Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**8 MARCH 2023**
TITLE:	**Risk Management Framework Review for Periods Ending 31 December 2022**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Exempt Appendix 1 – Mercer Report: Risk Management Framework Review to 31 December 2022**	

1. THE ISSUE

1.1. The Funding and Risk Management Group (FRMG) is responsible for agreeing the operational aspects relating to the Fund's Risk Management Framework (RMF) thereby ensuring that strategic objectives continue to be met. This report informs Panel of issues considered and decisions made by FRMG as well as any recommendations.

1.2. Exempt Appendix 1 shows all risk management strategies are rated green and continue to perform in line with expectation. At the end of December and based on the existing collateral adequacy framework, the collateral in the QIF remained rated 'green'. However, FRMG are reviewing the current collateral adequacy framework with the manager who has indicated a greater level of collateral may be required in future to ensure resilience against market shocks of the same magnitude as those seen during the gilts crisis in September.

1.3. Exempt Appendix 1 is the Mercer report the FRMG considered at its last meeting on 9 February. A summary of the FRMG discussion is included in Section 5 of this report.

2. RECOMMENDATION

The Avon Pension Fund Investment Panel is asked to note:

2.1. **The performance of each of the underlying RMF strategies**

2.2. **That ongoing FRMG workstreams relating to the collateral adequacy and LDI trigger frameworks**

3. FINANCIAL IMPLICATIONS

2.3. The risk management strategies have been implemented to provide greater certainty that the funding plan will be achieved and therefore contribution levels will be stable and minimised. Any changes to the framework can affect the level of employer contributions in the future.

4. UPDATE ON RISK MANAGEMENT STRATEGIES

Strategy/Objective	Commentary	RAG	Trend
LDI	• Trigger framework currently suspended pending strategic review • Interest rate hedge ratio c. 40% • Inflation hedge ratio c. 40% • Mandate performed as expected. Manager in compliance with investment guidelines		⟺
Equity Protection	• Since inception the dynamic EPS has led to c. £8.1m of downside impact. This consists of £12.6m foregone on the developed market indices and £4.5m of gains crystallised on the emerging market leg that was closed out in December 2021.		⟺
Low Risk Corporate Bonds	• Level of cashflow matching has declined since inception due to the rise in inflation which impacts the liability cashflows but not the corporate bonds cashflows. Ongoing monitoring by FRMG – to update mandate following provision of 2022 actuarial valuation data.		⟺
Collateral Position	• TPR and the Central Bank of Ireland (as the regulator of the QIF) have issued guidance on collateral requirements following significant market volatility in Sept/Oct. • FRMG have worked with the manager to ensure collateral ‘headroom’ and monitoring levels are in line with current best practice. To formalise new collateral adequacy framework post ISR 2Q23.		⟺

5. FRMG CURRENT WORKSTREAMS

5.1. The LDI trigger framework was paused in September last year due to the collateral implications arising from the market volatility associated with the ‘mini-budget’. FRMG will await the conclusion of the investment strategy review in order to better assess the future role of LDI within the investment portfolio and whether the trigger framework in its current form is still fit for purpose.

5.2. LDI managers are now revisiting their collateral monitoring frameworks, including their calculation methodologies, in order to improve the robustness of client portfolios. Based on regulatory guidance from TPR and the Central Bank of Ireland the recommended collateral headroom is now 300-400bps. The collateral headroom at the end of December was c.190bps. Post quarter end BlackRock sold a portion of the passive equity fund that is in place to release cash for collateral purposes, taking the headroom to c. 350bps. FRMG will work with the manager to formalise the collateral monitoring framework in March, following the conclusion of the investment strategy review.

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 Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7. EQUALITIES

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

8. CLIMATE CHANGE

8.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council’s Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Paris Aligned Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9. OTHER OPTIONS CONSIDERED

9.1. None

10. CONSULTATION

10.1. The Head of Pensions has reviewed this paper for publication.

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Background papers	FRMG papers
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