Appendix 1

AVON PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

Types of Investment Held

1. Fund monies are invested in equities (both United Kingdom and overseas), index-linked and fixed interest stocks, Fund of Hedge Funds and property. Some of these investments are in segregated portfolios but the majority are now in pooled funds. In addition the Fund will normally hold a proportion of its monies in short-term bank deposits and money market funds.

2. The Fund actively hedges its US dollar, Yen and Euro equity exposure which is managed on a segregated basis.

Asset Allocation and Expected Long Term Returns on Investment

3. The Avon Pension Fund Committee ("the Committee") periodically reviews its investment strategy in order to ensure the strategy reflects the Fund's liability profile. The 2005/06 review resulted in diversifying some of the Fund's assets into property and hedge funds. In 2009 the strategy was reviewed in light of the credit crisis which concluded that the current asset allocation was appropriate but highlighted areas where the Fund may be able to enhance returns without significantly increasing risk. As a result, the Fund reduced its allocation to UK equities in favour of overseas equities and implemented active currency hedging of the US dollar, Yen and Euro denominated equities.

4. In 2010 following an assessment of sector and stock concentration risk within the UK FTSE All Share Index (the benchmark for the passively managed UK equity portfolio), the allocation to passively managed UK equities was reduced further and the monies allocated to global equities.

5. The current customised benchmark for the Fund, along with assumptions on expected return and volatility of each asset class, is:

Asset Class	% of Fund	Expected Return (long term, p.a.)	Expected Volatility (p.a.)
UK Equities	18%	8.4%	15% - 20%
Overseas Equities	42%	8.4%	15% - 20%
Index-Linked Gilts	6%	5.1%	5% - 10%
Fixed Coupon Gilts	6%	4.7%	5% - 10%
UK Corporate Bonds	5%	5.6%	5% - 10%
Overseas Fixed Interest	3%	5.6%	10% - 15%
Fund of Hedge Funds	10%	6.6%	6% -15%
Property	10%	7.4%	5% -10%

6. The inclusion of property and hedge funds in the asset allocation strategy is expected to reduce the overall volatility of returns without significantly altering the Fund's expected long term return. The reduction in volatility results from property and hedge funds having a lower correlation to both bond and equity returns over the long term. Foreign currency exposure is unrewarded risk, thus the currency hedging is to protect the sterling value of the hedged portfolios and to reduce the volatility that arises from currency. Using JLT Actuaries and Consultants Limited's long term risk and return expectations for each asset class as at 2009, the expected overall return for the current Fund structure is equivalent to long-dated gilts +2.8% and the expected volatility (of the returns relative to liabilities) is 10.2%.

7. The expected returns set out in the table are consistent with the asset out-performance objective used by the Fund's actuary in the triennial valuation.

8. Although the Fund has a customised benchmark, there is some scope for the expected returns set out in the table to be exceeded through the performance of the active managers (see paragraph 9 below).

9. In 2004 the Committee considered private equity investments but, having taken advice from its investment consultant, and having considered the prospective returns on private equity against the associated risks, the Committee resolved in March 2004 that it would not invest in private equity. This decision was confirmed in the 2009 strategy review.

10. An Asset Liability Study is normally undertaken following the triennial actuarial valuation which establishes the value of the Fund's liabilities. In the interim period the equity and bond proportions are rebalanced periodically when the

proportions deviate by more than the permitted range and the valuation metric to re-balance is triggered.

11. Cash is not included in the customised benchmark. However, cash is held by the managers, at their discretion within their investment guidelines, and internally to meet working requirements. The managers of the segregated portfolios can utilise money market funds offered by the custodian, BNY Mellon, or put cash on deposit in line with their cash management policy. The cash within the pooled funds is managed internally by the managers. The cash managed by Blackrock in the property portfolio is invested in the Blackrock Sterling Liquidity Fund. The cash held internally by the Fund to meet working requirements is managed by the Council's Treasury Management Team. This cash is separately accounted for and is invested in line with the Fund's Treasury Management policy which was approved by the Committee on 16 February 2012.

Investment Management Structure

12. The 2005/06 and 2009 strategic reviews resulted in a significant restructuring of the investment management arrangements. In addition to the Fund of Hedge Fund and property mandates, the new investment structure includes the following approaches to investing:

    a. Passive multi-asset portfolio – a low risk approach where the portfolio replicates indices to generate a return in line with those indices.

    b. Enhanced indexation equities – a low risk active management approach that can produce incremental excess returns (net of fees) on a consistent basis.

    c. Unconstrained equities (UK and global) – an active investment approach where the manager does not constrain stock selection to an index and risk is measured in absolute terms.

    d. Emerging market equities – a specialist active mandate to exploit the market inefficiencies present in emerging markets.

    e. Corporate bonds – a specialist active mandate to exploit opportunities in the UK corporate bond sector.

    f. Property – a specialist UK property manager and a specialist global property manager to exploit opportunities in property markets.

    g. Active currency hedging – actively manage the hedge to seek to ensure that the Fund benefits from favourable foreign currency movements but that adverse movements (i.e. when sterling strengthens) are hedged against.

13. The investment structure is detailed in the table below:

Manager	Mandate	Performance Objective	% of Fund	Inception date
BlackRock	Passive multi-asset	In line with customised benchmark	44%	1 April 2003
Jupiter Asset Management (Jupiter)	UK Equities (Socially Responsible Investing)	FTSE All Share +2% p.a.	5%	1 April 2001
TT International	UK Equities (unconstrained)	FTSE All Share +3-4% p.a.	5%	11 July 2007
Invesco Perpetual	Global ex-UK Equities (Enhanced Indexation)	MSCI Global ex-UK Index +0.5% p.a.	6.5%	19 December 2006
State Street Global Advisors	Europe ex-UK Equities (Enhanced Indexation)	FTSE World Europe ex-UK Index +0.5% p.a.	3.5%	14 December 2006
State Street Global Advisors	Pacific inc. Japan Equities (Enhanced Indexation)	FTSE Developed Asia Pacific Index +0.5% p.a.		14 December 2006
Schroders Investment Management	Global Equities (unconstrained)	MSCI All World Index +2-4%	6%	1 April 2011
Genesis Investment Management (Genesis)	Emerging Market Equities	MSCI Emerging Markets Index	5%	13 December 2006
Royal London Asset Management (RLAM)	UK Corporate Bond Fund	iBoxx £ non-Gilt Index +0.8% p.a.	5%	11 July 2007
MAN Investments	Fund of Hedge Funds	LIBOR +4-6% p.a.	3.0%	1 August 2007
Gottex Asset Management	Fund of Hedge Funds	LIBOR +4-6% p.a.	2.5%	1 August 2007
Signet Capital Management	Fund of Hedge Funds	LIBOR +4-6% p.a.	3.0%	1 August 2007
Stenham Asset Management	Fund of Hedge Funds	LIBOR +4-6% p.a.	1.5%	1 August 2007
Schroders Investment Management	UK Property	IPD UK Pooled Property Fund Index +1% p.a.	5%	1 February 2009
Partners Group	Overseas Property	IPD Global Property Index +2% p.a.	5%	18 September 2009
Record Currency Management	Currency hedge (US$, Yen and Euro equity exposure)	N / A	n/a	26 July 2011

The performance objective for each manager is based on the manager's expectations which take into account the performance they have achieved historically. Although these are annual targets, the performance of the active managers will generally be reviewed over a longer period.

14. In 2011 a review of the hedge fund portfolio resulted in the reduction in the number of Fund of Hedge Fund managers and altered the allocation between managers to better reflect the opportunities generated from the managers' investment strategies.

15. In the current structure 45% of the Fund is invested in passive mandates which rely solely on market returns to generate the investment return. The other 55% is invested in mandates where the investment return is derived, to a greater or lesser extent, from manager skill.

16. The Fund's investment managers are remunerated either by way of an ad valorem fee, i.e. the fee is a percentage of the value of assets under management, or a combination of an ad valorem and performance-related fee. The principle of performance-related fees is that the base fee is lower and that the manager is only paid a higher fee if the performance objective set by the Fund is met or exceeded.

Risk Control and Diversification

17. Risk is controlled through the diversification of investments across a range of asset classes that have low correlations with each other and across a selection of managers. Furthermore, a significant proportion of the investments is passively managed (or in enhanced indexation funds).

18. The implementation of the currency hedge is to manage the unrewarded risk that arises from the foreign currency exposure. Adverse movements in the currency that overseas assets are denominated in will reduce the value of those assets when translated into sterling.

Regulatory Investment Limits

19. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) impose certain "prudential" limits on the way in which the Fund's assets can be invested. In principle these are designed to ensure diversification and reduce risk. For example there are limits on the amounts which can be invested in partnerships, unlisted securities, unit trusts and life funds. There is a two tier system of prudential limits. The first tier is the "normal" limit; the second tier is a set of higher limits which can only be utilised once the Committee has passed a resolution, having complied with certain conditions.

20. Currently all the "normal" prudential investments limits apply to the Fund, except for the following:
    a) Investments in Life Funds - following a Committee resolution in March 2006, this has been increased to the maximum limit of 35% to accommodate the life fund investments managed by Blackrock.
    b) Investments in single partnerships - following a Committee resolution in December 2008, this has been increased to the maximum limit of 5% to accommodate the property investments managed by Partners.

Realisation of Investments

21. The Fund's investment policy is structured so that the investments which it holds can, except in the most extreme market conditions, be readily realised. There are longer "lock-up" periods for the investments in Fund of Hedge Funds and property

funds given the nature of these investments. However, the Fund has sought to minimise the length of these “lock-up” periods. The growth in indirect property funds has provided the Fund with the opportunity to invest in this relatively illiquid asset class and to build a well-diversified property portfolio.

22. At the present time, the Fund’s outgoings (principally the payment of pensions) can be met from income (principally employer and employee contributions) without the need for investments to be sold or investment income to be used to pay pensions. However, the Fund’s maturity has accelerated due to reductions in active members as employers respond to the funding squeeze. At the same time the number of pensioners continues to grow and pensions are uprated by inflation. Therefore, the investment strategy will be reviewed to manage the use of income/divestments to meet pension payments.

Social, Environmental and Ethical Considerations

23. Blackrock’s mandate requires stocks to be held which will replicate the performance of selected market indices. In this case the manager has no discretion with regard to the stocks which are held. As the enhanced indexation managers are also required to hold a significant number of stocks for risk control purposes, similar considerations apply to these. In the case of TT International, Genesis, Schroders (global equity mandate) and RLAM these mandates allows for discretion over stock selection and each manager has provided a statement setting out the extent to which they take social, environmental and ethical considerations into account in their investment processes. These statements are included as Appendices to this Statement.

24. The Fund has a fiduciary duty to invest Fund monies in order to achieve the best possible financial return consistent with an acceptable level of risk. Operating within this framework, in 2001 the Fund appointed Jupiter to manage a UK equity portfolio in accordance with Socially Responsible Investment (SRI) criteria (within this context SRI means investing in companies which contribute to, or benefit from, the trend towards more environmentally and socially sustainable economic activity), justified by the argument that superior performance could be achieved over time from a portfolio constructed on this basis. However, the SRI portfolio managed by Jupiter has a bias towards smaller companies and this, together with the concentrated nature of the portfolio, means that the volatility of investment returns is high.

25. The SRI portfolio includes companies providing products which solve environmental and social problems and those which minimise the environmental and social impacts of their processes. The categories of stock which the portfolio would exclude are for example, tobacco, armaments, nuclear power and animal testing of cosmetics and toiletry products.

26. At the strategic level, a manager’s approach to identifying and managing SRI risks and opportunities is evaluated as part of the tender process for appointing

new managers. It is also incorporated into the ongoing process of monitoring the investment managers' performance.

27. In December 2010 the Fund adopted the FRC UK Stewardship Code which aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice on engagement with investee companies The Fund seeks to adhere to the Stewardship Code, and encourages its appointed asset managers to adopt the Code. As a result, each of the investment managers has an explicit corporate governance policy explaining how and when they will intervene in a company and how they measure the effectiveness of their strategy. In practice the Fund's policy is to apply the Code both through its arrangements with its asset managers, the monitoring of its voting activity by an independent 3rd party and through membership of the Local Authority Pension Fund Forum.

Exercise of Voting Rights

28. The Fund recognises its responsibility as a shareholder to actively encourage good corporate governance standards in the companies in which it invests. In order to fulfil this responsibility, the Fund requires its managers to vote their UK company shares in line with their internal voting policy. The Fund has appointed Manifest (an independent proxy voting agent) to monitor the voting activity of the managers which will be reported to the Committee on a quarterly basis. The Fund will also publish an annual summary of its voting activity and trends (provided by Manifest).

29. For overseas markets voting is left to the discretion of the managers but they are encouraged to exercise voting rights where practical.

Stock Lending Policy

30. The Fund allows stock held by the Fund within its segregated portfolios to be lent out to market participants. The Fund's custodian acts as the Fund's lending agent and the Fund receives income from the lending activities. The Fund retains the right to recall loaned stock or block stock from being loaned from its segregated portfolios should the Fund wish to not lend the stock for any reason.

31. The stock lending policy on pooled funds is determined by the individual investment managers. Any income is incorporated in the net asset values of each pooled fund.

Myners Principles

32. Having asked Paul Myners to carry out a review of institutional investment, in 2002 the then Chancellor of the Exchequer endorsed the ten principles of investment for pension funds which Myners recommended. Following a review in

October 2008, the Treasury published a revised set of six principles. Regulations state that local authority pension funds are required to make clear in their Statement of Investment Principles the extent to which they comply with these principles.

33. Appendix 5 sets out the existing position with regard to the Fund's compliance with the revised principles.

To be approved by the Avon Pension Fund Committee on 16 March 2012