

Pension Fund Investment Sub-Committee

Risk monitoring

14 June 2021

Recommendation

1. That the Investment Sub-Committee notes and comments on the attached risk register.
2. That the Investment Sub-Committee notes and comments on the attached risk appetite statement.

1. Executive Summary

- 1.1 The Pension Fund maintains a risk register to manage the risks facing the Fund. This sets out the risks that the Fund is exposed to before and after mitigating actions.
- 1.2 The risk register is monitored quarterly by the Investment Sub-Committee and Local Pension Board.
- 1.3 The Fund updated its risk register ahead of the March 2021 Investment Sub-Committee to reflect the initial risk management position for business year 2021/22.
- 1.4 The document is designed to assess strategic risks, and to ensure that appropriate high-level actions are in place to mitigate them. Further actions relating to risks in the register are housed either within the Business Plan's Single Action Plan, or business as usual activities.
- 1.5 The assessment of risk uses a model that includes five categories of likelihood and five categories of impact backed by definitions and examples. This will be helpful when considering how residual risks change during the year.

2. Risk appetite

- 2.1 Risk Appetite 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 at the same time that it does take risks that it does have the appetite for (in order to access the opportunities associated with taking those risks).

- 2.2 The Fund had planned to conduct a risk workshop in April/May to undertake training on risk and to discuss and develop a risk appetite statement. Unfortunately, the event did not go ahead and the intention is to rearrange it during June or July. The commentary below provides a summary at a high level of risk appetite and an updated draft statement that will be used to help to inform the discussion and development of an approved statement.
- 2.3 The table below sets out a draft risk appetite classification based upon a widely used approach (for example similar examples are set out in the Treasury Orange Book guidance on risk management):

Risk Appetite	Risk Appetite Description
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

- 2.4 The table below sets out an updated draft risk appetite at a high level. As this is in the early stages of development, it is not a definitive or an approved statement of risk appetite for the Fund.

Risk Category	Description	Risk Appetite
Liability profile	Risk that actual benefit costs are higher than expected leading to increased contributions or investment risk to make up the shortfall. This includes higher inflation, increased longevity and changes to the composition of membership i.e. maturing fund	Minimalist
Governance	Actuarial, legal or investment advice is not sought, or is not heeded, or proves to be insufficient in some way. This includes Committee and officer skills, the decision-making structure and operational abilities.	Minimalist
Climate risk	Climate change affects liabilities (increased mortality), operational processes (physical disruption), and investment returns (pricing into company returns and covenant).	Cautious
Data	Administering Authority holds incorrect data so the Fund collects incorrect contributions and/or sets an inappropriate funding plan. This could impact the funding level.	Averse
Financial - Matching Assets (strategic)	Requirement to manage operating cashflows and ensure assets meet liabilities over the lifetime of the Scheme.	Cautious
Financial - Non-matching Assets	Requirement to generate enough returns to meet future liabilities whilst minimising employer contributions.	Open

(implementation)		
Regulatory	Changes by Government to LGPS rules e.g. employer participation, altered requirements. Also includes direct intervention. Could impact on funding and/or investment strategies	Averse
Administration	Pensions Act/GDPR or other breaches as a result of process risks around holding data, in particular member data.	Averse

3. Risk register

3.1 The Pension Fund maintains a risk register to manage the risks facing the Fund. This sets out the risks that the Fund is exposed to before and after mitigating actions.

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

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

3.3 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.

3.4 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

3.5 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:

3.6 Appendix B sets out the 2021/22 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	3.00	18.00	3.00	2.00	8.00
3	Liabilities cannot be met	2.00	5.00	15.00	1.00	5.00	10.00
4	Employer contributions not paid	3.00	3.00	12.00	2.00	2.00	6.00
5	Pooling objectives not met	3.00	3.00	12.00	2.00	3.00	9.00
6a	Covid-19 - Inv	5.00	5.00	30.00	4.00	3.00	15.00
6b	Covid-19 - Admin	5.00	5.00	30.00	4.00	3.00	15.00
7	Inability to meet demand for activity	5.00	3.00	18.00	4.00	3.00	15.00
8	Business interruption	3.00	4.00	16.00	2.00	3.00	9.00
9	Cyber Security	4.00	5.00	25.00	3.00	4.00	16.00
10	Climate Change	5.00	5.00	30.00	4.00	4.00	20.00
11	Data Quality	3.00	3.00	12.00	2.00	2.00	6.00
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	3.00	9.00

3.7 Risk scores and actions have been reviewed and some scores have been changed since Quarter 1. No individual impact or likelihood score has moved more than one point in either direction. Appendix B details each risk, and changes in commentary are highlighted in red font in the appendix. Key changes are summarised below:

- **Short term asset values** – slightly lower impact scores. The Fund has experience of managing Covid related cashflow risk and has not experienced any need to sell assets under distress.
- **Liabilities cannot be met** – refined (increased) impact score.
- **Employer contributions not paid** – refined (reduced) scores in light of experience to date since the Covid pandemic started.
- **Covid 19** – this risk is now split into 2 risks – investment related and administration/people related. Net risks adjusted – likelihood being higher (Covid is happening) and impact being lower (in light of

experience to date with regard to managing Covid impacts).

- **Business Interruption** – reduced likelihood in light of experience of dealing with Covid.
- **Cyber Security** – risk scores increased - this is considered a key Fund risk and the score has been refined to this end.
- **Climate Change** - risk scores increased - this is considered a key Fund risk and the score has been refined to this end.
- **Data Quality** (re-titled – was previously Customer Satisfaction) – title changed to better reflect the risks this relates to. Customer satisfaction is still flagged but now as a consequence of data quality and governance risks. Net risk assessment is lower risk as Fund activities do reduce the likelihood of an issue and the previous register did not capture this in the scores.
- **Governance Failure** – risk score reduced – activities to mitigate this risk should mitigate impact and this was not captured in the previous scores.

3.8 The fact that the scores have been reviewed in some detail is a positive sign, illustrating how consideration of risk is an increasingly high-profile aspect of the management of the fund. However, the most important issue is to ensure that key risks are broadly captured and that management actions to deal with risks are appropriate.

4. Financial Implications

4.1 A number of 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 the decision and next steps

- 7.1 Risk monitoring (risk register and risk appetite statement) will continue to be reported quarterly to both the Pension Fund Investment Sub-Committee and the Local Pension Board

Appendices

Appendix A - Definitions for Impact Scores

Appendix B - Risk Register

Background Papers

None

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

Local Member(s): None

Other members: Councillors Horner & Gifford

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>