

Local Pension Board 5 March 2019

Risk Register

Recommendation

That the Local Pension Board notes and comments on the fund risk register.

1.0 Key Issues

- 1.1 The pension fund maintains a risk register and this has been reviewed and updated as attached at Appendix A.
- 1.2 The format of the risk register has been updated. Risks are still assessed on the basis of likelihood and impact. Both of these factors are still scored from 1 (low) to 5 (high). Previously, the risk register then provided an overall classification of low, medium, or high risk for each risk within the register. In the updated register, the likelihood and impact scores are simply multiplied together to give an overall risk rating from 1 to 25.

1.3 Table 1 – Summary of Risk Scoring

		Impact				
		Very Low 1	Low 2	Medium 3	High 4	Very High 5
Likelihood	Very Low 1	1	2	3	4	5
	Low 2	2	4	6	8	10
	Medium 3	3	6	9	12	15
	High 4	4	8	12	16	20
	Very High 5	5	10	15	20	25

- 1.4 Risk ratings consider the position *after* taking into account identified management actions and controls.
- 1.5 Management actions to mitigate risks have been simplified into one column, and the risk ratings have been updated to reflect the current assessment of each risk. An additional column has been added to the Risk Register to make the changes transparent and to provide an indication of the direction of travel of each risk. The following table summarises the changes.

Table 2 – Summary of Changes

Change Type	Description
New Risks	<p>1.14 New sub funds being set up by Border to Coast that do not match the Fund's requirements</p> <p>1.15 Brexit - risk of impact on asset values</p> <p>2.14 That the Fund becomes cash flow negative and has to realise illiquid assets under time pressure</p> <p>3.2 Fund's reputational risk due to tPR data scoring</p> <p>4.4 Cyber-crime and other generic or targeted information security threats</p> <p>5.3 Lack of succession planning</p> <p>5.4 Staffing levels failing to support required service delivery</p> <p>5.7 Increasing administration expenses</p> <p>5.8 Other workload pressures and priorities of the Scheme Administrator impacting adversely on pension fund governance or administration</p>
Increasing Risks	<p>1.2 Short term falls in equity markets</p> <p>2.5 Changes to regulations, e.g., more favourable benefits package, potential new entrants to scheme. Changes to national pension requirements and/or HMRC rules</p> <p>2.6 An employer ceasing to exist with insufficient funding or adequacy of a bond</p> <p>2.13 The Pension Fund failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body or failing to complete the cessation within the 3 month timescales as required under the Regulations.</p>
Reducing Risks	<p>1.1 Long term fund asset returns fail to be in line with the actuarial valuation and funding strategy assumptions</p> <p>1.9 Inadequate governance arrangements in respect of Border to Coast</p> <p>2.8 Deterioration in funding because of a mismatch of assets and liabilities</p>
Risks Deleted From Register	None
Restated risks (in this case ratings changes do not mean risks have changed, but that the previous risk assessment has been corrected)	<p>2.1 Fall in risk free returns on gilts, leading to rise in value placed on liabilities and increased cost of benefits</p> <p>2.2 Declining active payrolls leading to underpayment of deficit recovery amounts.</p> <p>2.3 Cross subsidies between employers become significant and affect employer asset share calculations</p>

- 1.2 Risk ratings consider the position *after* taking into account identified management actions and controls.
- 1.3 Risks are grouped into the following categories:
- Investment
 - Funding
 - Strategic
 - Hazard
 - Operational
- 1.4 The following developments have occurred during the last year that have changed the risk landscape:
- Increasing levels of investment in alternatives.
 - The developments of the Border to Coast Pension Partnership.
 - The implementation of new sub-funds by the Border to Coast Pension Partnership.
 - The public sector financial backdrop of continuing financial pressure.
 - GDPR requirements.
 - Increasing risks in the area of cyber-crime and information security.
 - The growth of the workload, complexity, and governance requirements associated with the administration of the scheme
 - The positive cash flow position is very sensitive to investment returns.
 - Increasing expectations of the Pensions Regulator and Scheme Advisory Board.
- 1.5 The Risk Register was presented to the Pension Fund Investment Sub Committee and one additional risk has been added as a result in relation to Brexit (Risk 1.15).

Background papers

None.

	Name	Contact Information
Report Author	Chris Norton	chrisnorton@warwickshire.gov.uk
Assistant Director	Lisa Kitto	lisakitto@warwickshire.gov.uk
Strategic Director	David Carter	davidcarter@warwickshire.gov.uk
Portfolio Holder	Peter Butlin	cllrbutlin@warwickshire.gov.uk

The report was circulated to the following members prior to publication:

Local Member(s):

Other members:

1. Investment Risks

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
1.1	Long term fund asset returns fail to be in line with the actuarial valuation and funding strategy assumptions	<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 valuations are provided on a quarterly basis as a standing Committee agenda item.</p>	2	4	8	The funding methodology is very prudent. The likelihood lowered from 3 to 2, and impact lowered from 5 to 4.
1.2	Short term falls in equity markets	<p>The composition of the Fund's growth asset portfolio will be reviewed on a regular basis.</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> <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, private equity, private debt, and infrastructure in order to reduce the exposure to short term stock market volatility. The fund has also undertaken training on the option of equity protection.</p>	4	4	16	<p>Likelihood is higher in the short term, increased from 3 to 4.</p> <p>Diversification assets portfolio updated and reference to training on equity protection added</p>
1.3	Inappropriate long-term investment strategy	<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>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 advisors.</p>	2	5	10	None

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
1.4	High levels of inflation in the future are not matched by asset returns	<p>The risk attached to future inflation levels is assessed within liability modeling exercises and considered as part of the regular reviews of investment strategy.</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>	2	4	8	None
1.5	Fund faces short term liquidity problems and is unable to meet benefit outgoings	<p>The majority of the Fund's investments are in asset classes which are relatively liquid.</p> <p>The Fund has the option of selling units in pooled funds at short notice. This will continue to be the case under pooling. In the short term, arrangements are in place with investment managers to be able to access additional income when required.</p> <p>Expected cash movements are forecast and monitored on a regular basis.</p>	2	5	10	Mitigating actions and controls updated
1.6	Underperformance by active investment managers leads to poor Fund returns.	<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>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 in order to reduce the impact on the Fund from underperforming active managers.</p> <p>Investment in funds managed by Border to Coast will benefit from the concentration of expertise in place in the pool.</p>	3	4	12	<p>Reference added in respect of pooling benefits.</p> <p>The shape of management actions will change as pooling becomes more prevalent.</p> <p>Risk level unchanged at this time.</p>
1.7	A change to the Fund's investor status under MiFID 2	<p>A review is being undertaken of MIFID 2 compliance during 2018 and requirements to maintain compliance in 2019.</p> <p>Officers will continue to liaise with fund managers regarding the likely implications.</p>	2	5	10	Reference to a review being undertaken during 2018.

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
1.8	Poor value as a result of new asset pooling arrangements	Detailed performance reporting of all BCPP investments will be available to the Committee on a regular basis. Asset allocation decisions will continue to be made by the Committee. Management of the individual BCPP funds will be the responsibility of a professional investment management team appointed by or employed by BCPP.	3	4	12	Scope widened from “poor returns” to “poor value” to recognise returns, ongoing fees, and transition costs.
1.9	Inadequate governance arrangements within BCPP lead to poor investment decision-making	The Fund will have representation on both the BCPP Shareholder Board and joint governance committee. A professionally staffed FCA regulated company is being established for asset management purposes – with a joint oversight committee for participating funds.	2	4	8	Likelihood reduced from 3 to 2 in light of experience of working with Border to Coast
1.10	Inappropriate choice of new investment manager.	Members of the Investment Sub-Committee have been involved previously in all decisions relating to the appointment of new managers. Under pooling, the responsibility for appointing new managers within the pool has passed to Border to Coast but the design of each fund and the process for manager selection is co-designed with partner funds. Rigorous procurement exercises are carried out and advice taken from the professional advisors and independent advisor.	2	3	6	Reference added to the co-design approach to new funds being taken by Border to Coast
1.11	Fraud or counterparty default by investment managers / brokers / custodian leads to losses for the Fund.	Fund managers produce detailed internal controls documents which are independently audited. Due diligence on managers will be undertaken by the pool. Client agreements with new service providers are subject to legal review Securities are either held in ‘ring-fenced’ accounts or pooled funds. Due diligence undertaken on transfers to the Border to Coast Pool	1	4	4	Reference added in respect of Pooled fund transfers
1.12	Non-compliance with CIPFA/Myners Code of Practice	Adherence to Code of Practice is reviewed on a regular basis. Level of compliance is published annually in the Investment Strategy Statement and Pension Fund Annual Report.	1	1	1	None

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
1.13	High transition costs incurred through transfers of assets into BCPP pool.	<p>Full cost analysis of all transition activity will be available.</p> <p>Professional transition advisors and transition managers will be employed to oversee and implement the transition activity required for pooling of assets.</p>	3	2	6	None
1.14	New sub funds being set up by Border to Coast that do not match the Fund's requirements	<p>Engaging with Border to Coast and Partner Funds in the design and specification of new sub funds through the Operational Officers Group, Joint Committee, Section 151 Officer Meetings, and other means as appropriate.</p> <p>Action includes both technical input and also influencing/negotiating the direction a fund is taking given that no fund can perfectly match every partner's requirements.</p> <p>Decision making will have regard to the case by case merits of each fund and also the bigger picture benefits of pooling overall, given that sometimes the latter reason may justify joining a fund when the former reason may not.</p>	4	4	16	A new risk.
1.15	Brexit - risk of impact on asset values	<p>Investments in overseas assets/currency will mitigate negative impacts on domestic investments.</p> <p>Larger long term employers will have valuations based upon future return expectations which would mitigate any short term Brexit impact.</p> <p>Shorter term employers, for example who may be on a path to exit the fund will be identified and options to mitigate risk considered.</p>	4	4	16	A new risk.

2. Funding Risks

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
2.1	Fall in risk free returns on gilts, leading to rise in value placed on liabilities and increased cost of benefits	<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>Inter-valuation monitoring and asset /liability modelling as above. Some investment in bonds helps to mitigate this risk.</p>	3	4	15	Impact reduced from 5 to 4 due to funding methodology
2.2	Declining active payrolls leading to underpayment of deficit recovery amounts.	<p>The Fund insists that most employers make deficit recovery payments as monetary amounts, rather than as a percentage of payroll.</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>	2	4	8	Likelihood reduced to 2 due to use of monetary contributions, impact reduced to 4 due to the relative size of contributions compared to employer asset values and the volatility in the markets
2.3	Cross subsidies between employers become significant and affect employer asset share calculations	<p>Fund uses the cash flow approach employed under the unitised asset tracking system to reduce cross subsidy risk</p> <p>The Pension Fund uses a unitised asset tracking system to determine employer asset shares</p>	3	4	12	Likelihood reduced from 4 to 3 considering the role of the asset tracking system

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
2.4	Pensioners living longer	<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>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>	3	3	9	None
2.5	<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>The Pension Fund considers all consultation papers and comments where appropriate and necessary.</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>	5	4	20	Likelihood increased from 3 to 5 and impact from 3 to 4 due to recent developments such as the scheme paying full increases on GMP for Members with an SPA after April 2016

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
2.6	An employer ceasing to exist with insufficient funding or adequacy of a bond.	<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>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>There has been a recent exercise run in conjunction with WCC to reduce this risk by pro-actively reviewing higher risk admitted bodies</p>	4	3	12	Likelihood increased from 3 to 4 in light of the continuing financial challenges facing the public sector generally
2.7	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>The Pension Fund actively monitors membership movements, especially with regard to falling active membership and increases in deferred and pensioner numbers.</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>	4	3	12	None

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
2.8	Deterioration in funding because of a mismatch of assets and liabilities.	<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>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>	2	4	8	Impact could be anywhere from low to high, reduced from 5 to 4
2.9	Incorrect membership data leading to inaccurate assessment of liabilities and/or contribution rate	<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> <p>The Pension Fund regularly checks and reviews membership data submitted by employers.</p> <p>The Fund is reviewing options to improve systems functionality in respect of the transfer of data from employers to the Fund.</p>	3	4	12	None
2.10	Incorrect financial data leading to inaccurate assessment of employer asset shares	<p>Actuary carries out high level data checks on financial data received for calculation of employer asset shares</p> <p>The Pension Fund regularly checks and reviews financial data against membership data and general ledger.</p>	3	4	12	None

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
2.11	Employer actions (e.g. excessive salary increases, outsourcings) lead to unanticipated liability increases and reduce affordability of contributions	<p>The Fund reserves the right to review contribution rates and funding strategy in light of employer actions</p> <p>The Fund engages with employers to ensure early awareness of specific actions</p>	2	4	8	None
2.12	Employer unable to afford contributions or contribution increases due to a change in their funding position and/or profile	<p>Employers are consulted with through senior management contacts, the Pension Fund AGM, the Funding Strategy Statement consultation and regular bulletins.</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>	3	2	6	Risk description changed – it was about potential impact on employer service delivery, this is changed to being about the employer being unable to afford contributions
2.13	The Pension Fund failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body or failing to complete the cessation within the 3 month timescales as required under the Regulations.	<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> <p>The Pension Fund requires employers to disclose forthcoming changes.</p> <p>The Pension Fund ensures the Actuary is aware of necessary timescales and deadlines.</p>	2	3	6	<p>Risk updated for timescale requirements.</p> <p>Impact increased from 2 to 3 as breaching 3 months could result in a claim against the fund</p>
2.14	That the Fund becomes cash flow negative and has to realise illiquid assets under time pressure	<p>Undertake a 3 year cash flow projection forecast during 2019 and develop an appropriate plan accordingly</p>	3	4	12	New risk.

3. Strategic Risks

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
3.1	Reputation risk with employers and members	Complaints are acted on immediately and monitored and reported to senior management. Group and senior management work hard to foster good relations with employers and members and provide a quality service.	2	2	4	None
3.2	Fund's reputational risk due to tPR data scoring	tbc	tbc	3	tbc	tPR have launched data scoring for all LGPS funds. This will allow comparison between funds to understand the quality of member data. This could lead to comparisons between funds and the associated reputational risk
3.3						

4. Hazard Risks

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Notes re Changes
4.1	Administration records corrupted or destroyed.	Office is subject to corporate and departmental disaster planning. Data back-ups are stored off site. The administration team has now digitally imaged all active and preserved member records.	1	5	5	None
4.2	Financial fraud	Scrutiny by internal and external audit processes. Comprehensive system of internal controls adopted by management. Fund manager reports of internal control are checked by Pension Fund staff.	1	4	4	Impact reduced from 5 to 4, impact at the level of individual fraud (the most likely form) would not be very high impact
4.3	Fire/flood/terrorism	Office is subject to corporate and departmental disaster planning. Data well backed up on a regular basis. Main investment data is held by the Fund's global custodian and available online.	1	5	5	None
4.4	Cyber-crime and other generic or targeted information security threats	The office is subject to the local authority's information security and information usage policies.	2	5	10	New risk

5. Operational Risks

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
5.1	Insufficient number of external contract service providers, therefore insufficient choice and consequent poor service	Usage of appropriate procurement processes to maximise choices. Regular monitoring of the service provider market.	2	4	8	Actions updated.
5.2	Poor communication	Feedback taken from scheduled and admitted bodies at the Fund's annual meeting. Variety of means employed for communication to members. Communication strategy is in place and adhered to.	2	2	4	None
5.3	Lack of succession planning	Staff levels are regularly monitored. Regular discussions take place as to the implications of future staff resignations and retirement.	5	4	20	Succession planning is pro-actively planned but staff turnover has been quicker than succession planning can work with. Likelihood increased from 2 to 5 and impact increased from 2 to 4.
5.4	Staffing levels failing to support required service delivery	Regular monitoring of the staffing position and the prioritization of recruitment and training.	5	4	20	Difficulty in recruitment and retention has been significant during the last year. Likelihood increased from 2 to 5 and impact increased from 2 to 4.
5.5	Failure to establish adequate ICT infrastructure.	Requirements are monitored continually. Data is "cleansed" before each actuarial valuation. The Pension Fund works closely with providers.	2	3	6	None
5.6	Inadequate user training	Training is monitored on a constant basis.	2	2	4	None

Ref	Risk Description	Mitigating Actions and Controls	How Likely	Impact	Net Risk	Changes
5.7	Increasing administration expenses (met from the normal contribution rate)	<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> <p>The Pension Fund Administration budget is subject to the Council's approval and monitoring process. Regular reports are monitored by officers.</p>	4	3	12	The fund has kept costs down whilst the complexity and the scale of the work required has increased. The need to meet governance and performance expectations requires greater resources. Likelihood increased from 2 to 4, impact increased from 2 to 3.
5.8	Other workload pressures and priorities of the Scheme Administrator impacting adversely on pension fund governance or administration	Ensuring that planning for pension fund governance and administration has regard to the financial capacity of the fund, and the expectations of the pensions regulator and Scheme Advisory Board and is planned based on the resources available to the Pension Fund.	4	4	12	New risk.