Clwyd Pension Fund

FRMG update

Advisory Panel

May 2021

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Summary of FRMG meeting

This paper has been prepared for the Advisory Panel of the Clwyd Pension Fund to provide a summary of the Funding and Risk Management Group meeting on Thursday 6 May.

Equity protection strategy

- The existing contract that directs the equity protection strategy is due to expire on 23 May 2021. We propose that the Fund rolls the contract maintain the current equity exposure agreed as part of the wider investment strategy.
- As part of the roll, Mercer have negotiated a revised cost structure which equates to approximately a 50% reduction in transaction costs, equivalent to a total saving of c. £1m p.a. for the Fund.

Collateral update

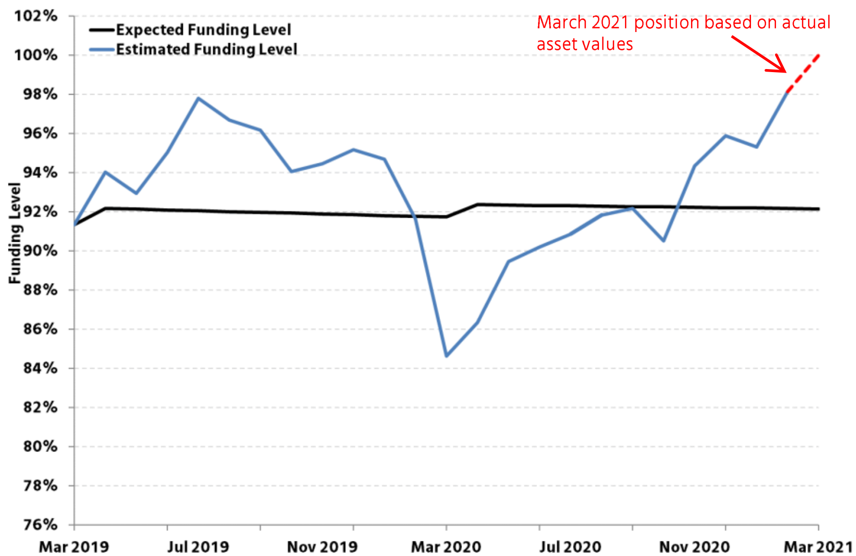
- Mercer have conducted analysis based on the 31 March 2021 collateral position of the risk management framework. Given the strong performance of the framework, there is sufficient collateral available to allow a disinvestment of £100m upon rolling the equity protection strategy, if desired.
- The Officers agreed to retain this amount within the risk management framework for the time being, whilst awaiting drawdown for future Private Market investments.
- Approximately 50% of the excess collateral amount will be invested in the daily dealing Tier 2 funds (split equally between the High Grade ABS and Global ABS funds) initially whilst further analysis of the Private Market drawdowns is undertaken. Additional investments of the excess collateral in Tier 2 will then be investigated.

Funding level trigger breach

- As at 31 March 2021, the Fund breached the “soft” funding level trigger of 100% at 31 March and has improved further since. Further analysis on potential next steps will been undertaken and if/when action will be taken.

Funding level monitoring
Position at 31 March 2021

Estimated funding position since 31 March 2019



The positions allow for the results of the 2019 actuarial valuation.

Funding Level Triggers

It was concluded at the FRMG on 20 June 2017 that the funding level is not currently sufficiently high to warrant de-risking in a traditional sense via a change in long term strategy.

It was agreed that a “soft” trigger will be put in place to prompt FRMG discussions regarding potential actions as the funding level approaches 100% on the current funding basis. This funding level will be monitored approximately by Mercer on a daily basis.

Comments

The **black line** shows a projection of the *expected* funding level from the 31 March 2019 valuation based on the assumptions (and contributions) outlined as part of the 2019 actuarial valuation. The expected funding level at 31 March 2021 was around 92%.

The **blue line** shows an estimate of the progression of the funding level from 31 March 2019 to 28 February 2021. The **red dashed line** shows the progression of the estimated funding level over March 2021. At 31 March 2021, we estimate the funding level to be:

100% (Nil)*

This shows that the Fund’s position was ahead of the expected funding level at 31 March 2021 by around 8% on the current funding basis.

Uncertainty continues to be prevalent in the investment environment due to the potential economic impact of the COVID-19 pandemic. This means that the likelihood of achieving the assumed real returns (CPI + 1.65% p.a. at this update) going forward has fallen. 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 c.4% to c.96% with a corresponding increase in deficit to £90m.

This will be kept under review in light of changing market conditions and the economic outlook.

**Asset values based on assets provided by Mercer investment consultants as at 31 March 2021.*

Funding level trigger breach
Possible actions for discussion

- As the Fund has breached the soft funding level trigger of 100%, this should warrant a discussion around possible de-risking actions that the Officers may wish to consider, such as:
  - ➢ Increasing the level of interest rate or inflation hedging
  - ➢ Reducing the Fund’s exposure to equities / growth assets
  - ➢ Increasing the level of equity protection
- We don’t recommend any immediate action given the funding position is only just above the 100% trigger although it has continued to improve.
- The first step is to refine the estimated funding position of the Fund, accounting for any asset or liability estimates.
- The next step is to then consider when we might de-risk by doing scenario analysis to assess the impact of de-risking actions on the contributions. This will take into account the investment outlook as a reduction in the assumed return/discount rate will affect the funding level and contributions.
- This will allow us to set some “harder” triggers to take action if/when they are achieved.

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