<table>
<tr><td colspan="3">Bath & North East Somerset Council</td></tr>
<tr><td>MEETING:</td><td colspan="2">AVON PENSION FUND COMMITTEE</td></tr>
<tr><td>MEETING DATE:</td><td>22 JUNE 2012</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td colspan="2">RECOMMENDATIONS FROM THE INVESTMENT PANEL & MINUTES
• REVIEW OF REBALANCING POLICY</td></tr>
<tr><td>WARD:</td><td colspan="2">ALL</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
<tr><td colspan="3">List of attachments to this report:
Appendix 1 – Draft minutes from Investment Panel meeting held 17 May 2012
Appendix 2 – Current Rebalancing Policy
Appendix 3 – Rebalancing Policy Paper from JLT
Appendix 4 – Proposed Rebalancing Policy</td></tr>
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1 THE ISSUE

1.1 The Investment Panel is responsible for exploring investment issues including the investment management arrangements and the performance of the investment managers, and making recommendations to the Committee.

1.2 The Panel has held one meeting since the March 2012 committee meeting and the recommendations from the Panel are set out in this report. The minutes of the Investment Panel meeting provide a record of the Panel's debate before reaching any recommendations. These *draft* minutes can be found in at Appendix 1.

1.3 The Fund's rebalancing policy seeks to ensure the Fund is invested in line with its strategic benchmark. Because of a period of increased investment market volatility, the Fund's rebalancing policy is currently suspended. In response to Committee members expressing the view that the policy should be reviewed rather than remain suspended indefinitely, the Investment Panel proposes changes to the rebalancing policy so that it can be implemented across all market environments.

2 RECOMMENDATION

That the Committee:

2.1 **Notes the draft minutes of the Investment Panel meeting held on 17 May 2012**

2.2 **Approves the revised Rebalancing Policy set out in Appendix 4 which incorporates the recommendations from the Investment Panel**

3 FINANCIAL IMPLICATIONS

3.1 The rebalancing policy will be implemented by the Investments Team in consultation with the Investment Consultant where required. Where the Officers need to seek the Investment Consultant's advice in detail, there will be extra advisory charges.

3.2 There will be normal transaction costs in the event that any rebalancing is required.

4 BACKGROUND

4.1 The Fund's current rebalancing policy was agreed by Committee in September 2009 (see Appendix 2). Following recent market volatility, the rebalancing policy has been suspended to avoid incurring costs due to overtrading.

4.2 In the Committee meeting on 16 March 2012, some Committee members expressed the view that the policy should be reviewed rather than remain suspended indefinitely.

4.3 In response, the Investment Panel considered a report by the Investment Consultant at their meeting on May 17 2012 and recommended the Committee make changes to the rebalancing policy as set out in 6.3 below.

5 REBALANCING POLICY

5.1 The Fund's current rebalancing policy is to rebalance between equities and bonds when the ratio of equities to bonds deviates by +/-2% from 75%:25% ratio. The hedge fund portfolio and the investments in property are not included in the rebalancing mechanism but are included in the broader policy for reviewing their allocation against the strategic benchmark.

5.2 In addition, rebalancing is subject to an additional trigger based on the relative value between equities and gilts (estimated using the equity gilt ratio). This additional trigger aims to minimise overtrading and ensure rebalancing only occurs if market valuations were favourable.

5.3 The current policy operates using a mechanical process and as such there is no opportunity for tailoring the process to market conditions except for the policy to be suspended.

6 PROPOSED CHANGES

6.1 The Fund's investment consultant has produced a report at Appendix 3 that proposes changes to the current rebalancing policy, focusing on the triggers for rebalancing.

6.2 The rationale behind the proposed changes is to make it less 'mechanical' by introducing an element of flexibility that allows for tactical views to be incorporated into the decision making and so avoid trading at inopportune times. The proposal also seeks to formally include the triggers for rebalancing the less liquid assets into the framework.

6.3 The changes to the policy recommended by the Panel are as follows:

(1) For the ratio between and equities / bonds, amend the thresholds for rebalancing by introducing a two-tiered set of boundaries;

(i) A deviation of 2% to 5% is subject to tactical review by Officers, having consulted the Investment Consultant, and

(ii) A deviation of 5% or more results in ‘automatic’ rebalancing back to at least the 2% threshold. An additional tactical decision is then taken by the Officers supported by the Fund’s consultants on whether this is fully rebalanced back to the central benchmark allocation or otherwise, recognising market conditions.

(2) Introduce soft boundaries for hedge funds and property allocations that trigger a review by the Investment Panel, no-less than 6 monthly:

(i) Property +/- 5% (i.e. a range of 5% to 15% of Fund assets)

(ii) Fund of Hedge Fund +5% (i.e. a max range of 15% of Fund assets)

6.4 The rebalancing policy will be implemented by Officers, having consulted the Investment Consultant. Any recommendations from the Panel regarding 6.3(2) would have to be agreed by the Committee.

6.5 Any rebalancing activity will be reported to Committee at the following quarterly meeting.

6.6 Prior to any rebalancing, officers will take into account any cashflow requirement that may be imminent.

6.7 The revised Rebalancing Policy incorporating the proposed changes to is set out in Appendix 4.

6.8 For clarity, the percentages referred to in 6.3(1) refer to the *ratio* allocation between equities and bonds which is currently 75% equities to 25% bonds. It is the changes in this allocation that will trigger the rebalancing as outlined in the policy. The 75%:25% ratio reflects the strategic benchmark allocations of 60% to equities and 20% to bonds. Therefore the corresponding trigger levels expressed in terms of the strategic benchmark allocations are as follows:

	Equity Bond Ratio for Rebalancing	**Corresponding Strategic Benchmark Allocation**
Strategic Allocation	75% : 25%	60% Equities, 20% Bonds
Boundary for tactical review by officers	73% : 27% or 77% : 23%	58.4% Equities, 21.6% Bonds or 61.6% Equities, 18.4% Bonds
Boundary for 'automatic' rebalancing	70% : 30% or 80% : 20%	56% Equities, 24% Bonds or 64% Equities, 16% Bonds

7 RISK MANAGEMENT

7.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

7.2 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund’s future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund. The rebalancing policy has the objective of avoiding significant drift from the strategic benchmark.

8 EQUALITIES

8.1 An equalities impact assessment is not necessary.

9 CONSULTATION

9.1 N/a

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The issues being considered are contained in the report.

11 ADVICE SOUGHT

11.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Feinstein, Investments Manager 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	