SFHA

PENSION SCHEME

Annual Report 2005

Administered by

The Pensions Trust

Benefits of the Scheme

As a contributing member of the SFHA Pension Scheme you benefit from the following:

- A pension payable from retirement for the rest of your life, related to your final pensionable earnings at retirement
- Annual pension increases in retirement
- The option to exchange some pension for a tax-free lump sum on retirement; you may choose the amount (within limits) that best suits your needs
- Partner's and/or children's pensions if you die before or after retirement
- Life assurance (of three times your pensionable earnings) if you die whilst contributing to the Scheme (not applicable once contributions cease)
- An immediate pension if you retire due to ill-health (in defined circumstances)
- Retirement age of 65, with the option to take early retirement
- Lump sum payment to your nominee(s), if you die after leaving the Scheme but before you start to receive your pension

Chairman's Statement 2005

I am pleased to present this Annual Report on behalf of the SFHA Pensions Committee, the first following my election as Chair.

Your pension scheme continued to grow and develop and also produced a strong investment performance in the year to 30 September 2005, as shown below:

- Total membership increased by 5.8% to 6,573 members
- Net assets of the Scheme increased by 30.6% to £225m
- Annual contributions receivable increased by 15.7% to £16.8m
- A strong investment return of 22.1%

Whilst this has been another year of growth for your scheme, there is no doubt that pension schemes in general are operating in a very difficult environment. This is particularly the case for final salary pension schemes, to which the SFHA Pension Scheme belongs.

Hardly a week passes without a fresh reference to the 'pensions crisis' in the media and another addition to the list of well known companies that have either: closed their final salary pension scheme to new members; reduced benefits; increased contribution rates; closed to existing members; or become insolvent.

The recent list has included: Rentokil; Provident Finance; Scottish Power; Arcadia and the Co-operative Group.

The reasons for the 'pensions crisis' are well known and include:

- People are living longer
- Recovery in stock markets and in investment returns have failed to dent pension fund deficits because bond yields have also fallen
- Removal of the ACT tax credit by Chancellor Gordon Brown effectively reduced the income from dividends used to fund pensions by around 20% per annum
- People are failing to save enough for a decent pension
- Employers are struggling with the cost of providing final salary pension schemes and with the increase in regulation
- The introduction of the Pension Protection Fund by the government to protect members' pensions where their employer becomes insolvent – with the cost being borne solely by existing pension schemes. This is expected to accelerate the closure of these pension schemes by employers

The long-awaited report of the Pensions Commission was recently published. It recognised that we are not yet in a 'pensions crisis', but urged the need for a national consensus on the future direction of pensions and also for firm early action by the government.

Among its key proposals was reform of the state pension, which would include addressing the inadequacy of the state pension for people with interrupted careers and caring responsibilities – in particular women. The Pensions Commission also recommends reversing the policy of means-testing the state pension which was introduced by Chancellor Gordon Brown. It believes that preventing the spread of means-testing will encourage more people to save in pension schemes.

Comment in the media suggests the government response to the Pension Commission's report has been lukewarm. To call this response by the government disappointing is an understatement.

Against this backcloth of a difficult environment and change, the SFHA Pensions Committee, working with The Pensions Trust and its staff, has had a heavy workload. In the last year we dealt with:

- Ensuring your scheme complied with statutory regulations introduced by the Pensions Act 2004
- Preparing for the introduction of 'tax simplification' measures introduced by the Finance Act 2004, which come into force from 6 April 2006
- Communication of issues and changes to our members and employers
- Review of our existing applications policy for new employers, to protect existing employers and members
- Progressing the major review of your pension scheme

Regarding the major review, your Pensions Committee was heartened by feedback from employers involved in the initial focus groups that they are committed to providing decent pensions for their staff – our members. Ideally, they would like to continue providing the existing final salary scheme with its existing benefits. These employers have also indicated that the cost of the Scheme is currently affordable, but further increases in the cost of funding the existing pension scheme will raise affordability issues.

Comment in the media suggests the government response to the Pension Commission's report has been lukewarm. To call this response by the government disappointing is an understatement.

Our next actuarial valuation for the three years to 30 September 2006 will heavily influence the major review process. This valuation will also have to recognise the requirements for a scheme specific funding objective that came into force on 23 September 2005. This latter requirement has the aim of taking a more prudent view of scheme funding to protect members, but may increase the cost of the Scheme.

I would like to thank all members of the Committee for their hard work during the year, particularly Jim Wilson who stepped down from the Chair in September 2005. As Chair he served as a model of dedication to the Scheme. I thank him for his valued contribution over many years of service in this role and I am pleased that he will continue to serve as a committee member.

This is a challenging time for pensions. Although difficulties lie ahead, your scheme is more favourably placed to cope with these difficulties than many other pension schemes.

- Continuity of the Scheme with its present benefit structure is dependent on the support of the employers. Commitment to providing decent pensions for their staff by employers has been positive and discussions with the trade unions representing our members have also confirmed their commitment to preservation of the existing pension scheme
- Your scheme also benefits from being a relatively 'immature' scheme. This means that it is still growing, has a high ratio of active members compared to the number of pensioners and in turn, a positive cashflow. This affords the Scheme greater flexibility for adjusting to change
- The government has recently introduced various measures to protect members' pension rights. These include compensation from the Pension Protection Fund where an employer becomes insolvent, and the pension scheme is unable to cover members' benefits, and the requirement for employers to fully fund existing members' pension rights if they close their final salary pension scheme
- Pension administration and investment services are carried out by The Pensions Trust on behalf of the Scheme. Your Pensions Committee monitors its performance carefully to ensure members and employers receive a high quality service at very competitive rates

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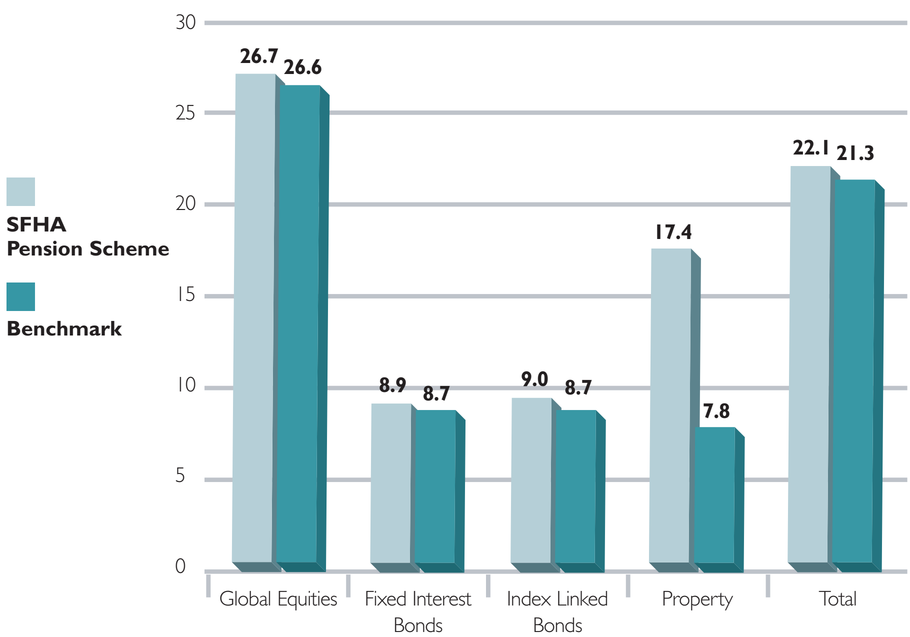
Finally, I would like to thank the staff of The Pensions Trust for the continued progress and successful growth of the Scheme during the year and also our employers and members for their support. Members can be assured that the protection of your scheme and the provision of decent pensions for our members will remain the highest priorities of the SFHA Pensions Committee in the year ahead and beyond.

Malcolm MacDonald
Chair
22 January 2006

	2002	2003	2004	2005
Active Members	3,764	3,869	3,986	4,058
Deferred Members	1,205	1,441	1,562	1,767
Pensioners	509	575	665	748
Total*	5,478	5,885	6,213	6,573
Employers	192	189	193	191

Annualised Investment Return



Membership Growth

Total membership continues to grow steadily and has increased by 5.8% to 6,573 at 30 September 2005.

*In addition to the pensioners shown in the table opposite, there are 35 former members and beneficiaries who receive annuities from Standard Life.

Annualised Investment Return

The total benchmark shown is the weighted average return of the benchmarks of the component funds.

For the period to 30 September 2004, the asset allocation of the SFHA Pension Scheme tracked the WM (average pension fund) asset allocation. During the year to 30 September 2005, schemes within The Pensions Trust adopted scheme specific investment strategies, whereby asset allocations appropriate to individual schemes were implemented. The SFHA Pension Scheme has adopted a strategy that is invested 75% in global equities, and 25% in fixed interest bonds and property.

The Pensions Committee is pleased with a positive return of 22.1% for the Scheme year, and that each fund achieved a return in excess of the benchmark return.

Fund Statement for the year ended 30 September 2005

	2005 £'000	2004 £'000
Contributions paid by members and employers	16,764	14,484
Group and individual transfers in	2,180	3,022
Total money in	**18,944**	**17,506**
Benefits paid (pensions and lump sums)	(3,702)	(3,686)
Payments to leavers	(361)	(709)
Administrative costs	(628)	(575)
Specific expenses	(106)	(99)
Pension Protection Fund	(43)	(0)
Total money out	**(4,840)**	**(5,069)**
Net new money available for investment	14,104	12,437
Return on investments		
Investment income and gains	39,127	16,907
Investment management expenses	(423)	(347)
Net returns on investments	38,704	16,560
Net increase in the fund during the year	**52,808**	**28,997**
Fund summary		
At the beginning of the Scheme year	172,249	143,252
At the end of the Scheme year	**225,057**	**172,249**

Net Asset Statement at 30 September 2005

Global Equities	167,566	115,767
Fixed Interest Bonds	40,849	33,041
Index Linked Bonds	0	12,115
Property	12,949	8,504
	221,364	169,427
Other Assets	3,693	2,822
	225,057	**172,249**

The SFHA Pension Scheme is part of The Pensions Trust and this statement summarises the transactions of the Scheme and its proportionate share of expenses, investment returns and investments. The figures shown in the statement have been extracted from the audited accounts of The Pensions Trust, which were approved at a meeting of the Trustee on 14 December 2005.

The summary report is not intended to be a formal financial statement according with the terms of the SORP (Statement of Recommended Practice) for Pension Schemes. The full Report & Accounts of the Trust and the Scheme are available on request.

Pensions Act 2004 Update

Many of the provisions of the Pensions Act 2004 came into force on 6 April 2005, including The Pension Protection Fund (PPF) and The Pensions Regulator. The Act contains several provisions to protect the interests of pension scheme members. Some of the key provisions are undernoted:

- The Pension Protection Fund opened on 6 April 2005. It will provide compensation where an employer becomes insolvent and the pension scheme is unable to cover members' benefits. It is paid for by levies charged to pension schemes, so security comes at a cost
- New regulations governing scheme funding apply from 23 September 2005. The regulations require defined benefit schemes, such as the SFHA Pension Scheme, to take a more prudent view of scheme funding. Shortfalls in scheme funding will have to be paid off as quickly as the employers can afford. Like the Pension Protection Fund, the Scheme Funding regulations may add to the cost of running the SFHA Pension Scheme
- The Occupational Pensions Regulatory Authority (OPRA) was replaced by the Pensions Regulator from 6 April 2005. The main objectives of the Regulator will be to protect members' benefits, keep claims on the Pension Protection Fund to a minimum and to promote good pension scheme administration

The Pensions Committee adopted the following change to the existing pension scheme, effective from 6 April 2005:

- Any pension received in respect of service after 6 April 1997 must be increased by the lower of 5% or the increase in the Retail Prices Index (RPI). This is known as Limited Price Indexation (LPI). With effect from 6 April 2005 LPI will become the lower of 2.5% or the increase in RPI for any pension received in respect of service after 6 April 2005. This change only applies to pension payments

The Act contains several provisions to protect the interests of Pension Scheme Members.

Finance Act 2004 Update

The provisions of the Finance Act 2004 come into force on 6 April 2006. All previous Inland Revenue limits are replaced by one set of rules that covers all pension arrangements. Individuals may save more, with tax relief, than before and they can contribute to several different pension arrangements at the same time if they wish.

The following changes will affect the SFHA Pension Scheme:

- The earliest retirement age increases from 50 to 55, from 6 April 2010. Special arrangements will exist for members of the pension scheme on 5 April 2006, who wish to retire early on or after 6 April 2010. These members will retain the option to take their pension from age 50. This is known as 'protected pension age'. If you exercise this option then you must leave employment before you draw your pension
- Currently, the Normal Pension Age (NPA) under the Scheme is 65 and your employment must end before you draw your pension. From 6 April 2006, there will no longer be any requirement for you to end your employment before you draw your pension. Pension benefits may be paid while you continue to work for the same employer, with the exception of members retiring on the grounds of ill-health or members who retire before age 55 under the protected pension age provisions

All other scheme benefits will remain unchanged. Please refer to the 'Benefits of the Scheme' section of this report. Other options for change resulting from the Finance Act will be fully considered as part of the Major Review.

Individuals may save more, with tax relief, than before and they can contribute to several different pension arrangements at the same time.

Major Review Phase 2

In August 2005, the Pensions Committee advised members that it was conducting an evaluation of the future of the Scheme, and that research was being carried out on a number of options. The Pensions Committee was to assess the findings in late 2005. Unfortunately, legislation governing new scheme funding requirements, as detailed in the Pensions Act 2004 section of this report, was delayed until 30 December 2005.

The timetable for the evaluation process has been extended to allow the new legislation to be taken into consideration. The options being considered are:

- Retaining the existing scheme and benefit structure
- Reducing future benefits under the existing benefit structure
- Introducing for the future, a Career Average Revalued Earnings (CARE) Scheme
- Introducing a defined contribution (DC) scheme
- Offering a scheme with different tiers
- Whether the scheme should continue to 'contract out' of the State Second Pension
- Merging with the Social Housing Pension Scheme (SHPS)

Additional Voluntary Contributions (AVC)

The SFHA Pension Scheme offers the Growth Plan and Ethical Plan for member AVCs.

In September 2005, The Pensions Trust announced to all Growth Plan members and employers that no discretionary bonus would be awarded for Series 1 and 2 benefits.

This decision was taken on the advice of the Scheme Actuary in order to strengthen the fund.

However, Series 2 and 3 pensions in payment did receive an increase, as required by law and the rules of the Growth Plan.

Growth plan contributions from October 2001 are invested in the Money Market Fund. This fund invests in short-term high quality securities and deposits; it aims to preserve the capital invested and to ensure liquidity of the assets.

Your Pensions Committee

The Pensions Committee meets at least four times a year to monitor the Scheme. It has responsibility for the successful management and operation of the Scheme in the interests of all members.

The Pensions Committee includes:

- Three individuals elected by members
- Three individuals elected by employers
- Up to three co-opted members

The Pensions Committee members are currently:

Malcolm MacDonald (Chair)	Member nominated
Christine Murphy (Vice Chair)	Member nominated
Jim Wilson	Member nominated
Jim Michael	Employer nominated
David Molyneaux	Employer nominated
Kathryn Miller	Employer nominated
Sally Inkster	Co-opted member
Alistair Miller	Co-opted member

The Scheme Secretary is Susan Wardlaw, who is based in The Pensions Trust's Edinburgh office.

The Pensions Committee elections are under way. Nominations were sought for both member and employer nominated representatives. You will receive your election papers in May 2006.

Professional Advisers & Bankers

Actuarial Consultants
HSBC Actuaries and Consultants Ltd

Scheme Actuary
Steven Robinson of HSBC Actuaries and Consultants Ltd

Auditors
KPMG LLP

Solicitors
Mayer, Brown, Rowe & Maw LLP
McGrigor Donald

Bankers
The Royal Bank of Scotland plc

Investment Managers
Legal & General Investment Management Ltd
Fidelity Pensions Management Ltd
Barclays Global Investors Ltd
Capital International Ltd
F & C Asset Management plc
Morley Fund Management Ltd
Standard Life Investments

Property Investment Managers
CB Richard Ellis Investors Ltd

Investment Consultants
Watson Wyatt Investment
Mercer Human Resource Consulting Ltd

Custodians
The Northern Trust Company (inc. Illinois)
Mayer, Brown, Rowe & Maw LLP (for property deeds)

Measurement of Investment Performance
The Northern Trust Company (inc. Illinois)

Custody Consultants
Chatham Partners

Pensions Consultants
SBJ Benefit Consultants Ltd

Trustee
Verity Trustees Ltd

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