Medical Research Council Pension Scheme

STATEMENT OF INVESTMENT PRINCIPLES (as at November 2011)

in accordance with The Pensions Act 1995 (as amended)

Section One – Introduction and Objectives

1.1 Introduction – This is the Statement of Investment Principles (SIP) required by Section 35 of the Pensions Act 1995, as modified by subsequent legislation, including the Pensions Act 2004. The Trustees review the SIP on a regular basis, and this latest version of the SIP is effective from November 2011. It replaces the previous SIP effective from June 2010.

1.2 Consultation and Advice – When deciding upon Investment Strategy, the Trustees consult the Medical Research Council in its role as the employer sponsoring the Pension Scheme. This SIP reflects the Investment Strategy following consultation with the employer. Also, the Trustees have taken written advice on Investment Strategy from their Investment Consultant (Steven White of Buck Consultants (Administration & Investment) Ltd).

1.3 The Scheme – The Medical Research Council Pension Scheme (MRCPS) is a defined-benefit (final salary) pension scheme, first established in 1975, and is financed on the traditional balance–of–cost basis. The MRC Supplementary Benefits Scheme was also set up at the same time to provide additional death-in-service and ill-health benefits, to be financed wholly by the members. The two Schemes were originally established under separate trusts, but were merged to form one trust, with effect from 1 April 1988. The Supplementary Section of the MRCPS was formally merged with the Main section with effect from April 2006, and this SIP relates to the combined assets of the combined MRCPS. The rules require pensions in payment to be increased in line with increases in the CPI.

1.4 Membership – The MRCPS has now been in existence for about 36 years and, although not yet fully mature, the number of pensions in payment has been growing steadily. The MRCPS is open to new members, who are expected to replace members who retire or leave the MRCPS for other reasons. The changing composition of the membership is illustrated by Table One below which gives the number of members at 31 December in each of the years 2010, 2009, 2004, and 1999.

Table One – MRCPS Membership

	NUMBER OF MEMBERS			
	@ 31.12.2010	@ 31.12.2009	@ 31.12.2004	@ 31.12.1999
Active Members	3,110	3,466	3,076	2,634
Deferred Pensions	3,837	3,232	2,648	2,265
Pensions in payment	2,392	2,276	1,734	1,411
Total Membership	**9,339**	**8,974**	**7,458**	**6,310**

1.5 Assets – The assets of MRCPS are held in trust by the Trustees. The investment powers of the Trustees, which are quite wide-ranging, are set out in Section 15.2 of the Rules of the MRCPS. These powers do not conflict with the investment policy set out below. The market value of the assets held by the MRCPS was approximately £842 million at 31 December 2010, excluding AVCs and cash held for liquidity purposes with Royal London Cash Management, which stood at approximately £40 million.

1.6 Investment Objectives – The Trustees have a fiduciary duty to invest the assets of the MRCPS for the benefit of MRCPS members, with the primary duty of managing the financing of the MRCPS to deliver the benefits promised to the membership. The Trustees consider their key Investment Objectives are:

- to seek to ensure that MRCPS benefits are securely financed;
- to maximise the investment returns on the MRCPS's assets (while having due regard to security and risks);
- to control the risks of low returns and loss of value;
- to prevent unauthorized use of funds; and
- to comply with long-term funding requirements, while meeting short-term cash needs.

The Trustees' investment policy described in Section 2 and Section 3 deals with investment manager structure. The Trustees' policy for securing compliance with the relevant parts of the Pensions Act 1995 relating to investments is also described.

1.7 Socially Responsible Investment – The Trustees attach high importance to social, environmental and ethical considerations in relation to the selection of appropriate assets, and give significant weight to these considerations both in determining investment policy and in selecting suitable investment managers. The investment managers appointed have been instructed to work proactively (using both formal and informal approaches) to promote the highest standards of:

- Socially responsible corporate behavior;
- Environmentally responsible corporate behavior;
- Corporate ethics; and

- Corporate governance.

1.8 The Trustees have instructed managers to provide written statements on their policy in relation to socially responsible investment. Also, the managers are required to report their actions to the Trustees on a regular basis and to justify controversial decisions. The managers are aware that their activity on socially responsible investment may be communicated to MRCPS members.

1.9 Where the Trustees appoint managers to manage a segregated portfolio of equities on an active basis (rather than on a passive basis), the managers have been given specific instructions not to invest in the shares of those companies whose predominant business revenues come from tobacco related products. Subject to that specific exclusion, the Trustees have delegated to the investment managers the selection of individual assets and the exercise of responsible ownership of the assets selected.

1.10 Corporate Governance – The Trustees do not directly exercise the voting rights attached to the investments held by the MRCPS, but have delegated this responsibility to the investment managers appointed by the Trustees. Most of the investment managers have indicated that they will exercise voting rights in accordance with the recommendations made by independent bodies acting on behalf of institutional investors.

1.11 All the managers have discussed their practice in relation to Corporate Governance with the Trustees, and this practice is reviewed from time to time in discussion with the managers. The managers are expected to exercise voting rights with the general objective of enhancing shareholder value in the longer term.

Section Two – Investment Policy

2.1 Nature of Investments Held – The Trustees' policy is to invest in a diversified range of asset classes, including (but not necessarily restricted to) equities, property and bond investments, both in the UK and overseas. Such a mix of asset classes is expected to provide a balance of real capital growth and investment income over the long-term, while mitigating to some extent the risk of over-concentration in a single asset class. The Trustees consider alternative asset classes from time to time, either with a view to enhancing returns or to further diversify the potential risks.

2.2 The Trustees have obtained advice from the Scheme Actuary about the nature and term of the liabilities of the MRCPS, and the expected changes in the maturity profile of the liabilities over coming years. In the light of that advice about the increasing maturity of the MRCPS, the Trustees have decided to reduce exposure to equity investments, and to increase diversification, but on a phased and gradual basis, taking into account market conditions from time to time. Table Two shows the current asset allocation strategy adopted by the Trustees. For each asset class and sub-asset class, there is a long-term strategic allocation and a "control range" around the strategic allocation, within which the actual allocation may move without the need for re-balancing.

Table Two – Long Term Asset Allocation Strategy

Asset Class	Sub-Asset Class	Management Style	Strategic Allocation	Control Range %
Equities	UK	Active	19.0	10.0 – 30.0
		Passive	5.5	2.5 - 8.5
	UK Small Cap	Active	2.5	1.0 - 4.0
	UK Wealth Weighted	Passive	3.0	1.0 – 5.0
		TOTAL UK Equity	**30.0**	**20.0 – 40.0**
	North America	Passive	7.5	2.5 - 12.5
	Europe (ex UK)	Passive	7.5	2.5 - 12.5
	Asia Pacific (ex Japan)	Active	5.0	2.5 - 7.5
	Japan	Passive	5.0	2.5 - 7.5
	Emerging Markets	Active	5.0	2.5 - 7.5
		TOTAL Overseas Equity	**30.0**	**20.0 – 40.0**
	TOTAL Equity		**60.0**	**50.0 – 70.0**
Property	UK (inc Property Income)	Active	15.0	5.0 – 25.0
	European	Active	5.0	2.5 - 7.5
	TOTAL Property		**20.0**	**15.0 – 25.0**
Alternatives	Absolute Return/Private Equity	Active	**10.0**	**5.0 – 15.0**
Fixed Income and Cash	Corporate Bonds	Active	5.0	0.0 – 10.0
	Fixed Interest gilts	Active	0.0	0.0 – 10.0
	Index-Linked Gilts	Active	5.0	0.0 – 10.0
	Cash*		0.0	0.0 – 10.0
	TOTAL Fixed Income		**10.0**	**5.0 – 15.0**
	TOTAL Non Equity		**40.0**	**30.0 – 50.0**
TOTAL			**100.0**	

** Excludes cash held by investment managers within other sub portfolios*

2.3 Medium-term adjustments to asset allocation policy

The Trustees have a rebalancing framework for asset allocation which allows adjustments to the long-term asset distribution to reflect the medium-term outlook for investment markets. The Trustees have the flexibility of increasing or decreasing the allocation to asset classes and to regional equity portfolios. The Trustees have agreed Terms of Reference for the Investment Sub-Committee's role in amending asset allocations.

The relative attractiveness of different asset classes and regional equity markets will be assessed on a quarterly basis after taking appropriate advice. The maximum adjustments to the strategic asset distribution are set out in the tables below.

Table Three – Medium Term Asset Allocation within overall strategic range

Asset Class	Allocation Range
UK Equity	20% - 40%
North America Equity	1.5% - 13.5%
Europe (ex UK) Equity	1.5% - 13.5%
Asia (inc Japan) Equity	4% - 16%
Emerging Markets Equity	1% - 9%
Total Equity	50% - 70%
Total Property	15% - 25%
Cash	0% - 10%
Alternatives	5% - 20%
Total Fixed Income	5% - 20%
Total Non Equity	30% - 50%

When the Trustees have applied one or more adjustments to the strategic allocations to reflect the medium-term outlook, the same control ranges as specified in Table Two will apply to the revised allocation. For example, if the current strategic allocation to North American equities is 7.5% with a control range of 2.5% - 12.5% (+/-5%) and an allocation range of 1.5% - 13.5%, then the strategic allocation may be moved anywhere between 1.5% and 13.5%. If the strategic allocation was then moved from 7.5% to 12.0%, the revised +/5% control range would be 7.0% - 17.0%.

Reconsideration of the strategic allocations, or re-balancing, will be undertaken when actual allocations drift beyond these control ranges.

2.4 Equity Investment – The Trustees recognise that the returns from investment in equity-type assets are likely to be more volatile than from other asset classes, and that lower returns may be achieved from this asset class in the short-term. Such an outcome may require the employer to pay a higher rate of contribution for a period. Nevertheless, the Trustees, having consulted the employer, have taken a conscious decision to maintain a significant proportion of the fund in equity-type assets, in the expectation of achieving a higher real rate of return in the long term.

2.5 Expected Return – The investment policy adopted by the Trustees reflects the objective of achieving a rate of return in excess of price increases, in order to assist in maintaining the real value of pensions in payment. It is anticipated that the expected returns over the long-term should exceed price increases by at least 4% per annum, although there will be significant short-term volatility on a year-by-year basis. If long-term returns are achieved at this level, this should provide a modest margin relative to the assumptions made by the actuary in carrying out the periodic actuarial valuations of the MRCPS.

2.6 Investment risk – The Trustees understand that active investment policy implies the acceptance of risk of poor investment returns. The risk of default could be minimised by investing the MRCPS wholly in government bonds and similar guaranteed investments, but with the probability of lower returns. In order to enhance prospective returns, the Trustees have accepted the risk involved in holding equity-type assets which have typically delivered higher returns over past periods.

2.7 Other risks – the risks are controlled as follows:

- **Lack of diversification**. Investments are spread among a range of asset classes. Also, within each asset class, the MRCPS is to be invested in a range of securities, avoiding over-concentration of investment in any one company or organisation. No more than 8% of any individual portfolio should be held in the form of securities of any one company, but in the event that any holding exceeds 5%, the investment manager must report the fact to the secretary.
- **Unauthorised activities**. Service agreements between Trustees and their investment managers define the limits of the manager's authorized activities.
- **Inappropriate investments**. Managers of segregated equity portfolios are specifically prohibited from investing in tobacco related shares, or in open-ended derivative instruments (except in limited circumstances), and are not authorized to borrow against the portfolio.
- **Illiquidity**. The majority of the MRCPS's assets are capable of being readily traded or realized, and so there should be no difficulty in selling assets, if this is required in order to meet benefits.

Section Three – Investment Manager Structure

<u>3.1 Specialist Management</u> – The Trustees have decided to appoint investment managers with specialist mandates, and with scheme-specific benchmarks.

<u>3.2 Investment Mandates</u> – The investment mandates can be broadly categorized as follows:

(1). Passive UK and Overseas Equities
(2). Passive Wealth-Weighted UK Equities
(3). Active Small-Cap UK Equities
(4). Active UK Equity
(5). Active Asia Pacific (ex Japan) Equity
(6). Active Emerging Markets Equity
(7). Property
(8). Gilts, Corporate Bonds and Index-Linked Gilts
(9). Private Equity
(10). Absolute Return

3.3 Generally, a different investment manager is appointed for each of the investment mandates, partly in order to minimise investment manager risk, but also to facilitate the appointment of the most preferred manager.

3.4 Table Four shows the long-term strategic allocations to these investment mandates, consistent with the long-term strategic allocations specified in Table Two. Also shown in Table Four are the investment managers appointed, the benchmark used for performance measurement, and the out-performance target which has been specified for each manager. The out-performance target shown is the additional return anticipated over the benchmark, and is generally monitored on a rolling 3-year basis (with information provided quarterly).

Table Four – Current Investment Managers

Mandate	Target Allocation (%)	Investment Manager	Benchmark	Target Over Benchmark gross of fees unless otherwise stated (p.a.)
Passive UK and Overseas Equities[1]	25.5%	LGIM	Bespoke Indices	±0.50%
Passive Wealth-Weighted UK Equities	3.0%	LGIM	FTSE GWA UK Index	±0.75%
Active Small-Cap UK Equities	2.5%	Montanaro	Hoare Govett Small Companies Total Return Index (ex Investment Trust Companies)	2.0% (net of fees)
Active UK Equities	19.0%	Mirabaud	FTSE All Share Index	2.0%
Active Asia Pacific (ex Japan) Equities	5.0%	First State	MSCI Asia Pacific AC (Ex Japan) Index	3.0% (net of fees)
Active Emerging Markets Equities	5.0%	Morgan Stanley	MSCI Emerging Markets (Net) Index	2.0%
Property	20.0%	Henderson	IPD Pension Fund index <£250m	1.0%
		M&G	FTSE UK Gilts Index	4% above UK RPI (net of fees)
		Aviva	50 % FTSE 5-15Yr Gilt Index + 50% FTSE >15Yr Gilt Index	1.5%
Fixed Income	10.0%	RLAM	50% FTSE A UK Gilts All Stocks Index + 50% iBoxx Sterling Non-Gilts Index	0.75%
Private Equity	5.0%	Hg Capital (& Vesey St)	n/a	n/a
		Partners Group	n/a	n/a
Absolute Return	5.0%	Barings	3 Month GBP LIBOR	4.0% (net of fees)

Note 1: 50% of the MRCPS passively managed European (ex UK) and Japan Equity assets are invested in GBP currency hedged funds to reduce the currency risk expected in the Euro and Yen over the medium term.

3.5 Cash Flow/Rebalancing – The contribution income to the MRCPS at the present time is currently below the standard contribution rate (based on actuarial advice following the triennial valuation as at 31 December 2007) and is less than is required to meet the expenditure on benefits. Income from the MRCPS's investments may be distributed to the Trustees as a source of liquidity to meet the net cash outflow. The Trustees may disinvest from other asset classes from time to time to meet further cash flow requirements.

3.6 The Trustees will keep the allocation of assets to the investment managers under regular review. Formal consideration of the allocation, including the desirability of rebalancing, will be given at least once a year. More frequent changes will be made, if considered appropriate.

3.7 Appointment - The detailed terms of appointment of the investment managers selected (who are all regulated by the Financial Services Authority) are set out in Investment Manager Agreements (IMAs) between the Trustees and the managers. These agreements specify the assets in which the managers may invest, the flexibility given to the managers to vary the assets held, and the benchmark against which performance will be assessed. The IMAs also specify the target out-performance which the investment managers are aiming to achieve, the tolerance levels with regard to risk, and the scale of fees charged by the managers.

3.8 Written reports – The Trustees receive quarterly written reports from their investment managers and from their Investment Consultant. These reports compare investment activities with those permitted by the Trustees' investment policy, summarise the recent performance of the MRCPS's investments, and advise on future market expectations and investment prospects. The reports give details of all transactions as required by the MRCPS's auditors.

3.9 Monitoring – The Trustees meet regularly to review the MRCPS's investments and are responsible for monitoring investment performance. The Trustees monitor the investments by:

- Comparing investment returns achieved by each manager against the benchmark returns set by the Trustees;
- Regular review of the investment policy, and any specific policies currently specified by the Trustees;
- Regular review of the extent to which the investments are diversified, and the suitability for the MRCPS of the chosen investments;
- Regular review of any divergence from the investment policy, and the investment manager's future intentions; and
- Regular review of the choice of investment managers and other advisers.

3.10 Control – The Trustees are responsible for ensuring that appropriate systems of control are in place to safeguard the MRCPS's assets and to prevent and detect fraud and other irregularities. Suitable systems have been set in place in collaboration with the Trustees' investment managers, custodian, bankers and auditors.

Section Four – Funding Requirements

4.1 Funding – The Trustees are responsible for ensuring that the assets of the MRCPS are likely to be sufficient to meet the MRCPS's liabilities. The MRCPS Actuary advises the Trustees on the adequacy of the MRCPS's assets, by carrying out a full Actuarial Review every three years. The latest Actuarial Review was undertaken as at 31 December 2007. An Interim Funding Update was completed as at 31 December 2008 and 31 December 2009.

4.2 MRCPS Specific Funding – The Pension Act 2004 introduced the concept of "Scheme Specific Funding", replacing the previous legislative provision regarding the "Minimum Funding Requirement". Under the Scheme Specific Funding regime, the Trustees are required to ensure that the assets held by the MRCPS are sufficient to cover the technical provisions of the MRCPS. Information on the MRCPS funding objective, and actuarial assumptions adopted, is set out in the Statement of Funding Principles prepared in connection with the 2007 actuarial valuation.

Section Five - Review

5.1 Review – The Trustees accept the need to review regularly whether the investment policy is consistent with the MRCPS's funding requirements, and benefit obligations. The MRCPS Actuary and Investment Consultant advise on whether the current investment guidelines and policy continue to be suitable. This Statement of Investment Principles will be reviewed and updated at two-year intervals, unless circumstances dictate that a more frequent review is needed.

The Trustees of the Medical Research Council Pension Scheme

November 2011

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