

**AGENDA MANAGEMENT SHEET**

**Name of Committee** Pension Fund Investment Board  
**Date of Committee** 17 February 2006  
**Report Title** Pension Fund Risk Management

**Summary** Report setting out proposed policy with regard to the management of risk associated with the Pension Fund.

**For further information please contact:** Phil Triggs  
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**Would the recommended decision be contrary to the Budget and Policy Framework?** No.

**Background papers**

**CONSULTATION ALREADY UNDERTAKEN:-** Details to be specified

- Other Committees  .....
- Local Member(s)  .....
- Other Elected Members  Cllr Davis, Chair of Pension Fund Board
- Cabinet Member  .....
- Chief Executive  .....
- Legal  Jane Pollard, Assistant County Solicitor,  
Catherine Witham, Senior Solicitor
- Finance  David Clarke, Strategic Director of Resources –  
reporting officer
- Other Chief Officers  .....
- District Councils  .....

- Health Authority  .....
- Police  .....
- Other Bodies/Individuals  .....

**FINAL DECISION YES**

**SUGGESTED NEXT STEPS:**

Details to be specified

- Further consideration by this Committee  .....
- To Council  .....
- To Cabinet  .....
- To an O & S Committee  .....
- To an Area Committee  .....
- Further Consultation  .....

## Pension Fund Investment Board – 17 February 2006

### Risk Management

#### Report of the Strategic Director of Resources

##### Recommendation

That the Board note the report and approve the schedule of key risks and controls in place to manage those risks.

#### 1 Introduction

- 1.1 Warwickshire County Council is responsible for the delivery of benefit promises made to members of the Warwickshire Pension Fund. They achieve this by setting objectives and goals with varying timeframes. Risks lie in failing to meet the intended goals.
- 1.2 Risks that are established as an issue for the Warwickshire Pension Fund must be identified and evaluated via a risk evaluation model. The risks must be prioritised with existing controls or new controls implemented to mitigate the risks. This should be recorded in a risk register, which needs at least annual monitoring.
- 1.3 As the Pension Fund Investment Board (PFIB) has decision-making powers with regard to the running of the Fund, it is recommended that members should have a reasonable understanding of risk management in a pension scheme context.
- 1.4 Moreover, the PFIB should be asked as to their perception of risk within the Pension Fund and the plan adapted accordingly. This approach, whilst not requiring a significant input from the Board, should engage the Board sufficiently so that it sees the value from the process and feel sufficiently included in the outcome decisions.
- 1.5 A schedule of risks and the control mechanisms in place are shown in **Appendix A**.

## **2 Risk Management Process**

- 2.1 The risk management process needs to start with the objectives of the Pension Fund. These are set out in the Fund's business plan. The risks involved in achieving those objectives then need to be identified, and quantified in terms of the likelihood of them occurring and the impact if they did occur.
- 2.2 Once the risks have been quantified, the Fund will need to identify which are the priorities. Priorities will be scheme specific and will reflect the Fund's perception of the risks identified and should be set having regard to the objectives.
- 2.3 Controls then need to be implemented in order to manage the identified risks. In many cases, controls will already been in place but they should be reviewed for their appropriateness and revised as necessary.
- 2.4 The process is summarised as follows:
  1. Identify the objectives of the Fund (Business Plan)
  2. Identify the risks
  3. Quantify the risks
  4. Decide on priorities
  5. Set control mechanisms in place
  6. Monitor

## **3 Register of Key Risks and Control Mechanisms**

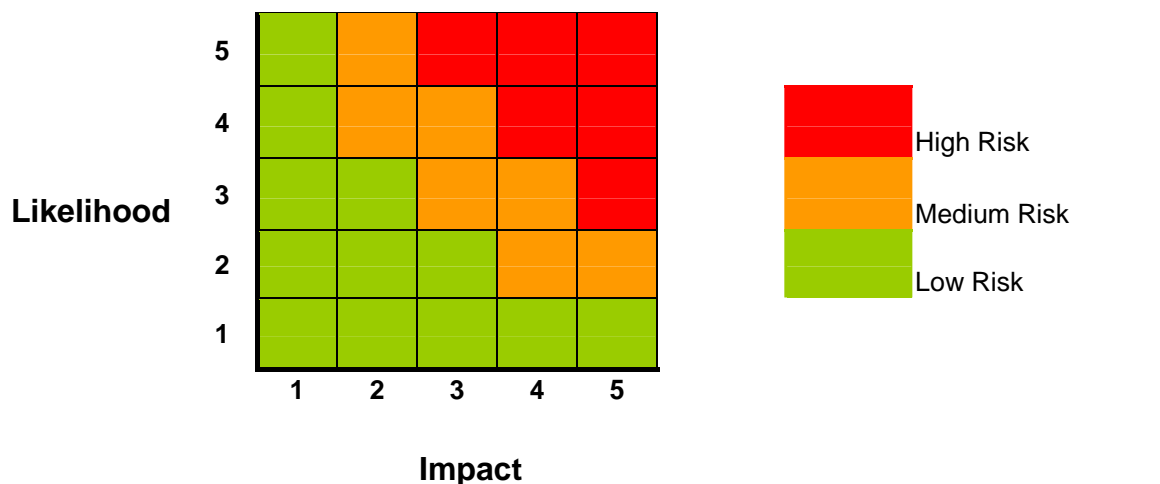
- 3.1 A risk register is a useful way of recording risks and resultant controls and is in a convenient format for ongoing monitoring and review, which is essential in a changing environment.
- 3.2 Continual monitoring will identify changes in risk exposure, relative to any agreed tolerances, and the emergence of new risks.
- 3.3 As well as identifying the risks, officers have scored each risk according to its possible impact and also its likelihood of happening.
- 3.4 A table showing the various scores attributable to impact and likelihood is shown in Table 1 below.

**Table 1: Scoring attached to levels of impact and likelihood**

	Score 1 (maybe one or more of the following)	2	3	4	High 5
<b>Impact</b>	No financial impact	Minimal financial impact	Financial impact on the scheme	High financial impact on the scheme	Very high financial impact on the scheme
	Affect benefits at individual member level	Affects several individual members	Specific category of members affected (e.g. active, deferred, pensioner)	Affects more than one category of membership	Affects entire membership
	No impact on Trustee reputation	May have some impact but limited to individual or small groups of members	Trustee may be under the spotlight at local media level	Major reputation issue for the trustee (e.g. national press)	Trustees pursued in the Courts
<b>Likelihood</b>	Very unlikely that risk will occur	Unlikely that risk will occur	Risk may occur	Likely that risk may occur	Very likely that risk will occur

3.5 According to the level of impact and likelihood, a category (high, medium or low) can be attributed to each risk according to the following table:

**Table 2: Ascertainment of Risk Level according to levels of impact and likelihood**



- 3.6 A register of risks, the control mechanisms in place, the levels of impact and likelihood and assessed risk levels are shown in **Appendix A**.

#### **4 Recommendation**

- 4.1 Members are asked to consider the register of risks in **Appendix A** and to approve the process by which this has been compiled, making any suitable additions or amendments as appropriate.

DAVID CLARKE  
Strategic Director of Resources

Shire Hall  
Warwick  
February 2006

## Key Risks & Controls

## Appendix A

The Administering Authority has an active risk management programme in place.

The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- investment;
- funding;
- financial;
- strategic;
- hazard;
- operational

Risk	Control Mechanism
<b>Investment Risks</b>	
<p>Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.</p> <p><b>Impact: 5</b>  <b>Likelihood: 3</b>  <b>Risk Level: High</b></p>	<p>Anticipation of the long-term return on a relatively prudent basis (as recommended by the actuary) to reduce the risk of under-performing.</p> <p>Analysis of the fund's progress at regular three-yearly valuations.</p> <p>Interim valuations provided when thought necessary.</p>
<p>Inappropriate long-term investment strategy.</p> <p><b>Impact: 5</b>  <b>Likelihood: 1</b>  <b>Risk Level: Low</b></p>	<p>Setting of a fund-specific benchmark underpinned by asset-liability modeling of liabilities.</p> <p>Decision taken as to the equity/bond split according to the unique characteristics of the liability structure.</p> <p>Setting of fund managers' targets and related performance measurement set according to market indices.</p>
<p>Fall in equity markets leading to deterioration in funding levels and increased contribution requirements from employers.</p> <p><b>Impact: 5</b>  <b>Likelihood: 3</b>  <b>Risk Level: High</b></p>	<p>Proportion of fund given to gilts.</p> <p>Acceptance that equities are the best proven asset class over long term.</p>

<p>Fall in risk-free returns on gilts, leading to rise in value placed on liabilities</p> <p><b>Impact: 4</b> <b>Likelihood: 4</b> <b>Risk Level: High</b></p>	<p>Inter-valuation monitoring as above. Investment in gilts helps to mitigate this risk.</p>
<p>Active investment manager underperformance relative to set benchmark targets.</p> <p><b>Impact: 3</b> <b>Likelihood: 3</b> <b>Risk Level: Medium</b></p>	<p>Regular quarterly investment monitoring with analysis of market performance of the active managers relative to their benchmark target.</p>
<p>Poor investment manager choice.</p> <p><b>Impact: 3</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b></p>	<p>Medium number of managers and index tracker portfolio enables immediate contract termination and redistribution of funds prior to appointment of replacement manager.</p>
<p>Non-compliance with CIPFA/Myners Code of Practice</p> <p><b>Impact: 1</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b></p>	<p>Compliance situation is published annually in the Pension Fund Annual Report.</p>
<p><b>Funding Risks</b></p>	
<p>Deterioration in funding because of a mismatch of assets and liabilities.</p> <p><b>Impact: 4</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b></p>	<p>Triennial valuations supplemented with interim valuations.</p>
<p>Pensioners living longer</p> <p><b>Impact: 4</b> <b>Likelihood: 5</b> <b>Risk Level: High</b></p>	<p>Setting of mortality assumptions by actuary with some allowance for future increases in life expectancy.</p> <p>Recent reports (Turner Report) is promoting a later retirement culture.</p>
<p>Falling active payrolls</p> <p><b>Impact: 2</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b></p>	<p>Active membership is regularly monitored. Recruitment advertising campaigns are regularly undertaken.</p>



<p>Increasing administration expenses (met from the normal contribution rate)</p> <p><b>Impact: 2</b>  <b>Likelihood: 2</b>  <b>Risk Level: Low</b></p>	<p>The Pension Fund Administration budget is subject to the Council's approval and monitoring process.</p>
<p>Funding drain on Transfers Out</p> <p><b>Impact: 2</b>  <b>Likelihood: 1</b>  <b>Risk Level: Low</b></p>	<p>Generally compensated by Transfers In. Monitored on a regular basis.</p>
<p>Administering Authority unaware of structural changes in an employer's membership (e.g., large fall in employee members, large number of retirements).</p> <p>Administering Authority is not advised of an employer closing the scheme to new entrants.</p> <p><b>Impact: 2</b>  <b>Likelihood: 2</b>  <b>Risk Level: Low</b></p>	<p>The Administering Authority monitors membership movements.</p> <p>The Actuary may be instructed to consider revising the rates and adjustments certificate to increase an employer's contributions (under Regulation 78) between triennial valuations.</p>
<p><b>Financial Risks</b></p>	
<p>Pay and price inflation significantly more than anticipated.</p> <p><b>Impact: 3</b>  <b>Likelihood: 2</b>  <b>Risk Level: Low</b></p>	<p>The focus of the actuarial valuation process is on the real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early prior warning.</p> <p>Investment in index-linked bonds also assists the mitigation of this risk.</p> <p>Employers fund their own salary awards and are reminded of the gearing effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</p>

<p>Changes to regulations, e.g., more favourable benefits package, potential new entrants to scheme, such as part-time employees.</p> <p>Changes to national pension requirements and/or Inland Revenue rules.</p> <p><b>Impact: 3</b>  <b>Likelihood: 4</b>  <b>Risk Level: Medium</b></p>	<p>The Administering Authority is alert to the potential creation of additional liabilities.</p> <p>It considers all ODPM consultation papers and comments where appropriate.</p> <p>The Administering Authority will consult employers where appropriate.</p>
<p>Administering Authority failing to commission the Fund actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.</p> <p><b>Impact: 2</b>  <b>Likelihood: 2</b>  <b>Risk Level: Low</b></p>	<p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p>
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p> <p><b>Impact: 2</b>  <b>Likelihood: 2</b>  <b>Risk Level: Low</b></p>	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <ul style="list-style-type: none"> <li>• Seeking a funding guarantee from another scheme employer, or external body, wherever possible.</li> <li>• Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</li> <li>• Vetting prospective employers before admission.</li> <li>• Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.</li> </ul>
<p>Effect of possible increase in employers' contribution rate on service delivery.</p> <p><b>Impact: 2</b>  <b>Likelihood: 3</b>  <b>Risk Level: Low</b></p>	<p>Seeking of feedback from all employers on scope to absorb short-term contribution rises.</p> <p>Mitigation of the impact of revised rates through deficit spreading and phasing-in of contribution rises.</p>

<b>Strategic Risks</b>	
Poor employee recruitment/retention  <b>Impact: 2</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b>	Membership members monitored regularly.
Poor communication  <b>Impact: 2</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b>	Communication strategy is being compiled.
Reputation risk  <b>Impact: 2</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b>	Work of the Pension Group is monitored continually. Staff/user surveys regularly conducted.
Legislative changes  <b>Impact: 3</b> <b>Likelihood: 5</b> <b>Risk Level: High</b>	Group staff networks point to early recognition of likely change and possible proactive planning.
<b>Hazard Risks</b>	
Hyperinflation  <b>Impact: 5</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b>	Extremely unlikely in the context of the independent Monetary Policy Committee's role with regard to the setting of interest rates in the control of inflation.
Deteriorating patterns of early retirements.  <b>Impact: 2</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b>	Employers are charged the extra capital cost of non ill-health retirements following each individual employer decision.  Ill health retirement experience is monitored.
Administration records corrupted or destroyed.  <b>Impact: 5</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b>	Authority is undertaking computerised document imaging.

<p>Financial fraud</p> <p><b>Impact: 5</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b></p>	<p>Comprehensive system of internal controls adopted by management. Fund manager systems of internal control are also monitored via the Society of County Treasurers.</p>
<p>Fire/flood/terrorism</p> <p><b>Impact: 5</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b></p>	<p>Subject to the Council's corporate policy re disaster recovery.</p>
<p><b>Operational Risks</b></p>	
<p>Lack of succession planning</p> <p><b>Impact: 2</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b></p>	<p>Staff levels are regularly monitored with regular discussions as to the future implications of staff resignations and retirement.</p>
<p>Staffing levels failing to support required service delivery</p> <p><b>Impact: 2</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b></p>	<p>Regular monitoring takes place via comprehensive quarterly reports.</p>
<p>Failure to correctly establish adequate IT systems and supporting hardware and software.</p> <p><b>Impact: 3</b> <b>Likelihood: 2</b> <b>Risk Level: Low</b></p>	<p>IT consultant is currently working specifically on pensions systems with the support of in-house IT staff.</p>
<p>Inadequate user training</p> <p><b>Impact: 3</b> <b>Likelihood: 1</b> <b>Risk Level: Low</b></p>	<p>Full programme of user training currently being implemented backed up with training evaluation feedback.</p>