

Policy and Procedure Note – Monitoring of Investment Mandates

To ensure the Fund meets its return objectives, it is important to maintain a portfolio of investment managers in which we have a high degree of confidence. The monitoring of investment managers is therefore an essential “trustee” function.

Policy - 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 a pooled Fund restructuring or other issues that affect performance as identified within the Red Amber Green (RAG) framework. Manager meeting programme will prioritise active managers. Monitoring of Investment manager performance to be primarily the responsibility of the Panel who will report significant changes or decisions to Committee.

1 Overview

This document provides a framework for the monitoring of the Fund’s external investment management mandates. It provides a structured approach to the monitoring of performance and risk, and allows for any action taken to be justified and recorded.

The aim of this monitoring process is to identify and address:

- underperformance by investment managers
- the taking of inappropriate risks within externally managed investment portfolios
- identify factors that impact the managers ability to achieve out-performance targets over the long term
- the process to decide to terminate a mandate

The focus of the process is to identify and understand the risks of a manager not achieving return targets. It is important that the evaluation and decision making process is practical and not prescriptive so that it retains the flexibility required for the diverse range of mandates and the wide range of situations that may occur. The Committee has delegated any decision to terminate a mandate to the Panel who report such decisions to the Committee. It is envisaged that this monitoring process will continually evolve to ensure risks are fully addressed and understood.

2 Investment Management Mandates

The Fund’s investment management mandates are set out in the Fund’s Statement of Investment Principles (SIP). Each mandate has a set of ‘investment guidelines’ set out in an Investment Management Agreement or in the case of pooled funds a Policy or Prospectus document. These documents specify the objective of the mandate/fund, permitted investments, risk characteristics, performance targets and in some cases risk limits that were agreed at the outset of the mandate.

3 Governance Structure

The Committee has delegated to the Panel the responsibility for appointing managers, monitoring their performance and terminating mandates. Officers and the Fund’s Investment Consultant (and Independent Performance Provider) support the

Panel providing analysis and comprehensive monitoring of the investment managers.

The Panel seek to meet each active manager a minimum of every 18 months but meet with managers as issues dictate. Officers meet with all managers on either a quarterly or 6 monthly basis depending upon the nature of the mandate and implications for risk. In the absence of organisational/external factors, unconstrained active mandates are prioritised over passive mandates.

4 Reporting and Analysis

(i) Panel

The RAG reporting framework (explained below) summarises the monitoring and evaluation undertaken by Officers and Panel and provides the rationale for decisions taken. The Panel receive a summary report on a quarterly basis highlighting all Amber and Red mandates with a brief explanation of the current status of action and progress. It is expected in the majority of cases of Amber or Red assessments, the Panel will have been involved in agreeing a specific monitoring or action plan and so the summary report is a progress update. The summary report is in addition to the performance report on all managers provided by investment consultant.

(ii) Committee

The Committee receive a report from the Panel on any change in RAG status of a manager and are provided with a summary list of all Amber and Red managers. This forms part of the quarterly performance report to Committee. Examples of both reports can be found in Exempt Appendix 2. In order to provide effective reporting to Panel and Committee the RAG reports are exempt from publication as they include commercially sensitive information regarding the performance and contractual status of investment mandates.

(iii) Officers

Officers use a comprehensive Investment Manager Assessment spreadsheet as a management tool – this is a quarterly document with interim monthly updates. It captures all factors that may impact mandate performance and provides a record of issues as they arise and are addressed. Analysis from the Investment Consultant and the Fund's Independent Performance Provider are included.

5 Manager Evaluation Process - RAG evaluation and reporting

Investment mandates are evaluated against the characteristics agreed in the mandate originally awarded.

Each manager is assessed in terms of investment performance against target, actual risk against expectations, organisational concerns and external factors. These 4 evaluation factors are explained below and are grouped as hard factors (these use hard data, which is quantifiable, specific and appropriate for each mandate) and soft factors (organisational and external factors based on events or subjective judgement of changing environment).

Each manager is given a RAG grade for hard factors and soft factors with a view to identifying the ability of the manager to achieve the aims of the mandate within the expected risks and mandate characteristics. These culminate in an overall 'grade' each quarter, resulting in a corresponding level of monitoring and potential actions/consequences. An Amber or Red grade will result in greater focus and require an explanation and where appropriate measures will be put in place and the impact of the changes assessed within an agreed timeframe.

(i) Hard RAG Factors

- *Performance* – Each mandate has a performance benchmark and in the case of active managers an out-performance target. Measuring actual performance against such measures will identify trends of underperformance or exceptional outperformance. This is an identifiable measure but it is important the RAG evaluation is understood in the context of when different approaches may under/out perform. The boundaries (see table below for detail) are set so that a manager that materially underperforms the performance target is graded Amber and a Red grade signifies a significant underperformance of the performance target (scaled by the size of the out-performance target set for the mandate to reflect increased risk and volatility expectations associated with higher out-performance targets). The RAG grade measures 3 year rolling performance, with one year performance providing a 'direction of travel' + or - indicator. In the case where there are 2 consecutive quarters where the 12 month rolling return is a below the Red boundary then this will also result in a Red grade.
- *Investment Risk* – This measure seeks to identify where a manager may be taking too much risk or indeed not enough risk, given the performance target of the mandate. The appropriate measure of risk varies depending on the type of mandate, volatility in markets and the difference in investment approach. Officers will work with the Consultant and managers to define meaningful risk measures for each mandate over time to develop an appropriate quantitative measure that gives an objective measure of risk expectations. In addition officers monitor more qualitative risk measures (such as risk attribution between stock selection and market, active share or information ratio) for the active equity managers on a routine basis.

(ii) Soft RAG Factors

- *Organisational factors* – Changes within the investment manager organisation need to be monitored and evaluated in terms of their potential impact on the manager's ability to achieve the out-performance target. Such factors include loss of key personnel, merger/acquisitions or ownership change, pooled Fund restructure or domicile change, operational changes, 'newsworthy' events such as compliance/fraud issues, loss of clients, material transaction errors.
- *External factors* – Changes in external factors such as changes in the regulatory environment, changes in the market environment, culture or practice can hamper the effectiveness of a mandate. Such factors are material where they have a significant and long term impact on the ability of

the mandate to achieve its objectives. This factor identifies any external reasons why a specific mandate may not be able to achieve its performance objective in the long term, as opposed to short term/temporary (often market related) changes that do not have material long term implications.

The RAG assessment for each factor and the resulting changes to the monitoring and decision making framework are summarised in the following table:

Grade	Assessment	Consequences
Green or Green -	- <i>Performance</i> ¹ : Within -0.5% of performance target for annualised rolling 3 year measure, plus an additional 'direction of travel' indicator (-) where 12 month measure is below -0.5% of performance target. AND - <i>Risk</i> : Measure within expectations AND <i>Soft Factors (Organisation & External)</i> : No material issue	Normal monitoring programme (monitoring by Officers and Consultant, Panel meeting programme, Quarterly performance reported to Panel).
Amber or Amber + or Amber -	- <i>Performance</i> : Between -0.5% of performance target and minus 2x performance target for annualised rolling 3 year measure, plus an additional 'direction of travel' indicator (+) or (-) based on whether 12 month performance is green or not. OR - <i>Risk</i> : Measure outside expectations OR - <i>Organisation</i> : Temporary impact on ability to achieve risk return performance target OR - <i>External</i> : Temporary impact on ability to achieve risk return performance target	'Watch List' - Seek explanation, understanding and require appropriate action taken by manager within agreed timeframe, stay on watch list until either can see positive impact of actions taken and one year performance at target level, or no improvement then Red. Reported to Panel and meet with Panel. OR 'Sick List' - Quicker consideration by Panel and Officers, and appropriate action plan set. NB Where an issue has been adequately addressed but the RAG is an Amber +, the Panel can remove from watch list or sick list, and normal 'green' monitoring applies whilst still have a '+' direction of travel.
Red	- <i>Performance</i> : Below minus 2x performance target for annualised rolling 3 year measure, OR below minus 2x 12 month performance target for 2 consecutive quarters, plus an additional 'direction of travel' indicator (+) or (-) based on whether 12 month performance is green or not. OR - <i>Risk</i> : Measure outside expectations over 6 month period OR - <i>Organisation</i> : Longer term impact on ability to achieve risk return performance target OR - <i>External</i> : Longer term impact on ability to achieve risk return performance target OR Amber situation not resolved within specified timeframe	Panel take a decision and notify Committee. Possible consequences are: - Manager summoned to Panel - New action plan put in place - Mandate terminated

¹ i.e. If mandate performance target = benchmark + 3%, then:

Green if performance = benchmark + 2.5% and above,

Amber if performance between benchmark + 2.5% and - 6%

Red if performance below - 6% (either over 3 years or in the case of 2 consecutive 12 month measures of -6%).