

## CLWYD PENSION FUND COMMITTEE

<b>Date of Meeting</b>	29 November 2017
<b>Report Subject</b>	Funding, Flightpath and Risk Management Framework Update
<b>Report Author</b>	Clwyd Pension Fund Manager

### EXECUTIVE SUMMARY

Members should note that:

- On a consistent basis the estimated funding position at the end of October is 91% which is around 12% ahead of the expected position from the 2016 actuarial valuation. However, there remains uncertainty in future return expectations. Following a question at the previous Committee there will be an explanation on how a small change in the return expectation can impact on the funding position.
- The level of hedging remains at 20% for interest rate and 40% for inflation at 30 September 2017.
- No triggers have been breached since the interest rate triggers were re-structured in September 2017.
- The LDI restructure completed in March 2017 is expected to achieve a net long-term gain of £36.5m. A gain could be crystallised earlier in certain market conditions. Since the restructure, the Fund has benefitted by around £4.5m at the end of August. This position will continue to be monitored to highlight an opportunity to crystallise a gain earlier (subject to a minimum of £25m).
- The Equity protection strategy was implemented on 24th April 2017 to protect against losses of more than 15% over a one year period on the equity mandate with Insight but retain full gains in the markets. The value of the equity option will be monitored on a quarterly basis.

### RECOMMENDATIONS

1	That the Committee note the updated funding and hedging position for the Fund and the progress being made on the various elements of the Risk Management Framework.
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## REPORT DETAILS

1.00	<b>FUNDING, FLIGHTPATH AND RISK MANAGEMENT STRUCTURE UPDATE</b>
1.01	<p><b><i>Update on funding and the flightpath framework</i></b></p> <p>The monthly summary report as at 31 October 2017 from Mercer on the funding position and an overview of the liability hedging mandate is attached in Appendix 1. It includes a “traffic light” of the key components of the Flightpath and hedging mandate with Insight. The report will be presented at the meeting including a reminder of the principle objectives of the framework.</p>
1.02	<p>The estimated funding level is 91% with a deficit of £183m at 31 October. In absolute terms the relative funding position is 12% ahead of the expected position at the end of October 2017 when measured relative to the 2016 valuation expected funding plan. Uncertainty continues to be prevalent in the investment environment due to ongoing external political and fiscal factors. To illustrate the impact, a reduction of 0.25% p.a. in the assumed future investment return/real discount rate would reduce the funding level by 4% to 87% with a corresponding increase in deficit of £91m to £274m. Following a question raised at the last Committee further explanation of this impact will be provided at this Committee meeting.</p>
1.03	<p>The revised interest rate and inflation triggers agreed at the November 2016 Committee meeting were put in place with Insight following updated investment guidelines being signed in August 2017. None of the new triggers have been satisfied.</p>
1.04	<p>The level of hedging was around 20% for interest rates and 40% for inflation at 30 September 2017. The hedging implemented to date provides access to a lower risk investment strategy but maintaining a sufficiently high real yield expectation to achieve the funding targets.</p>
1.05	<p>Based on data from Insight, our analysis shows that the management of the Insight mandate is rated as “green” meaning it is operating in line within the tolerances set by our strategic risk advisors.</p>
1.06	<p><b><i>Update on Risk Management framework</i></b></p> <p>(i) Restructuring the Insight Portfolio</p> <p>As reported previously, Insight and Mercer identified an opportunity to restructure Insight’s mandate that will be more efficient for the Fund. This involved buying assets with a higher yield/return and selling an equivalent asset with a lower yield/return.</p> <p>Insight implemented the trade subject to achieving a minimum level of benefit (net of transaction costs) of £25m. The trade was completed over the period 20<sup>th</sup> February to 3<sup>rd</sup> March 2017.</p> <p>The net long-term gain achieved was £36.5m (made up of a yield gain of £38m and transaction costs of £1.5m) which was a very positive result and lower trading costs than expected. The Fund’s hedge ratios remain at 20%</p>

	<p>for interest rates and 40% for inflation.</p> <p>Going forward the relative value trade will be monitored to see if a gain can be crystallised earlier if market conditions allow. Since inception the Fund has benefited by around £4.5m. This will continue to be monitored.</p> <p>Cash collateral of £41m was potentially available to invest elsewhere following advice from Mercer. At the FRMG meeting on 30<sup>th</sup> October it was considered if this should be released. It was agreed not to do this at the current time but that the ongoing collateral adequacy of the LDI portfolio mandate is monitored on a monthly basis as opposed to a quarterly basis.</p>
1.07	<p>(ii) Equity protection on the Insight mandate</p> <p>It was previously approved by Committee that, subject to fair market pricing, protection against potential falls in the equity markets via the use of “Equity Options” should be implemented. This will provide further stability in employer contributions (all other things equal) in the event of a significant equity market fall although it is recognised it will not protect the Fund in totality. It was agreed to implement a 1 year term contract to cover any losses on the mandate (£325m) of 15% or more. This was subject to the premium being no more than 3% of the total exposure (£10m). The strategy was implemented on 24th April 2017 at a premium of £7.2m (including transaction costs) or 2.2% of exposure.</p> <p>It was agreed by the FRMG on 30<sup>th</sup> October that the options on extending the protection (including taking off the protection) would be considered in detail prior to the expiry date. This will include consideration of a more sophisticated “dynamic” option and any change will be implemented on consultation with the finance officers of the other unitary authorities. This will be reported to Committee in 2018.</p> <p>The strategy and the value of the equity option contract will continue to be monitored on a monthly basis.</p>

<b>2.00</b>	<b>RESOURCE IMPLICATIONS</b>
2.01	None directly as a result of this report. Officers will be required to input on any revised Equity Protection strategy through the FRMG.

<b>3.00</b>	<b>CONSULTATIONS REQUIRED / CARRIED OUT</b>
3.01	None required

<b>4.00</b>	<b>RISK MANAGEMENT</b>
4.01	This report addresses some of the risks identified in the Fund's Risk Register. Specifically, this covers the following (either in whole or in part): <ul style="list-style-type: none"> <li>• Governance risk: G2</li> <li>• Funding and Investment risks: F1 - F6</li> </ul>
4.02	The Flightpath Strategy manages/controls the interest rate and inflation rate impact on the liabilities of the Fund to give more stability of funding outcomes and employer contribution rates. The Equity option strategy will provide protection against market falls for the synthetic equity exposure in the Insight mandate only.

<b>5.00</b>	<b>APPENDICES</b>
5.01	Appendix 1 - Monthly monitoring report - October 2017

<b>6.00</b>	<b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>
6.01	Report to Pension Fund Committee – Flightpath Strategy Proposals – 8 November 2016, Report to Pension Fund Committee – 2016 Actuarial Valuation and Funding/Flightpath Update – 27 September 2016 and Report to Pension Fund Committee – Funding and Flightpath Update – 22 March 2016.
6.02	Report to Pension Fund Committee – Overview of risk management framework – Previous monthly reports and more detailed quarterly overview.  <b>Contact Officer:</b> Philip Latham, Clwyd Pension Fund Manager <b>Telephone:</b> 01352 702264 <b>E-mail:</b> philip.latham@flintshire.gov.uk

<b>7.00</b>	<b>GLOSSARY OF TERMS</b>
7.01	(a) <b>The Fund – Clwyd Pension Fund</b> – The Pension Fund managed by Flintshire County Council for local authority employees in the region and employees of other employers with links to local government in the region.  (b) <b>Administering Authority or Scheme Manager</b> – Flintshire County Council is the administering authority and scheme manager for the Clwyd Pension Fund, which means it is responsible for the management and stewardship of the Fund.

- (c) **The Committee – Clwyd Pension Fund Committee** - the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund.
- (d) **LGPS – Local Government Pension Scheme** – the national scheme, which Clwyd Pension Fund is part of
- (e) **FSS – Funding Strategy Statement** – the main document that outlines how we will manage employers contributions to the Fund
- (f) **Actuary** - A professional advisor, specialising in financial risk, who is appointed by Pension Funds to provide advice on financial related matters. In the LGPS, one of the Actuary’s primary responsibilities is the setting of contribution rates payable by all participating employers as part of the actuarial valuation exercise.
- (g) **ISS – Investment Strategy Statement**  
The main document that outlines our strategy in relation to the investment of assets in the Clwyd Pension Fund

Further terms are defined in the Glossary in the report in Appendix 1.