



Risk management framework

Monthly monitoring report: 30 June 2021

Clwyd Pension Fund
July 2021

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welcome to brighter

Overriding objectives

Stable and
affordable
contribution
rate



Versus

Achieve returns
in excess of CPI
required under
funding
arrangements



Objectives are two-fold but conflicting

- Risk needs to be taken in order to achieve returns, but risk does not guarantee returns

Need to ensure a reasonable balance between the two objectives

- Do you need to take the same level of risk when 70% funded (say) as when 110% funded?

Executive summary



= as per or above expectations



= to be kept under review



= action required



Overall funding position at 30 June 2021

- Ahead of existing recovery plan
- New funding level trigger introduced at 110%

The funding position is ahead of the target by around 12% as at 30 June 2021. There is continuing uncertainty in the outlook for future returns and inflation which could impact on the future funding requirements.



Liability hedging mandate at 31 March 2021

- Insight in compliance with investment guidelines
- Outperformed the benchmark marginally over Q1 2021

No triggers breached over Q1 2021.



Synthetic equity mandate at 31 March 2021

- Insight in compliance with investment guidelines
- Underperformed the benchmark over Q1 2021

A dynamic protection structure was implemented in late May 2018, with refinements made in November 2020. The TRS structure rolled on 23 May 2021 with no further changes to the strategy. No action required.



Currency hedging at 30 June 2021

- Currency hedging overlay implemented in the QIF in August 2019
- As at 30 June 2021, the market value of the currency hedge since inception on 22 August 2019 was £13.6m

No action required.



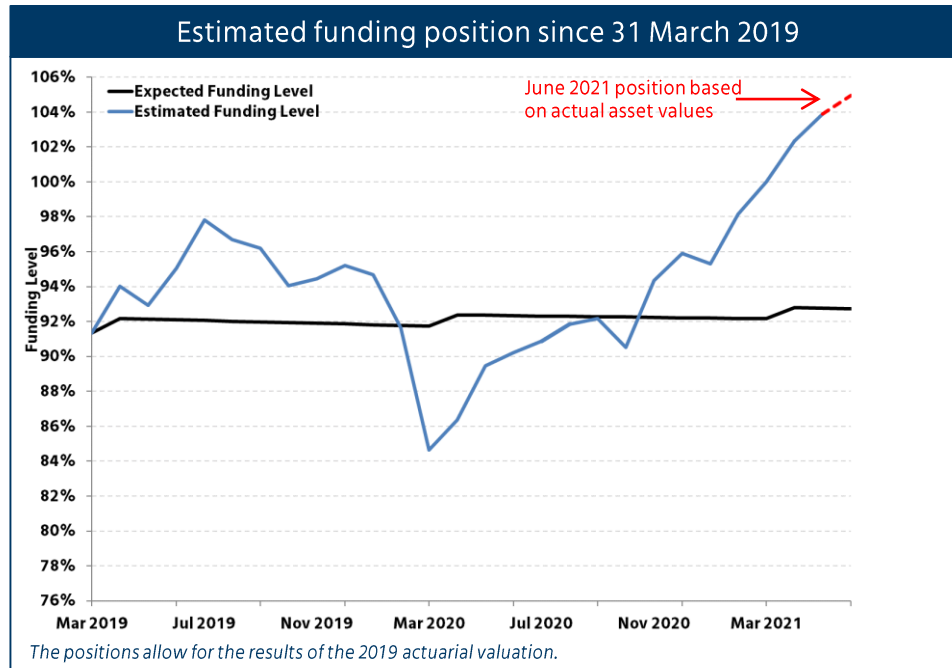
Cash Plus Funds, collateral and counterparty position at 31 March 2021

- The Cash Plus Fund has underperformed the benchmark since inception, but the collateral waterfall outperformed over Q1 2021. We will continue to monitor performance.
- The Insight QIF can sustain at least a 1.4% rise in interest rates or 0.8% fall in inflation without eliminating all headroom.

Overall, the collateral waterfall has increased by £7.6m at 31 March 2021 since implementation at 31 January 2019 versus the previous structure.

The Fund has sufficient collateral to withstand this as at 31 March 2021. No action required.

Funding level monitoring to 31 May 2021



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 30 June 2021 was around 93%.

The **blue line** shows an estimate of the progression of the funding level from 31 March 2019 to 31 May 2021. The **red dashed line** shows the progression of the estimated funding level over June 2021. At 30 June 2021, we estimate the funding level and surplus to be:

105% £106m*

This shows that the Fund's position was ahead of the expected funding level at 30 June 2021 by around 12% on the current funding basis.

Uncertainty continues to be prevalent in the investment and inflation 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.101% with a corresponding decrease in surplus of £106m to £11m.

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

Funding Level Triggers

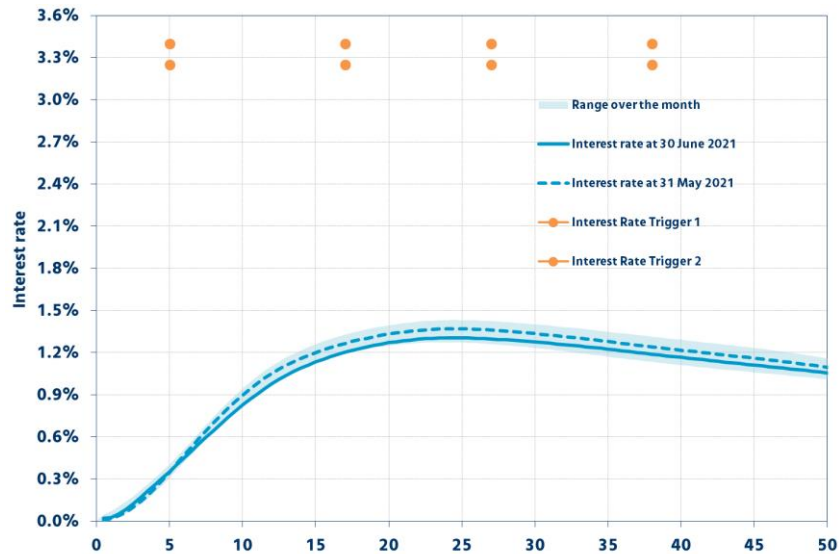
It was concluded at the FRMG on 20 June 2017 that the funding level is not currently sufficiently high to warrant de-risking in a traditional sense via a change in long term strategy.

It was agreed that a new trigger will be put in place to prompt FRMG discussions regarding potential actions as the funding level approaches 110% on the current funding basis. This funding level will be monitored approximately by Mercer on a daily basis.

*Asset values based on assets provided by Mercer investment consultants as at 30 June 2021.

Update on market conditions and triggers

Change in interest rates



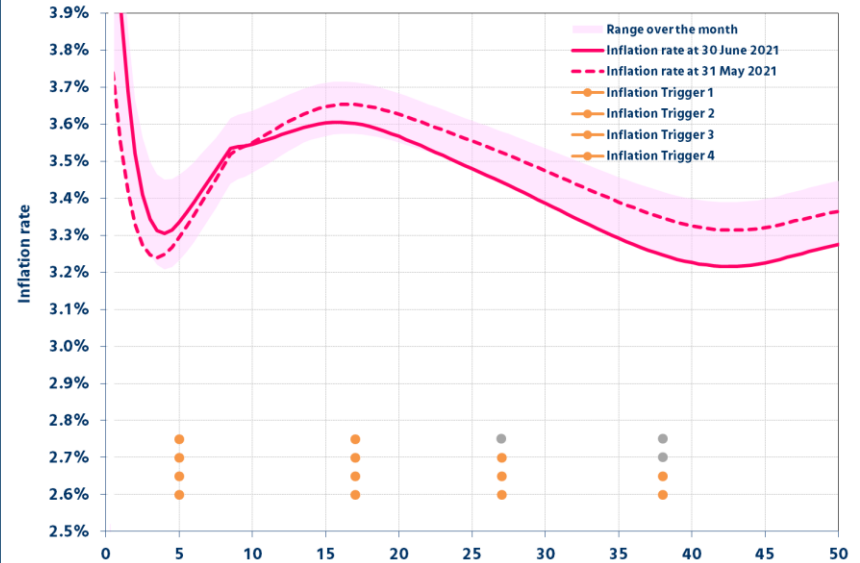
Date	Band 1	Band 2	Band 3	Band 4	Actual
31 March 2021	18.80%	18.77%	19.83%	27.72%	22.5%

Comments

Over the month of June, interest rates fell slightly for all but the shortest durations.

Based on market conditions as at 30 June 2021, yields would need to rise by c. 1.9% p.a. before the Fund would hit any of the revised interest rate triggers implemented by Insight in Q3 2017.

Change in inflation rates (note: different scale)



Date	Band 1	Band 2	Band 3	Band 4	Actual
31 March 2021	38.61%	21.49%	30.10%	60.09%	39.7%

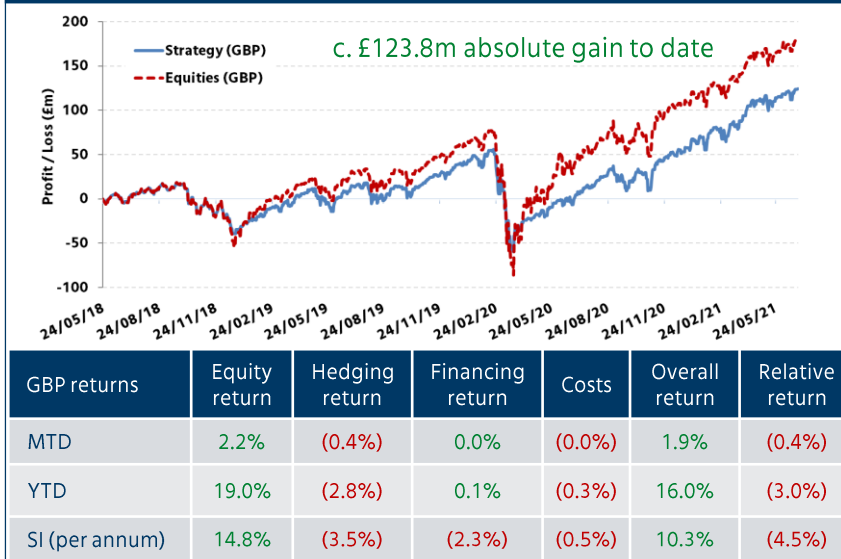
Comments

Over the month of June, the inflation curve 'twisted', with expectations rising at shorter durations and falling at longer durations.

Trading took place over August and September 2020 to move to the new benchmark, which brings the portfolio back to a c.20% interest rate hedge ratio and c.40% inflation hedge ratio overall. No triggers were breached in June.

Update on equity protection mandate

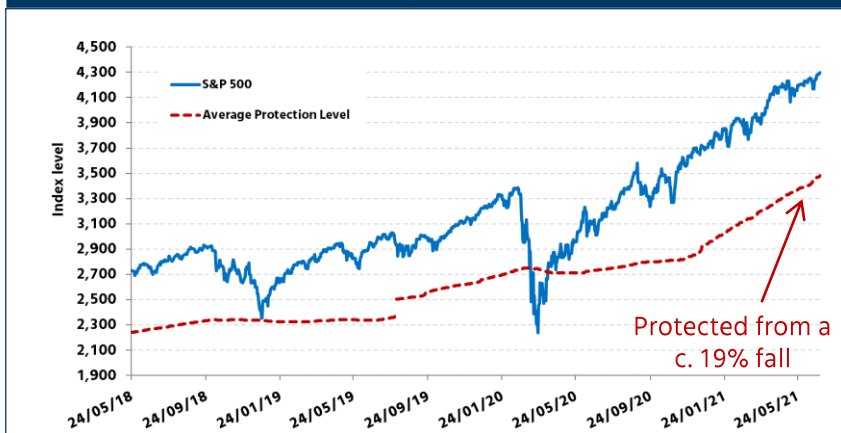
Strategy versus equity index



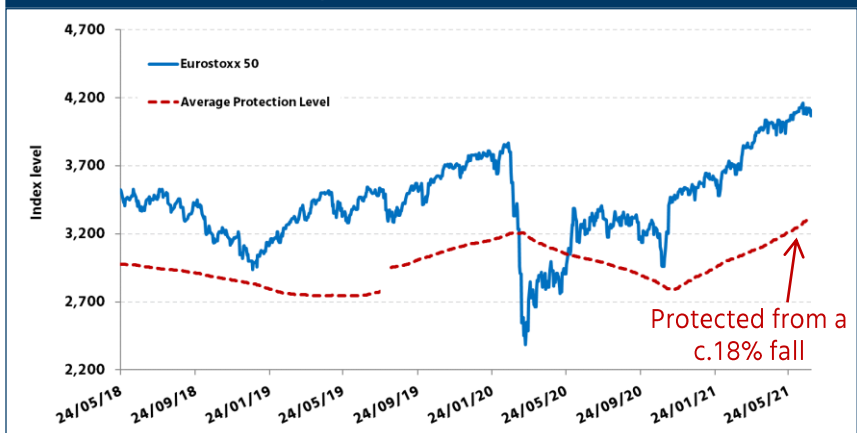
Comments

- The Fund implemented a dynamic equity protection strategy on 24 May 2018 with exposure of £362m. The equity protection strategy was revised in Q4 2020, increasing the call frequency to two weekly. This ensures that the Fund can participate in more upside as equity markets rise. The TRS structure was extended for a further 3 years on 23 May 2021 with no further changes to the strategy.
- Positive equity returns over June meant that the strategy performed well, with the financing leg adding marginally to returns. As at 30 June 2021, there was a gain of c. £123.8m on the strategy since inception, relative to a c. £179.8m gain had the Fund invested in passive equities (with no frictional costs).
- From inception on 8 March 2019 to 30 June 2021, the currency hedge of the market value of the synthetic equity mandate has resulted in a c. £0.3m loss relative to an unhedged position, as sterling has weakened at an overall level since inception, following considerable weakening against the dollar over the month.

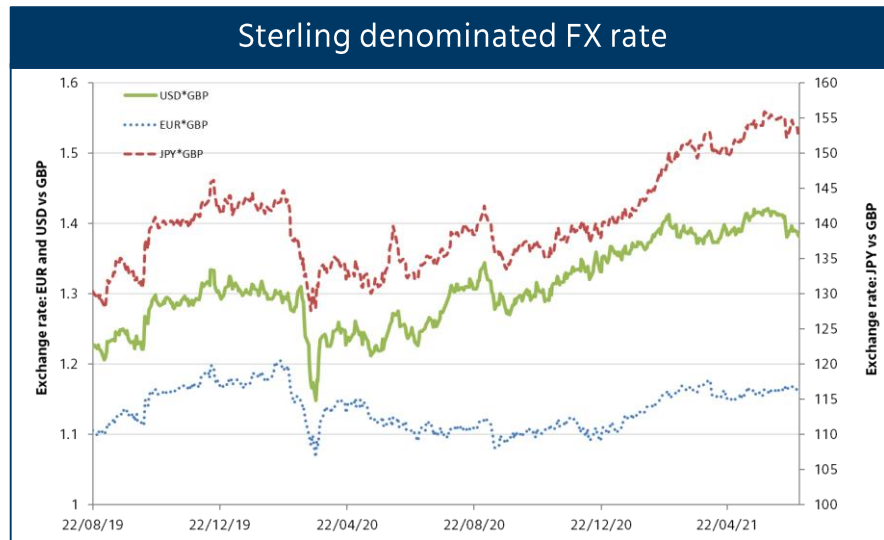
US equity exposure



European equity exposure (note different scale)



Developed market physical equity currency hedge



- Comments**
- A currency hedge was placed on the physical, developed equity portfolio to lock-in gains from sterling weakness and reduce currency risk.
 - The hedge has been implemented via a currency overlay, using 3 month forward contracts, within the Insight QIAIF. The hedge is updated quarterly to allow for changes in the underlying equity exposure.
 - As at 30 June 2021, the market value of the currency hedge since inception on 22 August 2019 was £13.6m.
 - The market value has decreased over June due to a weakening of sterling against the Yen and US dollar. This fall was partially offset as sterling strengthened marginally against the Euro.

	Currency basket weight	FX performance (since inception*)	FX change in performance since 31 May 2021
EUR	16%	£1.6m	£0.1m
JPY	9%	£2.8m	(£0.2m)
USD	75%	£9.2m	(£4.2m)
	100%	£13.6m	(£4.3m)

*Insight transacted on the currency hedge on 22 August 2019.
 Figures may not sum due to rounding.

Glossary

- **Actuarial Valuation** - The formal valuation assessment of the Fund detailing the solvency position and determining 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.
- **Collateral** – Liquid assets held by the Fund as security which may be used to offset the potential loss to a counterparty.
- **Counterparty** – Commonly an investment bank on the opposite side of a financial transaction (e.g. swaps).
- **Deficit** - The extent to which the value of the Fund’s liabilities exceeds the value of the Fund’s assets.
- **Dynamic protection strategy** – Strategy to provide downside protection from falls in equity markets where the protection levels vary depending on evolution of the market.
- **Equity option** – A financial contract in which the Fund can define the return it receives for movements in equity values.
- **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.
- **Funding level** - The difference between the value of the Fund’s assets and the value of the Fund’s liabilities expressed as a percentage.
- **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 Advisor.
- **Hedging** - A strategy aiming to invest in low risk assets when asset yields are deemed attractive. Achieved by investing in government backed assets (or equivalent) with similar characteristics to the Fund future CPI linked benefit payments.
- **Hedge ratio** – The level of hedging in place in the range from 0% to 100%.
- **Insight QIAIF (Insight Qualifying Investor Alternative Investment Fund)** – An investment fund specifically designed for the Fund to allow Insight to manage the liability hedging and synthetic equity assets.

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