

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	13 NOVEMBER 2017
TITLE:	RISK MANAGEMENT FRAMEWORK MONITORING
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report:	
Exempt Appendix 1 – Risk Management Framework Quarterly Monitoring Report	

1 THE ISSUE

- 1.1 The Committee has agreed a number of risk management strategies that are designed to protect the funding level from a decrease in equity markets and increases in inflation and interest rate risk. This began with the establishment of a Qualified Investor Fund (QIF), which initially contained assets attaching to the Liability Risk Management Framework. Since agreement from the Committee on 5 July 2017 and further ratification from the Panel at 4 September 2017 meeting, Officers have been working towards implementing an appropriate equity risk management strategy to manage equity downside risk and further protect recent gains in the funding level. The intention is to hold the equity risk management assets in the QIF.
- 1.2 The Panel require a report to monitor the effectiveness of the risk management framework by addressing the impact of performance of the QIF in aggregate on the funding position. The report will also provide Panel members with a dedicated review of the liability and equity risk management mandates, commentary of the collateral position of the QIF (against the proposed 2 tier monitoring framework) and an update on performance of the QIF against the agreed investment guidelines. Mercer has drafted a monitoring report that they will present at the meeting (Exempt Appendix 1).
- 1.3 From 4Q17 QIF performance will be reported as an appendix to the quarterly Investment Performance Report. Given that 3Q17 is the first full quarter since inception of the QIF, the report is presented as a standalone item so Panel members have the opportunity to consider in detail the format and content.

2 RECOMMENDATION

That the Investment Panel:

- 2.1 **Agrees the format and contents of the Risk Management Framework Quarterly Monitoring Report.**
- 2.2 **Notes that the report will be part of the quarterly Investment Performance Report (as a separate appendix) in the future.**
- 2.3 **Notes that there is sufficient collateral in the QIF to support the LDI and proposed equity protection strategies.**

3 FINANCIAL IMPLICATIONS:

- 3.1 The triennial valuation of the Fund's liabilities and assets determines the contribution levels. The extent to which changes in the value of the Fund's assets and liabilities can be managed and the cost of doing so will affect the next triennial valuation in 2019.

4 RISK MONITORING FRAMEWORK

- 4.1 The risk management strategy seeks to manage investment risks with regard to the liabilities; this ensures the investment strategy is aligned to the funding position. As a result the risk management framework allows the Fund to reduce investment risk as the funding level approaches 100% funding. In time this should stabilise the cost of funding the pension benefits for scheme employers.
- 4.2 Mercer's report (Exempt Appendix 1) sets out all the aspects of the monitoring framework that need to be considered by the Panel. These include:
- (1) **Overall funding position** – The funding level is c. 9% ahead of plan. At 30 September 2017 the estimated funding level was 96%, which equates to a deficit of £165m in monetary terms.
 - (2) **Liability hedging mandate** – At November 2016 meeting it was resolved that Panel members should be notified when triggers were either changed or activated. Activity during the period to 30 September was:
 - a. No interest rate triggers were activated during the period. As a result the interest rate hedge ratio remained static at c.14%, expressed as a percentage of assets (6.8% on a gilts flat basis).
 - b. 10 inflation based triggers were activated over the period, 8 of which were activated at the very outset as market conditions had moved favourably during the set-up phase of the mandate. The majority of hedge extensions took place in the first band that covers liabilities which fall due between 2017- 2032. In aggregate this hedging activity meant the inflation hedge ratio moved from c.12% to c.29% at the end of the period (expressed on a gilts flat basis this equates to a move from 6.4% to 14.4%).
 - c. BlackRock remained in compliance with investment guidelines throughout the quarter. Officers in consultation with the Investment Advisor will undertake a twice yearly review of the appropriateness of the trigger framework and invite BlackRock to present to the Panel on the same basis.
 - (3) **Equity option mandate** – the equity option strategy has not yet been implemented. Reporting will commence at Q4 with an update to Panel on the value of physical equity prices against the extent to which the equity option structure has added to, or detracted, from performance.
 - (4) **FX** – As a result of EMIR (European Markets Infrastructure Regulations for derivatives), the current collateral of £40m will be increased to c. £165m over time. This strategy is not as yet part of the QIF and is managed separately by Record.
 - (5) **Collateral and counterparty position** – Exempt Appendix 1 refers to the proposed collateral management two tier monitoring framework [see Exempt Item 8] that will contain an early warning test and a collateral top up test. Currently the LDI mandate passes both collateral adequacy tests; in addition

the proposed equity option strategy will also pass both tests meaning there is sufficient collateral in the QIF to support both strategies. BlackRock will monitor collateral on a daily basis and Mercer will report the collateral position against the parameters included in the report on a quarterly basis.

5 RISK MANAGEMENT

5.1 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 Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) that is aligned with the Funding Strategy. 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.

6 EQUALITIES

6.1 An Equality Impact Assessment has not been completed as this report is for information only.

7 CONSULTATION

7.1 N/a as delegated to Investment Panel.

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 The issues to consider are contained in the report.

9 ADVICE SOUGHT

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

Contact person	Liz Woodyard, Investments Manager (Tel: 01225 395306)
Background papers	Committee Papers and Investment Panel minutes
Please contact the report author if you need to access this report in an alternative format	