

# Local Pension Board

13 April 2021

## Risk Management 2012/22

### Recommendations

1. That the Local Pension Board notes and comments on the attached risk register.
2. That the Local Pension Board comments on the development of a formal Risk Appetite for the Fund.

### 1 Executive Summary

- 1.1 The Pension Fund maintains a risk register to manage the risks facing the Fund.
- 1.2 For the first time, during 2020/21, risk monitoring was reported quarterly to the Pension Fund Investment Subcommittee and the LGPS Local Pension Board as part of a wider set of actions to improve governance of the Fund.
- 1.3 The risk register for 2020/21 was set in February 2020, prior to the seriousness of Covid becoming apparent within the UK. A separate and specialist risk register was created in March, designed to focus on Covid related risks and actions.
- 1.4 A number of risks transpired during 2020/21, including the impact of Covid presenting challenges to business operations and business continuity, significant volatility in financial markets, and challenging governmental developments for example in respect of the McCloud remedy and the £95k cap on public sector exit payments.
- 1.5 For the coming year, the following changes and updates are proposed to the risk register:
  - **Consolidate to a single risk register** covering all risks, including Covid. This should provide the Fund with clarity around strategic risks allowing us to remain aware of and proactive about Covid issues, but at the same time be prepared for the broad spectrum of risk events. Covid appears as a distinct risk/line and appears as a driver/cause of other risks.
  - The set of strategic risks has been **reviewed fundamentally** rather than rolled on incrementally, to avoid risk management becoming habitual.

- The Fund is setting a **single action plan** for 2021/22, with all strategic actions located in one place. The single action plan is appended to the business plan (reported elsewhere on the agenda). Therefore, in the risk register, although further actions are bulleted, all actions have been housed either within the Single Action Plan, or within business-as-usual activity.
- The document is **designed to assess strategic risks**, and to ensure that appropriate high-level actions are in place to mitigate them. The risk register is not intended to be a detailed document to avoid it missing the big picture.
- The assessment of risk uses **a new model that includes five categories of likelihood and five categories of impact**. This will provide slightly more granularity and will be helpful when considering how residual risks change during the year.
- Likelihood and impact **scores are backed by definitions and examples**.
- A **draft assessment of a Risk Appetite** is set out for the Fund.

1.6 When monitoring risk, the fund will continue to look out for emerging and changing risks.

1.7 This risk register was reported to the Pension Fund Investment Subcommittee in March 2021. The sub-committee have agreed to the idea of developing a formal risk appetite for the Fund during 2021/22 and requested that the Covid risk line be split into two lines – one for investment and one for other Covid impacts, including impact on people. This change will be made before reporting risk monitoring in June.

## 2. Risk Appetite

2.1 At present, the fund maintains a risk register which sets out the risks that the fund is exposed to before and after mitigating actions. A risk appetite assists an entity in managing risk by articulating the levels of risk within which an entity aims to operate. This can be used to help to manage risk by focusing an entity on ensuring it avoids risks it does not have the appetite for, and while it does take risks that it does have the appetite for (to access the opportunities associated with taking those risks). This is summarised below:

<b>Description</b>	<b>Purpose</b>
Risk Appetite	The level of risk within which an entity <i>aims</i> to operate.
Risk Tolerance	The level of risk within which an entity is <i>willing</i> to operate if necessary.
Inherent Risk Score	Empirical estimate of the risks facing an entity, before having regard to any actions that the entity might take to mitigate them (also called “gross” risk).
Residual Risk Score	Empirical estimate of the risks facing an entity after having regard to any actions the entity has taken to mitigate them (also called “net” risk).

The table below sets out a widely used draft risk appetite classification (similar examples are set out in the Treasury Orange Book guidance on risk management):

<b>Risk Appetite</b>	<b>Risk Appetite Description</b>
Averse	Avoidance of risk and uncertainty is a key organisational objective
Minimalist	Uncertainty is to be avoided unless essential; only prepared to accept the possibility of very limited financial loss
Cautious	Tolerance for risk taking is limited to events where there is little chance of significant downside impact
Open	Tolerance for decisions with potential for significant risk, but with appropriate steps to minimise exposure
Hungry	Eager to pursue options offering potentially higher rewards despite greater inherent risk

2.2 The table below sets out a draft risk appetite at a high level. This is intended to illustrate risk appetite and promote discussion: it is not a definitive or an approved statement of risk appetite for the Fund.

<b>Risk Category</b>	<b>Description</b>	<b>Risk Appetite</b>
Administration - Member Services	Risk of failure to pay benefits or failure to maintain complete and correct data	Averse
Administration - Employer Services	Risk of failure to collect appropriate data or contributions from employers, or failure to have appropriate governance in place, for example having admission agreements in place and appropriate contribution rates calculated	Averse
Cashflow	Risk of inability to pay benefits due to members and other amounts due to third parties (e.g. capital calls)	Minimalist
Investment - Income and Protection Assets	Risk of failure to manage operating cashflows and failure to ensure assets match liabilities	Cautious
Investment - Growth Assets	Risk of failure to generate enough returns to meet future liabilities whilst minimising employer contributions	Open
Long term funding assumptions	Risk of failure to correctly estimate and therefore provide for future liabilities	Cautious
Governance	Risk of governance failure	Averse
Climate Change	The risk of causing an adverse effect on the environment	Cautious

2.3 The Fund will only choose to take risks that are expected to be appropriately rewarded, and to mitigate or avoid risks where this is not the case.

2.4 This draft sets out certain categories within which to consider risk appetite (risk appetite should be categorised in relation to appetite for risk, not in relation to risk experience), therefore the headings would not necessarily align

with the risk register.

- 2.5 If a Fund risk appetite is developed and approved, it could then be used to assess more formally whether the assessed residual risk levels are acceptable.
- 2.6 With respect to investment management and funding strategy, the Fund does remark on attitude to risk, and this informs Fund activity including actuarial assumptions and investment risk. However, the Fund does not currently consider risk appetite as such and does not consider risk appetite across all its activities including administration.
- 2.7 The Fund's Investment Strategy Statement was updated in March 2021 including significant updates in respect of the detailing of investment risks.
- 2.8 The Pension Fund Investment Sub-Committee have agreed to explore risk appetite further and develop a formal risk appetite statement for approval.

### 3 Risk Register

- 3.1 Risks are now assessed on a five-point scale across likelihood and impact, with impact weighted more than it was previously, as follows:

$$\text{Total Risk} = (\text{Likelihood} \times \text{Impact}) + \text{Impact}$$

- 3.2 Risks with a high impact / low probability should be prioritised because over a long time span low probability events are more likely to occur eventually.
- 3.3 The most important issue is that the risk register broadly captures the most significant strategic risks, it is less important that each score is completely accurate. There is an element of subjectivity to scoring because risk is, by its nature, to do with uncertainty. Likelihood definitions are set out below.

Score	Description		Likelihood of Occurrence
1	Highly Unlikely	The event may occur in only rare circumstances (remote chance)	1 in 8 + years
2	Unlikely	The event may occur in certain circumstances (unlikely chance)	1 in 4-7 years
3	Possible	The event may occur (realistic chance)	1 in 2-3 years
4	Probable	The event will probably occur (significant chance)	1 in 1-2 years
5	Very Likely	The event is expected to occur or occurs regularly	Up to 1 in every year

3.4 Appendix A sets out definitions for impact scores, including examples. These result in a scoring matrix as follows, which illustrates the increased emphasis on impact compared to likelihood:

<b>Impact</b>	Catastrophic	10	15	20	25	30
	Major	8	12	16	20	24
	Moderate	6	9	12	15	18
	Minor	4	6	8	10	12
	Insignificant	2	3	4	5	6
		Highly Unlikely	Unlikely	Possible	Probable	Very Likely
		<b>Likelihood</b>				

3.5 Appendix B sets out the new risk register (if printed on paper, this is designed to be printed on A3 paper). The headline risks and scores are summarised below:

Risk Identification		Inherent Risk Scoring			Residual Risk Scoring		
Risk No.	Risk Description	Likelihood	Impact	Risk Score	Likelihood	Impact	Risk Score
1	Long term asset values do not meet expectations	3.00	5.00	20.00	2.00	4.00	12.00
2	Short term asset values do not meet expectations	5.00	4.00	24.00	3.00	3.00	12.00
3	Liabilities cannot be met	2.00	4.00	12.00	1.00	4.00	8.00
4	Employer contributions not paid	4.00	3.00	15.00	3.00	3.00	12.00
5	Pooling objectives not met	3.00	3.00	12.00	2.00	3.00	9.00
6	Covid-19	5.00	5.00	30.00	3.00	4.00	16.00
7	Inability to meet demand for activity	5.00	3.00	18.00	4.00	3.00	15.00
8	Business interruption	4.00	4.00	20.00	3.00	3.00	12.00
9	Cyber Security	3.00	4.00	16.00	3.00	3.00	12.00
10	Climate Change	4.00	5.00	25.00	3.00	3.00	12.00
11	Customer satisfaction	3.00	3.00	12.00	3.00	2.00	8.00
12	Fraud	3.00	3.00	12.00	2.00	3.00	9.00
13	Governance Failure	3.00	4.00	16.00	2.00	4.00	12.00

## 4 Financial Implications

- 4.1 Several risks include financial risks and implications, where this is the case, these are addressed and reported on in specific reports as appropriate.

## 5 Environmental Implications

- 5.1 Climate risk is a key issue facing the fund in the longer term, and this is featured within the risk register.

## 6 Supporting Information

- 6.1 None.

## 7 Timescales Associated with Next Steps

- 7.1 Risk monitoring will be reported quarterly to both the Pension Fund Investment Sub-committee, and the Local Pension Board.
- 7.2 The Fund will do further work on developing a formal Risk Appetite for approval.

## Appendices

Appendix A - Definitions for Impact Scores

Appendix B - Risk Register

## Background Papers

None

	<b>Name</b>	<b>Contact Information</b>
Report Author	Chris Norton	chrisnorton@warwickshire.gov.uk
Assistant Director	Andy Felton	andrewfelton@warwickshire.gov.uk
Lead Director	Rob Powell	<a href="mailto:robpowell@warwickshire.gov.uk">robpowell@warwickshire.gov.uk</a>
Lead Member	Peter Butlin	<a href="mailto:cllrbutlin@warwickshire.gov.uk">cllrbutlin@warwickshire.gov.uk</a>

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

Local Member(s): None

Other members: N/a

## Definitions for Impact Scores

## Appendix A

Score	Description	Members and Employers	Investments and Funding	Administration
1	Insignificant	<p>Negligible impact - not noticeable by members or employers, no complaints or issues likely to be raised by members or employers.</p> <p>Example - Member or employer communication newsletter issued a few days later than planned.</p>	<p>Negligible impact - of a level that would not register for investment action.</p> <p>Example - Normal volatility levels being experienced in the investment portfolio.</p>	<p>Negligible impact - low level administrative issues resolved internally with no impact on key performance indicators</p> <p>Example - A manageable backlog of data to be uploaded to the administration system that has no impact on actual member payments.</p>
2	Minor	<p>Minor impact on members and/or employers which may cause correspondence about issues that can be resolved at source.</p> <p>Example - A member not being given the correct information first time when corresponding with the Fund and this having to be corrected, but having no impact on benefits paid</p>	<p>Minor impact on investment operations requiring monitoring and attention but not requiring anything other than business as usual actions.</p> <p>Example - minor adverse fund investment event, such as a credit default within a private credit portfolio which is of a business as usual nature.</p>	<p>Minor impact on administration performance requiring action within business as usual parameters.</p> <p>Example - an employer experiencing persist difficulty in providing correct data resulting in the need for extra training/support/correspondence to resolve</p>
3	Moderate	<p>Material adverse impact on members or employers that is of cause for concern to them and the Fund and requires escalation for non-business as usual resolutions</p> <p>More likely to be isolated issues but could have some scale.</p> <p>Example - Inability to finalise and sign off an admission agreement with a new employer resulting in escalation.</p>	<p>Material impact requiring bespoke corrective action, but manageable within the existing Investment Strategy</p> <p>Examples - Significant drift or step change in actual in asset allocation taking the Fund risk profile out of tolerances, or significant slippage in the implementation of a significant Fund transfer</p>	<p>Material impact on administration performance, but manageable within approved policies and procedures.</p> <p>Examples - Inability to agree a transfer of membership and liabilities from another fund, requiring arbitration by a third party, or disappointing data quality scores resulting in a need for an improvement plan.</p>
4	Major	<p>Significant adverse impact on members or employers that result in a direct impact on benefits paid or contributions due or member or employer satisfaction with Fund performance. Likely to result in complaints.</p> <p>More likely to be systemic issues.</p> <p>Examples - A significant delay in the issue of member annual benefit statements, or persistently charging an employer an incorrect contribution rate.</p>	<p>Major impact requiring significant corrective action and a change in Investment Strategy or Funding Strategy, or the significant sale of assets under distress. May result in noticeable changes to employer contributions.</p> <p>Examples - Major change in the world economic outlook, or in the present value of future liabilities requiring a change in strategy, or inability to implement a significant Fund launch.</p>	<p>Major failure of administration function, likely to be systematic in nature, of a high profile nature to members and employers.</p> <p>Example - Widespread and persistent failure to meet key performance indicators such as dealing with certain types of administration query or action within deadlines, and receipt of significant numbers of complaints from members.</p>
5	Catastrophic	<p>Serious and systematic errors in benefits payments or administration KPIs, or significant volatility or increase in employer contributions.</p> <p>Significant breaches of the law</p> <p>Serious complaints and reputational harm caused</p> <p>Example - Systematic failure to monitor employer contributions resulting in subsequent identification of a large number of contribution deficits that employers cannot then catch up with.</p>	<p>Resulting in significant volatility or increase in employer contributions, inability to pay member benefits, or a need to significantly increase investment risk exposure.</p> <p>Significant failure to meet legal or regulatory requirements.</p> <p>Serious reputational harm caused</p> <p>Example - Catastrophic deterioration in the ability of employers to pay contributions resulting in a need for emergency investment and cashflow measures in order to keep paying benefits.</p>	<p>Catastrophic failure of administration function leading to inability to pay benefits accurately or at all on a large scale.</p> <p>Significant breaches of the law</p> <p>Serious complaints and reputational harm caused</p> <p>Example - Wholesale failure of the pension payroll function resulting in no member payments being made.</p>