Pension Fund Panel

13 December 2018

Pension Fund Risk Register

Report by Head of Investment, Risk and Commercial Finance - Resources

Purpose

To update the Panel on the review of the Fund's Risk Register and seek approval for the approach to managing the key risks.

Recommendation

To **note the** Pension Fund risk register and endorse the actions in place to mitigate the key risks.

Key Points

A. The Fund has a range of measures in place to manage the various risks affecting its operation and management.

B. This report updates the Panel on the latest review of the Fund's risk register.

Context

1. The Fund has a range of arrangements in place to manage the various risks affecting its operation and management. Historically, these were managed operationally, and documented in the Fund's various publications (eg the Annual Report, Funding Strategy Statement, Statement of Investment Principles etc).
2. As the focus on Fund Governance matters generally has increased, notably (but not solely) with the introduction of the Pensions Regulator, it is considered best practice for each Fund to manage and monitor its approach to dealing with these risks through a single risk register.
3. The risk register has been recently reviewed and updated with a focus on consolidating risk lines, removing risk lines that are no longer applicable or represent day to day administrative tasks related to the fund as opposed to risks that need to be overseen and mitigated.
4. The latest version of the updated Risk Register is attached at **Annex 1 (Exempt).**

Risk Management Approach

5. In developing the risk register, officers have followed RBK's methodology for managing risks - categorising each risk by reference to its likelihood (scored 1 to 5) and impact (1 to 5). The risk score is given by multiplying the impact and likelihood scores together (eg a likelihood of 2 and an impact of 4 would give a risk score of 8).

6. A RAG (red / amber/green) rating is then applied, as follows:
   - Risks with a score of 20 or 25 are ranked as Red Risks - these require immediate action and monitoring;
   - those with a score of 12 to 16 are ranked amber - they require action and monitoring but are less time critical,

- Risks with a score of 0 to 10 are ranked “green” - they do not require immediate attention

7. The 28 identified risks have been categorised under four main headings
    - Liabilities (4 risks)
    - Funding Strategy (2 risks)
    - Investments (5 risks)
    - Governance and Administration (14 risks)
    - Scheme Employers (3 risks)

8. It should be noted that it is not possible to treat some risks directly - for example those relating to the global economy - however various strategies can be put in place to mitigate the impact of these.

Key Risks

9. Currently there are no red risks. There are seven amber risks - these are detailed in the following paragraphs, together with an indication of the actions being taken to mitigate their impact.

10. <u>Risk 1 - Economic - Liabilities - *impact of unfavourable trends in interest rates, bond and gilt yields.*</u>
It is not possible to treat this risk - movements in long term interest rates / yields are outside of the Fund’s control. However these rates drive the discount rate used to calculate the present value of the Fund’s liabilities. Their significance (in terms of the impact of a small change in rates) is demonstrated by the sensitivity analysis in the Fund Actuary’s most recent (2016) triennial valuation report. That document indicated that a 0.5% reduction in the discount rate would increase the Fund’s liabilities by £65m (8.2%). Conversely, an increase in interest rates / yields would reduce the Fund’s liabilities. A significant adverse movement in forecast long-term rates, would have a marked impact on liabilities, and hence the funding level. This in turn would impact on employer contribution rates. To mitigate the impact of this risk, the funding position is monitored on a half-yearly basis, and is used to inform the investment strategy / asset allocation accordingly. Appropriate stabilisation mechanisms are in place for setting employer contribution rates.

11. <u>Risk 4 - Financial - Liabilities - Mortality / Longevity - *impact of increase in pensioners’ life expectancy.*</u>
It is not possible to treat this risk, as the Fund has no control over its members’ life expectancy. An increase in life expectancy would in turn increase the Fund’s liabilities, as pensions would be paid for longer. The sensitivity analysis in the Fund Actuary’s most recent (2016) triennial valuation report indicated that an increase of 1 year in life expectancy would increase the Fund’s liabilities by £19m (2.4%). The Fund seeks to mitigate the risk through the actuary’s analysis and use of up-to-date statistical evidence of mortality.

12. <u>Risk 7 - Economic - Investments - *market volatility / falls in investment market values.*</u>
It is not possible to treat this risk, as the factors which influence market volatility are beyond the Fund’s direct control. Measures in place to mitigate the impact of market

volatility are the diversification of the Fund investments across a range of asset classes, and the use of investments which have a high level of liquidity. Cash and other assets held by investment managers and the custodian are in ring-fenced client accounts.

13. Risk 8 - Economic - Investments - *impact of unfavourable trends in interest rates, bond and gilt yields.*
It is not possible to treat this risk since movements in interest rates / yields are outside the Fund's control. This risk arises as an increase in interest rates will reduce the underlying market value of the Fund's bond assets (target allocation is 15% of the investment portfolio). The measure in place to mitigate this risk is that the allocation of approximately a third of the bond portfolio is allocated to an absolute return vehicle.

14. Risk 9 - Financial - Investments - *impact of investment managers failing to meet their return targets.*
It is not possible to treat this risk directly as managers' returns will be driven partly by the underlying markets in which they invest (benchmark indices), and in the case of active managers by their stock selection. Measures to mitigate this risk are the diversification of managers as well as asset classes (eg the Fund has 3 equity managers and 4 DGF managers, and the approach of each differs from the others in its asset class), and regular monitoring of managers' performance. The Investment Strategy / strategic asset allocation is driven by the return target required by the underlying valuation assumptions.

15. Risk 14 - Employment - Governance and Administration - *increased workload and under-resourced service / lack of expertise.*
This continues to be a risk given the specialist nature of the roles connected with the pension fund.

A key factor in the reduced level of risk was the successful recruitment process undertaken by the shared service, and the ongoing training and succession planning. The risk arose partly because of the workload - the impact of financial and other pressure on employers (which in turn leads to increased workloads for the administration team arising from staffing restructures, redundancy exercises or outsourcing of functions) , and partly from regulatory and other changes required by central government. These factors continue to cause a high level of demand into the service with exceedingly high levels of work that have fallen outside of timescales. However, priority cases (retirements, deaths, transfers) are being actively managed and further mitigation measures include ensuring sufficient staff are retained to cover this workload and recruiting additional (temporary) capacity as required.

16. Risk 21 Information - Governance and Administration - *failure to maintain accurate and up to date records.*
The impact of this risk is that there could be delays in producing statutory accounts, as well as impacting on scheme members (via delayed or inaccurate payments being made) and on investment process. Mitigation is through appropriate validation checks, data transfer and reconciliation processes between various systems and regular audit reviews. The risk remains rated amber. This is because of the issues highlighted in the external audit report on the 2015-16 accounts though there was a improvement in 2016-17 and potential risk through staff changes as part of the

introduction of the new finance shared service. Mitigation action is through robust handover arrangements and management oversight.

Future Actions

17. In accordance with the arrangements previously approved by the Panel the risk register will be reviewed on an ongoing basis, and kept up-to-date as risks are monitored through the various workstreams. The Panel will receive half-yearly updates as a minimum - if any additional amber or red risks are identified these will be reported to the earliest available Panel meeting.

Background papers
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None other than those referred to in this report