Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**5 SEPTEMBER 2024**
TITLE:	**Risk Management Framework Review for Periods Ending 30 June 2024**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Exempt Appendix 1 – Mercer Report: Risk Management Framework Review to 30 June 2024** **Exempt Appendix 2 – Revised Trigger Framework**	

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.

1.3. FRMG has considered whether to reinstate the inflation trigger framework which has been suspended since the 2022 gilt crisis. Following the liquidity review in June 2024 it was agreed that given the projected liquidity position over the next few years we would not utilise any of the excess capital to increase the interest rate or inflation hedge ratios.

1.4. Mercer has since explored with Blackrock how the inflation hedge ratio could be increased without impacting the collateral buffer. This proposal is explained in Exempt Appendix 2 for the Panel to consider.

2. RECOMMENDATION

The Avon Pension Fund Investment Panel:

2.1. **Agrees to reinstate the inflation triggers to up to a 40% hedge ratio without impacting the collateral buffer as set out in Exempt Appendix 2.**

2.2. **Notes the performance of each of the underlying RMF strategies and current collateral position.**

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. INFLATION TRIGGER FRAMEWORK

4.1. The long-term strategic target is to achieve a 70% hedge ratio for interest rates and inflation (as a proportion of the Fund's assets). However hedging has become more capital intensive since the gilts crisis as we are required to hold a larger collateral buffer to support the strategy in times of market stress. Therefore the interim target is capped at c. 40%. Given the interest rate hedge is at 40% (and the inflation hedge is at c.22%) the trigger framework is currently suspended.

4.2. In the June meeting the Panel reviewed the liquidity requirements for the Fund over the next few years. Given the increased commitment to private markets it was agreed that the hedge ratios could not increase without depleting the collateral headroom. However Mercer have explored whether the inflation hedging could be increased in isolation towards 40% without impacting the collateral buffer.

4.3. Mercer's assessment and proposal are set out in Exempt Appendix 2 (this paper was originally prepared for the FRMG). By changing the instruments that Blackrock can use to implement the hedge, a higher hedging ratio could be achieved, capped at 40% without impacting the collateral buffer.

4.4. The existing inflation trigger levels will not be changed as they represent attractive levels to lock in inflation, therefore no immediate action is expected to take place upon reactivation of the inflation triggers.

4.5. Officers have considered the proposal and support it.

5. UPDATE ON RISK MANAGEMENT STRATEGIES

5.1. The underlying equity benchmark rose over the quarter, with the equity protection strategy (EPS) performing in line with expectations, decreasing net equity performance by 0.4% as markets moved toward the protection levels. Since inception the dynamic EPS has detracted c. 2.6% from equity returns and reduced volatility by c. 25%.

5.2. There was no change to the hedge ratios during the quarter with the interest rate hedge ratio at 40% and the inflation hedge ratio was around 22%.

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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