

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	27 FEBRUARY 2024
TITLE:	Risk Management Framework Review for Periods Ending 31 December 2023
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Exempt Appendix 1 – Mercer Report: Risk Management Framework Review to 31 December 2023	

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 the equity protection strategy rated amber 'under review' given the drag on returns since inception and the fact Officers are in the process of reducing the overall hedge ratio under delegated authority from Panel. All other risk management strategies are rated green and continue to perform in line with expectation.

2. RECOMMENDATION

The Avon Pension Fund Investment Panel is asked to note:

- 2.1. **The performance of each of the underlying RMF strategies and current collateral position.**
- 2.2. **The approach to reducing the EPS hedge ratio as set out in Section 5 of this report.**

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

- 4.1. The underlying equity benchmark rose over the quarter, with the equity protection strategy (EPS) performing in line with expectations, decreasing net equity performance by 1.6% as markets moved toward the protection levels.

Since inception the EPS has detracted c. 2.5% from equity returns and reduced volatility by c. 25%.

- 4.2. Following the reinstatement of the interest and inflation trigger framework in October 2023, several interest rate triggers were hit leading BlackRock to trade up to the 39% cap on the aggregate interest rate hedge ratio. The inflation hedge ratio was around 22% at the same date. The decrease in yields during the quarter helped the LDI mandate deliver a positive return.

5. UPDATE ON EPS HEDGE RATIO REDUCTION

- 5.1. FRMG met on 14 February and resolved to reduce the hedge ratio pro rata across the existing 3 counterparties; JPM, Goldman Sachs and Citi.

- 5.2. Implementation of the hedge ratio reduction will commence in early March and be staggered across 2 weeks to reduce the impact of timing risk. All trading will be complete prior to the Fund's financial year end.

- 5.3. The collateral buffer is currently >600bps, which is expected to increase marginally post EPS hedge ratio reduction. Guidance from the regulator stipulates a buffer of c. 400bps is appropriate for the type of LDI mandate the Fund employs. Mercer will prepare an analysis of the Fund's liquidity position to determine the best use of any excess collateral. The analysis will look at the prospect of reinstating the interest and inflation trigger framework, which is currently suspended, and will also look at the cash requirements of the Fund including outstanding private markets capital commitments. A paper will be brought to the next panel meeting for consideration.

6. RISK MANAGEMENT

- 6.1. An effective governance structure, defining clear responsibilities, and ensuring that the decision-making body has an adequate level of knowledge and access to expert advice, is a key aspect of the risk management process.

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 addresses this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable 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 had the opportunity to input to this report and has cleared it for publication.

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Background papers	FRMG papers
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