

Bath & North East Somerset Council						
MEETING:	AVON PENSION FUND INVESTMENT PANEL					
MEETING DATE:	28 May 2021	AGENDA ITEM NUMBER	8			
TITLE:	Governance Framework for the Risk Management Strategies					
WARD:	ALL					
AN OPEN PUBLIC ITEM						
List of attachments to this report: Appendix 1 – Draft Committee Terms of Reference						

1 THE ISSUE

- 1.1 The purpose of this report is to set out a more robust and efficient governance framework for the Investment Risk Management Strategies which includes the Equity Protection, Liability Driven Investing, Low Risk Funding Strategy and Foreign Exchange hedging strategies. The governance has evolved as the strategies have developed and been implemented involving significant and ongoing Investment Panel engagement. The strategies are now at a point where the role of the Committee needs to focus on ongoing objective delivery and strategic effectiveness rather than broader detailed operational aspects. The proposed framework therefore addresses the following:
- a) The role of the Committee and Panel in terms of strategic oversight of the Risk Management strategies
 - b) The operational arrangements to agree structures and implementation of the strategies
 - c) Timeliness of decision making given need to react to market environment
- 1.2 The Panel are asked to consider the proposal and provide feedback. Any changes to the Terms of Reference will be submitted to the Avon Pension Fund Committee for approval.

2 RECOMMENDATIONS

- 2.1 The Panel notes the proposed changes to the governance arrangements of the Risk Management Strategies as set out in paragraphs 5.1 to 5.4. and proposed changes to the Committee Terms of Reference in Appendix 1.

3 FINANCIAL IMPLICATIONS

- 3.1 The advisory costs of monitoring the Risk Management (RM) Strategies is included in the annual budget. The changes to the governance arrangements are not expected to significantly increase these costs.

4 CURRENT GOVERNANCE FRAMEWORK

4.1 Committee Terms of Reference

The Committee's Terms of Reference sets out the oversight and monitoring of the RM strategies as follows:

The key duty of the Committee is to determine the investment strategy and strategic asset allocation having taken appropriate advice. In addition, it has overriding responsibility to monitor the performance of the investment strategy, that is, whether the strategy at the total Fund level is delivering the investment objectives that have been determined by the Committee.

The Committee has delegated the following responsibilities to the Investment Panel:

- a) Review the performance of the investment and risk management strategies; this entails the quarterly monitoring of performance at the portfolio level.
- b) Report matters of strategic importance to the Committee; this ensures that any issue that is/could impact the strategy is reported to Committee for further consideration.

The Panel has delegated authority to make decisions on behalf of the Committee in specific areas (and report back to Committee about any decisions made). In particular, in respect of the Risk Management strategies, the Panel has responsibility to 'monitor the implementation of the structures, consider strategies for restructuring, and monitor collateral requirements.'

Finally, Officers have delegated authority to restructure the risk management strategies as required where sensitive to market prices/conditions or technical in nature, having taken expert advice.

4.2 Governance in practice

- a) **Committee** – in the annual review of the RM strategies the Committee considers recommendations from the Panel whether any changes need to be made to meet the investment objectives i.e. should the equity protection be removed, or the LDI 'triggers' for locking in interest rates or inflation changed. Committee also receive reports as needed to alter the strategies in between annual reviews; these will normally be recommendations from Panel.
- b) **Panel** - receive a detailed quarterly report covering performance, market environment, collateral management as well as any technical market related issues that could impact the strategies (for example the RPI reform in 2020). Panel then agree any recommendations for Committee to consider. Panel also consider the annual review before recommending to Committee
- c) **Officers** – prior to any discussions with Panel/Committee, officers discuss material issues with Advisors, to agree appropriate action that is required. This includes:

- Technical changes that may affect the strategies (e.g. RPI reform)
- Rollover, recalibration or restructuring of any strategy
- Collateral issues (e.g. whether the collateral ‘pot’ needs to be replenished)
- Market driven issues (e.g. equity market levels breaching EPS upside cap)

4.3 Issues arising from current arrangements

- Operational rather than strategic focus** – as a bi-product of the significant workload in developing the RM Strategies the Investment Panel has continued to be involved in operational decision-making issues which has diverted attention from strategic outcomes and ongoing effectiveness of the strategy.
- Appropriate Delegation** – the Committee and Panel consider complex matters including technical aspects around structuring and implementation of the strategies; this duplicates the role of officers who work with advisors in developing all proposals and ensuring appropriate due diligence is undertaken.
- Whilst the **Good Governance Recommendations** reinforces the need for members to have the appropriate level of knowledge and understanding to carry out their duties, members should not be expected to be ‘a subject matter expert or act operationally’. The role involves ‘receiving, filtering and analysing professional advice in order to make informed decisions.’ It is therefore appropriate to reinforce the Officers role in implementation activities to avoid unnecessary duplication.
- Timing of decisions** - some decisions are market or time sensitive and the formal meeting schedule does not adequately allow for this, yet the decision making primarily rests with the Panel and Committee with very limited discretion for officer decisions.

5 PROPOSED GOVERNANCE FRAMEWORK

5.1 Having identified weaknesses in the current arrangements it is proposed that the governance framework is realigned to better reflect the spheres of responsibility and roles which should be undertaken both strategically and operationally between the Committee, Investment Panel, and Officers as follows:

- Committee**
 - As part of strategic asset allocation, determine which Risk Management strategies meet the Fund’s objectives
 - Monitor impact of the Risk Management strategies on the overall performance of the Fund in respect of the investment objective
- Investment Panel**
 - Agree the overall framework for the Risk Management strategies
 - Ensure that the strategy is achieving the desired outcome to manage risk
 - Review the ongoing rationale for the strategies to achieve strategic objectives

- Monitor the financial impact

c) **Officers**

- On the advice of experts, agree the operational structures to meet the strategic objectives determined by the Committee. Make changes to the structures as needed to ensure strategic outcomes continue to be achieved or to manage emerging risk.
- Implementation of the strategies including counterparty selection, trigger and collateral arrangements.

5.2 As the new framework gives more authority to officers, in order to give assurance to the Committee as to how this authority will be exercised, an Advisory Group will be created which will report back to Investment Panel.

5.3 A **Funding and Risk Management Group** (FRMG) will formalise the decision-making process. It will consist of Officers (including Head of Pensions), Investment & Risk Consultants and the Fund Actuary. This will ensure both the funding and investment aspects of each strategy are holistically considered.

5.4 There will be a Terms of Reference (ToR) for the group and minutes of each meeting will be provided to the Investment Panel. FRMG will meet at least quarterly to review in depth the strategies, with the ability to convene more frequent meetings as necessary depending on market conditions or whether action needed to control risk or change the structures (in order to ensure the strategic outcome is delivered). FRMG meetings will cover both strategic and operational matters. All actions and decisions of the FRMG will be reported to the next Panel meeting.

5.5 The Committee's current ToR have been revised to include the ToR for the FRMG and slight change to the Panel responsibilities and Officer Delegations to clarify the delegated powers. The draft ToR is in Appendix 1.

5.6 The main changes are as follows:

a) **Investment Panel section:**

Bullet 8 - changed to focus on strategic outcome rather than implementation / operational aspects.

Current wording:

For Risk Management Strategies, monitor the implementation of the structures, consider strategies for restructuring, and monitor collateral requirements.

Proposed:

For the Risk Management Strategies monitor the outcome versus strategic objectives and consider whether any strategic changes are required to manage emerging risks.

b) **Officer Delegations:**

Bullet 4 – gives responsibility for implementation to officers, with FRMG considering all issues.

Current wording:

Restructuring the risk management strategies as required where sensitive to market prices or technical in nature, having taken expert advice.

Proposed:

Implement the strategic risk management objectives of the Fund and take necessary action to ensure delivery of strategic outcomes. Ongoing consideration of these issues will be undertaken by the Funding and Risk Management Group (see section 6) who will report decisions and ongoing considerations to the Investment Panel.

- c) **Funding and Risk Management Group** – new section
- 5.7 Panel members are asked to consider the proposed changes prior to the proposal being put before the Committee.

6 RISK MANAGEMENT

- 6.1 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.

7 CLIMATE CHANGE

- 7.1 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 addresses this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

8 EQUALITIES

- 8.1 A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

9 OTHER OPTIONS CONSIDERED

- 9.1 None.

10 CONSULTATION

- 10.1 The Council's Section 151 Officer has 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	