

Pension Fund Committee

16 June 2022

Review of Pension Fund Risks



Report of Paul Darby, Corporate Director of Resources

Purpose of the Report

- 1 To update members on the revisions to the LGPS Pension Fund risk register, following a review with the Principal Risk and Governance Officer in June 2022.

Executive summary

- 2 The review of the risk register was undertaken in line with the Chartered Institute of Public Finance and Accountancy (CIPFA)'s 2018 guidance on Managing Risk in the Local Government Pension Scheme, an extract from which is attached as Appendix 1. There are 14 risks on the Pension Fund risk register, which is attached as Appendix 2. There are four medium risks and ten low risks.

Recommendation(s)

- 3 Members are asked to confirm that this report provides assurance that the Pension Fund risks are being effectively managed within the council's risk management framework.

Background

- 4 The introduction of new governance requirements in the LGPS in 2015, specifically the Pensions Regulator's new role and the establishment of local pension boards, reflects the increasing importance of risk management. It also reinforces the need for administering authorities to focus their risk management activities on all areas of scheme management and not just investment, noting of course that management of investment risk is rightly a fundamental concern.
- 5 The Chartered Institute of Public Finance and Accountancy (CIPFA) publication, *Managing Risk in the Local Government Pension Scheme 2018*, includes guidance on managing risks in LGPS financial management and administration. It states that, as part of their governance processes, funds should regularly report risks to committee and local pension boards, embedding robust risk management. An extract from the CIPFA guidance is attached as Appendix 1.
- 6 The Pension Fund risk register uses the council's corporate risk assessment methodology and is reviewed in detail by officers twice each year. In accordance with its terms of reference, the Pension Fund Committee will also review and monitor the Pension Fund risk register annually.

Risk Update

- 7 There are 14 risks on the Pension Fund risk register, which is attached as Appendix 2. There are four medium risks, whilst the remaining ten risks are within the corporate appetite and are therefore deemed to be at an acceptable level. The four areas assessed as medium risk are:
 - a) *Inappropriate investment in breach of the Fund's **environmental, social or governance principles**, leading to reputational damage*
 - b) *The **pension fund assets** may fail to grow in line with the developing cost of pension fund liabilities, leading to an adverse financial impact on the pension fund.*
 - c) Risk that the amount of money needed to meet the fund's **liabilities** turns out to be greater than expected, leading to an adverse financial impact on the pension fund.
 - d) *Risks associated with **asset pooling** through BCPP Ltd.*

- 8 Following initial discussions with the Fund's Actuary, the gross risk score associated with the Fund's Liabilities (4) has been increased. This is due to both elevated inflation expectations as well as the impact on investment markets following the invasion of Ukraine. The net impact of the Risk to Service Delivery (9) has been increased as it is considered that this impact was previously understated.

Sources of Assurance

- 9 Appendix 3 summarises the sources of assurance in managing the Fund's 14 Risks. Each of the 14 Risks are mapped to a source of assurance, detailing when that assurance was provided and where appropriate the level of assurance provided. Members of the Committee had previously asked for more information on the Cybersecurity controls (12). A presentation from the council's ICT Strategic Manager, intended to provide assurance to the Committee on the management of this Risk, is scheduled for 16 June.

Author(s)

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Appendix 1: Extract from Managing Risk in the LGPS (CIPFA, 2018)

Effective risk management stands at the heart of sound corporate governance across all organisations and functions and the Local Government Pension Scheme (LGPS) is no exception. Using established risk management techniques, risks can be identified, analysed and managed effectively.

As part of their governance processes funds should be regularly reporting all risks to committee and the local pension board, embedding a robust risk management approach and processes which link to all key strategic documents as well as recording risks and progress on an active risk register. Effective risk management will lead to substantial financial and non-financial benefits and should be an integral part of both committee and local pension board meetings. The need for effective risk management is reflected throughout LGPS regulation and guidance, including:

- Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016.
- The Pensions Regulator's Code of Practice 14, which includes a section on internal controls and managing risks.
- The CIPFA Publication Delivering Good Governance in Local Government: Framework (2016 Edition).
- Statutory guidance under Regulation 58 of the LGPS Regulations 2013.
- Preparing and Maintaining a Funding Strategy Statement in the LGPS, 2016 Edition.
- CIPFA's guidance on Investment Pooling and Governance Principles, published in 2016.

Overall responsibility for risk management falls to the body with delegated responsibility for managing the fund, and the legal requirements relating to internal controls apply equally where schemes outsource services connected with the running of the scheme. However, the local pension board and officers advising the committee and assisting in the running of the fund should also have a role in relation to risk management.

The Pensions Regulator's Code of Practice 14 states that scheme managers must establish and operate internal controls. The risk management process should use a risk-based approach and ensure that sufficient time and attention is spent in:

- identifying, evaluating and managing risks
- developing and monitoring appropriate controls

Appendix 2: Pension Fund Risk Register

The table below profiles the pension fund risks by net risk evaluation. The full risk register is shown in the subsequent pages of this appendix.

| Net Impact | | | | | |
|-------------------------------|--|---|--|--------------------------------|---|
| Critical Over £15m | 2 Counterparty | 1 Assets 3 Environmental, Social, Governance 4 Liabilities 8 Pooling | | | |
| Major £5m - £15m | | | | | |
| Moderate £1m - £5m | 11 Data Breach 13 Fraud | 5 Employers 12 Cyberattack | | | |
| Minor £0.5m - £1m | | 14 Non-compliance 9 ICT Failure | 7 Resources 10 Data Quality | | |
| Insignificant £0.5m | | | 6 Administration | | |
| Net Likelihood | Remote over 5 years | Unlikely every 3-5 years | Possible every 1-3 years | Probable once a year | Highly Probable more than once a year |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|---|------------------|--------------------|------------|------------------|---|------------------|-----------------|----------------|
| 1 | The pension fund assets may fail to grow in line with the developing cost of pension fund liabilities, leading to an adverse financial impact on the pension fund (Asset & Investment Risk). | Financial | 5 | 5 | 25 | <ol style="list-style-type: none"> 1. Investment Strategy Statement (ISS) Approach to Risk. 2. ISS Counterparty Risk Acceptability. 3. Adoption of Myners Principles of Investment Decision Making and Disclosure. 4. Local Pension Board reviews activity of the Pension Committee. 5. Professional advice from XYZ. 6. Extensive due diligence is to select investment managers. 7. Several investment managers are chosen to spread risk. 8. Diversified allocation of investments. 9. Significant investment in bonds and alternatives. 10. Investment advisor reviews the portfolios of the investment managers on a regular basis. 11. Performance monitoring. 12. Regular cashflow monitoring. 13. Regular monitoring to ensure that funding objectives are achieved. 14. Investment Advisors reports to Pension Fund Committee quarterly. 15. Quarterly performance figures of the investment managers are reported and challenged at the Pension Fund Committee. 16. Investing in assets which produce cashflows or withdrawing cash from fund managers. | 5 (Critical) | 2 (Unlikely) | 10 (Medium) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|---|------------------|--------------------|------------|------------------|---|------------------|----------------|----------------|
| 2 | A counterparty may default in meeting its obligations, leading to an adverse financial impact on the pension fund (Asset & Investment Risk). | Financial | 5 | 3 | 15 | <ol style="list-style-type: none"> 1. Spreading of investments across different counter parties reduces risk of defaults being material. 2. Investments made through Treasury Management (TM) Team are done in line with TM strategy and policy. 3. Due diligence before appointing counterparty. 4. Appointment of pension fund custodian. 5. Cash balances are invested in line with the Council's Treasury Management Strategy. This sets out the maximum principal sums which can be invested and the maximum time limits which can be placed with each financial institution. 6. The TM team reviews and monitors the Council's TM Strategy and updates counterparties in line with information supplied by the Council's TM Advisers. | 5 (Critical) | 1 (Remote) | 5 (Low) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|--|----------------------------|--------------------|------------|------------------|---|------------------|-----------------|----------------|
| 3 | Inappropriate investment in breach of the Fund's environmental, social or governance principles , leading to reputational damage (Asset & Investment Risk). | Financial and reputational | 5 | 4 | 20 | <ol style="list-style-type: none"> 1. Environmental, Social & Governance Policy through the fund's Investment Strategy Statement. 2. Environmental, Social & Governance factors form part of asset manager selection rationale. 3. Reporting from current investment managers includes details of voting activity. BCPP Ltd publish voting activity quarterly. 4. Responsible Investment Policy agreed with BCPP Ltd and jointly owned with partner funds. | 5 (Critical) | 2 (Possible) | 10 (Medium) |
| 4 | Risk that the amount of money needed to meet the fund's liabilities turns out to be greater than expected, leading to an adverse financial impact on the pension fund (Liability Risk). | Financial | 5 | 4 | 20 | <ol style="list-style-type: none"> 1. Investment in a range of assets. 2. Inflation linked income, subject to a tolerable level of volatility. 3. Actuary takes a long-term view. 4. Ongoing liaison with the actuary. 5. Regular liaison with affected employers. 6. Mitigating actions would be taken such as investing in assets which produce cashflows or withdrawing cash from fund managers. 7. Regular cashflow monitoring. 8. Quarterly reporting to Pension Fund Committee. 9. Targeting returns in excess of the discount rate. | 5 (Critical) | 2 (Unlikely) | 10 (Medium) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|---|------------------|--------------------|------------|------------------|--|----------------------|-----------------|----------------|
| 5 | Scheme employers may not meet their contribution requirements as they fall due, leading to an adverse financial impact on the pension fund (Employer Risk). | Financial | 3 | 3 | 9 | <ol style="list-style-type: none"> 1. Annual returns reconciled to monthly payments. 2. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding. 3. Use of bonds and guarantees. 4. The Fund considers admittance of admitted bodies, following process to manage risk of each admission. 5. Actuary calculation of the bond options (with DCC making final choice). | 3 (Moderate) | 2 (Unlikely) | 6 (Medium) |
| 6 | Scheme employers may fail to administer the scheme efficiently , leading to disruption to the discharge of administering authority functions (Employer Risk). Includes potential data quality issues. | Service delivery | 1 | 4 | 4 | <ol style="list-style-type: none"> 1. Clear communication of requirements to scheme employers. 2. Electronic processing offered to all employers improving efficiency and ease of administration. 3. As part of the process for the actuary's triennial valuation, bodies have opportunity to discuss funding. 4. The Fund considers admittance of admitted bodies, following process to manage risk of each admission. | 1 (Insignificant) | 3 (Possible) | 3 (Low) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|--|------------------|--------------------|------------|------------------|--|------------------|-----------------|----------------|
| 7 | Potential lack of resources / skills , leading to disruption to the discharge of administering authority functions (Resource and Skill Risk). | Service delivery | 2 | 3 | 6 | <ol style="list-style-type: none"> 1. Training for Pension Fund Committee and Local Pension Board. 2. Appropriately qualified staff in key roles. 3. Segregation of duties among pensions staff. 4. Fit for purpose staffing structure in place. 5. Training budget in place. | 2 (Minor) | 3 (Possible) | 6 (Low) |
| 8 | Risks associated with asset pooling through BCPP Ltd (Administrative Risk). | Financial | 5 | 3 | 15 | <ol style="list-style-type: none"> 1. BCPP Ltd is a Financial-Conduct-Authority regulated operator and alternative investment fund manager. 2. Delay transition of assets during set-up period, until necessary conditions for investment are met. 3. PF Committee consider risks of investment and approve transitions into BCPP Ltd. 4. Due diligence on sub-funds in conjunction with investment consultants. 5. Part owners/control – fund represented on BCPP Joint Committee by Pension Fund Committee Chair, statutory officer groups, senior pension officer groups and AGM. 6. Transitions managed by externally appointed Transitions Manager. | 5 (Critical) | 2 (Unlikely) | 10 (Medium) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|--|------------------|--------------------|------------|------------------|---|----------------------|-----------------|----------------|
| 9 | A serious ICT failure , leading to disruption to the discharge of administering authority functions (Administrative Risk). | Service delivery | 4 | 4 | 16 | <ol style="list-style-type: none"> 1. UPM computer database system and ResourceLink system (pension payments) are supported by DCC ICT service for systems security. 2. UPM computer database system and ResourceLink system (pension payments) are covered by the Resources BCP. 3. Back up data centre is in place. | 2 (Insignificant) | 2 (Unlikely) | 4 (Low) |
| 10 | Poor standards of data quality , leading to disruption to the discharge of administering authority functions (Administrative Risk). | Service delivery | 3 | 4 | 12 | <ol style="list-style-type: none"> 1. Actuary gets annual reports and checks the figures against these. 2. Collection of member data through automated monthly process for large employers. 3. Internal checking and validation procedures. 4. Checking and validation by the Actuary. 5. Annual data quality report to regulator. | 2 (Minor) | 3 (Possible) | 6 (Low) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|---|------------------|--------------------|------------|------------------|---|------------------|----------------|----------------|
| 11 | Serious breach of law regarding management of data/information , including an unauthorised release requiring notification to ICO, leading to disruption to the discharge of administering authority functions (Administrative Risk). | Service delivery | 3 | 5 | 15 | <ol style="list-style-type: none"> 1. Corporate Information Governance Group oversees policies, procedures & activities. 2. Comprehensive training to officers and members. 3. Data breach procedure in place. 4. Formal appointment of Senior Information Risk Owner to provide senior authority on information governance. 5. Assurance obtained from third party suppliers & contractors on compliance with relevant legislation. 6. Data Protection Officer appointed as required by the GDPR legislation. 7. Access levels in system set up for individual users. 8. Secure data exchange for transmission of data with actuary. | 3 (Moderate) | 1 (Remote) | 3 (Low) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|--|------------------|--------------------|------------|------------------|--|------------------|-----------------|----------------|
| 12 | A successful cyberattack , leading to disruption to the discharge of administering authority functions (Administrative Risk). | Service delivery | 3 | 5 | 15 | <ol style="list-style-type: none"> 1. The LGPS application is hosted on premise at the Council's Data Centre and is covered by corporate cyber security measures. 2. Strategic co-ordination of IT-business continuity incident management ensures clear system recovery priorities and staff redeployment. 3. User awareness of social engineering and telephone-based cybercrime. 4. Staff training and awareness. 5. Software support agreements in place. 6. Anti-Virus, Anti-spam, Spyware software protection in place. 7. Regular Intrusion Detection test. 8. Firewalls. 9. Password protection. 10. Email scanning for known phishing exploits and staged phishing exercises. 11. Cyber Security Steering Group. | 3 (Minor) | 2 (Unlikely) | 6 (Low) |

| Ref | Risk | Potential Impact | Gross Impact Score | Likelihood | Gross Risk Score | Mitigating controls | Net Impact Score | Net Likelihood | Net Risk Score |
|-----|---|----------------------------|--------------------|------------|------------------|---|------------------|-----------------|----------------|
| 13 | Serious incident of fraud / corruption in the administration function, leading to an adverse financial impact on the pension fund (Administrative Risk). | Financial | 3 | 3 | 9 | <ol style="list-style-type: none"> 1. Segregation of duties among administering authority staff. 2. Monthly reconciliations. 3. Fraud awareness training. 4. Participate in National Fraud Initiative data matching exercises. 5. Rigorous checks of supporting documentation (e.g., death certificate). 6. Pre-employment checks. | 3 (Moderate) | 1 (Remote) | 3 (Low) |
| 14 | Non-compliance with some elements of pensions legislation may result in specific penalties or sanctions, leading to an adverse financial impact on the pension fund (Regulatory and Compliance). | Financial and reputational | 2 | 4 | 8 | <ol style="list-style-type: none"> 1. Participation in regional Pension Officer forums. 2. Subscription to Local Government Association circulars. 3. Professional advice taken from the Fund's Actuary and investment consultants, as well as the admin authority's Legal team. 4. Staff training. 5. Subscription to providers' legislative updates. | 2 (Minor) | 2 (Unlikely) | 4 (Low) |

Appendix 3: Pension Fund Risks – Sources of Assurance

| # | Risk | Assurance Source | Title | Last Audit reported to PFC | Audit Committee | Assurance Level | Note |
|---|----------------------------|------------------------------|---|----------------------------|-----------------|-----------------|-------------------|
| 1 | Pension Fund Assets | Pension Fund Audit Assurance | Investments | 2021/22 | | Substantial | |
| | | Pension Fund Audit Assurance | Contributions | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Governance Arrangements | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Bank Reconciliation | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Debt Recovery | 2018/19 | | Substantial | |
| | | External Monitoring | Quarterly Investment Consultant Reporting to Pension Fund Committee | Quarterly | | n/a | |
| | | External Monitoring | Quarterly Independent Advice to Pension Fund Committee | Quarterly | | n/a | |
| | | External Audit | External Audit Report 2020/21 | 2020/21 | | n/a | |
| | | BCPP AAF | AAF Type II Assurance Report | 2020/21* | | n/a | *provided by BCPP |

| | | | | | | | |
|----------|-----------------------|------------------------------|--|-----------|---------|-------------|--|
| 2 | Counterparty | Pension Fund Audit Assurance | Investments | 2021/22 | | Substantial | |
| | | DCC Corporate Controls | Treasury Management | | 2020/21 | Substantial | |
| 3 | ESG | Pension Fund Audit Assurance | Investments | 2021/22 | | Substantial | |
| | | External Monitoring | Quarterly ESG Reporting to Pension Fund Committee | Quarterly | | n/a | |
| | | BCPP RI Reporting | Annual RI Report, Annual TCFD Report, UK Stewardship Code Compliance | 2021/22 | | n/a | |
| 4 | Liabilities | Valuation Report | Triennial Valuation | 2019/20 | | n/a | |
| | | Annual Report | Annual Statement of the Fund Actuary 2020/21 | 2020/21 | | n/a | |
| | | External Monitoring | Quarterly Investment Consultant Reporting to Pension Fund Committee | Quarterly | | n/a | |
| | | External Monitoring | Quarterly Independent Advice to Pension Fund Committee | Quarterly | | n/a | |
| 5 | Employers | Pension Fund Audit Assurance | Contributions | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Admission Bodies / Funding Risks | 2022/23 | | Substantial | |
| 6 | Administration | Pension Fund Audit Assurance | Pensions Payroll | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Transfer In/Out | 2021/22 | | Substantial | |

| | | | | | | | |
|----------|----------------|------------------------------|---|----------|---------|-------------|-------------------|
| | | Pension Fund Audit Assurance | Additional Voluntary Contributions | 2021/22 | | Substantial | |
| | | Pension Fund Audit Assurance | Benefit Calculations | 2019/20 | | Substantial | |
| | | Pension Fund Annual Report | Governance Compliance Statement | 2020/21 | | n/a | |
| 7 | Skills | Pension Fund Annual Report | Governance Compliance Statement | 2020/21 | | n/a | |
| 8 | Pooling | Pension Fund Audit Assurance | Investments | 2021/22 | | Substantial | |
| | | Pension Fund Audit Assurance | Governance Arrangements | 2020/21 | | Substantial | |
| | | BCPP AAF | AAF Type II Assurance Report | 2020/21* | | n/a | *provided by BCPP |
| 9 | ICT | Pension Fund Audit Assurance | Pension System ICT Controls, Data Quality and Performance | 2019/20 | | Moderate* | *current review |
| | | DCC Corporate Controls | Corporate Controls Presented to PF Committee June 2022 | 2022/23 | | n/a | |
| | | DCC Corporate Controls | Windows Operating System | | 2017/18 | Substantial | |
| | | DCC Corporate Controls | Backup Arrangements | | 2021/22 | Moderate | |
| | | DCC Corporate Controls | Mobile Computing (Follow Up) | | 2018/19 | n/a | |

| | | | | | | | |
|-----------|---------------------|------------------------------|---|----------|---------|-------------|-----------------------|
| | | DCC Corporate Controls | Business Continuity for ICT | | 2018/19 | Moderate | |
| | | DCC Corporate Controls | Incident Management | | 2019/20 | Substantial | |
| | | DCC Corporate Controls | Vulnerability Management (Advice) | | 2021/2 | n/a | |
| 10 | Data Quality | Pension Fund Audit Assurance | Pension System ICT Controls, Data Quality and Performance | 2019/21 | | Moderate* | *current review |
| 11 | Data Breach | Pension Fund Audit Assurance | Pension System ICT Controls, Data Quality and Performance | 2019/21 | | Moderate* | *current review |
| | | Pension Fund Audit Assurance | Compliance With Breach Policy | deferred | | n/a* | *part of 2022/23 plan |
| | | DCC Corporate Controls | Corporate Controls Presented to PF Committee June 2022 | 2022/23 | | n/a | |
| 12 | Cyber | Pension Fund Audit Assurance | Pension System ICT Controls, Data Quality and Performance | 2019/23 | | Moderate* | *current review |
| | | DCC Corporate Controls | Corporate Controls Presented to PF Committee June 2022 | 2022/23 | | n/a | |
| | | DCC Corporate Controls | Windows Operating System | | 2017/18 | Substantial | |
| | | DCC Corporate Controls | Backup Arrangements | | 2021/22 | Moderate | |
| | | DCC Corporate Controls | Mobile Computing (Follow Up) | | 2018/19 | n/a | |

| | | | | | | | |
|-----------|------------------------------|----------------------------------|---|---------|---------|-------------|--|
| | | DCC Corporate Controls | Business Continuity for ICT | | 2018/19 | Moderate | |
| | | DCC Corporate Controls | Incident Management | | 2019/20 | Substantial | |
| | | DCC Corporate Controls | Vulnerability Management (Advice) | | 2021/2 | n/a | |
| 13 | Fraud | Pension Fund Audit Counter Fraud | National Fraud Initiative – Data matching to identify potential error/fraud | 2021/22 | | n/a | |
| 14 | Regulatory Compliance | Pension Fund Audit Assurance | Pensions Payroll | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Transfer In/Out | 2021/22 | | Substantial | |
| | | Pension Fund Audit Assurance | Additional Voluntary Contributions | 2021/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Contributions | 2020/21 | | Substantial | |
| | | Pension Fund Audit Assurance | Benefit Calculations | 2019/20 | | Substantial | |
| | | Pension Fund Audit Assurance | Governance Arrangements | 2020/21 | | Substantial | |
| | | Pension Fund Annual Report | Governance Compliance Statement | 2020/21 | | n/a | |