

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	22 May 2013
TITLE:	INVESTMENT PERFORMANCE MONITORING AND REPORTING
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Policy and Procedure Note: Monitoring of Investment Mandates Exempt Appendix 2 – Example Reporting under RAG framework	

1 THE ISSUE

- 1.1 The increased flexibility within the revised strategic asset allocation, coupled with the greater delegations by the Committee to the Panel and Officers, heightens the importance of a robust monitoring and reporting framework for investment performance.
- 1.2 The revised monitoring and reporting arrangements seek to strengthen current processes by focusing on the management of risk and performance through effective evaluation of investment strategy and investment managers in meeting the returns assumed in the strategy.
- 1.3 Reporting has been revised to ensure effective transparency whilst providing the appropriate level of detail for the Committee and Panel to carry out their respective responsibilities. The monitoring framework will continue to evolve as risks and mandates change over time.

2 RECOMMENDATION

The Investment Panel is asked to:

- 2.1 Agree the new monitoring policy and reporting arrangements by Officer to Panel and by Panel to Committee as set out in section 6.
- 2.2 Note the new arrangements for investment performance monitoring by Officers to support the RAG reporting process, as set out in Exempt Appendix 1.

3 FINANCIAL IMPLICATIONS

- 3.1 The investment returns achieved by the Fund are a key driver for the solvency of the Fund and returns for the three years commencing 1 April 2013 will impact the next triennial valuation which will set employer contribution rates, to be calculated as at 31 March 2016.

4 BACKGROUND & CURRENT ARRANGEMENTS

- 4.1 Achieving returns from the Fund's investment portfolio is a key tenet of the Funding Strategy. The returns are driven largely by asset allocation and to a lesser extent the performance of external investment managers in achieving the performance targets of their mandate.
- 4.2 Monitoring and evaluating investment performance (both strategy performance and manager performance) are key to managing the risks to the Fund.
- 4.3 Investment returns are monitored against medium to long term performance benchmarks in order to evaluate performance. The Fund has a strategic benchmark that reflects the returns of the strategic asset allocation. Actual performance by the Fund will differ from that of the benchmark to the extent that allocations differ (due to market drift or tactical positions) or where performance within an asset class does not meet benchmark assumptions. Analysis of the attribution of the variance between actual performance and benchmark performance develops an understanding of how the strategy drives returns but also the impact of tactical decisions and aggregate manager performance.
- 4.4 At the individual investment mandate level, each investment mandate has its own specific benchmark and performance target. Relative performance against targets along with any particular issues such as team / organisational changes, market or regulatory changes are monitored and reported. The Panel address issues as they arise, setting a timeframe for resolution or for improvements to be evidenced.
- 4.5 Currently, strategic and manager performance is reported quarterly to Committee with the Investment Panel focusing on manager performance and strategic issues identified for investigation. Officers monitor the managers on an on-going basis and the Investment Consultant produces a quarterly report on aggregate fund and individual manager performance.

5 STRENGTHENING INVESTMENT PERFORMANCE MONITORING

- 5.1 The new arrangements for monitoring investment performance seek to provide a framework for the management of risk and performance through the effective and robust evaluation of investment strategy and performance of investment managers.
- 5.2 Reporting has been revised to ensure effective transparency and the appropriate level of detail is provided for each of the Committee and Panel to carry out their responsibilities in this area.
- 5.3 The new arrangements are explained below (5.4 to 5.12) and are summarised in a brief policy statement in section 6.

Monitoring Investment Strategy

- 5.4 The asset allocation decision takes into account individual asset class risk/return characteristics in determining the most appropriate allocation to achieve the aggregate fund risk/return target. It is important to monitor over the long term how asset allocation is contributing to the original investment rationale and whether the assumptions remain appropriate given the changing nature of the Fund and the investment environment.
- 5.5 Under the new governance arrangements the Committee's primary focus is on the long term investment strategy, evaluating how far the strategy is achieving long term aims and to what extent it remains appropriate (i.e. addressing the right risks) over time. To support this, quarterly performance reports to Committee will focus more on the strategic performance, and the Fund will introduce an annual report to Committee assessing all aspects of the investment strategy (including the performance of managers).
- 5.6 In addition the Committee's role is to monitor and challenge the use of tactical allocations and therefore tactical decisions will be reported, explained and justified in the quarterly performance report to Committee, following consideration by the Panel. A recent example of this in practice was the tactical allocations in the bond portfolio undertaken in 2012.

Monitoring Manager Performance

- 5.7 To ensure the Fund meets its return objectives, it is important to maintain a portfolio of investment managers in which the Fund has a high degree of confidence. The monitoring of investment managers is therefore an essential "trustee" function. As the number of managers and the complexity of some of the mandates require a detailed level of understanding the Committee has delegated this monitoring activity to the Panel.
- 5.8 In monitoring investment mandates it is important to understand the original reasons for selecting the manager and to consider performance within the context of (i) the market conditions in which the specific investment approach may underperform or out-perform and (ii) expectations of an appropriate risk level for the particular mandate.
- 5.9 The aim of monitoring is to identify and address underperformance or the taking of inappropriate risks by investment managers. Factors that impact the manager's ability to achieve out-performance targets over the long term must be identified and addressed in a comprehensive way.
- 5.10 Officers have developed their existing framework for monitoring managers that seeks to monitor manager performance against outperformance target and risk parameters as well as more qualitative factors such as organisational change or loss of key personnel. It provides evidence and information for decision-making and sets out the process for terminating a mandate. This Red Amber Green (RAG) framework is explained in detail at Appendix 1. The framework also sets out the role of Committee, Panel, Investment Consultant and Officers.
- 5.11 Any changes in the RAG assessment on any manager decided by Panel will be reported to Committee. An example of the type of reports that will be provided to the Committee and Panel can be found in Appendix 2. This shows how the process and due diligence undertaken by Officers and the Panel will be reported.

5.12 Officers and the Panel will undertake a meeting programme with investment managers based on the potential risk of manager / mandate to investment performance. The programme will therefore prioritise active managers and managers where issues dictate the need for meetings, whilst still seeking to meet all managers over an 18 month period, resources and time permitting.

6 PERFORMANCE MONITORING POLICY

6.1 Investment Strategy: To evaluate how far the strategy is achieving long term aims and to what extent it remains appropriate (i.e. addressing the right risks) over time. Effectiveness and rationale of tactical decisions to be monitored and challenged. The long term evaluation of the investment strategy is primarily the Committee's responsibility.

6.2 Investment Manager Performance: To monitor the performance of the investment managers on a monthly basis (by Officers), with quarterly reports to the Avon Pension Fund Investment Panel. More in-depth reviews to be undertaken in the event of sustained underperformance, significant increase in risk, or other issues that affect performance as identified within the RAG framework. The manager meeting programme will prioritise active managers or those where there are significant risk issues. Short term investment strategy (i.e. use of ranges, tactical allocations and rebalancing) and monitoring of Investment manager performance to be primarily the responsibility of the Panel who will report significant changes or decisions to Committee.

6.3 Reporting activity:

- (1) Panel and Investment Consultant (JLT) produce annual report to Committee evaluating the effectiveness and continued appropriateness of the Investment Strategy and performance of managers.
- (2) Quarterly reports to Committee to focus on reporting on the strategy and any tactical positions taken.
- (3) Quarterly reports to Panel focusing on tactical positions and manager performance.
- (4) Officers and Panel to implement RAG reporting for assessment of investment managers, with clear framework for decisions taken and reporting outcomes.

7 RISK MANAGEMENT

7.1 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 and through the selection process followed before managers are appointed. This report sets out the monitoring arrangements for (i) the strategic policy and (ii) the performance of the investment managers. 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.

8 EQUALITIES

8.1 An Equality Impact Assessment is not necessary.

9 CONSULTATION

9.1 N/a

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The issues to consider are contained in the report.

11 ADVICE SOUGHT

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

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Background papers	
Please contact the report author if you need to access this report in an alternative format	