

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Thursday 16 th February 2017
Report Subject	Funding, Flightpath and Risk Management Framework Update
Report Author	Clwyd Pension Fund Manager

EXECUTIVE SUMMARY

Members should note that:

- The estimate funding position at the end of January is 84% which is around c7% ahead of the expected position from the 2016 actuarial valuation.
- The level of hedging is estimated to be 19% for interest rate and 40% for inflation at the end of 2016. The revised interest rate and inflation triggers agreed at the November PFC have now been communicated to Insight and the required documentation will be updated in due course.
- It has been provisionally agreed that c£60m of collateral can be released into the portfolio from the hedging mandate to rebalance the holdings with Insight and bring it more into line with the strategic benchmark. Before implementation more detailed analysis will be undertaken and the final amount will be agreed and instruction will be provided to Insight.
- The instruction to restructure the LDI portfolio has been provided to Insight. At the time of writing they are awaiting appropriate market conditions to implement the target level of net benefit of at least £25m.
- The implementation of the Equity option in relation to the synthetic equity mandate with Insight is ongoing. Subject to reasonable market pricing the appropriate level of insurance cover will be put in place.

RECOMMENDATIONS

1	Note the updated funding and hedging position for the CPF and the progress being made on the various elements of the Risk Management Framework.
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REPORT DETAILS

1.00	FUNDING, FLIGHTPATH AND RISK MANAGEMENT STRUCTURE UPDATE
	<i>Update on funding and the flightpath</i>
1.01	The monthly summary report as at 31 January 2017 from Mercer on the funding position and an overview of the liability hedging mandate is attached in Appendix 1. This latest update allows for the results of the 2016 actuarial valuation. It includes a “traffic light” of the key components of the Flightpath and hedging mandate with Insight.
1.02	The estimated funding level is 84% at 31 January. In absolute terms the relative funding position is 7% ahead of the expected position at the end of January 2017 when measured relative to the 2016 valuation expected funding plan.
1.03	The revised interest rate and inflation triggers agreed at the November PFC have been communicated to Insight and the documentation will be updated in due course. None of the new triggers have been met.
1.04	The level of hedging was around 19% for interest rate and 40% for inflation at the end of 2016. The hedging implemented to date has provided some protection to the funding position against the changes in interest rates and inflation.
1.05	Based on data from Insight, the 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.
1.06	It has been provisionally agreed that c£60m of collateral can be released into the portfolio from the hedging mandate to rebalance the holdings with Insight and bring it more into line with the strategic benchmark. Instruction will be given to Insight on the final appropriate figure once further analysis has been completed. It is currently expected this will be done towards the end of February or early March.
	<i>Update on Risk Management framework</i>
1.07	<p>(i) Restructuring the Insight Portfolio</p> <p>As reported in the last meeting, Insight and Mercer identified an opportunity to restructure Insight’s mandate that will be more efficient for the Fund. This involves buying assets with a higher yield/return and selling an equivalent asset with a lower yield/return. The precise benefit to the Fund depends on prevailing market conditions at the point of transaction and is quite volatile in nature.</p> <p>Instructions have been issued to Insight and they are awaiting appropriate market conditions to implement the restructure with a minimum level benefit (net of transaction costs) of £25m.</p>

1.08	<p>(ii) Implementation of Equity Option protection on the Insight mandate</p> <p>As reported in the last meeting, market conditions are particularly challenging and we are expecting further volatility over potentially a long period. It was provisionally agreed that, subject to fair market pricing, we implement protection against potential falls in the equity markets via the use of “Equity Options” potentially by giving up some market upside potential. 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.</p> <p>The process is ongoing and the structure and level of protection is being agreed by the FRMG. Subject to fair market pricing this will then be implemented.</p>
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2.00	RESOURCE IMPLICATIONS
2.01	None directly as a result of this report.

3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	None required

4.00	RISK MANAGEMENT
4.01	<p>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):</p> <ul style="list-style-type: none"> • Governance risk: G2 • Funding and Investment risks: F1 - F6
4.02	<p>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.</p>

5.00	APPENDICES
5.01	Appendix 1 - Monthly monitoring report - January 2017

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	<p>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.</p>

6.02	<p>Report to Pension Fund Committee – Overview of risk management framework – Previous monthly reports and more detailed quarterly overview.</p> <p>Contact Officer: Philip Latham, Clwyd Pension Fund Manager Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk</p>
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7.00	GLOSSARY OF TERMS
7.01	<p>(a) CPF – Clwyd Pension Fund – 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</p> <p>(b) Administering Authority or Scheme Manager – 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.</p> <p>(c) PFC – Clwyd Pension Fund Committee - the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund</p> <p>(d) LGPS – Local Government Pension Scheme – the national scheme, which Clwyd Pension Fund is part of</p> <p>(e) Actuarial Valuation - The formal valuation assessment of the Fund detailing the solvency position and determine the contribution rates payable by the employers to fund the cost of benefits and make good any existing shortfalls as set out in the separate Funding Strategy Statement.</p> <p>(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.</p> <p>(g) Flightpath A framework that defines a de-risking process whereby exposure to growth assets is reduced as and when it is affordable to do so i.e. when “triggers” are hit, whilst still expecting to achieve the overall funding target.</p> <p>(h) Deficit The extent to which the value of the Fund’s liabilities exceeds the value of the Fund’s assets.</p> <p>(i) Funding level The difference between the value of the Fund’s assets and the value of the Fund’s liabilities expressed as a percentage.</p>

(j) **Hedging**

A strategy that aims to reduce funding volatility. This is achieved by investing in assets that mimic changes in liability values due to changes in market conditions.

(k) **Insight QIF – Insight Qualified Investor Fund**

An investment fund specifically designed for the Fund to allow Insight to manage the liability hedging and synthetic equity assets.

(l) **Funding & Risk Management Group (FRMG)**

A subgroup of Pension Fund officers and advisers set up to discuss and implement any changes to the Risk Management framework as delegated by the committee. It is made up of the Clwyd Pension Fund Manager, Pension Finance Manager, Fund Actuary, Strategic Risk Adviser and Investment Consultant.