
36,259		Cash and Short Term Investments	43,768	
4,093		Other investments	5,854	
	1,008,011			1,327,861
	5,271	Current assets and liabilities (see Note 10)		5,839
	1,013,282	NET ASSETS OF THE FUND AT 31ST MARCH		1,333,700

NOTES TO PENSION FUND ACCOUNTS

1. BASIS OF PREPARATION

The Pension Fund accounts have been prepared in accordance with the accounting recommendations of Financial Reports of Pension Schemes – A Statement of Recommended Practice. However, disclosures have been limited to those required by the Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice.

The financial statements summarise the transactions of the Fund and deal with the net assets at the disposal of the management. They do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial position of the Fund which does take account of such obligations is dealt with in Note 14.

2. ACCOUNTING POLICIES

The following principal accounting policies, which have been applied consistently, have been adopted in the preparation of the financial statements:

INVESTMENTS

(a) *Valuation of Investments* -

Investments are shown at their market value which has been determined as follows:

- (i) Securities traded through the Stock Exchange Electronic Trading Service (SETS) are valued on the basis of the latest mid-market price. Other quoted investments are valued on the basis of the mid-market value quoted on the relevant stock market at 31st March.
- (ii) Unit Trusts and managed funds are valued at the average of the bid and offer prices provided by the relevant fund managers, which reflect the market value of the underlying investments.
- (iii) Overseas securities and cash are translated into sterling at the rate ruling at the balance sheet date.
- (iv) Fixed Interest Stocks have been included in the accounts at market value, which does not include accrued interest, which is included within accrued investment income.
- (v) Unlisted securities are valued by the fund managers at the year-end in accordance with generally accepted guidelines.

NOTES TO PENSION FUND ACCOUNTS

(b) ***Investment income*** -

Income from equities is accounted for on the date stocks are quoted ex-dividend. Income from overseas investments is recorded net of any withholding tax where this cannot be recovered.

Income from fixed interest and index-linked securities, cash and short-term deposits is accounted for on an accruals basis.

Income from other investments is accounted for on an accruals basis.

Foreign income has been translated into sterling at the date of the transactions, when received during the year, or at the exchange rates applicable at 31st March where amounts were still outstanding at the year-end.

(c) ***Investment transactions*** -

Investment transactions arising up to 31st March but not settled until later are accrued in the Accounts.

CONTRIBUTIONS

Contributions represent the total amounts receivable from the various employing authorities in respect of their own contributions and those of their pensionable employees. The employers' contributions are made at rates determined by the Fund's Actuary.

Contributions due at 31st March are accrued in the Accounts but no provision is made for employees' and employers' contributions relating to sums due on pay awards not yet settled.

BENEFITS PAYABLE

Under the rules of the Scheme, members receive a lump sum retirement grant in addition to their annual pension. Lump sum retirement grants are accounted for from the date of retirement. Where a member can choose whether to take a greater retirement grant in return for a reduced pension these lump sums are accounted for on an accruals basis from the date the option is exercised.

Other benefits are accounted for on the date the member leaves employment or on death.

TRANSFERS TO AND FROM OTHER SCHEMES

Transfer values represent the capital sums either receivable in respect of members from other pension schemes of previous employers or payable to the pension schemes of new employers for members who have left employment. Transfers are accounted for on a cash basis in accordance with Financial Reports of Pension Schemes – A Statement of Recommended Practice.

NOTES TO PENSION FUND ACCOUNTS

ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVC's)

Money purchase AVCs and movement in money purchase AVCs are not shown in the accounts, but as a note to the accounts (see Note 12).

3. CONTRIBUTIONS RECEIVABLE

2004/2005		2005/2006
£000		£000
50,556	Employers - normal contributions	56,877
9	additional contributions	-
4,416	Special contributions	1,301
17,921	Employees - normal contributions	19,180
93	additional contributions	61
72,995		77,419
34,548	Durham County Council	36,640
38,177	Scheduled bodies	40,407
270	Admitted bodies	372
72,995		77,419

4. BENEFITS PAYABLE

2004/05		2005/06
£000		£000
51,513	Pensions	54,670
6,979	Commutations and lump sum retirement grants	6,644
706	Lump sum death grants	563
-4,664	Recharged benefits	-4,695
54,534		57,182
24,686	Durham County Council	28,621
29,753	Scheduled Bodies	28,416
95	Admitted Bodies	145
54,534		57,182

Recharged benefits relate to benefit enhancements to retirees awarded and funded by employers. The cost of these additional enhancements is recovered from employers as the additional benefits are incurred.

NOTES TO PENSION FUND ACCOUNTS

5. PAYMENTS TO AND ON ACCOUNT OF LEAVERS

2004/05		2005/06
£000		£000
185	Refunds to members leaving service	119
-37	Payments for members joining state scheme	191
8,252	Individual transfers to other schemes	10,470
-	Group Transfer - Centrex	1,251
8,400		12,031

6. ADMINISTRATIVE EXPENSES

2004/05		2005/06
£000		£000
958	Recharges from Durham County Council	962
51	CLASS – CPX pensions system	45
4	FRS 17	5
36	Actuarial consultancy fees	-
35	Audit fees	12
7	Subscriptions	6
64	Consultancy Fees	91
3	Legal Services	3
5	Euraplan investment monitoring system	13
0	Debts Written off	7
21	Publications	18
2	Other	2
	Receipts -	
-3	costs received on pensions increase	-3
-37	consultancy fees recharged	-39
1,146		1,122

A proportion of relevant officers' salaries has been charged to the Fund on the basis of actual time spent on investment and related matters and pensions administration. Certain specific expenses have been charged directly to the Fund and other office expenses and related overheads have been charged to the Fund in proportion to the salaries charged.

NOTES TO PENSION FUND ACCOUNTS

7. INVESTMENT INCOME

2004/05		2005/06
£000		£000
2,386	UK Investments -	2,384
99	Fixed interest securities	40
10,483	Index linked securities	13,165
1,882	Equities	2,029
1,551	Income from cash deposits	1,275
	Property unit trusts	
495	Overseas Investments -	685
11	Fixed interest securities	16
2,314	Index linked securities	2,910
	Equities	
19,221		22,504

8. INVESTMENTS

<i>Value at 31.3.05</i>	<i>Purchases at cost</i>	<i>Sales proceeds</i>	<i>Change in market value</i>	<i>Value at 31.3.06</i>
£000	£000	£000	£000	£000
1,008,011	653,309	-612,972	279,513	1,327,861

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

NOTES TO PENSION FUND ACCOUNTS

NOTE 8 (CONTINUED)

31.3.05		31.3.06
£000		£000
35,454	Fixed interest securities -	40,491
-	UK – Government	-
12,266	UK - other	24,354
3,527	Overseas - Government	-
51,247	Overseas - other	64,845
	Equities -	
321,832	UK quoted	444,446
371	UK unquoted	431
118,302	Overseas quoted	184,409
-	Overseas unquoted	5
440,505		629,291
	Index linked securities -	
1,969	UK quoted	679
531	Overseas quoted	562
2,500		1,241
	Managed and unitised funds -	
239,355	Managed funds - non-property - UK	307,157
114,721	Managed funds – non-property – overseas	161,787
18,590	Unit Trusts – non-property-UK	23,081
71,070	Unit Trusts – non-property-Overseas	59,679
29,671	Unit Trusts - property	31,158
473,407		582,862
	Cash and Short Term Investments -	
782	Loans - long term - local authorities	765
30,247	Loans - short term - money market	34,898
5,230	Cash in Hand	8,105
36,259		43,768
	Other Investments -	
159	Investment transactions	529
3,875	Dividend Accruals	5,263
59	Recoverable Taxation	62
4,093		5,854

NOTES TO PENSION FUND ACCOUNTS

9. INVESTMENT MANAGEMENT EXPENSES

2004/05		2005/06
£000		£000
1,168	Administration, management and custody	1,222
12	Performance measurement services	11
38	Other advisory fees	79
1,218		1,312

The investment managers are paid quarterly fees in arrears on a sliding scale based on the market value of the investments managed at the end of each quarter.

10. CURRENT ASSETS AND LIABILITIES

2004/05		2005/06
£000		£000
5,953	Contributions	7,156
0	Transfer Values	-70
811	Refunds and Pensions	158
-1,493	Administration expenses	-1,405
5,271		5,839

11. OPERATION AND MEMBERSHIP OF THE FUND

The fund provides benefits for employees of Durham County Council, Durham County Magistrates' Courts and Probation Services, Durham Police Authority (civilians), District, Parish and Town Councils within the County, Commission for New Towns and certain other bodies. On retirement, contributors receive payments of lump sums and annual pensions. Entitlement to these benefits arises mainly on the grounds of reaching retirement age and retirement through ill health, through early retirement schemes or being made redundant. Contributors who leave and who are not immediately entitled to these benefits may have their pension rights transferred or preserved until reaching retirement age. In a minority of cases refunds of contributions can be made.

NOTES TO PENSION FUND ACCOUNTS

12. ADDITIONAL VOLUNTARY CONTRIBUTIONS

The Fund offers two types of AVC arrangement:

- (a) Purchase of additional years of service, which is invested as an integral part of the Fund's assets.
- (b) Money purchase scheme, managed separately by HECM, Standard Life and Prudential. Funds may be invested in three funds – deposit, with-profits and managed.

	Value at 01.04.05	Purchases	Sales	Change in Market Value	Value at 31.03.06
	£	£	£	£	£
HECM	2,791	102	298	225	2,820
Prudential	895	284	58	90	1,211
Standard Life	1,002	99	124	204	1,181
Total	4,688	485	480	519	5,212

In line with the recommendations of the Code of Practice in Local Authority Accounting; A Statement of Recommended Practice, AVC contributions have not been included in the Statement of Accounts of the Pension Fund.

13. CURRENCY HEDGING

Baring Asset Management Limited have authority to enter into foreign exchange contracts to buy and sell US Dollars, Japanese Yen and Euros up to the value of 80% of the portfolio's American, Japanese, French, German and Italian holdings, in order to hedge against inflation in those currencies.

14. ACTUARIAL POSITION OF THE FUND

The latest valuation of the Fund was undertaken as at 31st March 2004, by the Pension Fund's Actuary, Hewitt Bacon and Woodrow. The results disclosed a funding deficit of £589.1m and a funding level of 61%.

The Actuary has set contribution rates for all employers who contribute to the Fund to eliminate the funding deficit over an agreed period of time, the recovery period. The Administering Authority has agreed that the recovery period should be 22 years except for a number of Admitted Bodies.

For some employers the contribution rate payable increases in three steps up to the rate required to finance the funding target over the recovery period. Different rates are therefore payable by different employers.

NOTES TO PENSION FUND ACCOUNTS

The valuation results are sensitive to the choice of financial assumptions. The table below shows the key financial assumptions used for the valuation:

	%
Price inflation	2.9
Pay increases	4.4
Pension increases in excess of guaranteed minimum pension	2.9
Discount rate:	
For active members whilst in service	6.2
For members not in service before retirement	5.2
For members after retirement	5.2
Investment return on bond type assets	5.2
Investment return on equity and property assets	7.7

If the Actuary's assumptions are borne out in practice, the funding deficit of £589.1m as at 31st March 2004 would be eliminated by an aggregate contribution increase of 190% of members' contributions over the next 22 years reduced for the first three years by a short-term adjustment, which has the effect of reducing contributions payable, on average, by 105% of members' contributions over the 3-year period to 31st March 2008. The benefits expected to accrue to members in the future are also calculated and the rate of contribution that would be appropriate, if the fund had no surplus or deficit and the assets were exactly equal to the funding target, is 230% of members' contributions.

The overall contribution rate applicable from 1st April 2005 to 31st March 2008 can be summarised as follows:

	% Members' Contributions
Long-term rate	230
Deficit funding	190
Short-term adjustment	-105
Overall contribution rate	315

For the County Council the contribution rate will be stepped over three years reaching 315% of members' contributions in the year beginning 1st April 2007.

15. ANALYSIS OF MARKET VALUE OF INVESTMENTS OVER FUND MANAGERS

The Fund's investments are managed by three Fund Managers. Legal and General Investment Management and Barings Investment Management (appointed with effect from 1st October 1993), and Morley Fund Management (appointed with effect from 19th July 1999). Apart from the funds under the control of the Managers a small proportion is managed in-house. The market values of investments in the hands of each Manager were as follows:

NOTES TO PENSION FUND ACCOUNTS

At 31st March 2005			At 31st March 2006	
£000	%		£000	%
327,328	33.83	Legal and General Investment Management Limited	424,900	33.24
327,334	33.83	Baring Asset Management Limited	434,846	34.02
312,626	32.31	Morley Fund Management	418,063	32.71
371	0.03	Managed in-house	431	0.03
967,659	100.00		1,278,240	100.00

16. TAXATION

(a) *United Kingdom Tax*

The Fund is an exempt approved Fund under the Finance Act 1970 and is therefore not liable to UK income tax on interest and property income, or to capital gains tax.

(b) *Value Added Tax*

As Durham County Council is the administering authority for the Fund, VAT input tax is recoverable on most Fund activities.

(c) *Foreign Withholding Tax*

Income earned from investments in stocks and securities in the United States, Australia and Belgium is exempt from tax. In all other countries dividends are taxed at source and, where the tax paid at source is greater than the rate of tax under the '*Double Taxation Agreement*', the excess tax is reclaimable except in the case of Malaysia.

17. RELATED PARTY TRANSACTIONS

The long-term loans referred to in Note 8 are loans made to a number of the current and former participating employers of the Fund. The loans outstanding were made between March 1964 and May 1967, this being common practice at the time. No further loans have been granted since January 1974. The Pension Fund receives interest of between 5.75% and 6.875% on the outstanding balance per annum in addition to capital repayments. The maximum amount outstanding on these loans at any time during the year was the opening balance. The table below shows the balance outstanding on these loans as at 31st March 2006:

NOTES TO PENSION FUND ACCOUNTS

Employer	Amount Outstanding 31st March 2006 £
Wansbeck District Council	180,203.63
Sedgefield Borough Council	255,771.50
Sunderland City Council	329,067.77

18. STATEMENT OF INVESTMENT PRINCIPLES

The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999 require the County Council to prepare and review a written statement of the investment policy of the Pension Fund. Such a Statement has been adopted by the Pension Fund Committee and is shown at Appendix 4. The Statement is currently being reviewed as a result of the Myners Report which set out a number of principles of best practice.

19. CAPITAL COMMITMENTS

At present the Pension Fund has invested £300,000 in Capital North East, but has entered into a commitment to invest up to £500,000 in this organisation, which provides start-up and development capital for businesses in the North East.

20. OTHER INFORMATION

Further information about the Fund can be obtained from The County Treasurer, County Hall, Durham, DH1 5UE.

APPENDIX 1

PARTICIPATING BODIES AND THEIR CONTRIBUTION RATES

The contribution rates of participating bodies are shown below, expressed as a percentage of members' contributions:

	2005/ 2006		2005/ 2006
	%		%
LOCAL AUTHORITIES		STATUTORY BODIES -	
Durham County Council	285	Durham Police Authority	255
Darlington Borough Council	290	Local Valuation Panels	285
Chester-le-Street District Council	365	Central Durham Joint Crematorium Committee	285
Derwentside District Council	390	County Durham and Darlington Fire and Rescue Authority	270
Durham City Council	375	County Durham Probation Service	270
District of Easington	410		
Sedgefield Borough Council	320		
Teesdale District Council	340		
Wear Valley District Council	300		
Parish Councils -		COLLEGES -	
Brandon and Byshottles	285	Bishop Auckland College	190
Chilton	285	Darlington College	210
Hutton Henry	285	Darlington QE 6 th Form	225
Easington Colliery	285	Derwentside College	215
Easington Village	285	New College, Durham	240
Esh	285	East Durham & Houghall Community College	210
Fishburn	285		
Framwellgate Moor	285		
Horden	285		
Monk Hesleden	285	ADMITTED BODIES -	
Murton	285	Barnard Castle School	205
North Lodge	285	Shildon and Darlington Training Limited	425
Shotton	285	Derwentside Leisure Ltd.	240
Thornley	285	Bowes Museum	385
Trimdon	285	East Durham Homes	375
Trimdon Foundry	285		
Wheatley Hill	285		
Wingate	285		
Town Councils -			
Ferryhill	285		
Great Aycliffe	285		
Peterlee	285		
Seaham	285		
Sedgefield	285		
Shildon	285		
Spennymoor	285		

APPENDIX 2

MEMBERSHIP STATISTICS

(1)	Summary of Pensionable Employees				Summary of Pensioners			
	Pensionable employees as at 31.3.05 (2)	Add New-comers during year (3)	LESS Leavers during year (4)	Pensionable employees as at 31.3.06 (5)	Pensioners as at 31.3.05 (6)	Add New pensioners during year (7)	LESS Pensioner Deaths During Year (8)	Pensioners as at 31.3.06 (9)
Durham CC	9,539	1,297	973	9,863	7,163	372	276	7,259
Darlington BC	2,573	327	280	2,620	1,113	36	39	1,110
District Councils:								
Chester-le-Street	398	51	42	407	433	14	17	430
Derwentside	647	29	45	631	822	18	24	816
Durham City	610	61	65	606	820	30	24	826
Easington	485	39	32	492	961	18	39	940
Sedgefield Borough	885	87	86	886	787	24	30	781
Teesdale	143	14	24	133	93	9	5	97
Wear Valley	424	33	28	429	525	8	20	513
Town Councils	160	10	17	153	67	6	3	70
Parish Councils	56	4	4	56	31	1	1	31
Joint Crem.Comm								
Central Durham	8	0	0	8	6	0	0	6
Statutory Bodies:								
Local Valuation Panels	6	0	1	5	4	1	0	5
Colleges:								
Bishop Auckland	157	16	16	157	12	2	0	14
Darlington College	201	35	37	199	35	6	2	39
DarlingtonQE6 th Form	54	5	4	55	3	1	0	4
Derwentside	125	10	54	81	24	21	0	45
NewCollege Durham	261	43	90	214	62	4	0	66
East Durham & Houghall Comm. College	199	43	18	224	29	5	0	34
Durham Police Auth.	821	54	52	823	101	10	3	108
County Durham and Darlington Fire and Rescue Authority	111	14	15	110	9	2	0	11
Durham Probation Service	274	22	12	284	21	5	0	26
Magistrates' Courts*	121	0	121	0	63	3	0	66
Admitted Bodies:								
Barnard Castle Sch.	58	11	8	61	13	0	0	13
Shildon & Darlington Training Limited	3	0	0	3	2	0	0	2
Derwentside Leisure	39	0	5	34	2	3	0	5
Bowes Museum	12	0	2	10	8	2	0	10
3 Rivers Housing	2	0	0	2	0	0	0	0
East Durham Homes	369	7	26	350	14	2	0	16
Hobson Golf Club	2	0	0	2	0	0	0	0
Murton Welfare Ass.	5	0	0	5	0	0	0	0
Peterlee Fire Co.	0	2	0	2	0	0	0	0
Former Admitted Bodies	0	0	0	0	397	5	33	369
Commission for New Towns	0	0	0	0	5	0	0	5
Other Employers Pre 1974	0	0	0	0	44	6	9	41
Total	18,748	2,214	2,057	18,905	13,669	614	525	13,758

*Magistrates Courts all transferred to Civil Service

APPENDIX 3

PENSION BENEFITS

The pension is paid at the rate of one-eightieth of pay for each year of membership subject to an overall maximum of forty-five years at age sixty-five (forty years for employees who commenced membership of the Scheme on or after 1st June 1989).

Retirement grants are based on three-eightieths of pay and are subject to the same maximum rule. A married man with service prior to 1st April 1972, who has not elected to purchase this service (or did not complete the purchase of service), will have the membership value of the unpurchased service reduced by 11%.

Where a member dies in office a lump sum in the form of a death grant would be paid to the member's estate. This death grant is equal to two years' pay.

Widows' and children's pensions are paid in appropriate circumstances. The widow's pension is at a rate of half the member's pension and children receive a pension of one-quarter of the member's pension, subject to a maximum of half for two or more children. Widower's pensions are also payable (based on membership from April 1988 unless the employer has resolved to include all service).

In the main, benefits are payable immediately on leaving in the following circumstances:

- (a) On reaching sixty-five years of age (both men and women).
- (b) Between age sixty and sixty-five (if the employee was a Scheme member on 31st March 1998):
 - (i) full benefits would be paid if the member had twenty-five years membership or more;
 - (ii) reduced benefits may be paid if the member had at least three months but less than twenty-five years membership.
- (c) At age 50 or over with at least three months membership if the member retires under the Rule of 85. The member will require employer consent if under age 60 years. The 85 year Rule means that if a member's age (in whole years) and membership (in completed years) equals or exceeds 85 in total, then full benefits would be paid. Otherwise reduced benefits may be paid. From 1st October 2006 the Rule of 85 has been removed for all new entrants and there is protection for current employees up to 1st April 2013 under the rule.

- (d) At any age with at least three months membership if the member retired on ill-health. In the case of death in service, dependants' benefits are paid even if the membership is less than three months. For both ill-health retirement and death in office an additional period of membership is awarded under the Local Government Pension Scheme Regulations where membership is at least five years.
- (e) At age fifty and over with at least three months membership if the member is made redundant, or retires under an employer's early retirement scheme. If membership is at least five years, an additional period of membership up to a maximum of ten years may be awarded under the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations, 2000 by the employer. The employer, not the Fund, pays for this additional period of membership, either on a pay-as-you-go basis or by extra contributions to the Fund set by the Actuary.

If a member leaves with at least three months membership and is not entitled to immediate payment of benefits and does not elect for a transfer of accrued benefits, deferred benefits are awarded. Deferred benefits are benefits which are '*frozen*' in the Fund and are paid when the member reaches retirement age. Such benefits are subject to cost of living increases between the date of leaving and the date of payment.

DURHAM COUNTY COUNCIL

PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES **(AS AMENDED)**

INTRODUCTION

1. The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 1999 requires administering authorities to prepare and review a written statement recording the investment policy of the pension fund.
2. Durham County Council is the administering authority for the Durham County Council Pension Fund and the purpose of this document is to outline the broad investment principles governing the investment policy of the Pension Fund, thereby satisfying the requirements of the regulations.

INVESTMENT RESPONSIBILITIES

3. The Pension Fund Committee has responsibility for:
 - Preparing the Statement of Investment Principles;
 - Monitoring compliance with the Statement and reviewing its contents from time to time;
 - Appointing the investment managers and any external consultants felt to be necessary;
 - Appointing the custodian;
 - Reviewing on a regular basis the investment managers' performance against established benchmarks, and satisfying themselves as to the managers' expertise and the quality of their internal systems and controls; and
 - Ensuring that investments are sufficiently diversified, are not over concentrated in any one type of investment, and that the fund is invested in suitable types of investments.

APPENDIX 4

4. The investment managers are responsible for:
 - The investment of the pension fund assets in compliance with prevailing legislation, the constraints imposed by this document and the detailed Investment Management Agreement;
 - Tactical asset allocation around the strategic benchmark set out in Section 10(a) below;
 - Stock selection within asset classes;
 - Preparation of quarterly reports, including a review of investment performance;
 - Attending meetings of the Pension Fund Committee as requested;
 - Assisting the County Treasurer and Pension Fund Committee in the preparation and review of this document; and
 - Voting shares in accordance with the Fund's policy.
5. The Custodian is responsible for:
 - Its own compliance with prevailing legislation;
 - Providing the administering authority with quarterly valuations of the Scheme's assets and details of all transactions during the quarter;
 - Collection of income, tax reclaims, exercising corporate administration and cash management.
6. The Independent Advisers are responsible for:
 - Assisting the County Treasurer and Pension Fund Committee in the preparation and review of this document;
 - Assisting the County Treasurer and Pension Fund Committee in their regular monitoring of the investment managers' performance; and
 - Assisting the County Treasurer and Pension Fund Committee in the selection and appointment of investment managers and custodians.
7. The Actuary is responsible for:
 - Providing advice as to the maturity of the Scheme and its funding level in order to aid the Pension Fund Committee in balancing the short term and long term objectives of the pension fund.

APPENDIX 4

8. The County Treasurer is responsible for:

- Ensuring compliance with this document and bringing breaches thereof to the attention of the Pension Fund Committee; and
- Ensuring that this document is regularly reviewed and updated in accordance with the Regulations.

AUTHORISED INVESTMENTS

9. Approval has been given to investment as follows:

(a) **In-House Management**

(i) ***Midland Enterprise Fund for the North East Exempt Unit Trust***

Small, private and growing companies in the North East of England:

- £200,000 invested.

(ii) ***Capital North East***

Start up and develop capital for businesses in the North East:

- £300,000 invested, up to £500,000 may be invested.

(b) **External Investment Managers**

(i) ***Index-linked stocks***

Gilts (Government Stocks)

(ii) ***Fixed Interest***

Gilts (Government Stocks)

Sterling Bonds (Bulldogs, Corporate Debentures and Loan Stocks, Eurosterling Bonds)

Overseas Fixed Interest Bonds

Internal Pooled Funds

- BAM UK Intermediate Corporate Bond Fund} 30% of gilt
- BAM UK Long Maturity Corporate Bond Fund} holdings

(iii) **UK Equities**

Direct

Investment Trusts

Unit Trusts

Internal Pooled Funds:

- BAM UK Equity Small-Cap Fund -
limit 9% of UK equity and property unit trust holdings
- BAM UK Equity Mid-Cap Fund -
limit 9% of UK equity and property unit trust holdings

(iv) **Overseas Equities** provided freely negotiable

Direct:

- Japan
- USA
- USA Small Companies Fund
- Europe - markets in FTA (ex UK) Europe Index
Index includes: Austria, Belgium, Denmark, Finland, France,
Germany, Greece, Ireland, Italy, Netherlands, Norway,
Portugal, Spain, Sweden, Switzerland.
- Canada
- Australia, Hong Kong, Malaysia, New Zealand, Singapore,
Thailand.

Investment Trusts - Japan, Korea

Unit Trusts - Japan

Internal Pooled Funds:

- BAM Emerging Markets Fund - 4% of portfolio
- Legal and General Latin America fund - 0.4% of portfolio
- CU Morley European Exempt Trust
- CU Morley Far Eastern Exempt Trust
- Commercial Union Privilege Portfolio Emerging Countries Fund
- CUPPT Smaller Companies Fund
- BAM American Smaller Companies – 5% of US portfolio

(v) **Property (UK)**

Unit Trusts

(vi) **Cash**

The Manager may hold cash up to the value of 2% of the market value of the portfolio. Cash in excess of this value should be returned to Durham County Council as Administering Authority.

APPENDIX 4

(vii) ***Underwriting***

The Manager may only underwrite securities where the Manager would be prepared to acquire those shares at the price underwritten. The value of securities underwritten should not exceed the value of cash holdings (less known commitments) and short term deposits.

(viii) ***Currency Hedging***

Barings have authority to enter into foreign exchange contracts to buy and sell US Dollars, Japanese Yen, and Euros up to the value of 80% of the portfolio's American, Japanese, French, German and Italian holdings, respectively, in order to hedge against inflation in those currencies.

(c) **Legal and General Investment Management**

Managed Insurance Funds:

UK Equities)	
European Equities)	<i>Limit -</i>
Japan Equities)	35% of total Pension Fund
Other Pacific Equities)	

This limit was changed at the Pension Fund on 26th January 2004 in order to allow Legal and General to continue to mirror the asset structure of the median fund. This limit is in accordance with the 1998 Regulations (as amended) and will be reviewed on an annual basis.

ASSET ALLOCATION

10. The distribution of assets must be maintained within the following ranges:

(a) **Balanced (Active) Fund Managers**

ASSET CLASS	RANGE <i>(Percentage of Portfolio)</i>
UK Equities	45 - 65
Overseas Equities (Total)	5 - 35
Including:	
- Europe	0 - 15
- USA and Canada	0 - 15
- Japan	0 - 15
- Other	0 - 15
Index-Linked	0 - 10
Fixed Interest	5 - 25
Property	0 - 10
Cash	0 - 10

(b) **Consensus (Passive) Manager**

The asset allocation is to replicate the Russell Mellon CAPS (CAPS) average fund asset distribution (excluding property).

STOCK SELECTION

11. Individual investments are chosen by the managers with the Committee able to question the managers on their actions and, if necessary, issue direction thereon at each quarterly meeting.

APPENDIX 4

INVESTMENTS REQUIRING PRIOR APPROVAL

12. A detailed report must be submitted to and approved by the Committee prior to making investments in the following:
- (a) ***Foreign currency*** -
Currency can be purchased in advance of buying overseas equities. Sale proceeds of overseas equities can be retained pending reinvestment.
 - (b) ***Venture capital***
 - (c) ***Commodities***
 - (d) ***Internal pooled funds***
 - (e) ***Other countries***
 - (f) ***Futures, options and contracts for differences***
 - (g) ***Currency Hedging*** -
Agreed in principle, subject to prior consultation with County Treasurer.

PERFORMANCE OBJECTIVES

13. The performance objectives of the fund managers are as follows:

(a) **Balanced (Active) Fund Managers**

Baring Asset Management and Morley Fund Management

- (i) **Long-term objective:** to achieve returns of 0.5% per annum above the CAPS Total Fund (including property) Median, over rolling three year periods.
- (ii) **Short-term objective:** returns should not be worse than 1.0% per annum below the CAPS Total Fund (including property) Median over rolling twelve month periods.

(b) **Consensus (Passive) Manager**

Legal and General Investment Management

The performance objective is to track the relevant indices for each asset class and market, as follows:

<u>Asset Class</u>	<u>Index</u>
<i>UK Equities</i>	FTSE All-Share Index
<i>North American Equities</i>	FTSE North America Index (in Sterling)
<i>Japanese Equities</i>	FTSE Japan Index (in Sterling)
<i>European Equities</i>	FTSE Europe (ex UK) (in Sterling)
<i>Pacific Equities</i>	FTSE All World Asia Pacific (ex-Japan) Developed Index (in Sterling)
<i>UK Gilts</i>	FTSE-A Government (All Stocks) Index
<i>Index-Linked Gilts</i>	FTSE-A Index-Linked (All Stocks) Index
<i>Overseas Bonds</i>	JP Morgan Global (ex UK) Traded Bond Index (in Sterling)

SOCIALLY RESPONSIBLE INVESTING

14. The Fund Committee must act with the best financial interests of the beneficiaries in mind. The Committee believes that companies should be aware of the potential risks associated with adopting practices that are socially, environmentally or ethically unacceptable. As part of the investment decision-making process, Fund Managers are required to consider such practices and assess the extent to which this will detract from company performance and returns to shareholders.

APPENDIX 4

CORPORATE GOVERNANCE

15. Managers are required to exercise voting rights on behalf of the Fund when it is in the best interests of the Fund. The quarterly report from managers should include details of voting activity.

REPORTING REQUIREMENTS

16. The investment managers must report quarterly and their report should include reference to the following matters:

- (a) Managers' views on the economy and the proposed asset allocation for the future quarter.
- (b) Reports on any new investment policy issues requiring the approval of the Committee.
- (c) Performance during the previous quarter and previous twelve months.
- (d) Investment transactions schedule for the previous quarter.
- (e) A Portfolio valuation, including details of individual holdings.
- (f) Portfolio distribution and the changes in the markets - summary by:
 - (i) type of investment;
 - (ii) geographic and sector as appropriate.
- (g) Performance of internal pooled funds in which investments are held.
- (h) The commitments to underwriting.
 - (i) The cash position of the Fund.
 - (j) Voting activity.

17. A detailed report must be presented annually, by or on behalf of CAPS on the individual managers' fund performance and the combined fund performance.

This appendix sets out the extent to which Durham County Council as the administering authority of the Durham County Council Pension Fund complies with the ten principles of investment practice set out in the document published in April 2002 by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "CIPFA Pensions Panel Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom" (Guidance note issue No. 5).

Principle 1 - Effective decision-making

Fully compliant: Investment decisions are made by those with the skill, information and resources necessary to take them effectively. A training programme covering investment issues is being developed for new members joining the Pensions Committee.

Principle 2 – Clear objectives

Fully compliant: The overall investment objective for the Fund is set out in the Funding Strategy Statement.

Principle 3 – Focus on asset allocation

Fully compliant: All major asset classes are considered. An asset liability modelling exercise is being considered as part of the ongoing review of the administration of the Fund.

Principle 4 – Expert advice

Fully compliant: Two independent advisors were appointed in November 2004. Actuarial services have been subject to a separate open tender process.

Principle 5 – Explicit mandates

Partial compliance: Explicit written mandates agreed with all investment managers. Investment managers have been asked to report on transaction costs and commission.

Principle 6 – Activism

Partial compliance: Managers are required to exercise voting rights on behalf of the Fund when it is in the best interests of the Fund. The mandates do not specifically incorporate the principle of the US Department of Labor Interpretative Bulletin on activism.

Principle 7 – Appropriate benchmark

Fully compliant: Appropriate benchmarks have been set in consultation with the advisers and the actuary.

APPENDIX 4

Principle 8 – Performance measurement

Partial compliance: Performance of the Fund is measured, separate monitoring of Committee performance and adviser performance has yet to be established.

Principle 9 – Transparency

Partial compliance: Investment objective and asset allocation strategy covered in Funding Strategy Statement or Statement of Investment Principles. Manager and adviser fee structures still to be included.

Principle 10 – Regular reporting

Partial compliance: Funding Strategy Statement including Statement of Investment Principles available on the internet. A summary of overall Fund performance is reported to members of the Fund annually, considering splitting this down to manager level for the next report.

APPENDIX 5

UK EQUITIES

The following twenty largest holdings account for 62.6% of the Fund's investment in UK equities and 21.0% of the total Fund investments:

<i> Holding</i>	<i> Market Value as at 31st March 2006</i>
	£000
BP Amoco	41,106
HSBC	27,981
Royal Dutch	27,047
Glaxosmithkline	26,187
Vodafone	20,201
Royal Bank of Scotland	19,487
Barclays	14,121
Anglo-American	13,154
HBOS	12,203
BG Group	10,895
Astrazeneca	10,724
Prudential	10,137
Lloyds TSB	8,815
Standard Chartered	6,808
BHP Billiton	6,099
MAN Group	4,950
Alliance Unichem	4,632
Johnson Matthey	4,746
Tesco	4,620
Informa	4,549
	278,462

APPENDIX 5

FIXED INTEREST HOLDINGS

The following ten largest holdings account for 69.1% of the Fund's fixed interest holdings and 3.4% of the total portfolio:

<i> Holding</i>	<i> Market Value as at 31st March 2006</i>
	£000
Treasury 4.75% 7.9.15	9,714
Treasury 8% 7.12.15	9,705
Treasury 5% 7.3.12	7,148
General Electric 1.4% 2/11/06	4,621
Treasury 8% 2021	2,871
Treasury 4% 07/09/16	2,613
Germany 3.75% 2013	2,180
Treasury 4.75% 7.3.20	2,118
Treasury 6% 7.12.28	1,970
Treasury 4.25% 7.3.11	1,898
	44,838

APPENDIX 5

FUNDS AND UNITS

The following ten Funds and Units comprise 36.3% of the total Fund investments:

<i> Holding </i>	<i> Market Value as at 31st March 2005 </i>
	£000
Legal and General UK Equity Fund Units	251,557
Legal and General Europe (Ex-UK) Index Fund	57,633
Legal and General Asia Pacific (Ex-Japan) Index Fund	30,581
MPP Asia Pacific Equities	26,501
Legal and General Japan Equity Index Fund	22,525
Legal and General N America Equity Fund Units	21,857
Morley Pooled Japan Equities	20,384
BAM UK Equities Mid-Cap Fund	19,596
NU UK Smaller Companies Fund	17,473
Legal and General Overseas Bond Index Fund	13,310
	481,417

APPENDIX 5

OVERSEAS HOLDINGS

The following ten largest overseas equity holdings account for 17.1% of the Fund's investment in overseas equities and 2.4% of the total portfolio:

<i> Holding</i>	<i> Market Value as at 31st March 2006</i>
	£000
S & P Emini Futures June 2006	8,265
Total	3,146
BBVA	2,945
Axa	2,864
UBS	2,658
Fresenius	2,477
E.on	2,376
BHP Billiton	2,351
Roche	2,236
Allianz	2,163
	31,481

PROPERTY UNIT TRUSTS

The following holdings in property unit trusts comprise 2.4% of the total Fund investments:

<i> Holding</i>	<i> Market Value as at 31st March 2006</i>
	£000
Hermes	10,327
Schroder	8,281
Hanover	6,412
LAMIT	3,289
Merrill Lynch & Co	2,848
	31,157

APPENDIX 5

ANALYSIS OF INVESTMENTS BY FUND MANAGER (AS AT 31ST MARCH 2006)

	<i>Baring Asset Manage- -ment</i>	<i>Morley Fund Manage- -ment</i>	<i>Legal and General</i>	<i>Total Fund</i>	<i>CAPS Average Portfolio</i>
	%	%	%	%	%
UK Equities	56.1	55.8	58.9	56.6	46.9
Overseas Equities	28.5	30.6	31.1	30.2	39.4
UK Fixed Interest	5.6	5.2	6.2	5.6	4.9
Overseas Fixed Interest	2.5	2.7	3.1	2.8	1.5
Index Linked	0.0	0.2	0.3	0.2	0.4
Property/Property Unit Trusts	4.3	2.7	0.0	2.4	1.0
Cash	3.0	2.8	0.4	2.2	5.9
Other Investments	0.0	0.0	0.0	0.0	0.0
	100.0	100.0	100.0	100.0	100.0

CONTACTS FOR FURTHER INFORMATION

For further information on issues relating to the Pension Fund, please contact the County Treasurer.

Telephone: 0191 383 3520

E-mail treasurers@durham.gov.uk

or you can write to:

The County Treasurer
Durham County Council
County Hall
DURHAM
DH1 5UE

mas/rep/ANNR2004-05

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