

**FLINTSHIRE COUNTY COUNCIL**

**REPORT TO:** **CLWYD PENSION FUND COMMITTEE**

**DATE:** **5<sup>TH</sup> NOVEMBER 2014**

**REPORT BY:** **CHIEF OFFICER (PEOPLE AND RESOURCES)**

**SUBJECT:** **FUNDING AND FLIGHT-PATH UPDATE**

**1.00 PURPOSE OF REPORT**

1.01 To update Committee Members on the funding position and liability hedging undertaken as part of the Flight-path strategy for managing liability risks.

**2.00 BACKGROUND**

2.01 A role of the Committee is to monitor the funding position of the Fund and the management of the liabilities.

2.02 Mercer provides advice to the Fund on liability hedging and flight-paths. Insight Investments were appointed to manage the assets on behalf of the Fund.

2.03 The flight-path strategy commenced from 1<sup>st</sup> April 2014 with the following aims:

- Achieve a 'base level' of interest rate and inflation hedging (10% hedge ratio) at the outset.
- Aim for a target interest rate and inflation hedge of 40% by April 2019.
- Achieve a target interest rate and inflation hedge ratio of 80% in the long term.

To this end, Insight will construct and manage a portfolio of assets that aims to hedge a proportion of the Fund's liability cash flows.

2.04 By replacing the Fund's passive equity exposure with an Equity Total Return Swap (synthetic equity exposure) the Fund freed up capital to be used as collateral for a liability hedging portfolio. This enables the Fund to maintain its exposure to return seeking assets, while reducing the interest and inflation risks.

2.05 From the 'base level' further hedging will be achieved through an incremental build up over time overlaid with triggers according to prevailing market conditions. In addition there are funding level triggers which will result in the disinvestment of growth assets as the funding level improves. All the above is fully documented and understood by Mercer and Insight.

2.06 The triggers have been formulated on the understanding that the Fund's overall objective is to be fully funded within 10 to 12 years which is ahead of the average recovery plan based on deficit contributions of 18 years.

### **3.00 CONSIDERATIONS**

- 3.01 The quarterly summary report from Mercer on the funding position and an overview of the liability hedging mandate is attached as at 30 September 2014. It includes a “traffic light” analysis of the key components of the Flightpath and hedging mandate with Insight. This will be presented at the Committee meeting including a verbal update on how things have moved. As can be seen all traffic lights are “green” at 30 September meaning the mandate is operating in line with expectations.
- 3.02 With regards to specific actions since the commencement of the strategy a number of interest rate triggers have been met and the Fund had an interest rate hedge of approx. 23.5% and an inflation hedge of approx. 13.6% at 30 September. No funding triggers had been reached. Since 30 September further inflation triggers have been hit on 14 October and 15th October and the inflation hedge increased to approx. 18.3%.
- 3.03 The estimated funding position as at 30<sup>th</sup> September is 70% and an estimated deficit of £568m which is on track versus expectations. The hedges in 3.02 have protected the funding position against the recent changes in interest and inflation rates to the extent the deficit would have been approx. £30m higher if the hedges since inception had not been implemented via the triggers and the original strategy had remained in place.
- 3.04 Markets volatility continues and the Actuary will verbally update the Committee on developments since 30 September.

### **4.00 RECOMMENDATIONS**

- 4.01 That Committee Members note and discuss the estimated funding level and the liability hedging undertaken to 30<sup>th</sup> September 2014.

### **5.00 FINANCIAL IMPLICATIONS**

- 5.01 None directly as a result of this report.

### **6.00 ANTIPOVERTY IMPACT**

- 6.01 None directly as a result of this report.

### **7.00 ENVIRONMENTAL IMPACT**

- 7.01 None directly as a result of this report.

### **8.00 EQUALITIES IMPACT**

- 8.01 None directly as a result of this report.

### **9.00 PERSONNEL IMPLICATIONS**

- 9.01 None directly as a result of this report

**10.00 CONSULTATION REQUIRED**

10.01 None directly as a result of this report

**11.00 CONSULTATION UNDERTAKEN**

11.01 None directly as a result of this report

**12.00 APPENDICES**

12.01 Overview of risk management framework – Q3 2014

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**LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985**

Background Papers:           None

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