CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday 25 November 2020
Report Subject	Funding and Investment Updates
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The purpose of this report is to update the Committee on a number of Funding and Investment items. The paper includes:

- Economic and Markets update
- Investment Strategy and Manager Summary
- Funding and Risk management framework update
- Review of AVC provision

All reports cover periods ending 30 September 2020, and are attached as appendices to this report. This covering report summarises them.

Key points to note:

Economy and Markets
- The quarter saw positive returns across most markets reported, building on the strong positives returns seen in the quarter ending 30 June 2020
- COVID remains the biggest factor driving economies and markets, and the post quarter-end announcement of a potential virus has been greeted with cautious optimism.
- Brexit remains a key issue for UK and Europe.

Investment Strategy and Manager Summary
- Over the three months to 30 September, the Fund’s total market value increased by £39.3m to £2,003m.
- Fund Performance over 3 months, 12 months and 3 years; +2.3%, +0.6% and +4.6% respectively.

Funding and Risk management framework update
- The estimated funding position at the end of September is 92%, recovering somewhat since the fall in March 2020
- As at 30 September 2020, the synthetic equity strategy had made a gain of c. £21m since inception of the strategy in May 2018.

- The level of currency hedging of the Fund's total equity portfolio remains at 75%.
- As a result of the annual health check, officers agreed to refine the upside of the equity protection strategy.

Review of the Fund's AVC provision

- The Unit-linked performance of the prudential investments was mixed in the 5 years to 30 September 2020. The performance of the Global Equity Fund was of particular concern.
- It may be appropriate for the Fund to make further communication with members in respect of the Prudential "Dynamic Growth" strategies as take up is currently low.

RECOMMENDATIONS	
1.	To discuss and comment on the Market and Economic update for the quarter ended 30 September 2020, which effectively sets the scene for the Investment Strategy and Manager Performance summary.
2.	To discuss and comment on the Investment Strategy and Manager Performance summary for the quarter ended 30 September 2020.
3.	To discuss and note the Funding and Risk management framework update, and note the outcomes of the annual health-check review of the Risk management framework
4.	That the Committee members note the outcomes from the review of the Fund's AVC provision.

REPORT DETAILS

1.00	**INVESTMENT AND FUNDING RELATED MATTERS**
1.01	**Economic and Market Update** The economic and market update for the quarter from the Fund's Investment Consultant is attached at Appendix 1. The report contains the following sections: • **Market Background** – contains key financial markets data for the period under review, including performance of selected markets including equities, bonds inflation and currencies.

	• **Economic Statistics** – contains key economic statistics during the period under review, including Gross Domestic Product (GDP) Growth, Inflation Employment and Manufacturing. • **Market Commentary** – provides detailed commentary on the economic and market performance of major global regions and financial markets.
1.02	The quarter saw positive returns across most markets reported, building on the strong positives returns seen in the quarter ending 30 June 2020. Members will recall these two positive quarters followed the COVID related dramatic falls seen in February and March 2020. The positive six months has seen some markets post positive returns for the twelve months, although there are significant variances. The UK Equity market has returned -16.6% for the twelve months to 30 September, whilst North American Equity has returned +10.5%. The strong economic rebound had started to slow toward the end of the quarter. A number of areas of the economy recouped large portions of the losses from earlier in the year. Monetary and Fiscal policy support drove most of this recovery, and it remains to be seen what will happen when this support starts to be withdrawn. In the UK, aside from the obvious concerns around COVID, Brexit has moved back to the forefront with talks remaining at a stalemate, after the UK government announced that it might look to revisit elements of the withdrawal agreement.
1.03	**Investment Strategy and Manager Summary 30 September 2020** Over the 3 months to 30 September 2020, the Fund's total market value increased by £39.3m to £2,002.9m, giving an overall increase of circa £230m since the end of March 2020. • Total Fund assets returned 2.3% over the quarter, behind the composite target, which returned 3.2%. • Over the one-year period, Total Fund assets returned 0.6%, underperforming the composite target of 4.3%. • Over the last three years, Total Fund assets returned 4.6% p.a., behind the composite target of 5.7% p.a. The strongest absolute returns over the quarter came from the Fund's Credit investments and the Equity portfolio. Credit returned 3.6%%, and Total Equity returned 3.3%. Within the Credit portfolio, StoneHarbor Multi-Asset Credit fund returned 6.7%, and within the Equity Portfolio, Emerging Markets (Core) was the strongest performer returning 5.2% in the quarter. During the quarter, the Fund transitioned its assets to bring them in to line with the revised Strategic Asset Allocation. This asset transition took place at the same time as the transition of the Fund's Multi-Asset Credit (MAC) portfolio to the Wales Pension Partnership's new MAC sub-fund. The transition brings all asset classes more or less in line with their strategic weights.

1.04	**Funding, Flightpath and Risk management framework update** The Monthly Monitoring report for the Risk management framework as at 30 September is attached as Appendix 3 to this report and is summarised below.
1.05	The estimated funding position at the end of September is 92%, recovering somewhat since the fall in March 2020 and sitting in line with the expected position from the 2019 actuarial valuation.
1.06	The level of interest rate hedging remains at 20%. The inflation hedge was reduced in March 2020 from 40% to 20% due to concerns that the value of inflation-linked assets could fall as a result of the government's proposal to reform RPI to the lower CPIH measure. Since March, inflation fell due to reduced consumer demand because of Covid-19. Central bank and government intervention to manage the crisis has increased the probability of inflation rising materially, and more than offsetting the potential reduction due to RPI reform. In September, the inflation hedge was rebalanced back to 40% to reduce this risk. It is estimated that the changes made to the inflation hedge ratio over the year has led to a £4m gain for the Fund.
1.07	As at 30 September 2020, the synthetic equity strategy had made a gain of c. £21m since inception of the strategy in May 2018. This gain incorporates the impact of the synthetic equity currency hedge, described in further detail below.
1.08	The currency risk associated with the market value of the synthetic equity strategy is hedged and has made a loss of £5.5m since inception on 8 March 2019 to 30 September 2020 due to the weakening of sterling over that period. Further, the Fund's overseas developed market physical equity holdings are currency hedged and has made a gain of c. £3.1m since inception of the strategy in August 2019 to 30 September 2020 due to the strengthening of sterling over that period. The level of currency hedging of the Fund's total equity portfolio remains at 75%.
1.09	**Risk management framework – Health check 2020** The results of the annual health check for the Risk management framework for 2020 is attached as Appendix 4, and is summarised below.
1.10	Following the annual health check by Mercer, the Officers agreed to refine the upside of the equity protection strategy. Earlier in the year, the Funding and Risk Management Group (FRMG) were originally considering the action to increase the call strike to 110% from 105% on monthly contracts if volatility were to spike again. This would provide the Fund with additional upside potential; however, given the reduction in premium generation, this is not a suitable long-term solution. Further, this solution relies upon market timing to implement effectively and would be a reactive approach.

	Mercer instead recommended an alternative proposal of increasing the frequency of call selling to 2-weekly from monthly. This solution would collect a similar level of premium to the current approach, but increases the upside potential by resetting the 5% limit every 2 weeks rather than every month. This solution was not available in the past due to a lack of liquidity on shorter dated options causing transaction costs to be prohibitively high. The change will be implemented on 20 November 2020.

2.00	**REVIEW OF AVC PROVISION**
2.01	Mercer reviewed the Fund's Additional Voluntary Contribution (AVC) arrangements with Prudential, and the report included current AVC issues including Utmost Life and Pensions. The full report is attached as Appendix 5 to this report, and is summarised below.
2.02	**Prudential** The focus for the majority of the review was the past performance of the Prudential funds used by the Clwyd Fund. It found that the Unit-linked investment performance was mixed over the 5 years to 30 September 2020. The report had some concern over the performance of the Prudential Global Equity Fund over the period, although noted that there was little in terms of alternative. Prudential do have a Global Passive Equity fund available, however this is a new offering and has limited track-record, although as a passive offering this should be of less concern.
2.03	The underlying investment performance of the With Profits Fund fell in 2018, though it bounced back in 2019 (though quartile-ranking data is limited at this time). Prudential reduced the equity content of the underlying assets of the With Profits Fund in the year to 31 December 2018 (by around 8%), moving much closer to average relative to other with profits funds.
2.04	The Fund, together with Prudential, have sought to contact AVC members in order to remind them of the options available across a range of investment strategies. We recommend that further communication might be appropriate. Prudential closed a range of funds in late 2019 / early 2020 and further fund closures are expected in 2021. However, the funds expected to close are not currently in use by the Fund.
2.05	**Utmost Life and Pensions** Following the transition from Equitable Life to Utmost, the assets previously invested in the Equitable Life With-Profits Fund were initially reinvested in the Utmost Secure Cash Fund, which guarantees no reduction in the amount invested (including the "Uplifts" to the amount transferred). However, these assets had to be moved to alternative funds over the last six months of 2020. Since 1 July 2020, these assets have been transitioning to the Utmost Money Market Fund (unless a member has requested the use of an

	alternative fund(s)). This is only intended to be a temporary default, until the investment markets in the COVID environment become clearer
2.06	The member communication that the Fund issued, gave members with Utmost the option to select alternative investments with Utmost, or to transfer these assets to the Fund's Prudential policy or outside of the Fund. Some members selected alternative investments within Utmost.

3.00	**RESOURCE IMPLICATIONS**
3.01	None directly as a result of this report.

4.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
4.01	None directly as a result of this report.

5.00	**RISK MANAGEMENT**
5.01	The Fund's investment strategy has been designed to provide an appropriate trade off between risk and return. The Fund faces three key investment risks: Equity risk, Interest Rate Risk and Inflation Risk. Diversification of the Fund's growth assets away from equities seeks to reduce the amount of the equity risk (though it should be recognised that Equities remain an important long term source of expected growth). The implementation of the Fund's De-Risking Framework (Flightpath) has been designed to mitigate the Fund's Interest Rate and Inflation Risks.
5.02	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
5.03	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 via the Insight mandate only. The collateral waterfall framework is intended to increase the efficiency of the Fund's collateral, and generating additional yield in a low governance manner. Hedging the currency risk of the market value of the synthetic equity portfolio will protect the Fund against a strengthening pound, which would be detrimental to the Fund's deficit.

6.00	**APPENDICES**
6.01	Appendix 1 - Economic and Market Update – 30 September 2020 Appendix 2 - Investment Strategy and Manager Summary – 30 September

	2020 Appendix 3 – Risk management framework - Monthly monitoring report – September 2020 Appendix 4 – Risk management framework – Health Check 2020 – summary results Appendix 5 – AVC Review update

7.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
7.01	Economic and Market Update and Investment Strategy and Manager Summary 30 June 2020. **Contact Officer:** Philip Latham, Head of Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

8.00	**GLOSSARY OF TERMS**
8.01	A list of commonly used terms are as follows: (a) **Absolute Return –** The actual return, as opposed to the return relative to a benchmark. (b) **Annualised –** Figures expressed as applying to 1 year. (c) **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. (d) **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. (e) **Money-Weighted Rate of Return –** The rate of return on an investment including the amount and timing of cashflows. (f) **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. (g) **Three-Year Return –** The total return on the fund over a three year period expressed in percent per annum. (h) **Time-Weighted Rate of Return –** The rate of return on an investment removing the effect of the amount and timing of cashflows. (i) **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 cashflows.

	A comprehensive list of investment terms can be found via the following link: https://www.schroders.com/en/uk/adviser/tools/glossary/