

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	20 NOVEMBER 2019
TITLE:	EQUITY RISK MANAGEMENT STRATEGY EVOLUTION
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Exempt Appendix 1 – Mercer Report: Equity Protection Evolution	

1 THE ISSUE

- 1.1 The case for protecting the Fund from a sharp draw down in equity markets remains compelling. Significant gains in equity markets since inception of the original strategy highlight the need to protect the Fund's current funding level and ensure the affordability of employer contributions.
- 1.2 Following the September 2019 Committee meeting and the November 2019 Investment Strategy Workshop, Panel have delegated authority to put in place an interim equity protection strategy on expiry of the current strategy. The purpose of this interim solution will be to protect the value of the Fund's equity assets while the Panel considers alternative protection solutions.
- 1.3 Exempt Appendix 1 provides an update of the current funding position, the proposed objectives for the protection strategy, implementation options and an introduction to alternative protection solutions.

2 RECOMMENDATION

That the Investment Panel:

- 2.1 **Agrees which of the options set out on Page 13 of Exempt Appendix 1 best achieves the Fund's objective.**
- 2.2 **Delegates the implementation of the equity risk strategy to Officers in consultation with the Investment Consultant.**

3 FINANCIAL IMPLICATIONS

- 3.1 The equity protection strategy has been implemented to provide greater certainty that contribution levels will be stable and minimised. Any changes to the framework can affect the level of employer contributions in the future.
- 3.2 The cost of the strategy will depend on the final structure and option pricing in the market at inception. The aim will be to minimise the costs given the preferred structure.
- 3.3 Investment management costs will be consistent with what the Fund pays under its existing structure.

4 EVOLUTION OF EQUITY PROTECTION STRATEGY

- 4.1 **Case for hedging** Global macro risks and multi-year highs in equity markets have given rise to concerns that a large downward correction may materialise in the short term, especially in the US. The case for having protection in place ahead of a possible correction in market values remains strong. Equity exposure remains the biggest contributor to risk in the Fund's portfolio however reducing physical equity holdings is not an option as it would immediately reduce the Fund's return potential and drive contributions up. De-risking using an overlay strategy allows the Fund to simultaneously guard against a market correction while ensuring affordability of contributions.
- 4.2 **Implementation options – assets hedged.** The current strategy protects the funds developed market equity exposure. The structure can be refined to include or exclude certain regional markets. Any changes made to the hedge will have a direct impact on the potential value of the protection in differing market scenarios. These impacts are discussed further at Exempt Appendix 1.
- 4.3 **Duration of the hedge** - It is recommended that the duration of the interim strategy should allow sufficient time for the Panel to consider the alternative solutions and make a recommendation to the Committee.

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 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. 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 CLIMATE CHANGE

- 6.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and is in the process of addressing this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

7 OTHER OPTIONS CONSIDERED

- 7.1 None.

8 CONSULTATION

8.1 The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

Contact person	Nathan Rollinson, Assistant Investments Manager (Tel: 01225 395357)
Background papers	Committee Papers and Mercer Papers
Please contact the report author if you need to access this report in an alternative format	