

Community Staff Pension Fund

Investment Risk Disclosures

For year ended 31 March 2021

Introduction

This note has been prepared at the request of the Trustees (the “Trustees”) of the Community Staff Pension Fund (“the Fund”). It contains fair value hierarchy analysis of the Fund’s assets and investment risk disclosures for the Fund’s report and accounts as required under Financial Reporting Standard 102 (“FRS 102”) and the 2018 Pensions Statement of Recommended Practice (“2018 Pensions SORP”). Please note that statements relating to investment risk disclosures exclude the Fund’s AVC investments (if any).

To draft these disclosures, we have referenced the practical guidance produced by a joint working group of The Investment Association and the Pensions Research Accountants Group. The disclosures reflect our interpretation of this guidance. We are happy to work with the Fund’s auditor to update these disclosures should they believe this necessary.

Fair Value Hierarchy

The table below sets out the fair value hierarchy breakdown of the Fund’s assets as at 31 March 2021.

	Category 1 £k	Category 2 £k	Category 3 £k	Total £k
Defined Benefit Section				
Pooled investment vehicles		49,453		49,453
Total Investments		49,453		49,453

Note that the categorisation of assets has been provided by the investment manager Legal & General Investment Management. The above assets exclude current assets of c. £285k at 31 March 2021.

Investment Risk Disclosures

FRS 102 requires disclosure of information that allows users of financial statements to understand the nature and extent of credit risk and market risk emanating from the assets in which the Scheme invests. Under FRS 102, credit risk and market risk are defined as follows:

Credit risk: ‘The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.’

Market risk: ‘The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk:

- Interest rate risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
- Currency risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates
- Other price risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.’

The Trustees have set their investment strategy with reference to their investment objectives as set out below, having taken advice from the Fund's professional advisors. Risk is inherent to all investment strategies and the Trustees consider a number of risks when setting the Fund's investment strategy, including credit risk and market risk as defined under FRS 102, as well as other risks including those emanating from the Fund's liabilities and the strength of the Fund's sponsor covenant. The Trustees, in the design and implementation of the investment strategy, have sought to manage these key risks and monitor the investment strategy and associated risks on a regular basis.

An overview of the Fund's investment strategy and approach to risk management is set out below. To clarify, all statements relating to risk management exclude any annuity insurance policies or AVC investments as these are not considered significant in relation to the overall investment of the Fund.

Investment objective

The Trustees' investment policy is guided by the following objectives as defined in the Fund's Statement of Investment Principles ('SIP'):

- To invest the assets of the Fund prudently with the intention that the benefits promised to members are provided
- To set an investment strategy which targets an expected return over the liabilities (as valued by gilt yields) in excess of 2.0% per annum (net of fees)
- To have sufficient assets so as to make provision for 100% of the Fund's liabilities as determined by an actuarial calculation

Broad investment strategy

The Fund currently invest in a range of pooled investment vehicles including global equities, managed property, UK investment corporate bonds and index-linked gilts, all managed by Legal & General Investment Management ("Legal & General"). Legal & General is registered in the UK. Legal & General use Citibank as custodian for the global equity, corporate bond and index-linked gilt funds.

The Fund's strategic asset allocation as per the SIP is shown below:

Asset Class	Fund	Target Allocation
Global Equity	Legal & General All World Equity Index Fund – GBP Currency Hedged	40%
Corporate Bonds	Legal & General AAA-AA-A Corporate Bond Over 15 Year Index Fund	5%
Index-Linked Gilts	Legal & General Over 5 Year Index-Linked Gilts Index Fund	45%
Property	Legal & General Managed Property Fund	10%
Total		100%

The Fund's actual asset allocation as at 31 March 2021 was:

Asset Class	Fund	Actual Allocation
Global Equity	Legal & General All World Equity Index Fund – GBP Currency Hedged	42%
Corporate Bonds	Legal & General AAA-AA-A Corporate Bond Over 15 Year Index Fund	5%
Index-Linked Gilts	Legal & General Over 5 Year Index-Linked Gilts Index Fund	44%
Property	Legal & General Managed Property Fund	10%
Total		100%

Note that totals may not sum due to rounding.

The one, three and five-year performance of the Fund's assets is included below with the Fund's overall performance to 31 March 2021:

	One-year performance (%)	One-year benchmark performance (%)	Three-year performance (%)	Three-year benchmark performance (%)	Five-year performance (%)	Five-year benchmark performance (%)
Legal & General All World Equity Index Fund – GBP Currency Hedged	49.1	49.2	11.8	11.8	12.7	12.7
Legal & General AAA-AA-A Corporate Bond Over 15 Year Index Fund	5.3	5.8	5.3	5.3	6.5	6.4
Legal & General Over 5 Year Index-Linked Gilts Index Fund	2.6	2.6	3.6	3.6	6.4	6.4
Legal & General Managed Property Fund	2.6	2.5	2.3	2.4	3.7	4.1
Total Fund	19.9	-	7.3	-	9.7	-

Source: Legal & General as at 31 March 2021. Note that all figures are gross of fees. Investment management fees to the asset manager are paid by cancellation of units in the respective funds. No performance-related fees are charged.

Market risk summary

Below is a summary of the Fund's market risk exposures and how the Trustees seek to manage these risks.

Interest rate risk

The Fund is subject to interest rate risk through its investments in the AAA-AA-A Corporate Bond Over 15 Year Index Fund and the Over 5 Year Index-Linked Gilts Index Fund, both managed by Legal & General. The combined investment in these pooled funds was c. £23.8m as at 31 March 2021 (c. 48% of total invested assets).

The value of these funds is likely to fall when interest rates rise as investment returns are particularly sensitive to trends in interest rate movements. While the market value of these assets is sensitive to changes in interest rates, these assets are held because this sensitivity will offset, to some extent, the Fund's liability exposure to interest rates.

Currency risk

The Trustees acknowledge that the Fund's liabilities are predominantly sterling denominated. As at 31 March 2021, c. 42% of the Fund was invested in the Legal & General All World Equity Index Fund – GBP Hedged which predominantly invests in overseas assets. To mitigate the currency risk, the Trustees have chosen to invest in the sterling hedged share-class of the Fund, which will significantly reduce currency exposure and will (broadly) provide the Fund with the local returns in each global region.

Other price risk

The Fund is exposed to changes in equity market prices through its investment in the All World Equity Index Fund, managed by Legal & General. The Fund held c. £20.7m (c. 42% of total invested assets) in equities as at 31 March 2021. The All World Equity Index Fund invests in a diverse portfolio of stocks, in line with the FTSE All-World Index, and therefore invests across various regional markets and sectors, which diversifies the Fund's exposure. The All World Equity Index Fund invests in emerging markets and may have exposure to additional volatility that arises from limited information being publicly available to investors.

The Fund is also exposed to the illiquidity of the property market and changes in its prices through its investment in the Legal & General Managed Property Fund, which made up c. 10% of total Scheme assets (c. £5.0m) as at 31 March 2021. The Managed Property Fund is invested in a diversified range of UK properties across different sectors, which mitigates this risk to some extent. The total property exposure acts as a diversifier to primary market risks such as equity risk and credit risk.

Credit risk summary

The Fund invests in pooled investment vehicles and is therefore exposed to direct credit risk. This direct credit risk is mitigated by the regulatory environments in which the investment managers operate and the fact that underlying assets within these pooled funds are ring-fenced from the investment manager.

A summary of the pooled investment vehicles by type of arrangement that the Fund holds is as follows (assets have been valued at bid):

	31 March 2020 (£'k)	31 March 2021 (£'k)
<i>Unit linked life insurance contracts</i>	42,162	49,453
Total Investments	42,162	49,453

The Fund holds unit-linked insurance policies issued by Legal & General, the values of which are based on units held in the respective underlying pooled funds. The Fund is exposed to the direct credit risk associated with this insurance policy and indirect credit risk through the underlying bond and cash assets held by Legal & General.

Pooled fund holdings

The Fund is exposed to direct credit risk because its holdings with Legal & General are in pooled investment vehicles. This risk is mitigated by the fact that underlying assets within these pooled funds are ring-fenced from the investment managers and the regulatory environments in which the investment managers operate. In addition, the Trustees carry out due diligence prior to investing in a pooled fund, taking advice from their investment advisor and legal advisor where relevant.

Bond holdings

The Fund is also exposed to credit risk indirectly through the underlying bond holdings in the AAA-AA-A Corporate Bond Over 15 Year Index Fund which represents c. 5% of the Fund's total assets as at 31 March 2021 (£2.3m), and the Over 5 Year Index-Linked Gilts Index Fund which represents c. 44% of the Fund's total assets (£21.5m).

Indirect credit risk arising from the bonds underlying the Over 5 Year Index-Linked Gilts Index Fund is mitigated by investing in government index-linked bonds, where the counterparty is the UK government and credit risk is therefore considered to be minimal.

The remainder of the exposure, to corporate bonds, will have a higher credit risk but the exposure is intentional in order to target a higher return, and the exposure is invested across a diversified portfolio which will help to diversify the risk and limit risk exposure to any one particular sector or issuer. In addition, the diversified portfolio of corporate bonds invests in bonds with credit ratings from AAA to A. The Trustees have delegated responsibility of managing credit risk to the investment managers of the fund.

Derivative holdings

The Fund is exposed to indirect credit risk across the derivatives in the Legal & General All World Equity Index Fund and Managed Property Fund that it invests in. The credit risk arising from the derivatives depends on whether the derivative is exchange traded or Over the Counter ("OTC"). OTC derivative contracts are not guaranteed by any regulated exchange and therefore the Fund is subject to the risk of failure of the counterparty. The Fund may be exposed to indirect credit risk through the use of derivatives within the global equity and UK property investments for efficient portfolio management, for example to reduce cost or to generate additional income within FCA Permitted Links rules.

Stock lending

Legal & General operates a stock-lending programme in certain overseas equity markets within the All World Equity Index, which represents c. 42% (£20.7m) of the total Fund's invested assets. Stock lending is a practice that has historically been taken by passive fund managers to enhance the returns of index tracking funds. Legal & General reinvests all revenues back into the pooled fund. The primary risk inherent with stock lending programmes is that of the borrower defaulting and therefore not returning the original asset. To mitigate this risk, Legal & General's stock lending programme is strictly controlled, with stringent collateral requirements both in terms of the form of collateral and the levels of collateral held. The required levels of collateral are monitored and, when necessary, adjusted on a daily basis.

Cash holdings

The Fund is exposed to indirect credit risk through its pooled fund investments to the extent that there are underlying cash holdings, albeit this allocation is typically small and therefore the risk exposure is limited.

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Risk Warnings

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

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