CLWYD PENSION FUND COMMITTEE	
Date of Meeting	Wednesday, 20 March 2024
Report Subject	Investment Strategy Review Phase 2 - 110% Funding Level Trigger Framework
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

At the Committee meeting on 29 November 2023, it was agreed to undertake a further investment strategy review to be completed in two phases, the first of which considered amendments to the Fund's investment strategy in order to free up liquidity whilst maintaining a similar level of expected return. The second phase considers possible actions the Committee could take should the 110% funding position be achieved in the future. Initial discussions of the review were presented at the Committee training session on Wednesday 28 February 2024. This paper covers the second phase of the review.

In this phase, the Funding and Risk Management Group (FRMG) have considered the funding and investment implications of maintaining the Fund's investment strategy when the trigger is attained, relative to de-risking the investment strategy by reducing the synthetic allocation to passive equities by 10% of total Fund assets. Further, the FRMG also considered refinements to the decision making framework when the trigger is attained in order to speed up implementation.

In order to achieve swift implementation if the trigger is attained, it is proposed that the Committee agree a default action that would be implemented without further Committee input, unless the Head of Pensions receives advice from the FRMG not to proceed. If the FRMG's advice is not to proceed with the Committee's default action, a special Committee meeting will be called in short order to determine a way forward. Mercer recommend that the default course of action should be for the Committee to de-risk the investment strategy by reducing equity exposure by 10% if the 110% trigger is attained. This is based on the desire to implement de-risking in a timely manner.

The Committee delegations have been updated to reflect this approach (see appendix 1) with the updates and the proposed default action to be agreed by the Committee.

RECOMMENDATIONS	
1.	The Committee to agree the proposed default action to de-risk by reducing equity exposure by 10% upon attaining the 110% trigger.
2.	The Committee to review and agree the updates to the scheme of delegations framework for implementing the 110% trigger if attained.

REPORT DETAILS

1.00	Investment Strategy Review - Phase 2
1.01	**Objectives** The main objective of Phase 2 of the review was to consider potential refinements to the Fund's investment strategy if the 110% funding level trigger is achieved, and to review the governance and implementation framework such that any actions could be implemented quickly should de-risking be desirable.
1.02	**Review** To meet the objectives of Phase 2, the FRMG first considered the funding and investment implications of the current investment strategy relative to the Phase 1 investment strategy. Given the intention of the Phase 1 strategy was to broadly maintain risk and return, there was no material impact on the funding arrangements should the Committee adopt the Phase 1 strategy recommendations. Next, assuming the Phase 1 strategy was adopted by the Committee, the FRMG considered the potential impact on funding strategy of achieving the 110% funding level trigger. As at 31 December 2023, the Fund was 108% funded, meaning the 110% trigger may be breached in the near future. Given the recent positive funding experience, this could potentially facilitate a reduction in the level of employer contributions at the next Actuarial Valuation should the positive funding experience persist. However, it is recognised that there is a balance to be struck between using the positive funding experience to offer contribution reductions to employers where possible and using the positive funding experience to de-risk the investment strategy. De-risking the investment strategy helps to increase the future stability of employer contributions by reducing the risk of negative funding experience in the future. In turn, this helps to mitigate potential future increases in contributions for employers, to the extent possible.
1.03	**Possible de-risked portfolio** A second candidate portfolio reflecting de-risking was also considered assuming that synthetic passive equity exposure was reduced by 10% (from 30% to 20% of total Fund assets) as shown overleaf:

30 September 2023	Phase 1 SAA	Reduce passive equity (-10%)
Equity	45.0%	35.0%
WPP Sustainable Active Equity	*15.0%*	*15.0%*
Passive synthetic equities [1]	***30.0%***	***20.0%***
MAC	12.0%	12.0%
Hedge Funds	-	-
TAA	11.0%	11.0%
Private Markets	29.0%	29.0%
Risk Management Framework	28.0%	28.0%
Strategic Cash	5.0%	5.0%
Total physical assets [2]	**100.0%**	**100.0%**
Expected Median absolute return, p.a.	**8.9%**	**8.6%**
Expected Median return over CPI, p.a.	**6.2%**	**5.9%**
3 Year 95% VaR	**£902m**	**£790m (-12.5%)**

Notes: Arrows show movement relative to current asset allocation. [1]Synthetic exposure excluded from total. Includes allocation to MSCI Paris Aligned Benchmark TRS, as well as Global protected equity strategy. [2]Physical assets only, excluding synthetic exposure. Expected return and downside risk figures are not guaranteed and subject to change.

The FRMG compared the impact on investment risk and the indicative level of employer contributions of the de-risked strategy and the Phase 1 investment strategy. The proposed de-risking activity resulted in a reduction in expected return over CPI of 0.3% p.a., with a corresponding 12.5% fall in Value-at-Risk (an estimate of potential downside risk) versus the Phase 1 strategy.

To determine the potential impact on funding of maintaining the Phase 1 strategy or the de-risked strategy, Mercer derived an actuarial discount rate that would be supported by each investment strategy and calculated the implied contributions.

1.04 **Results of the analysis**

The results of the analysis of the two portfolios were:

- When maintaining the Phase 1 strategy, the funding level would be unchanged at 110% and average employer contributions theoretically could reduce proportionately by c. 15% from the current level at the next valuation (all else equal).
- If the de-risked strategy was adopted, this would see a reduction in the funding level from 110% to 108% (due to a slightly lower discount rate given the lower expected return). In this scenario, a surplus would remain and average employer contributions could theoretically be reduced proportionately by c.10%.

It should be noted that the actual contributions emerging for employers will be determined by a number of factors (including changes in market outlook) and will depend on the funding strategy agreed at the 2025 valuation. The above figures are therefore for illustration only.

In determining the potential contribution impacts above, the Fund Actuary has assumed that any surplus that is used to offset what employers would otherwise pay in contributions still maintains a 105% funding position. This provides a buffer for adverse market movements ahead of the next formal reassessment of the contributions at the 2025 actuarial valuation. It also

	retains some further flexibility to de-risk or provide greater contribution reductions as part of the actuarial valuation cycle. In addition, the 10% reduction in equity exposure does not use up all of surplus via the reduced return i.e. there is still a reduction in contributions. It is possible for the Committee to reduce investment risk even more, adopting an investment strategy that would maintain contributions at current levels. However, this would involve a reduction in equity exposure of 20% of total Fund assets. The FRMG are not recommending that the Committee de-risk to the maximum extent possible at this stage, given that adverse market movements and economic outlook could then potentially lead to a contribution increase. Finding a middle-ground between reducing risk and reducing contributions at this point builds in a prudent buffer to provide some protection against changes in market conditions to reduce the probability that employer contributions might need to increase at the next actuarial valuation.
1.05	**Implementation framework** Mercer have updated the proposed implementation framework (appended to the Delegations – see appendix 1) when the 110% funding level trigger is attained. The aim is to reduce the timeframes between achieving the trigger and implementation. Having considered the above analysis ahead of attaining the trigger, this means that the timeframe can be reduced. In addition, in order to achieve a swift implementation of any actions, it is proposed that the Committee define a default course of action. This action would be implemented without further Committee input if the110% trigger was attained unless the Head of Pensions receives advice from the FRMG not to proceed for any reason. If the FRMG's advice is not to proceed with the Committee's default action, a special Committee meeting (online to ensure timeliness) will be called in short order to determine a way forward.
1.06	**Recommendation** The FRMG view either the Phase 1 investment strategy or the 10% de-risked investment strategy to be suitable strategies upon achieving the 110% trigger. Which strategy to adopt upon achieving the 110% trigger will be a nuanced decision at the point that the trigger is attained, taking into account the Fund's liquidity requirements, prevailing market conditions, the economic outlook and where the Fund is in the actuarial valuation cycle. Following input from the FRMG and wider discussions, Mercer recommend that the Committee's default action on achieving the 110% funding level trigger should be to de-risk the investment strategy by reducing synthetic passive equity exposure by 10% of total Fund assets. As this action involves taking steps to change the investment strategy, this would result in the quickest possible implementation timeframe (should the FRMG see no clear reason not proceed with the de-risking activity). If the FRMG's advice to the Head of Clwyd Pension Fund is not to proceed with the Committee's default action, and the Head of Clwyd Pension Fund agrees with this advice, then further Committee input would be required and the current strategy would remain in force during that time.

	The alternative default action of maintaining the current strategy upon attaining the 110% trigger may result in a lost opportunity should the FRMG advise that de-risking is the preferred course of action. This would require a special Committee meeting to be called, and during this time market conditions may change. The Fund's Investment Strategy Statement ("ISS") permits de-risking upon achieving the 110% funding level trigger.

2.00	**RISK MANAGEMENT**
2.01	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): • Governance risk: G2 • Funding and Investment risks: F1 - F6 and F8

3.00	**APPENDICES**
3.01	Appendix 1 – Delegation of Function to Officers – March 2024 – Draft

4.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
4.01	1. Current ISS available in the strategies and policies section of the CPF website - *https://mss.clwydpensionfund.org.uk/home/investments-and-governance/* **Contact Officer:** Philip Latham, Head of the Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

5.00	**GLOSSARY OF TERMS**
5.01	A list of commonly used terms are as follows: (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. (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. (c) **Absolute Return –** The actual return, as opposed to the return relative to a benchmark.

(d) **Annualised –** Figures expressed as applying to 1 year.

(e) **Duration –** The weighted average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields.

(f) **Market Volatility –** The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact.

(g) **Money-Weighted Rate of Return –** The rate of return on an investment including the amount and timing of cashflows.

(h) **Relative Return –** The return on a fund compared to the return on index or benchmark. This is defined as: Return on Fund minus Return on Index or Benchmark.

(i) **Three-Year Return –** The total return on the fund over a three year period expressed in percent per annum.

(j) **Time-Weighted Rate of Return –** The rate of return on an investment removing the effect of the amount and timing of cashflows.

(k) **Value-at-Risk** – a measure of investment risk, here defined as the difference in the expected value of the Fund's portfolio in 1 year's time and the value under a 1-in-20 downside scenario over the same period.

(l) **Yield (Gross Redemption Yield) –** The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cash-flows.

A comprehensive list of investment terms can be found via the following link:

www.schroders.com/en-gb/uk/intermediary/resources/glossary/