Appendix 1

AVON PENSION FUND

STATEMENT OF INVESTMENT PRINCIPLES

This statement sets out the principles that will guide the Avon Pension Fund Committee ("the Committee") when making decisions about the investment of the Fund's assets. It also sets out the framework for investing the Fund's assets and is consistent with the Fund specific funding strategy as set out in the Funding Strategy Statement (which states the actuarial assumptions underpinning the funding strategy).

The Local Government Pension Scheme (Management and Investments of Funds) Regulations 2009 ("the regulations") require the Avon Pension Fund ("the Fund") to prepare, publish and maintain a statement of the principles governing its investment of the Fund's monies. As required by the regulations, the Committee will review this statement periodically to ensure it is consistent with the Fund's funding strategy.

This statement is required to cover the following:

- Types of investments to be held
- The balance between different types of investments
- Risk, including the ways in which risks are to be measured and managed
- The expected return on investments
- The realisation of investments
- The extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments
- The exercise of voting rights (if there is any such policy)
- Stock lending
- Statement of compliance with the Myners Principles

1 Investment Objective

The investment objective is to achieve a return on the assets, consistent with an acceptable level of risk that will enable the Fund to meet its pension liabilities over time, that is, to achieve 100% funding in line with the funding strategy. The investment strategy must therefore generate returns that will help stabilise and minimise employer contribution rates in the long term as well as reflect the balance between maximising returns consistent with an appropriate level of risk, protecting asset values and matching liabilities. The investment strategy will reflect the Fund's appetite for risk and its willingness to accept short term volatility within a longer term strategy.

Implementation: At the strategic investment review in 2009, the expected return of the current strategy is equivalent to 2.8% p.a. over the expected return on long dated gilts and the expected volatility of the returns relative to liabilities is 10.2% p.a. (source: JLT). This investment objective was consistent with the funding strategy used at the 2010 actuarial valuation.

2 Types of Investment Held

The Fund may invest in any type of investment permitted under the regulations. Consideration of each asset class or investment approach will include potential risk adjusted return expectations and an assessment of non-financial risks, liquidity, product structure and management costs.

Implementation: The Fund currently invests in equities (both UK and overseas), index-linked and fixed interest stocks, Fund of Hedge Funds and property funds. Some of these investments are in segregated portfolios but the majority are in pooled funds. In addition, the Fund will normally hold a proportion of its monies in short-term bank deposits and money market funds to meet operational requirements.

3 Asset Allocation and Expected Long Term Returns on Investment

The Committee is responsible for setting the strategic asset allocation for the Fund which in turn must be consistent with the investment return assumed in the funding strategy.

The investment strategy reflects the medium to long term nature of the liabilities but must also provide flexibility to manage short term volatility in markets. In addition, the investment strategy must take account of possible changes to cash flows as the membership profile of the Fund or the benefits structure changes.

The investment strategy reflects the differing return and risk profiles of each asset class. However, long term expectations are not consistently generated over all time frames and, for all asset classes, there can be periods of under or out performance compared to the long term expectations.

For each portfolio managed on an active basis, the manager has an outperformance target which means that the Fund should outperform its strategic benchmark, everything else being equal. The outperformance target will reflect the level of risk and approach to investing taken by each active manager.

Implementation: The current strategic asset allocation along with assumptions for expected return and volatility for each asset class is set out in the table below. This strategy was reviewed in 2010.

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%*

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.

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

As the current strategy targets fixed allocations to each asset class, a dynamic re-balancing policy is triggered when the proportions invested in equities and bonds deviates by more than the permitted ranges.

Cash is not included in the strategic benchmark. However, cash is held by the managers, at their discretion within their investment guidelines, and internally to meet working requirements. The cash held internally 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.

The strategic policy and the medium term performance of the managers are monitored at quarterly committee meetings.

4 The balance between different types of investment and the Investment Management Structure

The Fund will at all times invest across a diversified portfolio of investments to reduce investment risk. In addition to diversifying by assets, the Fund will invest across a number of managers and via different approaches and styles to investing. Whilst the Fund experiences a deficit in its funding position, there will be a significant allocation to "return generating" assets such as equities. However, the equity portfolio will be diversified by manager, geography and investment style.

The Fund will invest via segregated and pooled portfolios based on the appropriateness for each portfolio (namely, cost, liquidity, impact on voting rights, flexibility and speed of implementation). The Fund will invest across a combination of passive, enhanced indexation, active and absolute return investment approaches based on return potential, cost and flexibility of implementation.

Implementation: Currently 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 active mandates where manager skill is expected to enhance the market return, to a greater or lesser extent.

Passive approaches aim to deliver the market return by replicating the index in a cost and implementation efficient manner. These are suitable for equity and bond portfolios managed on a pooled or segregated basis. Enhanced indexation equity portfolios aim to provide an incrementally higher return than the index but at a low risk. This approach utilises quantitative models to generate portfolios. Active managers seek to outperform the index through the selection of the underlying investments. Such portfolios are more concentrated and volatile than the index. Each mandate will have a portfolio specific outperformance and risk target. Absolute return portfolios seek to provide a positive return in all market environments. These managers use a wide range of investment techniques to generate returns. An active currency hedging mandate manages the currency exposure so that the Fund benefits from favourable foreign currency *movements but that adverse movements (i.e. when sterling strengthens) are hedged against.*

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%*	*01/04/03*
Jupiter Asset Management	*UK Equities (Socially Responsible Investing active)*	*FTSE All Share +2% p.a.*	*5%*	*01/04/01*
TT International	*UK Equities (unconstrained active)*	*FTSE All Share +3-4% p.a.*	*5%*	*11/07/07*
Invesco Perpetual	*Global ex-UK Equities (Enhanced Indexation)*	*MSCI Global ex-UK Index +0.5% p.a.*	*6.5%*	*19/12/06*
State Street Global Advisors	*Europe ex-UK Equities (Enhanced Indexation)*	*FTSE World Europe ex-UK Index +0.5% p.a.*	*3.5%*	*14/12/06*
State Street Global Advisors	*Pacific inc. Japan Equities (Enhanced Indexation)*	*FTSE Developed Asia Pacific Index +0.5% p.a.*		*14/12/06*
Schroders Investment Management	*Global Equities (unconstrained active)*	*MSCI All World Index +2-4%*	*6%*	*01/04/11*
Genesis Investment Management	*Emerging Market Equities (unconstrained active)*	*MSCI Emerging Markets Index*	*5%*	*13/12/06*
Royal London Asset Management (RLAM)	*UK Corporate Bond Fund (active)*	*iBoxx £ non-Gilt Index +0.8% p.a.*	*5%*	*11/07/07*
MAN Investments	*Fund of Hedge Funds*	*LIBOR +5.75% p.a.*	*3.0%*	*01/08/07*
Gottex Asset Management	*Fund of Hedge Funds*	*LIBOR +3% p.a.*	*2.5%*	01/08/07
Signet Capital Management	*Fund of Hedge Funds*	*LIBOR +3% p.a.*	*3.0%*	01/08/07
Stenham Asset Management	*Fund of Hedge Funds*	*LIBOR +3% p.a.*	*1.5%*	01/08/07
Schroders Investment Management	*UK Property (active)*	*IPD UK Pooled Property Fund Index +1% p.a.*	*5%*	*01/02/09*
Partners Group	*Overseas Property (active)*	*IPD Global Property Index +2% p.a.*	*5%*	*18/09/09*
Record Currency Management	*Currency hedge (US$, Yen and Euro equity exposure)*	*N / A*	*n/a*	*26/07/11*

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.

5 Risk

Investment by its very nature is a risk based activity where the returns achieved will reflect differing levels of risk. There are a number of investment risks to consider within an investment fund, namely, market, credit, currency and liquidity risks. Consideration of financially material non-financial risks is discussed in the section "Responsible Investment Policy".

However, the main risk for the Fund is that the investment returns are less than that required in the funding strategy which leads to a deterioration in the funding level, all else being equal. The aim of the investment strategy and management structure is to manage the appropriate level of risk for the return target.

The Fund’s investments are managed by external investment managers who are required to invest the assets in line with the investment guidelines set by the Fund, appropriate for each mandate. An independent custodian safe keeps the assets on behalf of the Fund.

Implementation: Investment risk is controlled through the strategic policy which ensures diversification of investments across a range of asset classes and markets that have low correlations with each other and across a selection of managers. As most of the portfolio is exposed to market risk, the main risk to the Fund is a fall in market prices. Although market movements cannot be completely avoided, and indeed there are periods when all assets become more highly correlated, the impact can be mitigated through diversifying across asset classes and approaches to investing.

Credit (and counterparty) risk arises in the bond portfolios, in the management of cash balances and in the trade settlement process. At all times the Fund ensures it appoints reputable and creditworthy external suppliers and that credit management policies are adhered to.

The currency hedge manages 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.

Liquidity risk is the risk that the Fund cannot realise its assets as needed. As a result, the Fund limits its investment in less liquid asset classes such as property. Hedge funds are also not as liquid as equity and bond portfolios.

Risk and return of the overall Fund and the individual portfolios is monitored closely to ensure the managers are investing in line with their expected long term risk return parameters and that the Fund overall is achieving its investment objectives.

6 Regulatory Investment Limits

The regulations 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.

Implementation: Currently all the “normal” prudential investment limits apply to the Fund, except for the following:

- *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.*

- *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.*

7 Realisation of Investments

The Fund must be able to realise its investments within a reasonable period appropriate for its cash flow and maturity profile. Therefore the investment strategy must reflect the need to realise assets or use of investment income to meet projected cash flow requirements.

Implementation: The Fund's investment policy is structured so that the majority of its investments (80% in quoted equities and bonds) which it holds can, except in the most extreme market conditions, be readily realised. Property is a long term investment which the Fund will not be able to realise in a short period. However, 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. There are "lock-up" periods for the investments in Fund of Hedge Funds given the nature of these investments. However, the Fund has sought to minimise the length of these "lock-up" periods.

Currently the Fund is transitioning to a more mature profile as the monthly payment of pensions is no longer met by pension contributions, thus there is a need to realise assets or income on an on-going basis within the investment strategy. Based on projected cash flow, investment income from the segregated portfolios will be used to meet any shortfall in cash inflows prior to divesting of assets.

8 Responsible Investing Policy

The Avon Pension Fund recognises that responsible investing (RI) issues can have a material impact on the value of the investments held by the Fund. It also believes it has a responsibility to carry out its stewardship activities effectively. As a result the Committee has a Responsible Investing Policy that sets out the framework for considering such issues throughout the investment decision-making process.

Implementation: The Committee approved its Responsible Investing Policy in June 2012. The full policy can be accessed via www.avon.avonpensionfund.org.uk .

The policy includes:

- *analysis of the impact of RI issues on each asset class as part of strategic reviews*
- *evaluation of an investment manager's approach for assessing RI risks within their investment process in mandate tenders*
- *monitoring of the decisions by its investment managers regarding RI issues that have a material financial impact on the Fund*
- *voting and engagement policy*
- *participation in collaborative groups to influence corporate behaviour*

Although the investment structure means that some parts of the policy are more relevant to some mandates than others, the strategic aspects will apply across the entire Fund. At the mandate level, the passive nature of Blackrock's mandate means 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. In addition, Invesco has a Responsible Investment Policy relating to their Enhanced Indexation funds. These statements are included as Appendices to this Statement.*

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 Jupiter was appointed 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, 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. Given the mandate objective, this SRI portfolio 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. This 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.

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 on-going process of monitoring the investment managers' performance.

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, a collaborative body seeking to promote best practice in corporate governance.

Exercise of Voting Rights

The Fund recognises its responsibility as a shareholder to actively encourage good corporate governance standards in the companies in which it invests as poor governance can negative impact shareholder value.

Implementation: 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 at least annually. The Fund will also publish an annual summary of its voting activity and trends (provided by Manifest).*

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

9 Stock Lending

The Fund allows stock held by the Fund to be lent out to market participants.

Implementation: The Fund permits holdings in 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.

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.

10 Myners Principles

The Myners Principles sets out a code of best practice in pension fund governance, investment decision making and disclosure. 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.

Implementation: The Fund fully complies with the principles. Appendix 6 sets out the Fund's compliance.

To be approved by Avon pension Fund Committee on 21 September 2012