

<b>Bath &amp; North East Somerset Council</b>		
MEETING:	<b>AVON PENSION FUND INVESTMENT PANEL</b>	
MEETING DATE:	<b>18 November 2015</b>	<b>AGENDA ITEM NUMBER</b>
TITLE:	<b>REBALANCING POLICY</b>	
WARD:	ALL	
<b>AN OPEN PUBLIC ITEM</b>		
<p>List of attachments to this report:</p> <p>Appendix 1 – Current Rebalancing Policy</p> <p>Appendix 2 – Mercer Report: Rebalancing Framework</p> <p>Appendix 3 – Proposed Rebalancing Policy</p>		

## **1 THE ISSUE**

- 1.1 The current policy for rebalancing has been in place since 2012. Changes to the asset allocation and the structure of the portfolio make it necessary to periodically review the rebalancing policy to ensure it remains appropriate.
- 1.2 In particular, in 2013 the Fund introduced flexibility into the strategic asset allocation by allowing 'permitted ranges' for each asset class.
- 1.3 Mercer have evaluated the current rebalancing policy (see Appendix 1) and provided recommendations for changes to be made to accommodate the permitted ranges and make the policy more efficient. Appendix 2 provides the detailed analysis and recommendations from Mercer, with the proposed policy drafted at Appendix 3 for agreement.

## **2 RECOMMENDATION**

### **2.1 The Panel recommends to Committee:**

- (1) the revised rebalancing policy set out in Appendix 3 Section 1.**
- (2) the implementation of the policy be delegated to Officers in consultation with the Investment Consultant where appropriate, as set out in Appendix 3 Section 2.**

### **3 FINANCIAL IMPLICATIONS**

- 3.1 There is provision in the 2015/16 budget for investment advice relating to the review of the Fund's rebalancing policy. Any change to the way rebalancing activity of the Fund is undertaken may incur additional costs for future budgets.

### **4 BACKGROUND**

- 4.1 **What is Rebalancing?** Rebalancing actions make adjustments within a portfolio to counteract the effect of varying performance of different asset classes over a period of time that result in the percentage allocated to any asset category moving away from intended targets.

- 4.2 **Why Rebalance?** Rebalancing is important in order to ensure the Fund's assets remain invested in line with the target investment strategy or that any allowable deviation is an active choice rather than a result of 'drift'. This helps the Fund to avoid taking unintended risks that could result in returns outside of expected parameters. A secondary consideration is that efficient rebalancing activity can itself add value over time as it forces the selling of relatively expensive assets and the purchasing of relatively cheap assets. This is explained further in Appendix 2.

- 4.3 **Current Rebalancing Policy.** This is attached at Appendix 1 and consists of 2 main elements:

- (1) Liquid Assets: Maintain the balance between growth and stabilising assets but requiring a review of possible action when the balance deviates by +/- 2% and automatic action when the balance deviates by +/- 5%.
- (2) Illiquid Assets: Review no less than 6 monthly with a further review by Panel when Property allocation deviates by +/- 5% and Hedge Funds by +5%.

### **5 MERCER REPORT**

- 5.1 The report produced by Mercer (see Appendix 2) includes the following:

- (1) The theory behind why rebalancing is desirable
- (2) The options for implementing a rebalancing policy
- (3) How the policy can incorporate tactical asset allocation
- (4) Proposed ranges and recommendations for how rebalancing should be implemented

- 5.2 When considering the report, Members should also have in mind the following:

- (1) How will the proposed changes impact upon the efficiency of maintaining target allocations and on the trading costs incurred?
- (2) Does the proposed policy appropriately address the differing characteristics of the asset classes within the portfolio (characteristics such as liquidity, cost and practicality of trading), and allow the flexibility to make tactical allocations?
- (3) How will the proposed changes impact upon the governance arrangements? Is there robust decision making and adequate monitoring? Will it enable timely decision-making and implementation?
- (4) Are there circumstances in which the policy should be suspended?

## 6 MERCER RECOMMENDATIONS

6.1 Mercer summarise their recommendations in Appendix 2. They comprise:

- (1) Narrow +/-2% rebalancing ranges for all liquid asset classes and +/-3% rebalancing range at the growth:stabilising asset level.
- (2) Allowance for rebalancing ranges to vary (whilst remaining within the permitted ranges set out in the Fund's Statement of Investment Principles (SIP)) when relative attractiveness of the asset class is judged to be attractive or unattractive at any particular time.
- (3) Illiquid assets allowed to vary within the permitted range set out in the SIP. Review by Panel no more frequently than 6 months apart.
- (4) Rebalancing within the neutral rebalancing range to be implemented by Officers.
- (5) Where it is intended for allocations to remain outside the neutral rebalancing range the decision will be based on advice from the Investment Consultant. It is proposed that Officers will use Mercer evaluations of the outlook for asset classes and, where Officers decide that using the wider range allowed in either the attractive or unattractive ranges is beneficial, they will seek advice from Mercer.
- (6) Any positions outside of the neutral rebalancing range will be reviewed at Panel meetings.

## 7 PROPOSED POLICY

7.1 Having considered Mercer's report and recommendations, Officers have drafted an updated rebalancing policy for agreement by Panel that reflects the recommendations.

**The proposed policy can be found at Appendix 3.**

The Panel are asked to agree the proposed policy and the delegations for implementing the policy.

7.2 The policy and its implementation will be monitored over the first year by Officers to ensure it is practical to implement and does not lead to overtrading. The policy ranges will be updated for any future changes to the allocation ranges in the SIP.

7.3 As the Fund's cash flow matures and assets are required to be sold down to meet cash outgoings, the rebalancing policy provides a guide to where such divestments can be made within the portfolio.

7.4 **Note on Rebalancing Policy and tactical asset allocations.** In 2013 the Fund added asset allocation ranges to the strategic asset allocation to allow flexibility for tactical allocations to be made as opportunities arise. Under the Terms of Reference, the Panel are permitted to make tactical asset allocation decisions within the permitted ranges and the revised rebalancing policy does not alter this. The implementation of any tactical position is done on the advice of the Investment Consultant and will usually set triggers for the reversal of the position. This type of allocation i.e. an active switch between asset classes for a particular gain is different from the overweight or underweights caused by the drift in asset values over time and whether they are allowed to remain in place or not. It is important to note that the Rebalancing policy is key to the latter (allocations as a result of drift) but in the case of the former (an active tactical allocation switch on specific advice of the consultant) the rebalancing policy is overridden by any triggers decided when the tactical position is put in place.

## **8 RISK MANAGEMENT**

8.1 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. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **9 EQUALITIES**

9.1 An equalities impact assessment is not necessary as the report contains only recommendations to note.

## **10 CONSULTATION**

10.1 N/a

## **11 ISSUES TO CONSIDER IN REACHING THE DECISION**

11.1 Are set out in the report.

## **12 ADVICE SOUGHT**

12.1 The Council's Section 151 Officer (Divisional Director – Business Support) has had the opportunity to input to this report and has cleared it for publication.

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