

Key Risks & Controls

Appendix A

The Warwickshire Pension Fund has an active risk management programme in place.

The Risk Register summarises key risks under the following headings:

- Investment
- Funding
- Strategic
- Hazard
- Operational

Investment Risks:

| Risk | Control Mechanism | Risk Action |
|---|---|--|
| <p>Fund assets fail to deliver returns over the long term in line with the expected returns underpinning the actuarial valuation and funding strategy.</p> <p>Impact: 5 Likelihood: 3 Risk Level: High</p> | <p>Assumptions on long term investment returns are made on a relatively prudent basis (as recommended by the actuary) to reduce the risk of under-performance.</p> | <p>Analysis of the funding position is carried out at regular three-yearly actuarial valuations.</p> <p>Interim annual valuations are provided when considered necessary.</p> |
| <p>Falls in equity markets lead to a short term deterioration in funding levels and increased contribution requirements from employers.</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>A long term stabilisation approach has been agreed in setting contribution rates for secure open employers.</p> <p>The 'growth' component of the Fund's strategy has been diversified across property, hedge funds and infrastructure in order to reduce the exposure to short term stock market volatility.</p> | <p>The composition of the Fund's growth asset portfolio will be reviewed on a regular basis and as part of the 2017 strategy review.</p> <p>The funding strategy recognises that pension funding has a long term time horizon which can dampen these short term volatile movements and pressure on contribution rates.</p> |

| Risk | Control Mechanism | Risk Action |
|---|--|---|
| <p>Inappropriate long-term investment strategy.</p> <p>Impact: 5 Likelihood: 2 Risk Level: Medium</p> | <p>The long term investment strategy is based on modelling of the Fund's specific liabilities and funding position under a range of economic scenarios. Advice is received from professional advisors.</p> <p>There is additional advice provided by the Fund's independent advisor.</p> | <p>The strategy is reviewed formally every three years in conjunction with the actuarial valuation – and more frequently when there has been a material change in market conditions.</p> <p>The Actuary will also provide an independent view of the Fund's investment strategy as and when required.</p> |
| <p>High levels of inflation in the future are not matched by asset returns</p> <p>Impact: 4 Likelihood: 2 Risk Level: Medium</p> | <p>The Fund is invested heavily in real assets (equities, property, infrastructure) which are expected to offer some protection against higher levels of inflation over the medium to long term.</p> | <p>The risk attached to future inflation levels is assessed within the liability modeling exercises and considered as part of the regular reviews of investment strategy.</p> |
| <p>Fund faces short term liquidity problems and is unable to meet benefit outgoings.</p> <p>Impact: 5 Likelihood: 2 Risk Level: Medium</p> | <p>Expected cash movements are forecast and monitored on a regular basis.</p> <p>Arrangements have been made with investment managers to receive income on a regular basis and to be able to access additional income when required.</p> | <p>The Fund also has the option of selling units in pooled funds at very short notice.</p> |

| Risk | Control Mechanism | Risk Action |
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| <p>Underperformance by active investment managers leads to poor Fund returns.</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>Regular quarterly performance monitoring reports are received.</p> <p>Managers are also monitored by the manager research team of the investment advisors.</p> <p>The Fund makes extensive use of passive management across equities and bonds.</p> | <p>Continued under-performance – or material changes in other relevant business factors - will lead to formal review of the mandate by the Investment Sub-Committee, with a view to possible contract termination.</p> <p>Assets can be switched rapidly to the Fund's passive manager.</p> |
| <p>A change to the Fund's investor status under MiFID 2</p> <p>Impact: 5 Likelihood: 2 Risk Level: Medium</p> | <p>Officers are liaising with LGPS peers regarding the publication of FCA guidance.</p> <p>It has been identified that a significant administrative burden may arise in Q4 2017.</p> | <p>Officers continue to liaise with managers regarding the likely implications.</p> |
| <p>Poor returns as a result of new asset pooling arrangements</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>Asset allocation decisions will continue to be made by the Committee.</p> <p>Management of the individual BCPP funds will be the responsibility of a professional investment management team appointed by or employed by BCPP.</p> | <p>Detailed performance reporting of all BCPP investments will be available to the Committee on a regular basis.</p> |
| <p>Inadequate governance arrangements within BCPP lead to poor investment decision-making</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>A professionally staffed FCA regulated company is being established for asset management purposes – with a joint oversight committee for participating funds.</p> | <p>The Fund will have representation on both the BCPP Shareholder Board and joint governance committee.</p> |

| Risk | Control Mechanism | Risk Action |
|---|--|--|
| <p>Inappropriate choice of new investment manager.</p> <p>Impact: 3 Likelihood: 2 Risk Level: Low</p> | <p>A rigorous procurement exercise is carried out and advice taken from the professional advisors and independent advisor.</p> | <p>Members of the Investment Sub-Committee are involved in all decisions relating to the appointment of new managers.</p> <p>Under pooling, the responsibility for appointing new managers will pass to the BCPP team.</p> |
| <p>Fraud or counterparty default by investment managers / brokers / custodian leads to losses for the Fund.</p> <p>Impact: 4 Likelihood: 1 Risk Level: Low</p> | <p>Securities are either held in 'ring-fenced' accounts or pooled funds.</p> | <p>Fund managers produce detailed internal controls documents which are independently audited.</p> <p>Client agreements with new service providers are subject to legal review</p> |
| <p>Non-compliance with CIPFA/Myners Code of Practice</p> <p>Impact: 1 Likelihood: 1 Risk Level: Low</p> | <p>Level of compliance is published annually in the Investment Strategy Statement and Pension Fund Annual Report.</p> | <p>Adherence to Code of Practice is reviewed on a regular basis.</p> |
| <p>High transition costs incurred through transfers of assets into BCPP pool.</p> <p>Impact: 2 Likelihood: 3 Risk Level: Low</p> | <p>A professional transition manager will be employed to oversee and implement the significant transition activity required for pooling of assets.</p> | <p>Full cost analysis of all transition activity will be available.</p> |

Funding Risks:

| Risk | Control Mechanism | Risk Action |
|---|---|---|
| <p>Fall in risk free returns on gilts, leading to rise in value placed on liabilities and increased cost of benefits</p> <p>Impact: 5 Likelihood: 3 Risk Level: High</p> | <p>Inter-valuation monitoring and asset /liability modelling as above. Some investment in bonds helps to mitigate this risk.</p> | <p>Allowance for future volatility on the returns available on gilts is built into the ALM and allowed for in the funding strategy. In particular, the Actuary's long term view is that gilt yields are on average likely to revert to a higher level than implied by markets at the 2016 actuarial valuation. This approach recognises that gilt markets have been distorted by recent unusual events (e.g. Brexit) and historically interest rates have reverted to a higher long term average.</p> |
| <p>Declining active payrolls leading to underpayment of deficit recovery amounts.</p> <p>Impact: 5 Likelihood: 4 Risk Level: High</p> | <p>Active membership is regularly monitored. Recruitment advertising campaigns are regularly undertaken. Auto enrolment (initial staging or triennial re-enrolment) may encourage some non-members to take up membership.</p> | <p>The Fund insists that most employers make deficit recovery payments as monetary amounts, rather than as a percentage of payroll.</p> |
| <p>Cross subsidies between employers become significant and affect employer asset share calculations</p> <p>Impact: 4 Likelihood: 4 Risk Level: High</p> | <p>The Pension Fund uses a unitised asset tracking system to determine employer asset shares</p> | <p>Fund uses the cashflow approach employed under the unitised asset tracking system to reduce cross subsidy risk</p> |

| Risk | Control Mechanism | Risk Action |
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| <p>Pensioners living longer</p> <p>Impact: 3 Likelihood: 3 Risk Level: Medium</p> | <p>Mortality assumptions set by the Actuary allow for future increases in life expectancy.</p> <p>'Baseline' mortality assumptions (i.e. current death rates) are based on the combined experience from Club Vita data of around 160 large occupational schemes. This gives the Fund a set mortality rates that are tailored to the unique membership profile of the Fund.</p> | <p>Mortality assumptions are reviewed every three years at each actuarial valuation.</p> <p>Annual updates on changes to mortality rates are provided by Club Vita and highlight the impact on liabilities.</p> <p>Pension reform means that retirement ages in the Fund on post 2014 benefits will be linked to State Pension Age (SPA). The Government is committed to adjusting the SPA if mortality rates change in future, which will help to manage this risk within the Fund.</p> <p>Changes to life expectancies are covered under the LGPS cost sharing mechanism e.g. if longevity increases, benefit levels may be reduced.</p> |
| <p>Changes to regulations, e.g., more favourable benefits package, potential new entrants to scheme.</p> <p>Changes to national pension requirements and/or HMRC rules.</p> <p>Impact: 3 Likelihood: 3 Risk Level: Medium</p> | <p>The Pension Fund is alert to the potential creation of additional liabilities.</p> <p>The Pension Fund will consult employers where appropriate.</p> | <p>The Pension Fund considers all consultation papers and comments where appropriate and necessary.</p> |

| Risk | Control Mechanism | Risk Action |
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| <p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p> <p>Impact: 3 Likelihood: 3 Risk Level: Medium</p> | <p>The Regulations require the Actuary to undertake a cessation valuation to assess the size of any debt at exit. The debt is levied on the departing employer. However, the Pension Fund believes that it is often too late to fully address the position at that point.</p> | <p>The Fund mitigates this risk by:</p> <ul style="list-style-type: none"> • Seeking a funding guarantee from another scheme employer, or external body, wherever possible. • Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. • Carrying out covenant analysis to inform the Fund of an employer's financial strength and ability to make good any funding deficit and reflecting this in the risk based approach used to set contribution rates. • Vetting prospective employers before admission. • Where permitted under the Regulations, requiring a bond to protect the scheme from the extra cost of early retirements. |
| <p>Pension Fund unaware of structural changes in an employer's membership (e.g., large number of retirements). Pension Fund is not advised of an employer closing the scheme to new entrants.</p> <p>Impact: 3 Likelihood: 4 Risk Level: Medium</p> | <p>The Actuary may be instructed to revise the rates and adjustments certificate to increase an employer's contributions between triennial valuations.</p> <p>Employers are charged the extra capital cost of (non-ill-health) early retirements.</p> | <p>The Pension Fund actively monitors membership movements, especially with regard to falling active membership and increases in deferred and pensioner numbers.</p> |

| Risk | Control Mechanism | Risk Action |
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| <p>Deterioration in funding because of a mismatch of assets and liabilities.</p> <p>Impact: 5 Likelihood: 2 Risk Level: Medium</p> | <p>Triennial actuarial valuations, supplemented with interim valuation funding updates that reflect changes to market conditions.</p> <p>Asset-liability modelling (ALM) is undertaken at least once every three years to assess the long-term financial health of the Fund.</p> | <p>Investment Sub-Committee Board receives regular reports on the Fund's performance and is aware of the potential impact of significant funding risks e.g. lower interest rates, increasing life expectancies.</p> <p>The Actuary, with input from the investment advisor, discusses and agrees the ALM output with officers and members and sets employer contribution rates at levels that are designed to keep the Fund solvent over the long term.</p> <p>Fund can consider implementing employer level investment strategies to reduce the mismatch risk where it would be beneficial to the employer's circumstances</p> |
| <p>Incorrect membership data leading to inaccurate assessment of liabilities and/or contribution rate</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>The Pension Fund regularly checks and reviews membership data submitted by employers.</p> | <p>The Pension Fund holds regular workshop and training days with employers to explain data submission and is on hand to discuss any queries</p> <p>Actuary carries out high level data checks on membership data received for calculation of liabilities and contribution rate</p> |

| Risk | Control Mechanism | Risk Action |
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| <p>Incorrect financial data leading to inaccurate assessment of employer asset shares</p> <p>Impact: 4 Likelihood: 3 Risk Level: Medium</p> | <p>The Pension Fund regularly checks and reviews financial data against membership data and general ledger.</p> | <p>Actuary carries out high level data checks on financial data received for calculation of employer asset shares</p> |
| <p>Employer actions (e.g. excessive salary increases, outsourcings) lead to unanticipated liability increases and reduce affordability of contributions</p> <p>Impact: 4 Likelihood: 2 Risk Level: Medium</p> | <p>The Fund engages with employers to ensure early awareness of specific actions</p> | <p>The Fund reserves the right to review contribution rates and funding strategy in light of employer actions</p> |
| <p>Effect of possible increase in employers' contribution rate on service delivery of Pension Fund employees.</p> <p>Impact: 2 Likelihood: 3 Risk Level: Low</p> | <p>Feedback is sought on employer's ability to absorb contribution rises.</p> <p>Mitigation of the impact of revised rates through deficit spreading, phasing-in of contribution rises and, for open secure employers, the use of a contribution stability mechanism.</p> | <p>Employers are consulted with through senior management contacts, the Pension Fund AGM, the Funding Strategy Statement consultation and regular bulletins.</p> |
| <p>The Pension Fund 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>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>The Pension Fund requires employers to disclose forthcoming changes.</p> | <p>Fund officers monitor via the local and national press for developments in admitted bodies that might have a detrimental effect on the Fund.</p> |

Strategic Risks:

| Risk | Control Mechanism | Risk Action |
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| Reputation risk with employers and members Impact: 2 Likelihood: 2 Risk Level: Low | Group and senior management work hard to foster good relations with employers and members and provide a quality service. | Complaints are acted on immediately and monitored and reported to senior management. |

Hazard Risks:

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| Administration records corrupted or destroyed. Impact: 5 Likelihood: 1 Risk Level: Low | The administration team has now digitally imaged all active and preserved member records. | Office is subject to corporate and departmental disaster planning. Data back-ups are stored off site. |
| Financial fraud Impact: 5 Likelihood: 1 Risk Level: Low | Comprehensive system of internal controls adopted by management. Fund manager reports of internal control are checked by Pension Fund staff. | Scrutiny by internal and external audit processes. |
| Fire/flood/terrorism Impact: 5 Likelihood: 1 Risk Level: Low | Data well backed up on a regular basis. Main investment data is held by the Fund's global custodian and available online. | Office is subject to corporate and departmental disaster planning. |

Operational Risks:

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| Insufficient number of external contract service providers, therefore insufficient choice and consequent poor service Impact: 4 Likelihood: 2 Risk Level: Medium | Regular monitoring of the service provider market. | Recent procurement tender processes have been achieved satisfactorily with no signs of lack of market interest. |
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| Risk | Control Mechanism | Risk Action |
|---|---|---|
| <p>Poor communication</p> <p>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>Communication strategy is in place and adhered to.</p> | <p>Feedback taken from scheduled and admitted bodies at the Fund's annual meeting.</p> <p>Variety of means employed for communication to members.</p> |
| <p>Lack of succession planning</p> <p>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>Office has experienced turnover through natural wastage.</p> | <p>Staff levels are regularly monitored. Regular discussions take place as to the implications of future staff resignations and retirement.</p> |
| <p>Staffing levels failing to support required service delivery</p> <p>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>Regular monitoring takes place via comprehensive quarterly reports.</p> | <p>Recent recruitment has been achieved as desired.</p> |
| <p>Failure to establish adequate ICT infrastructure.</p> <p>Impact: 3 Likelihood: 2 Risk Level: Low</p> | <p>The Pension Fund works closely with providers.</p> | <p>Requirements are monitored continually. Data is "cleansed" before each actuarial valuation.</p> |
| <p>Inadequate user training</p> <p>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>Full programme of user training currently being implemented backed up with training evaluation feedback.</p> | <p>Training is monitored on a constant basis.</p> |
| <p>Increasing administration expenses (met from the normal contribution rate)</p> <p>Impact: 2 Likelihood: 2 Risk Level: Low</p> | <p>The Pension Fund Administration budget is subject to the Council's approval and monitoring process. Regular reports are monitored by officers.</p> | <p>The Council continues to seek value for money with regard to fund administration by reviewing all vacancies, intelligent use of IT resources and benchmarking.</p> |