

# **Pension Fund Investment Sub-Committee**

## **Risk Monitoring**

13 December 2021

### **Recommendation**

1. The Pension Fund Investment Sub-Committee notes and comments on the report.

### **1. Executive Summary**

- 1.1 This report provides an update on the risks facing the fund and management actions to address them.
- 1.2 At the last meeting of the Sub-Committee, a risk appetite was agreed for the fund, this is reproduced for reference at Appendix 1. In summary the Fund has a relatively higher appetite for risk in respect of certain investment objectives where exposure to risk is required in order to access exposure to certain investment outcomes, and has a lower appetite for risk for example in terms of regulatory, data, and administration matters.
- 1.3 Fund officers have reviewed the risks facing the fund, and have updated the risk register with actions and revisions as appropriate. Appendix 2 and 3 reproduce the criteria for scoring risks, Appendix 4 provides an updated risk register. Any updates to the commentary in the risk register since the previous report to the Sub-Committee are presented in red font.
- 1.4 The net risks facing the Fund after having regard to existing management actions are summarised in a new pictorial format in Chart 1 on the following page. This follows feedback received on the Quarter 1 risk report. Comments are invited on this format.
- 1.5 The arrows highlight where risk scores have been amended since the previous report. The changes are:
  - 1.5.1 Long term investment risk likelihood is higher due to developments and uncertainties around inflation.
  - 1.5.2 Covid administration and people risk is lower in light of experience of managing Covid.

Chart 1 – Net Risk Summary

Impact	Catastrophic	3. Financial mismatch				
	Major		9. Cyber security	1. Long term market risk 10. Climate change		
	Moderate	5. Pooling objectives not met 8 Business interruption 12. Fraud	6b. Covid (administration and people related) 13. Governance failure	6a. Covid (investment related) 7. Inability to meet demand for activity		
	Minor	11. Data quality	2. Short term market risk 4. Employer risk			
	Insignificant					
		Highly Unlikely	Unlikely	Possible	Probable	Very Likely
		Likelihood				

1.6 Management action updates include:

1.6.1 Activities to increase capacity: tendering for the second independent investment advisor contract and progressing a business case regarding internal investment and accountancy capacity.

1.6.2 Activities relating to cyber security: testing our systems and planning audit activity.

1.6.3 Recruiting to the Local Pension Board vacancy.

## 2. Financial Implications

2.1 None.

## 3. Environmental Implications

3.1 Climate risk is identified as a key risk (Risk 10).

## 4. Supporting Information

4.1 None.

## 5. Timescales associated with the decision and next steps

5.1 This iteration of the risk register will also be reported to the next Local Pension Board for review.

## Appendices

1. Appendix 1 – Risk Appetite
2. Appendix 2 – Risk Scoring Convention and Likelihood Definitions
3. Appendix 3 – Risk Impact Definitions
4. Appendix 4 – Risk Register

## Background Papers

1. None.

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

Local Member(s):

Other members:

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 (implementation)	Requirement to generate enough returns to meet future liabilities whilst minimising employer contributions.	Open
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 because of process risks around holding data, in particular member data, but also asset administration and the Pension /Fund's payroll.	Averse

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

### Scoring Convention

Risks are assessed on a five-point scale across likelihood and impact, with impact weighted as follows:

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

Risks with a high impact / low probability are therefore more highly prioritised because over a long time span low probability events are more likely to occur eventually.

### Likelihood Definitions

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

## Impact Score Definitions

## Appendix 3

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>