

MERCHANT NAVY OFFICERS PENSION FUND SUMMARY ANNUAL REPORT 2003



SUMMARY ANNUAL REPORT 2003

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Trustee: MNOF Trustees Limited

Registered Office: Ashcombe House, The Crescent, Leatherhead, Surrey KT22 8LQ

Pension Scheme Registry Number: 10005645

CONTACT FOR FURTHER INFORMATION

Members enquiring about their own benefits should initially telephone the MNPA Member Liaison Service (tel: 01372 200200) or e-mail mnopf@mnpa.co.uk.

Any person who has a query in relation to the Fund in general, including a requirement to obtain copies of Fund documentation, should address their query to the Director of Pensions, Merchant Navy Officers Pension Fund, Ashcombe House, The Crescent, Leatherhead, Surrey KT22 8LQ.

The Merchant Navy Officers Pension Fund website is at www.mnopf.co.uk.

CHAIRMAN'S MESSAGE

INTRODUCTION

This Summary Report is sent to all active and pensioner members of the Merchant Navy Officers Pension Fund. It is based on the formal Annual Report but presented in a shorter and more readable form to enable members to see more easily the main issues affecting the Fund in the last year.

THE YEAR IN SUMMARY

The most significant matters affecting the Fund are summarised below. Further details relating to these matters and other issues are set out in the rest of this report.

MYNERS REVIEW

The Myners Report published in 2001 set out principles for the governance of occupational pension schemes. These were adopted by the Government which expects pension schemes to comply. As a consequence, the Trustee Board has spent much time over the last year developing a Strategic Plan for the management of the MNOFP and in defining the responsibilities of the committees set up by the Trustee Board. The responsibilities of the Investment Committee have been expanded so that it performs a more strategic and decision-making role and a new Investment Working Group has been set up to regularly monitor the Investment Managers and to deal with day to day investment matters. This is in addition to the Benefits Working Group that is responsible for making recommendations to the Trustee Board on administration, actuarial and legal issues.

STATEMENT OF INVESTMENT PRINCIPLES

As part of the implementation of the Myners' principles, the Trustee Board has reviewed and strengthened their Statement of Investment Principles and a summary is included in this Report. The full Statement of Investment Principles can be seen on the MNOFP Website or a copy can be requested in writing from the Director of Pensions.

INVESTMENT REVIEW

During the year the strategic asset allocations have remained substantially the same, being predominantly fixed interest investments in the Old Section and predominantly equity investments in the New Section. The investment returns reflect these different positions with the New Section particularly affected by the general fall in world stock markets. In both Sections, the Investment Managers' performance in the last year has been slightly under the benchmarks set but overall in the last five years the performance has been better than the benchmarks.

MEMBERS WITH UNKNOWN ADDRESSES

During the year, the Fund has undertaken a major exercise to attempt to locate the large number of members who cannot be contacted because they have moved without telling the Fund of their change of address. There has been considerable success in finding such members and many pensions have been put into payment for those over Normal Pension Age. However, a considerable number of addresses remain unknown and members are asked to ensure that they notify the Fund if they change address.

TRUSTEE BOARD DIRECTORS

The last year has seen the retirement from the Trustee Board of Peter Pratt, John Lusted and Charles Cunningham (Employer appointed Directors) and Derek Bond (NUMAST appointed). All provided considerable service to the Fund, in particular Peter Pratt who had been Chairman of the Investment Committee for many years, and their work has been much appreciated. The Trustee Board has appointed Laurie Attwood as the new Chairman of the Investment Committee. The vacancies on the Trustee Board have been filled by Alan Davies, Les Stracey and Edmund Brookes (Employer appointed) and Tony Minns (NUMAST appointed).

THE FUTURE

Actuarial Valuation

The triennial Actuarial Valuation of the Fund is due as at 31 March 2003 and the Trustee Board expect that the results will be available for their consideration towards the end of 2003.

Court Case

As mentioned last year, the Trustee Board intends to make an application to the Court to clarify the responsibilities of employers participating in the Fund, particularly with regard to making good any deficiency revealed by an Actuarial Valuation. Preparations for the Court action have continued although there have been some unavoidable delays. However, it is expected that the proceedings will commence in the near future although it may be mid-2004 before the case comes before the Court.

Legislation

The Government published a Green Paper in December 2002 aimed at encouraging pension provision in general together with proposals for the simplification of pensions taxation. Recently, the Government has published the proposals they intend to adopt, many of which will have an impact on occupational pension schemes. It is believed that most of these proposals will not be effective until 2005 and the Trustee Board will be considering the impact on the Fund as more details become available.

THE ANNUAL REPORT

A copy of the formal Annual Report for the year ended 31 March 2003 is available by writing to the Director of Pensions at the address shown on page 1. Any member of the Fund or a prospective beneficiary is entitled to receive a copy. In common with many industry wide pension schemes the audit report on the financial statements for the year ended 31 March 2003 includes a qualified statement about contributions to the Fund. The qualification is due to the fact that a few employers paid contributions later than the due date set out in the Schedule of Contributions. This has no effect on the level of members' benefits.



Peter McEwen
Chairman

July 2003

MANAGEMENT

The Fund is managed by MNOFP Trustees Limited. There is provision for fourteen Directors to be appointed to the Trustee Board with employers and members being equally represented. A list of Directors is shown at the back of this Report.

During the year the Trustee Board met regularly to review the management of the Fund. In addition there are a number of committees which met and reported to the Trustee Board. These are described in more detail below.

MYNERS REVIEW

A major part of the Trustee Board's work in the last year has been in consideration of the "Myners' Principles". These were the result of a report produced in March 2001 by Paul Myners which, following a period of consultation, was adopted by the UK Government. The Government expects that pension schemes will comply and publicly disclose their compliance with the principles on a voluntary basis. As a result of this review, the Trustee Board has adopted a strategic plan, developed by reference to the principles.

The Myners' principles cover the following:

- Ensure effective decision making
- Set clear investment objectives
- Review asset allocation strategies
- Review arrangements for provision of expert advice
- Ensure agreements are in place with investment managers covering objectives, policy towards risk, performance measurement, transaction costs and investment managers approach towards intervention in companies in which they invest
- Set appropriate investment benchmarks
- Arrange for the investment performance to be measured and for assessment of decisions made by their advisers
- Produce a strengthened Statement of Investment Principles and publish it with key information provided to members

COMMITTEES AND WORKING GROUPS

The investment management of the Fund is reviewed at quarterly meetings by an Investment Committee of six members of the Trustee Board supported by the Executive and investment advisers. The Investment Committee is responsible for the implementation of the Statement of Investment Principles and for dealing with such matters as strategic asset allocation, exercising investment powers, the appointment and removal of investment managers, performance review, implementation of investment strategies and setting specific performance objectives. To support the work of the Investment Committee the Trustee Board has established an Investment Working Group that meets quarterly to consider the performance of investment managers, receive reports from the MNOPF Executive Team and report to the Investment Committee thereon.

The Trustee Board has also delegated certain powers to a Benefits Working Group that is responsible for considering strategy relating to the management and future structure of the Fund, considering preliminary actuarial reports, monitoring legal and administration issues and making recommendations to the Trustee Board as appropriate.

The finance and accounting function and audit of the Fund's financial statements are reviewed by an Audit Committee that meets with the external auditors at least twice a year.

MNOPF EXECUTIVE

The Trustee Board has also established a dedicated MNOPF Executive (see back page) together with a small number of staff to implement the Trustee Board's decisions and supervise the day-to-day running of the Fund. This team of people is separate from MNPA Limited (see page 6). The Trustee Board has delegated certain authorities to the Executive to enable it to supervise the regular affairs of the Fund.

ADMINISTRATION

The administration of the Fund is delegated to MNPA Limited (“MNPA”), a wholly owned subsidiary of MNOPT Trustees Limited. MNPA receives a fee for this service under contract. In addition to administering members’ benefits, MNPA also provides financial accounting and property investment management services. The MNPA Member Liaison Service, to which members’ telephone calls are routed, continues to operate very successfully enabling a high proportion of queries to be dealt with at the time of calling.

MNPA also provides pensions administration services to a number of external clients. This activity provides a return to the Fund, effectively reducing the Fund’s operating costs.

PERSONAL FINANCIAL PLANNING

MNPA provides a personal financial planning service to members. This service, which is independent and objective, can provide guidance to members (and their families) who have a lump sum to invest either during their working careers or on retirement. MNPA is regulated by the Financial Services Authority in respect of the provision of this service.

FUND DOCUMENTATION

The Fund’s operations are governed by the Trust Deed and Rules. The last consolidated version of the Trust Deed and Rules was produced in June 1999 and a copy was circulated to all contributing members. Amendments have been made mainly as a consequence of the changes to benefits arising from the Actuarial Valuation as at 31 March 1999 and also to provide for a member’s pension rights to be split between the member and his or her ex-spouse in accordance with a Court Order issued as part of a divorce settlement.

With effect from 22 July 2002, the Rules were further amended to allow the Trustee Board discretion, where a member is not legally married at the date of death, to decide whether or not the Old Section (not, at this stage, the New Section) widow’s or widower’s pension could be paid to another person. The Trustee Board would be able to consider another person who, in their opinion, was dependent on the deceased member for the provision of all or any of the ordinary necessities of life. Members were informed of this amendment in last year’s Summary Annual Report.

MEMBERSHIP

	31 March 2003	31 March 2002
Scheme membership at the end of the year		
Actives	2,832	3,098
Deferreds	39,650	40,413
Pensioners	21,877	21,526
	<hr/>	<hr/>
Total	64,359	65,037
	<hr/>	<hr/>

The membership figures included in last year's report as at 31 March 2002 have been adjusted to those shown above following the discovery of an error in the preparation of last year's figures and also to include 13,600 members who each paid member's contributions to the Old Section (i.e. prior to 1978) of under £20 in total and therefore have very small benefits. The Fund does not have current addresses to check the continued existence of these members.

During this year, consideration has been given to what action can reasonably be taken to trace members whose whereabouts are no longer known. As well as the 13,600 mentioned above, there are many Old Section members who have paid larger amounts of contributions who cannot be contacted at the address they last supplied to the Fund.

The Trustee Board has enlisted the help of a professional tracing bureau that specializes in tracing members of pension schemes and has performed a similar service for many other well-known pension schemes. A significant number of Fund members have been located, many of them over pension age and who are now receiving their pension as a result of this exercise.

The Rules of the Fund permit the Trustee Board to treat benefits as forfeit in certain circumstances if a member's whereabouts is unknown, although the Rules also give the Trustee Board discretion to reinstate forfeited benefits. The Trustee Board has now established a policy on the forfeit of benefits.

Members are urged to ensure that they notify MNPA of any change of address.

ACTUARIAL VALUATIONS

The last valuation was carried out as at 31 March 2000 separately for the Old Section and the New Section. The results disclosed were as follows:

	Old Section £m	New Section £m
Present value of accrued liabilities for:		
Current contributors	-	505
Pensioners and dependants	680	683
Deferred pensions	543	447
Expenses	25	35
	<hr/>	<hr/>
Value of past service liabilities	1,248	1,670
Market value of assets	1,388	1,662
	<hr/>	<hr/>
Surplus / (shortfall)	140	(8)

Valuations were also carried out on the prescribed basis set out in the Minimum Funding Requirement regulations of the Pensions Act 1995. On this basis, the assets in each of the Old Section and the New Section were more than sufficient to cover the liabilities in the respective Sections as at 31 March 2000.

Copies of the valuation reports are available on request. The next triennial valuation is due as at 31 March 2003 and work is in progress. The results will be reviewed by the Trustee Board towards the end of 2003.

OLD SECTION

The Old Section closed to accrual of pension for service after 5 April 1978. As a result its members have a relatively high average age and there are a large and increasing number of pensioners.

Members have been advised previously of action taken by the Trustee Board to invest a high proportion of the Old Section assets in fixed interest investments. These generate known amounts of income to pay pensions and help protect the Old Section against stock market falls. However, this policy also means that the Old Section will have limited participation in any future stock market growth.

A discretionary bonus of 3% was paid in April 2002 and when the results of the 31 March 2003 valuation are known, the Trustee Board will be giving consideration to the payment of a further discretionary bonus.

NEW SECTION

The New Section has a membership with a lower average age than the Old Section and has less need of the known income of fixed interest investments. The investment policy of the New Section is geared more towards long-term growth achieved through investment in equities. As a result it is susceptible to changes in stock markets. In particular, the value of the New Section assets has been affected by the fall in stock markets since the last valuation in March 2000.

When the results of the valuation as at 31 March 2003 are known, the Trustee Board will be considering what action is required with regard to making good any deficit.

PROPOSED COURT APPLICATION

As reported last year, an ongoing concern of the Trustee Board has been to clarify the responsibilities of employers who participate in the Fund, particularly with regard to making good any deficiency in the Fund. The Trustee Board will be seeking guidance from the Court in this regard and the necessary preparatory work is in progress. It is expected that the legal proceedings will commence in the near future although it may be mid-2004 before the case comes before the court.

INCREASES TO PENSIONS IN PAYMENT - APRIL 2003

Old Section – There are no guaranteed increases to Old Section pensions. As mentioned above, the Trustee Board will be considering its policy on awarding bonuses after the results of the 31 March 2003 valuation are known. For this reason, no bonus was granted in April 2003.

New Section – Some benefits in the New Section are guaranteed to increase. At April 2003, increases were paid as follows:

- Guaranteed Minimum Pension accrued between 6 April 1988 and 31 March 1997: 1.7%
- Pension for service since 1 April 1997: 1.7%

The remaining New Section benefits are not guaranteed to increase and any increases are awarded at the discretion of the Trustee Board having taken actuarial advice. At April 2003 no discretionary increases were awarded due to the New Section being in deficit.

FINANCIAL REVIEW

Year to 31 March 2003

	Old Section £m	New Section £m
Contributions inflow	-	17.9
Benefits outflow	(77.7)	(71.2)
Net outflow	(77.7)	(53.3)
Net returns on investments	53.7	(263.6)
Net change in the fund for the year	(24.0)	(316.9)
Net assets of the fund		
at the start of the year	1,339.9	1,487.5
at the end of the year	1,315.9	1,170.6

CONTRIBUTIONS

As required by legislation, the Trustee Board has set a Schedule of Contributions. During the year a small number of contribution payments from a few employers were paid later than the due date set out in the Schedule of Contributions – in nearly all cases, only by a few days. Employers are made aware of the legal time limits and those who pay late are reported to the Occupational Pensions Regulatory Authority.

The employers listed below made late payments on two or more occasions in the year.

Charente Limited
Cruise Ship Manning Services Limited
Data Marine Systems Limited
DSND 7 Limited
Harwich International Port Limited
Highland Cruises Management Limited
J P Knight (Caledonian) Limited
Marine Manning Services Limited
Waverley Excursions (Guernsey) Limited
Xantic Satellite Solutions Limited (formerly Spectec Limited)

ADDITIONAL VOLUNTARY CONTRIBUTION (“AVCS”)

The AVC policies with Equitable Life continue in operation. Members who have investments in the Equitable Life AVC funds have been provided with information on Equitable Life produced by the Fund’s investment advisers, including information on surrender terms. Members can also invest AVCs in a range of funds managed by Clerical Medical Investment Group Limited, although the administration of these AVCs remains under the policy with Equitable Life.

INVESTMENT REVIEW

STATEMENT OF INVESTMENT PRINCIPLES (“SIP”)

During the year the Investment Committee has, with the support of professional advisers, reviewed the Fund’s previous SIP adopted in 1998 to meet the requirements of the Pensions Act 1995. The Investment Committee concluded that the previous SIP was no longer appropriate to meet the requirements of the Fund having regard to the Myners principles referred to previously, the differing profiles of the Old and New Sections of the Fund and more diverse and specialised investment markets. As a result of this review the Investment Committee proposed a revised SIP which was agreed by the Trustee Board in March 2003. Following consultation with participating employers the new SIP has now been implemented.

A summary of the main matters covered by the SIP is set out on pages 14 and 15.

STRATEGIC ASSET ALLOCATION

The Investment Committee has taken further professional advice during the year and considered the investment objectives and strategic allocations for the asset categories of the Fund. The allocations of the Old and New Sections of the Fund across asset classes have been reviewed to ensure that the assets are suitably diversified and continue to provide a reasonable expectation of meeting the investment objectives.

As previously mentioned, the investment requirements of the two Sections of the Fund are different. At 31 March 2003 the investment allocation of the two Sections was as follows:

	Old Section	New Section
	£m	£m
Investments		
Fixed interest securities	1,033.7	330.0
Equities	170.8	689.6
Properties	108.7	132.5
AVC investments	-	2.8
Cash deposits	12.6	19.6
Net current (liabilities)	(9.9)	(3.9)
Net assets of the Fund at 31 March 2003	1,315.9	1,170.6

INVESTMENT PERFORMANCE

Because the Old Section is substantially invested in fixed interest and the New Section is substantially invested in equities, the investment performance of the Sections differed during the year.

The Investment Committee monitors the performance of each specialist investment manager on a quarterly basis and on an annual basis against a performance target agreed with each investment manager. The investment performance of the Sections is measured independently by external consultants, Russell Mellon CAPS Limited (“CAPS”).

CAPS compares the investment performance results of each Section against a specific benchmark which reflects index performance and the asset allocation of each Section. For the calendar year 2002 and for the five years to 31 December 2002 investment performance was as follows:

	Year to 31 December 2002	Five years to 31 December 2002
Old Section		
Actual performance	+3.5%	+9.2% p.a.
Benchmark	+3.9%	+9.0% p.a.
New Section		
Actual performance	-14.3%	+2.1% p.a.
Benchmark	-13.8%	+1.9% p.a.

In the year to 31 December 2002 the investment performance of both Sections was slightly below the benchmark and over the last five years, slightly above the benchmark. The benchmark return for the New Section reflected the relatively weaker performance of world equity markets in 2002 compared with the benchmark for the Old Section, which is largely based on fixed interest investments.

CHANGES DURING THE YEAR

In June 2002, the Investment Committee, having taken appropriate investment advice, reduced regional asset allocations and created a new global equity mandate. In October 2002, Marathon Asset Management Limited was appointed to manage the new £80 million portfolio.

In December 2002, the Investment Committee with advice from the Fund's investment consultants, reviewed the management of the UK equity portfolio. It was agreed that Insight Investment Management Limited should cease to manage part of that portfolio and that it be switched to Invesco Asset Management Limited and Liontrust Investment Services Limited.

The Investment Committee continues to seek opportunities to improve the Fund's performance over the various portfolios in which it is invested. For example, the Investment Committee took an opportunity to invest in a series of portfolio loan notes (a type of fixed interest investment), improving the return to the Fund over the existing fixed interest portfolio. This is a long-term investment which was entered into in March 2003.

Significant progress has been made in realising a number of the relatively illiquid securities which the Fund has held with the objective of transferring the individual holdings or their realised value to other management at the appropriate time. This portfolio has included valuable investments that were not immediately disposable and for which the optimum price would take time to achieve. At 31 March 2003, the remaining securities had a market value of £54.6m representing 2.2% of the Fund as a whole. Since then the Fund has sold its US illiquid holdings including the sale of its interest in Ensign Oil & Gas Inc. The value of the illiquid portfolio has now been reduced to less than £7.5m.

PROPERTY INVESTMENT

Property investment within the Fund is managed by MNPA under a specialist investment contract. The portfolio has provided significant support to the Fund during the investment market downturn of the past three years. The value of the property portfolio at the year-end was £241.2 million with a total annual rent of £18.5 million. The portfolio generated a total return for the calendar year 2002 of 9.4%. Over the last three years the portfolio has produced an annualised return of 11.2% p.a.

STATEMENT OF INVESTMENT PRINCIPLES

SUMMARY OF MAIN POINTS

The overriding investment objectives of the Trustee are

- to acquire suitable assets of appropriate liquidity, which will generate income and capital growth to meet, together with contributions from MNOFP members and employers, the cost of current and future benefits which the MNOFP provides and
- to limit the risk of the MNOFP's assets failing to meet the MNOFP's liabilities over the long-term or to meet the Minimum Funding Requirement or other regulatory measures.

In pursuing these objectives the Trustee intends to have due regard to the following.

- **Investment objectives** are set by the Trustee, with advice from the Investment Adviser and the Scheme Actuary, and are expressed in monetary terms as to the investment return necessary to meet the Fund's liabilities, given its understanding of the contributions likely to be received.
- **Management** responsibility for the investment of the assets rests with the Trustee. However, the Trustee has delegated the day-to-day management of the assets of the Fund to the Investment Committee enabling appropriate and expert focus to be given to investment decision-making.
- **Diversification** of assets is achieved through equity, fixed interest, property and other liquid and illiquid investments, which are spread geographically to ensure adequate levels of performance without undue risk.
- **Asset allocation** between asset classes is determined by the Investment Committee in consultation with the Investment Adviser in accordance with the Strategic Asset Allocation. The Strategic Asset Allocation reflects the strategic diversification of the various assets within an acceptable level of investment risk.

SUMMARY OF MAIN POINTS (CONT)

- **Regular investment performance** reviews of investment managers are held quarterly by the Investment Working Group which monitors the investment performance of the various investment managers against their agreed performance objectives and which reports to the Investment Committee.
- **Investment Performance** measurement is provided by Russell Mellon CAPS, which provides quarterly investment performance statistics for the Fund and an annual overview, both of which are reviewed at the regular Investment Committee meetings.
- **Voting and Corporate Governance** issues are taken seriously by the Trustee, which uses all reasonable endeavours to procure the exercise of the ownership rights associated with its investments.
- **Socially Responsible Investment** is always considered by the Trustee in the investment process; however, the Trustee believes that it should always act in the best financial interests of the members of the MNOF. Through the Investment Committee, the investment managers are made aware that they should take account of these issues when making investment decisions.
- **The Statement of Investment Principles** is reviewed on a regular basis, with advice from the Investment Adviser and the Scheme Actuary following an actuarial valuation or where the Investment Committee determines that a review is needed for other reasons and complies with the Pensions Act 1995.

TRUSTEE BOARD

OFFICER DIRECTORS

Laurie Attwood+
Mark Dickinson•
Chris Jones
Peter McEwen *+ (Chairman)
Tony Minns
Paul Moloney•+
Brian Orrell *

EMPLOYER DIRECTORS

Edmund Brookes*•
John Crossman
Alan Davies+
William Everard (Vice Chairman)
Tom Graves
Captain Mike Marchant MBE+•
Les Stracey+

EXECUTIVES

Geoff Henry – Chief Executive
Peter Greenwood* – Director of Pensions

Alick Stevenson – Director of Investments
Nigel Barton – Director of Finance

* Director of MNPA Ltd + Member of the Investment Committee • Member of the Audit Committee

SECRETARY AND ADMINISTRATOR

MNPA Limited

Actuary:

Actuarial advisers:

Auditors:

Bankers and custodians:

Investment managers:

- UK fixed interest

- global fixed interest

- UK equities

- European equities
- US equities
- Japanese and Pacific equities
- global equities
- illiquid portfolio
- property
- AVC provider

Investment advisers:

- strategy
- property
- taxation

Legal advisers:

- pensions
- property in England
- property in Scotland

Peter Lofthouse

Watson Wyatt LLP

Deloitte & Touche

J P Morgan plc

National Westminster Bank plc

Henderson Global Investors Ltd

Morley Fund Management Limited

Western Asset Management Company Ltd

Invesco Asset Management Ltd

Liontrust Investment Services Ltd

Merrill Lynch Investment Managers Ltd

Société Générale Asset Management UK Ltd

Deutsche Asset Management Ltd

Alliance Capital Ltd

Schroder Investment Management International Ltd

Marathon Asset Management Ltd

G R Henry

MNPA Ltd

Equitable Life Assurance Society

Watson Wyatt LLP

J S Black

Deloitte & Touche

Baker & McKenzie

Hill Dickinson

DLA & Partners

The above information is correct as at 24 June 2003