

HEALTH WEALTH CAREER

LONDON BOROUGH OF ISLINGTON PENSION FUND

EQUITY PROTECTION
QUARTERLY MONITORING REPORT
AS AT 30 SEPTEMBER 2018

NOVEMBER 2018

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EQUITY PROTECTION INTRODUCTION

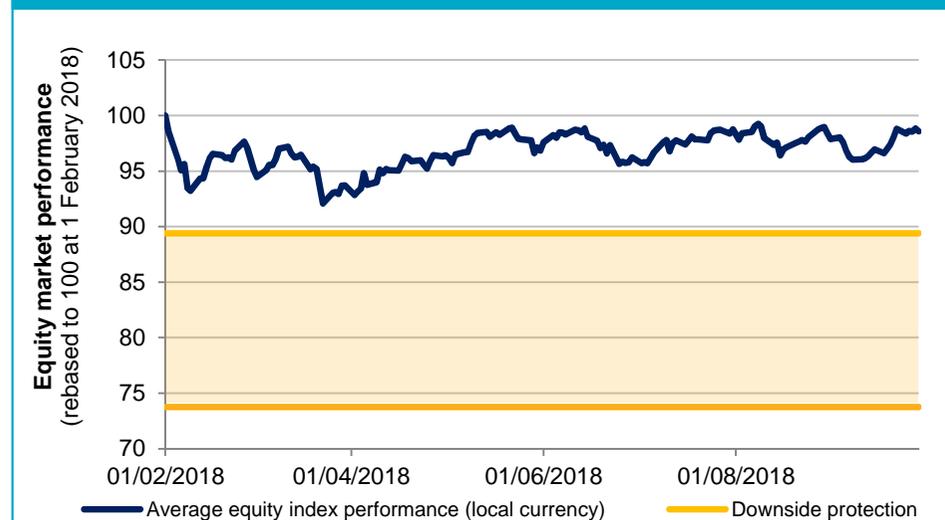
- Given the improvement in the funding position since the 2016 valuation, it was agreed at the Committee meeting in November 2017 to implement an equity protection strategy. The Committee stated a preference for “paying a premium” to finance the protection strategy as opposed to “not paying a premium” and giving up equity market gains above a certain threshold. The implementation of the protection strategy was then delegated to the Officers to implement on behalf of the Committee.
- The guiding objectives for this strategy were as follows:



- The equity protection strategy was implemented at the start of February 2018.

EQUITY PROTECTION MONITORING (I)

Equity protection to 30 September 2018



Comments

An equity option strategy has been implemented to protect the Fund against falls in equity market values over a c. two year period.

The chart opposite shows the equity market performance from inception to 30 September 2018 (the **blue line**) and the **orange shaded region** shows the range in which the Fund is protected against equity market falls. As market levels get nearer to the shaded region, the value of the option strategy increases as it is more likely that the options will expire “in-the-money” and the Fund will receive a payoff at maturity.

Over the period since inception to 30 September 2018, the Fund’s equity exposure increased by c. £26m and the mark-to-market value of the equity options decreased by c. £3m. We will continue to monitor this position.

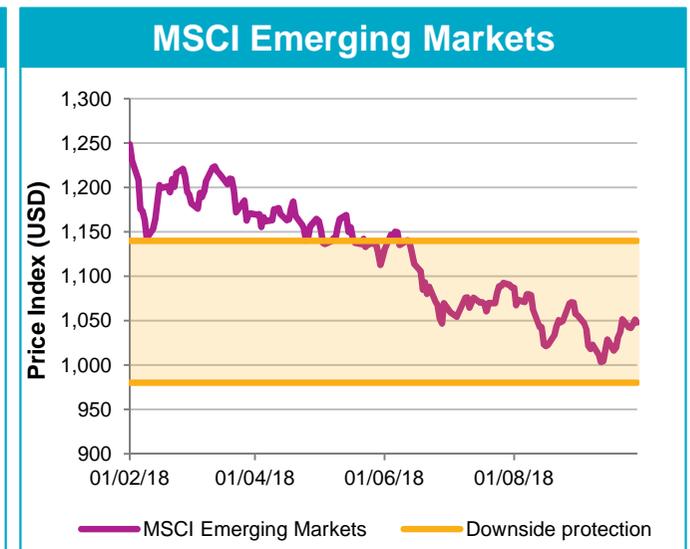
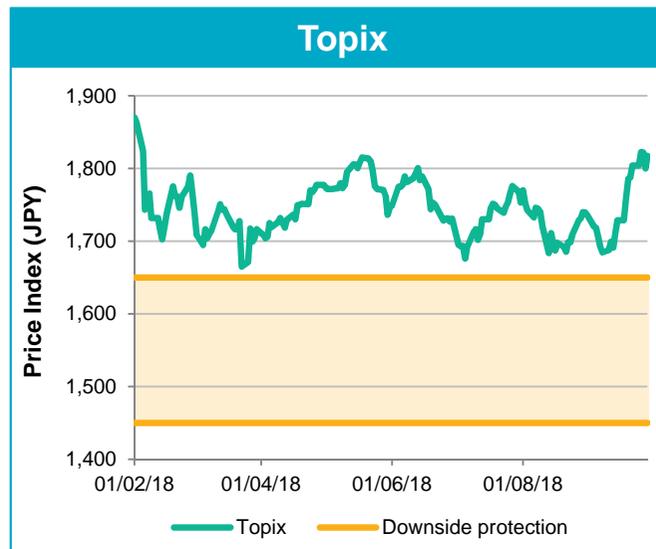
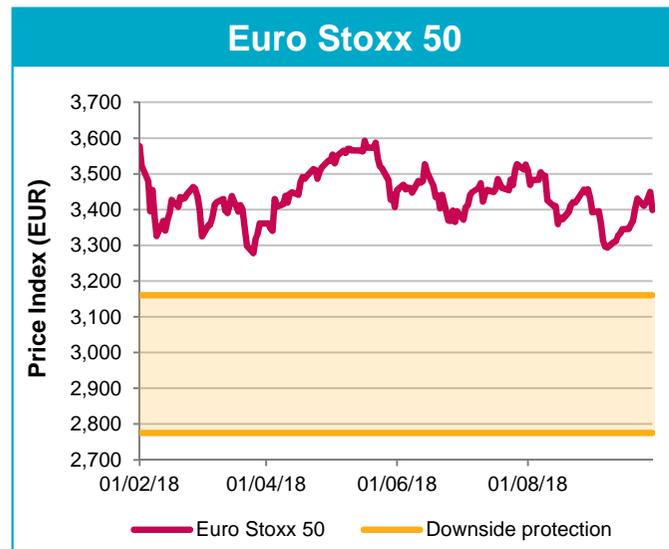
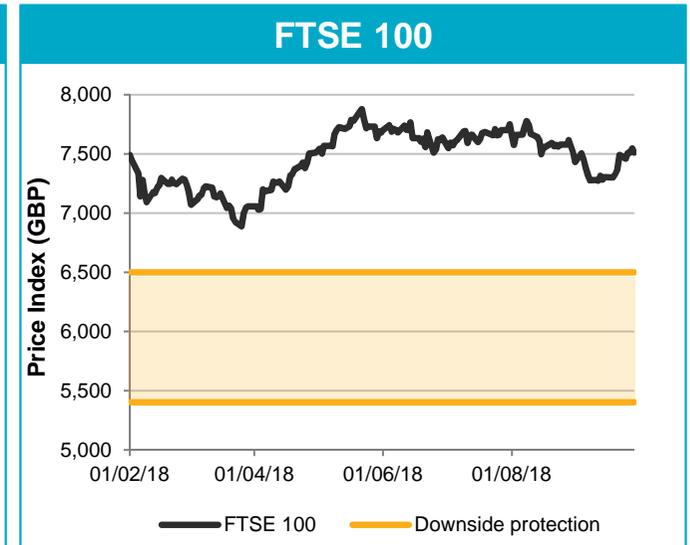
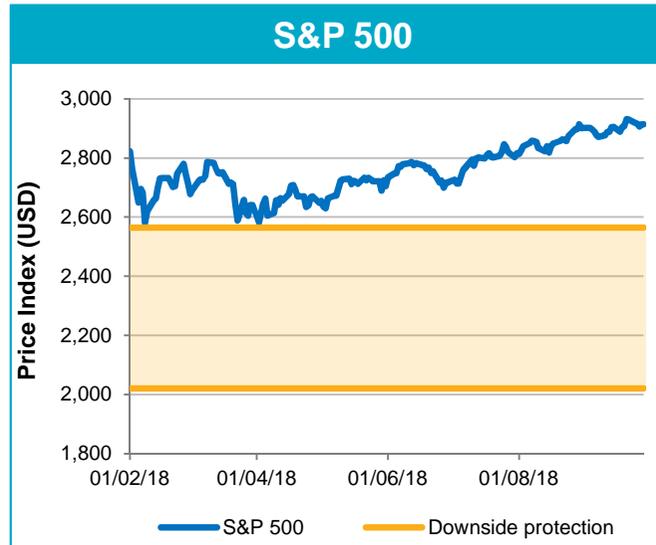
Note that the equity market performance and strikes shown in the chart above are based on price indices (as the options were traded on these indices) and hence the initial protection level shown differs from that shown in the Appendix on a total return basis.

Market index	Market exposure		Value of options	
	30-Sep-18	Change since inception of option strategy	30-Sep-18	Change since inception of option strategy
S&P 500	£330.9m	£37.3m	£7.2m	(£3.2m)
FTSE 100	£219.4m	(£0.8m)	£5.0m	(£2.2m)
Euro Stoxx 50	£77.3m	(£3.4m)	£2.6m	£0.0m
Topix	£45.3m	£1.2m	£1.3m	(£0.1m)
Emerging Markets	£87.1m	(£8.4m)	£5.6m	£2.4m
Total	£760.0m	£26.0m	£21.8m	(£3.0m)

Source: LGIM. Figures may not sum due to rounding. Does not include transaction costs or manager fees.

EQUITY PROTECTION MONITORING (II)

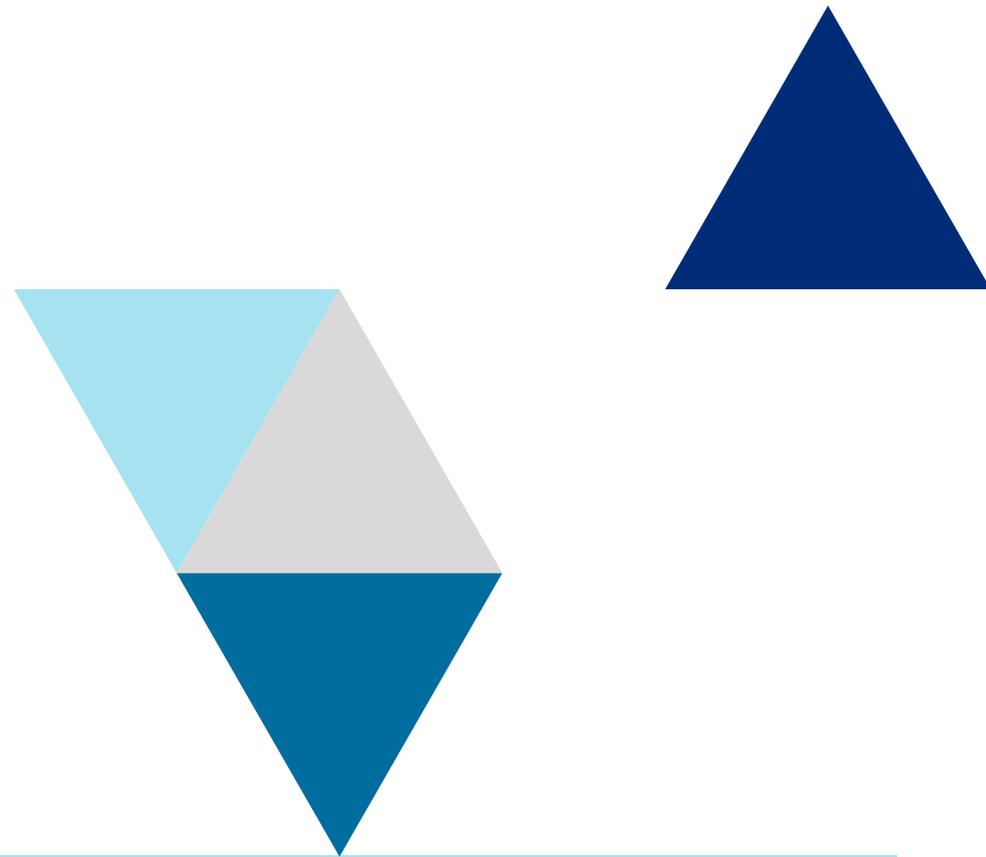
- The charts show the current market level as at 30 September 2018 and the market level when the options were implemented on 1/2 February 2018. The closer the market is to the option strike, the more valuable the protection.
- The MSCI Emerging Markets put option is “in the money” as at 30 September 2018, i.e. the Fund will receive a payoff of c.£7.7m at maturity if the index remains at the current level.



EQUITY PROTECTION SUMMARY

- The Fund's equity protection strategy was implemented on 1st/2nd February 2018 before the equity market sell off in February. Although there has been some recovery since then, on average markets are still slightly down compared to levels at inception.
- The exceptions to the above are the S&P 500 index which is now c. 3.3% higher than at inception and the FTSE 100 index which is now c. 0.3% higher (as at 30 September 2018) than at implementation. In addition, the MSCI Emerging Markets index has continued to fall over Q3 2018 (c. 16.0% lower as at 30 September 2018 than at inception) and is now materially below the put option strike, meaning that if the index remains at this level at expiry, the Fund will receive a c. £7.7m payout.
- The value of an option is impacted by many factors including the volatility of the market, the current market level against the strike level of the option and the time remaining until the option expires.
- At implementation, the Fund paid £24.7m to purchase the protection. As at 30 September 2018, the value of the protection has decreased to £21.8m, largely due to strong returns from the S&P 500 over Q3 2018.

APPENDIX



EQUITY PROTECTION

KEY DETAILS OF THE STRATEGY

Investment manager

After a competitive tender exercise, the Officers selected **Legal & General Investment Management (“LGIM”)** to manage the equity protection strategy for the Fund.

Investment strategy

Agreed to “pay a premium” of £25m to achieve the following protection:

- Purchasing financial contracts to protect c. 95% of the value of the equity portfolio to March 2020;
- Selling financial contracts to cheapen the above premium by exposing the equity portfolio to falls in markets should they fall by more than c. 19%.

An overview of what was achieved is shown below (source: LGIM). Note that the strikes shown are on a total return basis, i.e. allowing for dividends.



Equity region	Index	Weighting	Notional	Upper strike	Lower strike
North America	S&P 500	40%	£294m	94.8%	74.7%
UK	FTSE 100	30%	£220m	95.2%	79.1%
Europe	Euro Stoxx 50	11%	£81m	95.1%	83.6%
Japan	Topix	6%	£44m	93.6%	82.2%
Emerging Markets	MSCI Emerging Markets	13%	£95m	94.9%	81.6%
Total		100%	£734m	94.9%	78.3%

Costs

Cost of protection	=	£24.7m (vs. £25.0m expected)
Transaction costs	=	£0.15m (vs. £0.73m expected)
Manager fees	=	£0.44m (vs. £0.73m undiscounted fees)
Total	=	£25.29m (saving of c. £1.17m before advisory fees)

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