



STRATEGIC INVESTMENT BOARD

ANNUAL REPORT

1 APRIL 2003 TO 31 MARCH 2004

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1. Introduction

The Strategic Investment Board (SIB) is an advisory non-departmental public body set up by the then Lord Chancellor at the beginning of 2001 to advise on the investment activities of the Public Guardianship Office, the Official Solicitor & Public Trustee Office and the Court Funds Office. All are now within the remit of the Department for Constitutional Affairs (DCA), which was created as a new Government Department in June 2003. The Secretary of State is Rt Hon Lord Falconer of Thoroton. Lord Falconer is also the Lord Chancellor until this office is abolished as part of the DCA's legal and constitutional modernization programme.

Previously known as the Lord Chancellor's Strategic Investment Board, the name of the Board was changed to its present one with effect from 26 January 2004 and its terms of reference modified.

This, the third SIB annual report, covers the year from 1 April 2003 to 31 March 2004.

2. Chairman's Report

During the year under review significant progress was made on a number of fronts and organisational changes were put in hand by the DCA which, by giving a clearer and stronger executive focus for the Department's investment activities, should provide a more effective channel for the Board's advice on the formulation of investment strategy and its implementation.

The launch of the Equity Index Tracker Fund (ITF) was one of the highlights of the year. By the end of March 2004 the ITF, which stood at over £30m, had been running for just over 6 months and the low fees to clients and the tight tracking of the benchmark confirmed the Board's expectations and reinforced its conviction that the ITF should in most cases be regarded as the vehicle of choice for equity investments by DCA clients.

Reporting by fund managers, to the Board and to DCA clients, is an area to which SIB devoted a great deal of attention in the latter part of the year. In giving its advice the Board's aim has been to ensure full and open disclosure of fees and returns, to permit effective monitoring by the Board and to ensure that DCA clients are provided with the information they need to understand how well their assets have been managed and at what cost.

In June 2003 SIB produced a set of Questions and Answers in response to a number of queries that had been raised by OSPT staff following a presentation on SIB's investment strategy recommendations. The Board has also responded to various questions raised by the Official Solicitor & Public Trustee concerning the implementation of the new strategies and the guidelines to be used by OSPT staff when carrying this out.

SIB's views and input were sought in connection with the Investment and Banking Review, carried out in the latter half of 2003, which led to the bringing together of the Department's investment and banking resources under a Head of Investments and Banking. The Board welcomes this development, since it provides a clearer and more coherent executive responsibility for the investment issues on which SIB's advice is sought.

Discussions have been held with the CFO and the UK Debt Management Office, which manages the Court Funds Investment Account (CFIA), concerning the sustainability of the interest rates paid on Special and Basic Accounts and the future investment policy to be adopted for the Fund. Further progress on these issues is dependent on resolution of fundamental policy issues concerning the rationale for and operation of the CFIA. In the meantime SIB has provided advice to the Head of Investments & Banking concerning the level of interest rates paid by the CFIA in response to the changes in base rate announced by the Bank of England's Monetary Policy Committee.

The Board's achievements could not have been realised without the sustained efforts of my fellow appointed board members and the input of ex officio members and their staff, whose contributions have been greatly appreciated.

Colin Price
Chairman

3. Membership

The Board is independent and non-executive and comprises a Chairman and five appointed members, all drawn from financial services backgrounds, as well as a number of ex-officio members from within the DCA business areas. As at 31 March 2004, a vacancy was created by the resignation of one of the appointed members which is being filled.

The membership of the Board during the year included the following:-

Chairman

Dr Colin Price <i>(Reappointed 1 January 2004)</i>	Member of the Management Board and Chairman of the Audit Committee, UK Debt Management Office. Formally Global Advisor to Shell Pension Funds, Finance Director of Shell Pensions Management Services Limited and a Board member of IMRO.
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Appointed members

Mr Alan Clifton	Holds several non-executive directorships. Formerly Managing Director of Morley Fund Management Limited, the asset management arm of Aviva plc.
Mr Andrew Hutton	Managing Director of RBS Asset Management. Previously Head of Investment Management at Coutts Group and Managing Director, Head of International Mutual Funds at JPMorgan Investment Management.
Mr Laurence O'Mara	Managing Director of Lombard Odier Darier Hentsch (UK) Ltd, a post he has held since 1994, having previously been Head of the European Department of the Kuwait Investment Office.
Mr David Ritchie <i>(Reappointed 1 January 2004. Resigned 31 March 2004)</i>	Holds several non-executive directorships. Formerly Deputy Group Chief Executive of Scottish Widows and Executive Chairman of Scottish Widows Investment Management Limited.
Prof Janette Rutterford <i>(Reappointed 1 January 2004)</i>	Professor of Financial Management, Open University Business School. Consultant and author in the fund management field.

Ex-officio members

Mr Ian Hyams Director of the Supreme Court Group
(Resigned 12 May 2003)

Mr Mark Camley Director of the Supreme Court Group
(Appointed 12 May 2003)

Mr Rab Harley Head of Investments & Banking, DCA
(Appointed 26 January 2004)

Master Denzil Lush Master of the Court of Protection

Mr David Lye Chief Executive of the Public Guardianship Office

Mr Laurence Oates Official Solicitor & Public Trustee

Secretary

Mr Alan Palmer

The Chairman is remunerated at the rate of £15,000 per annum and the appointed members at the rate of £10,000 per annum.

4. Terms of Reference

The Strategic Investment Board (SIB) was appointed by the then Lord Chancellor in January 2001.

The role of the board is to:

- provide advice on investment strategy, performance benchmarks and related investment matters including guidelines for external managers;
- advise on the appointment of external managers to invest the client monies coming within the care of: the Public Guardianship Office, the Court of Protection, the Official Solicitor & Public Trustee Office, and the Court Service; and
- monitor their performance against established industry benchmarks.

In the discharge of this function the Board will, in particular:

- advise on investment management arrangements, on the appointment of managers and advisers, on fee arrangements and on custody arrangements;
- advise on the benchmarks and guidelines given to managers appointed to manage the funds, to include review of guidelines as to diversification, risk, use of derivatives and counter party risk, and review of exceptions where a non-standard policy is required;
- assess the performance of managers appointed to manage the clients' funds

at such times and in such manner, and including advice on such points as shall be specified by the Director General of Finance of the Department for Constitutional Affairs (DCA)

The Board may also advise on such matters related to investments that fall within the ambit of the Public Guardianship Office, the Official Solicitor & Public Trustee and the Courts as may be requested by the Head of Investments & Banking of the DCA.

SIB's role in respect of monitoring performance does not extend to those cases where the investment management of the fund has been outsourced to non-panel fund managers.

SIB provides advice on general investment matters but not on specific investments.

Note: These Terms of Reference were updated with effect from 26 January 2004.

5. Achievements During the Period

Support for the review of investment and banking activities set up by the DCA

During the latter part of 2003, the DCA undertook a review of all its investment and banking activities, encompassing administration, policy and developmental issues such as those covered by the existing Investment Programme. The review was directed by a steering committee on which the Chairman of SIB sat as an advisory member. The review was followed by the appointment of a Head of Investments & Banking for the DCA, bringing together responsibility for those investment and banking activities undertaken by the PGO, the OSPT and the CFO. SIB has welcomed this development since it will provide a better executive focus for these activities. The priorities are to reduce risk, improve client service and increase accountability. The new Head of Investments & Banking has become SIB's immediate point of contact with the DCA and he has joined the Board as an ex-officio member.

Advice given on the completion of the tender for a manager for the new Equity Index Tracker Fund and on the way in which this facility was implemented for the benefit of DCA clients

During the course of the year, the funds which constituted the existing Common Investment Funds (the High Yield Fund and the Capital Fund) were first merged and then replaced by the new Equity Index Tracker Fund. SIB not only advised on the contractual arrangements, the investment mandate and the monitoring procedures for the new fund manager, but also on the technical aspects of this complex transition. The new fund tracks a composite index made up of the FTSE All-Share Index (80%) and the FTSE World ex-UK Index (20%). SIB also advised on subsequent secondary legislation to widen the range of DCA clients and former clients that were entitled to hold units in that fund, as well as on the information about the fund that needed to be communicated to clients.

Advice given on the form of reporting of investment performance by the panel fund managers

The measurement of investment performance can be technically complex, but needs to be made as transparent and understandable as possible. Drawing on the skill and experience of its members, SIB's advice not only provided for a simple form of measurement at the individual client level, but also led to the introduction of a much improved process for performance monitoring for the business as a whole. In both cases, the benchmark against which equity performance is being measured is the composite index used for the Equity Index Tracker Fund.

Advice to the PGO on a transition process involving the retirement of a panel fund manager and the appointment of a new one, the introduction of the new Equity Index Tracker Fund and the implementation of the new investment strategies for clients that had previously been recommended by SIB

The transition process proved to be particularly complex with the need to communicate the changes to all PGO receivers and to invite them to indicate their preferences for the future management of their respective clients' investments. SIB advised both on the technical aspects of that transition and on the documentation that needed to be sent to receivers. The Board has also recommended ways in which investment risk can be explained more clearly to those receivers who may be unfamiliar with the investment management process.

Proposals to the OSPT for the measurement of investment performance on their private trust business

Investment on behalf of private trusts is not straightforward because of the different interests of the beneficiaries. While the life tenant is generally only interested in the income generated, the remainderman seeks capital growth. In giving its advice, SIB has tried to give recognition to these different interests and suggested separate benchmarks against which income and capital return can be monitored.

Advice to the OSPT on the possible outsourcing of the institutional fund investment portfolios which they currently manage

SIB has given advice on the choice of external parties that provide these services and the processes by which they might be selected. It was recognised however that it would be for the trustees involved to make the selection and agree terms.

Participation in discussion of policy issues relating to the management of the Court Funds Investment Account and specific advice on the setting of interest rates for the Special and Basic Accounts

Cash deposited in court is mainly held in the Special Account (PGO clients and children's funds) or the Basic Account (primarily payments in satisfaction). These monies are invested in the Court Funds Investment Account which is managed on behalf of the DCA by the UK Debt Management Office. The Chairman of SIB joined a working party set up to consider a number of policy issues which affected this fund and to make recommendations to the DCA.

SIB has also been invited to give its advice on whether there should be any change to the interest rates that are paid on the Special and Basic Accounts in the light of any change in the Bank of England Base Rate.

6. Work Programme for 2004/2005

SIB works closely with the new Head of Investments & Banking for the DCA and responds to requests for advice on a range of issues. Subject to more urgent matters requiring its attention, SIB's own programme of work for the year ahead is expected to include the provision of advice on the following:

- Possible changes to the investment strategies for clients of the PGO and children with damages awards in the event of lower rates of interest being paid on cash balances held in the Special Account.
- Investment management mandate for the Court Funds Investment Account, including the investment strategy to be followed, the choice of benchmark(s) and the performance monitoring process.
- The interest rate policy, as distinct from the specific rates, that is to be followed for the Special and Basic Accounts.
- Guidelines for the rebalancing of investment portfolios to take account of changes in client circumstances and their ongoing exposure to risk.
- Review of the investment implications of the use of structured settlements in damages awards in the light of the Courts Act 2003.
- Investment of client funds in a wider range of asset classes, e.g. property, private equity and/or hedge funds.
- The possible development of new investment products for DCA clients.