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.

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: The Fund has a strategic benchmark which reflects the Fund's liability profile. 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 10.0% p.a. (source: JLT). This investment objective is consistent with the investment return assumptions in the funding strategy used in the 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 invests in equities (both UK and overseas), diversified growth funds, index-linked and fixed interest stocks, Fund of Hedge Funds and property funds. The strategic benchmark includes an allocation to infrastructure which has yet to be invested. 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.

The strategic framework includes a target allocation against which strategic performance will be monitored. In addition there are ranges for each asset category that allow limited deviation within the framework. The ranges enable the Fund to reflect changes in the market outlook and provide greater flexibility to implement cash management and rebalancing. Over the longer-term it provides a framework within which de-risking strategies could be implemented.

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. The strategic benchmark does not assume any outperformance from the investment managers.

Implementation: The 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 agreed in 2013 and will be implemented during 2013 and 2014.

Asset Class	% of Fund	Range	Expected return*	Expected Volatility
Growth assets	**80%**	**65 -85%**		
Equities	*50%*	*45 - 55%*		
Developed	*40%*	*35 - 45%*	*+3.75%*	*15 - 20%*
Emerging	*10%*	*5 - 15%*	*+4.25%*	*15 - 25%*
Diversified Growth Funds	*10%*	*5 - 15%*	*+3.75%*	*10 - 15%*
Illiquid Growth	*20%*	*15 - 25%*		
Hedge Funds	*5%*	*0 - 7.5%*	*+1.5%*	*6 - 15%*
Property	*10%*	*5 - 15 %*	*+2.5%*	*5 - 10%*
Infrastructure	*5%*	*0 - 7.5%*	*+2.5%*	*5 - 10%*

Other Growth	*0%*	*0 - 5%*	*+2.5%*	
Stabilising Assets	**20%**	**15 - 35%**		
Government Bonds	*3%*	*0 - 10%*	*0%*	*5 - 10%*
Index linked bonds	*6%*	*3 - 10%*	*-0.25%*	*5 - 10%*
Corporate Bonds	*8%*	*4 - 20%*	*+1.0%*	*5 - 10%*
Other Bonds	*3%*	*0 - 5%*	*+1.0%*	*5 - 10%*
Cash	**0%**	**0 - 5%**		

** Expected return is expressed as an excess return over UK gilt yields or the "premium over gilts" to reflect the extra risk being taken. Gilts are used as the basis for expected returns as they are a proxy for valuing the liabilities.*

The inclusion of diversified growth funds (DGFs), property and hedge funds in the 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 these assets and investment approaches having a lower correlation to both bond and equity returns over the long term. In addition the Fund expects to benefit from the "illiquidity premium" from investing in property and infrastructure, and to a lesser extent, hedge funds.

The Fund takes a passive approach to hedging its US dollar, Yen and Euro developed market equity exposure. This is managed on a segregated basis. Foreign currency exposure is expected to be an unrewarded risk over the longer term, thus the currency hedging is to protect the sterling value of the hedged portfolios and to reduce the volatility that arises from currency. The passive approach seeks to achieve this reduction in volatility in an efficient and cost effective way. A dynamic rebalancing policy is triggered when the proportions invested in bonds and liquid growth assets (equities and DGFs) deviates by more than permitted. The rebalancing policy will ensure that the allocations remain within the strategic ranges.

Cash is included in the strategic benchmark but in principle the Fund will aim to be fully invested. Cash is held by the managers, at their discretion within their investment guidelines, and internally to meet working requirements. The strategic benchmark allows cash to be held for tactical or operational reasons.

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.

The strategic policy and the medium term performance of the managers are monitored at quarterly Panel and 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 and diversified growth funds. 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: A significant proportion of the Fund is invested in passive mandates (across equity and bonds markets only) which rely solely on market returns to generate the investment return. The rest of the Fund is invested in active mandates (across equities, bonds, DGFs, hedge funds, infrastructure and property) where manager skill is expected to enhance the market return and manage risk, 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. An "enhanced indexation" approach to managing equity portfolios aim to provide an incrementally higher return than the index but at a low risk relative to the index. This approach utilises quantitative models to generate portfolios. Active managers seek to outperform the index or benchmark through the selection of the underlying investments. Such portfolios are usually more concentrated and can be more or less volatile than the index/benchmark depending on the investment approach. Within the Fund, the active equity mandates tend to be more volatile than the index whereas the DGFs target a lower volatility through active management.

Each mandate has 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. A passive currency hedging mandate aims to reduce the volatility arising from currency exposure in an efficient and cost effective manner.

The investment structure is detailed in the table below. As the Fund is transitioning to the strategic benchmark set out in 3 above the allocations per manager will not be consistent with the strategic benchmark allocations and will exceed 100% as new mandates yet to be seeded are included:

Manager	***Mandate***	***Performance Objective***	***% of Fund***	***Inception date***
BlackRock	*Passive multi-asset*	*In line with customised benchmark*	*34%*	*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	*Emerging Market Equities*	*MSCI Emerging Markets*	*5%*	*13/12/06*

Management	*(unconstrained active)*	*Index*		
Unigestion	*Emerging Market Equities (active)*	*MSCI Emerging Markets Index + 2% p.a.*	*5%*	*21/01/14*
Standard Life	*Diversified Growth Funds (active)*	*LIBOR + 4% p.a.*	*6.7%*	*04/02/15*
Pyrford International	*Diversified Growth Funds (active)*	*RPI + 5% p.a.*	*3.3%*	*14/11/13*
JP Morgan Asset Management	*Fund of Hedge Funds*	*The higher of LIBOR +3% or 6% p.a.*	*5%*	*13/07/15*
Royal London Asset Management (RLAM)	*UK Corporate Bond Fund (active)*	*iBoxx £ non-Gilt Index +0.8% p.a.*	*5%*	*11/07/07*
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*
Current Structure			**100%**	
New mandates still to be seeded				
IFM	*Infrastructure (active)*	*Gilts +2.5% p.a.*	*5%*	*30/09/14*

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

The main risk for the Fund is the mismatch between its assets and liabilities. As a consequence if the investment returns are less than that required in the funding strategy the funding level will deteriorate, all else being equal. The main risks within the funding strategy are interest rate, inflation and mortality risks, and investment risk arising from the investment portfolio, which is partially offset through diversification.

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".

The aim of the investment strategy and management structure is to manage the appropriate level of risk for the return target which reflects the funding strategy. 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, the currency hedging programme, the management of cash balances and 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 and infrastructure.

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.

The investment strategy provides some protection against the liability risks, mainly interest rates and inflation. The gilt, corporate bond and other bonds (14% of the Fund) provides an interest rate hedge. Infrastructure could also provide some interest rate protection depending on the structure of the mandate. Index Linked bonds provide a direct hedge against inflation and changes to inflation expectations whilst property and infrastructure, and to a lesser extent, equities and DGFs, provide an inflation hedge over the medium to longer term. The Fund is not hedged against mortality risk.

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 (70% in quoted equities and bonds, 10% in DGFs) which it holds can, except in the most extreme market conditions, be readily realised. However, the growth in indirect investment vehicles enables the Fund to invest in less liquid asset classes and to build well-diversified portfolios. Property and infrastructure are long term investments which the Fund will not be able to realise in a short period. "Lock-up" periods are normal practice in Fund of Hedge Funds (to manage the in/out flows to ensure existing clients' capital is protected) which means that these investments are not readily realised. However, the Fund has sought to minimise the length of these "lock-up" periods when selecting managers and investment vehicles.

The Fund is transitioning to a more mature membership profile as the monthly payment of pensions is no longer met by pension contributions, thus there is a need to realise assets or utilise investment 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. The managers of actively managed portfolios have provided a statement setting out the extent to which they take social, environmental and ethical considerations into account in their investment processes, which 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, Jupiter manages 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 mid-sized / smaller companies and this, together with the concentrated nature of the portfolio, means that the volatility of investment returns is high. The portfolio includes companies providing products/services 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.

The Fund has adopted the FRC UK Stewardship Code which aims to enhance the quality of engagement between institutional investors and companies. The aim is to improve long-term returns to shareholders and by setting out good practice on engagement with investee companies, improve governance standards. 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.

9 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 negatively 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 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 the proxy voting agent).

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

10 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 not retained by the fund manager and / or the lending agent is incorporated in the net asset values of each pooled fund.

11 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 11 December 2015