



MERCHANT NAVY OFFICERS PENSION FUND

SUMMARY ANNUAL REPORT 2001

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CONTENTS

Chairman's Message	2
Management and Administration	5
Actuarial Valuation	7
Membership and Financial Review	9
Investment Report	10
Trustee Board, Executives and Advisers	12

Trustee: MNOFP Trustees Limited

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

Pension Scheme Registry Number: 10005645

CONTACT FOR FURTHER INFORMATION

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. Members enquiring about their own benefits should initially telephone the Member Liaison Service (Tel: 01372 200200).

CHAIRMAN'S MESSAGE

Introduction

This is the second summary report issued to members of the Merchant Navy Officers Pension Fund. As explained last year, due to changes in pensions and accounting legislation, the “full” Annual Report has become very prescriptive and includes considerable detail that can hinder communication to members. This summary seeks to overcome that problem, but if you wish to receive a copy of the formal Annual Report please contact the Fund.

The year in summary

The most significant matters affecting the Fund are summarised below, however, further details relating to these matters together with other more general issues are given later in this Report.

Contributions and benefits

The valuation at 31 March 1999 disclosed a deficit in the New Section. As a result, changes to the rate at which benefits accrue and the contributions paid by both member and employer were effected from 1 October 2000. These changes have previously been advised to employers and members in various announcements and last year's Annual and Summary Reports. In accordance with legislative requirements, details of the changes are included in this year's Annual Report.

Additional Voluntary Contribution (“AVC”) scheme

During the year the AVC scheme with Equitable Life Assurance Society was reviewed. Having taken advice the Trustee is appointing Clerical Medical Investment Group to receive future AVCs. The set up of the arrangement has been delayed due to the Equitable Life being taken over by Halifax plc (which is Clerical Medical's parent company) and the impact this may have for future administration procedures.

Actuarial valuation as at 31 March 2000

Having regard to the results of the triennial actuarial valuation at 31 March 1999 the Trustee requested the actuary carry out a further valuation at 31 March 2000. The results of that valuation showed a surplus of £140m in the Old Section (£20m surplus in 1999) and a shortfall in the New Section of £8m (deficit of £55m in 1999). The improvement in the financial position is mainly attributable to investment returns in the intervaluation period which were in excess of the valuation assumptions. Following consideration of the valuation results the Board decided not to award a discretionary increase as at 1 April 2001 to New Section or Old Section pensions in payment.

Investment review

During the year the Trustee carried out a major review of the strategic asset allocations of the Old and New Sections. This resulted in a substantial increase in the allocation to fixed interest securities in the Old Section. In the New Section there was a small increase in fixed interest securities but the major part of the assets remain in equities. A significant improvement in the funding position of the Fund was achieved in the year to 31 March 2001 due to actual investment returns exceeding the returns assumed in the actuarial valuation.

Investment management

During the year, the Trustee has appointed some new managers as a result of the review of investment strategy. The Trustee has also reviewed the performance of the investment managers and some have been replaced. The Trustee continues to monitor the performance of the managers against specific benchmarks and further details relating to this are included later in this report.

The Future

The last year has been a challenging time for the Fund with many important decisions being taken. Matters which continue to be addressed are:

- the need to clarify the responsibilities of employers who participate in the Fund, particularly with regard to making good any deficiency. The Trustee intends to seek guidance from the Court in this regard;
- to review the Old Section with a view to possibly increasing security for benefits through further increasing investment in fixed interest securities or by purchasing annuities with insurance companies. Further consideration will be given to whether Old Section pensions can be increased on a discretionary basis once this review has been completed.

The Annual Report

A copy of the "full" annual report for the year ended 31 March 2001 is available by writing to the Director of Pensions at the address shown on page 1. I would advise you that in common with many industry wide pension schemes the audit report on the financial statements for the year ended 31 March 2001 includes a qualified statement about contributions under 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.

A handwritten signature in black ink, appearing to read 'Peter McEwen', written over a dashed horizontal line.

Peter McEwen
Chairman

September 2001

MANAGEMENT AND ADMINISTRATION

The Fund is managed by the Trustee, MNOF Trustees Limited. There is provision for fourteen Directors to be appointed to the Board of the Trustee (the “Trustee Board”) with employers and members being equally represented. A list of current Directors is shown on page 12.

During the year the Trustee Board met regularly to review the management of the Fund. In addition there are separate Investment (dealing with investment management matters) and Audit (dealing with accounting and audit matters) Committees which meet and report to the Board.

The Trustee Board has delegated certain authorities to the Chief Executive and Director of Pensions (“the Executives”) to supervise the regular affairs of the Fund.

ADMINISTRATION OF THE FUND

The administration of the Fund is delegated to Merchant Navy Pensions Administration Limited (“MNPA”), a wholly owned subsidiary of MNOF Trustees Limited. MNPA receives a fee for this service under contract. In addition to managing the administration of the Fund, MNPA also provides financial accounting, an investment administration service which monitors external investment managers and property investment management. The 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. As a result of continuing efficiencies, the cost of MNPA’s administration has remained unchanged for 3 years, despite significantly increased demand.

Personal Financial Planning

MNPA provides a personal financial planning service to members. The 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. In most cases any commissions earned by MNPA for providing this service are in part re-invested in the product chosen by the member resulting in additional benefit to the member. MNPA is a member of the Investment Management Regulatory Organisation Limited and is regulated by that body 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 were made as a consequence of the changes arising from the Actuarial Valuation as at 31 March 1999.

ACTUARIAL VALUATION

The Fund is required to have an actuarial valuation at least once every three years. A valuation assesses the Fund's past service liabilities against the value of assets to see if there is a surplus or deficit. It also looks at the contributions required to fund future service benefits. The triennial valuation of the Fund was carried out as at 31 March 1999 separately for the Old Section and the New Section. The results disclosed were reported last year. As a result of the agreed changes to the Fund effected during the last year it was decided that a further actuarial valuation should be carried out as at 31 March 2000. The results of that valuation are as follows:

	Old Section £m	New Section £m
Value of past service liabilities	1,248	1,670
Market value of assets	1,388	1,662
Surplus / (deficit)	140	(8)

The surplus of £140 million in the Old Section compares with a surplus of £20 million as at 31 March 1999. In the New Section, the shortfall of £8 million compares with a shortfall of £55 million as at 31 March 1999. The improvement in the financial position is mainly attributable to investment returns in the intervaluation period which were in excess of the valuation assumptions. Copies of the valuation reports are available on request.

CONTRIBUTIONS

As required by legislation, the Trustee 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. As a consequence of these late payments, the audit report on the Fund's financial statements as required by regulation, includes a qualified statement about contributions due to the Fund.

ADDITIONAL VOLUNTARY CONTRIBUTION SCHEME

During the year, the Additional Voluntary Contribution ("AVC") scheme in force with Equitable Life was reviewed. Following a judgement against Equitable Life

in relation to the provision of guaranteed annuity rates on some of their with-profits policies, the Trustee Board took advice from its investment consultants, Watson Wyatt Partners, and decided to set up a new AVC policy with Clerical Medical Investment Group to receive future contributions.

A wide range of funds will be made available through Clerical Medical, including with-profits, managed funds and specialised funds. In addition, a Lifestyle fund will be available in which AVCs are automatically switched into more secure investments as retirement approaches. Once these arrangements have been fully set up, literature will be sent to all contributing members of the Fund.

PROPOSED COURT APPLICATION

An ongoing concern of the Trustee Board has been to clarify the responsibilities of participating employers, with regard to making good any deficiency in the Fund. The Trustee intends to seek guidance from the Court in this regard.

As a first step, the Trustee has written to as many employers as possible that participated in the New Section advising them of the Fund's financial position and the proposal to make an application to the Court. A questionnaire designed to ascertain employers' views and intentions has been included and the responses to this questionnaire will help the Trustee decide how best to progress the Court application.

REVIEW OF THE OLD SECTION

The Old Section is relatively mature (i.e. it has a high proportion of pensions in payment). Security is becoming an increasingly important issue and the Trustee needs to ensure that the ability to pay pensions, both for those who have already retired and those who are yet to retire, is not jeopardised by investing in assets which are geared to growth rather than producing income. The latest actuarial valuation has disclosed a moderate surplus. The Trustee is looking at the possibility of further increasing security for Old Section benefits as follows:

1. investing the whole of the Old Section assets in fixed interest securities which generate income rather than growth. This would protect the Fund against large downturns in the stock market;
2. to fully secure benefits by using the Old Section assets to purchase annuities with insurance companies.

This review of the Old Section will take some time to complete following which the Trustee can give further consideration to the question of discretionary increases to Old Section pensions.

MEMBERSHIP

	31.3.2001	31.3.2000
Scheme membership at the end of the year		
Actives	3,818	4,144
Deferreds	29,462	30,168
Pensioners	20,119	19,909
	<hr/>	<hr/>
	53,399	54,221
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FINANCIAL REVIEW

	Year to 31.3.2001 £m	Year to 31.3.2000 £m
Contributions inflow	17.6	15.6
Benefits outflow	140.3	133.8
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Net outflow	(122.7)	(118.2)
Returns on investments	(13.8)	363.7
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Net (decrease)/increase in the Fund for the year	(136.5)	245.5
Net assets of the Fund at the beginning of the year	3054.7	2,809.2
	<hr/>	<hr/>
Net assets of the Fund at the end of the year	2,918.2	3,054.7
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INVESTMENT REPORT

Statement of Investment Principles (“SIP”)

The SIP sets out the investment objectives of the Fund and a copy is available on request.

Strategic Asset Allocation

The Trustee has taken professional advice 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 by the Trustee, to ensure that the assets are suitably diversified and continue to provide a reasonable expectation of meeting the investment objectives. As a result, the assets are spread across different asset classes to achieve a balance of income and capital growth consistent with the long-term objectives of each Section.

The actuarial valuations of the Fund as at 31 March 1999 and 31 March 2000 indicated a divergence of the investment requirements of the two Sections:

In particular, the investment position of the Old Section is constrained by the need to pay from the Fund substantial levels of current pensions. The Trustee has substantially increased the allocation to fixed interest, from which income can be predicted with greater certainty, and to provide a better balance of the need to guarantee members’ benefits against the risk associated with equity investment.

The investment position of the New Section enables investment substantially in equities, this providing a reasonable probability of covering the liabilities and producing excess returns over the longer term to raise solvency to an acceptable level. The Trustee made a small increase in the allocation to fixed interest investments during the year.

A significant improvement in the funding position of the Fund was achieved in the year to 31 March 2001 as a consequence of the reduction in exposure of the Fund to UK government securities and a corresponding increase in exposure to international fixed interest securities, achieved without compromising the quality of the portfolio.

Investment Performance

The proportions of each Section of the Fund invested in equities and fixed interest are different as a consequence of the adoption of different Strategic Asset Allocations as referred to above. As a result, the investment performance of each Section differs.

The investment performance of the Sections is measured independently and externally by Combined Actuarial Performance Services Limited (“CAPS”). 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, as described earlier.

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 2000 and for the five years to 31 December 2000 investment performance is as follows:

	Year to 31 December 2000 (%)	Five years to 31 December 2000 (% Annualised)
Old Section		
Actual performance	+11.0	+13.3
Benchmark	+3.6	+14.0
New Section		
Actual performance	+4.0	+11.9
Benchmark	-2.5	+12.7

The CAPS Median Return represents the median (i.e. the middle value) of the investment return of 1703 pension funds measured by CAPS in 2000 covering over half of pension funds in the UK similar to the MNOPF.

Property Investment

Property investment within the Fund is managed by MNPA under a specialist investment contract. MNPA is remunerated by a fixed fee for investment advice and a percentage of rents invoiced. Fees are also charged in respect of rent reviews and lease renewals undertaken by MNPA. MNPA arranges insurance for the properties for which commission is received from the insurers.

The value of the property portfolio at the year end was £249.4m and comprised 95 properties with a total rent roll of £19.5m reflecting a yield on market value of 7.8%. The portfolio generated a total return for the calendar year 2000 of 7.0% compared with a benchmark return of 10.6%. Over the last three years the portfolio has produced an annualised return of 12.3% p.a. against a benchmark return of 12.2% p.a.

TRUSTEE BOARD, EXECUTIVES AND ADVISERS

OFFICER DIRECTORS

Laurie Attwood +
Derek Bond +
Mark Dickinson *•
Chris Jones
Paul Moloney •
Peter McEwen *+ *Chairman*
Brian Orrell *

EMPLOYER DIRECTORS

John Crossman
Charles Cunningham +•
William Everard *Vice Chairman*
Tom Graves
John Lusted *
Captain Mike Marchant MBE +•
Peter Pratt +

EXECUTIVES

CHIEF EXECUTIVE
Geoff Henry *

DIRECTOR OF PENSIONS
Peter Greenwood *

* Director of Merchant Navy
Pensions Administration Limited.

+ Member of the Investment Committee
• Member of the Audit Committee

SECRETARY AND ADMINISTRATOR

Merchant Navy Pensions Administration Limited

ADVISERS

Actuary:

Peter Lofthouse

Actuarial advisers:

Watson Wyatt Partners

Auditors:

Arthur Andersen

Bankers and custodians:

J P Morgan plc

National Westminster Bank plc

Investment managers:

- fixed interest securities

Henderson Investors Ltd

Merrill Lynch Investment Managers Ltd

Western Asset Management Company Ltd

- U K equities

Clerical Medical Investment Group Ltd

Merrill Lynch Investment Managers Ltd

Société Générale Asset Management UK Ltd

- European equities

Deutsche Asset Management Ltd

- U S equities

Alliance Capital Ltd

- Japanese and Pacific equities

Schroder Investment Management Ltd

- illiquid portfolio

G R Henry

- property

Merchant Navy Pensions Administration Ltd

- AVC provider

Equitable Life Assurance Society

Investment advisers:

- strategy

Watson Wyatt Partners

- property

J S Black

- taxation

Deloitte & Touche

Legal advisers:

- pensions matters

Baker & McKenzie

- property in England

Hill Dickinson

- property in Scotland

DLA & Partners



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