

Pensions Audit Sub Committee

2.30pm, Tuesday, 16 December 2014

Risk Management

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

The pension funds' risk management procedures require us to:

- (i) maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and our action to mitigate these risks (the **"Operational Risk Register"**); and
- (ii) produce a summary report of the risk register for the Pensions Committee and the Pensions Audit Sub-Committee which highlights the material risks facing the pension funds and identifies any new risks/concerns and the progress being made over time by the officers in mitigating the relevant risks (the **"Quarterly Risk Overview"**).

The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub-Committee.

The Quarterly Risk Overview, as at November 2014, is set out in the appendix to this report.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Report

Risk Management

Recommendations

- 1.1 Committee is requested to:
- note the Quarterly Risk Overview; and
 - highlight any points it wishes to raise at the Pensions Committee on 17 December 2014.

Measures of success

- 2.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Pensions Committee and Pensions Audit Sub-Committee should increase general awareness and allow productive analysis/feedback by the Pensions Committee/Audit Sub-Committee members on these fundamental issues.
- 2.2 Ultimately, risk management should lead to less third party exposure, an improved financial position and have a positive impact on the reputation of the pension funds.

Financial impact

- 3.1 There are no direct financial implications as a result of this report.

Risk, policy, compliance and governance impact

- 4.1 Please see the Quarterly Risk Overview appended to this report.

Equalities impact

- 5.1 None.

Sustainability impact

- 6.1 None.

Consultation and engagement

- 7.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None.

Alastair Maclean

Director of Corporate Governance

Contact: Struan Fairbairn, Legal and Risk Manager

E-mail: Struan.Fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

Links

Coalition pledges

Council outcomes CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

Single Outcome Agreement

Appendices Appendix 1 - Quarterly Risk Overview, as at November 2014

QUARTERLY RISK OVERVIEW

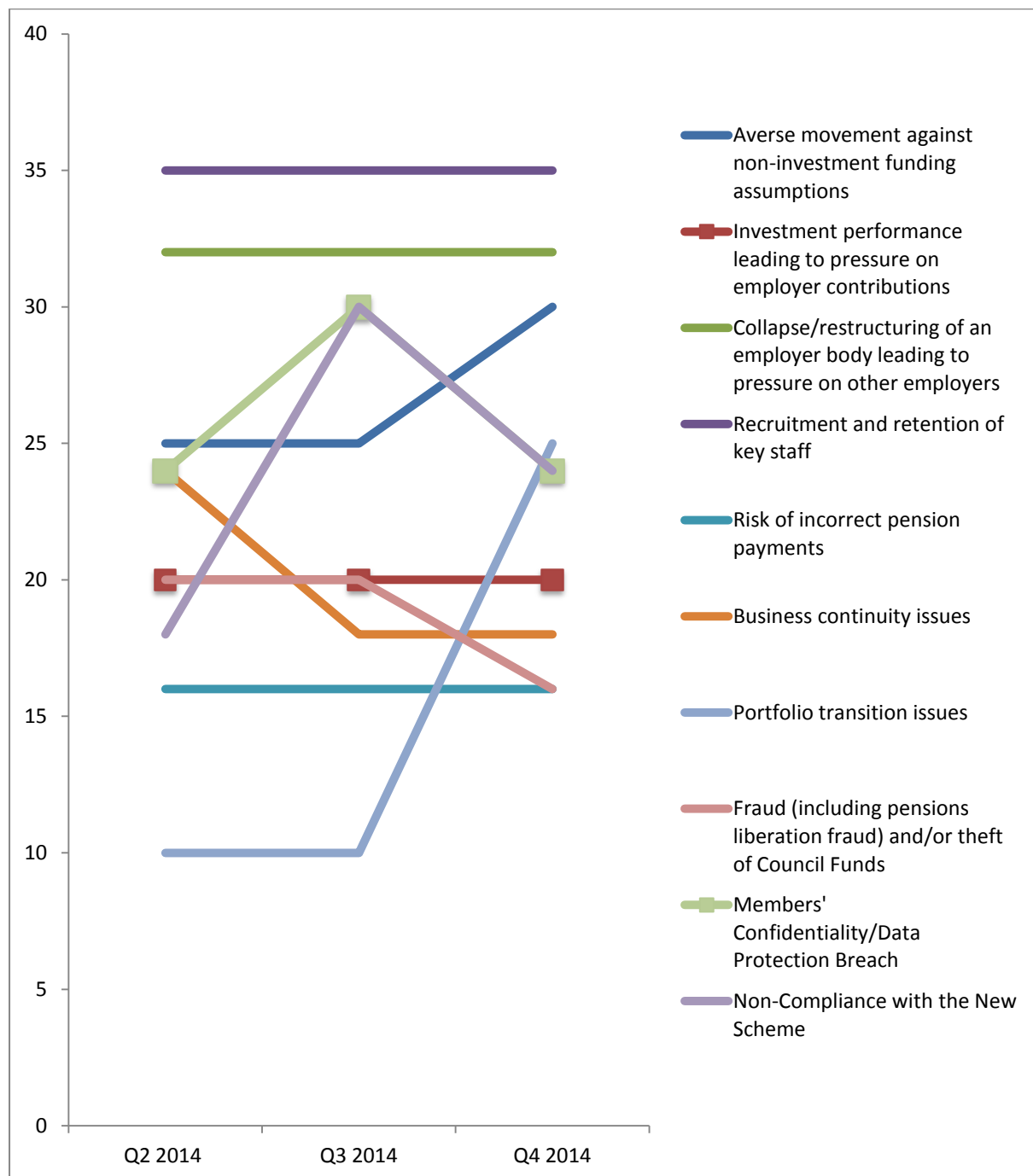
November 2014

UPDATE ON MOST NOTABLE RISKS

Risk	Update
Investment performance leading to pressure on employer contribution	The new lower volatility investment strategy continues to be implemented to mitigate this risk and more detailed reporting on the Investment Strategy has been produced for the Pensions Committee.
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	Progress continues to be made on the 2014 actuarial valuation and experience against funding assumptions and employer contributions are being assessed as part of this process.
Collapse/restructuring of an employer body leading to pressure on other employers	We have concluded our covenant analysis and will look to prioritise the actions arising from this and implement them accordingly. The employers are being made aware of their results as part of the 2014 valuation and we will look to build on this analysis and continue to monitor employer covenant on an ongoing basis.
Recruitment and retention of key staff	<p>This risk remains high as the agreed steps to mitigate the risk associated with the Investment function continue to be implemented and, separately, there have been a number of key departures from the Pensions Administration and Employer Relations teams. In the meantime, contingency plans have been considered for the internal investment portfolios in the event of significant staff turnover.</p> <p>We are also looking to recruit a newly qualified solicitor to provide appropriate cover and continuity for the Legal & Risk function in anticipation of our having to meet increased compliance requirements in advance of FCA authorisation.</p>
Risk of incorrect pension payments	Progress to achieve full integration/automation to reduce reliance on manual intervention in some processes is ongoing and is expected to complete in Q1 2015. The risk therefore remains static for now, but once appropriate solutions are implemented and internal audit have reviewed the processes, we would anticipate this risk being further reduced to the extent that it would not be worthwhile highlighting to the Committee.
Members' Confidential Data is lost or made public / breach of Data Protection Act	We are continuing to liaise with the Council's ICT and Data Protection teams regarding our systems and processes and initial feedback has been that our systems and processes are robust and fit for purpose. This risk has been reduced to reflect the work that has been done in reviewing our systems and controls and recognising that there have been no subsequent Data Protection breaches.

Fraud (including pensions liberation fraud) and/or theft of pension fund monies	We have received several responses from Action Fraud confirming that a number of the potentially fraudulent schemes we have highlighted concerns about are now under formal investigation. We have also been provided with the details of a direct contact at Action Fraud, which will greatly assist our ability to deal with these matters more quickly and provide our members with greater certainty in transfer-out processes that are reviewed with such concerns in mind. The risk of our being approached by fraudulent schemes continues, but we have lowered the overall risk here to reflect the fact that schemes are now being prosecuted/closed-down by Action Fraud and that we are better placed to make informed decisions in relation to cases that do arise.
Adverse assumptions leading to pressure on employer contributions; Fraud.	We continue to closely monitor the levels of transfers-out to determine whether there will be an increase in light of increased flexibility in Defined Contribution (DC) pensions and the decision to allow transfers from the LGPS to Defined Contribution schemes. This could have implications for funding and cash-flow and investigations on the potential implications will be taken forward.
Breach of Contract	The initial contract review has been completed and has not identified any material concerns. However, we are in the process of refining our review and so this risk should remain static until that process has been completed. We anticipate that this risk should be significantly reduced once this review has been completed.
Business continuity	Heywood Limited has outsourced the provision of the disaster recovery services to Blue Chip Limited and we await the results of the annual disaster recovery test, due to take place in November 2014 and Heywoods confirmation of their own assessment of Blue-chips systems. This risk should therefore remain static until this information has been received.
Non-compliance with the new LGPS Scheme in Scotland / Public Service Pensions Act 2013	Benefit regulations have been finalised. Implementation of the systems required to administer the new scheme remain challenging but manageable. The timetable for producing the regulations for the governance of the new scheme is challenging. We and the other Scottish administering authorities have raised concerns around the competency of the current draft regulations regarding the governance of the new scheme and await feedback from the consultation process. Progress to implement the required changes will be made in the coming months.
Portfolio Transition	Plans are being put in place to transition two investment portfolios to further implement the new investment strategy. The risk on the register has been increased reflecting the additional workload and issues involved. Following successful implementation, the risk will be reduced.

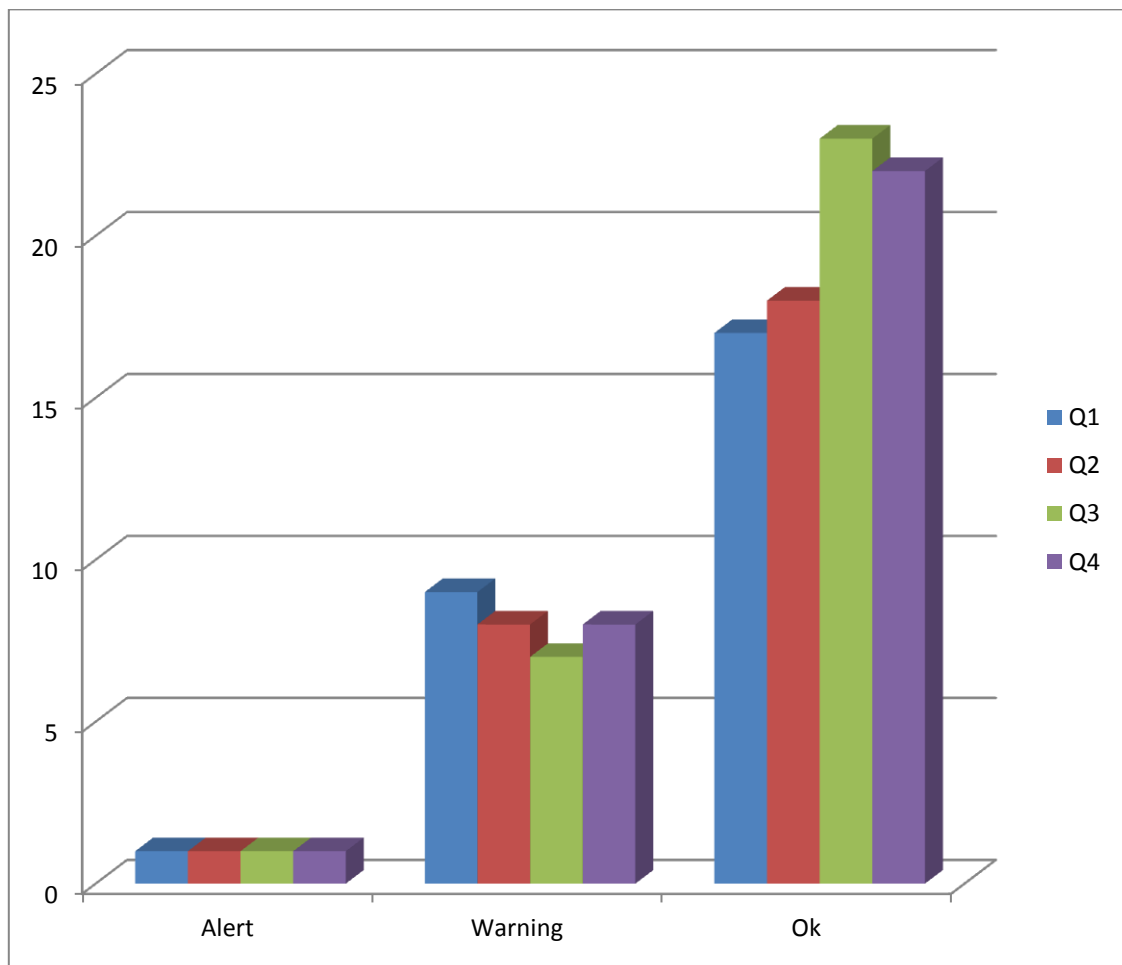
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



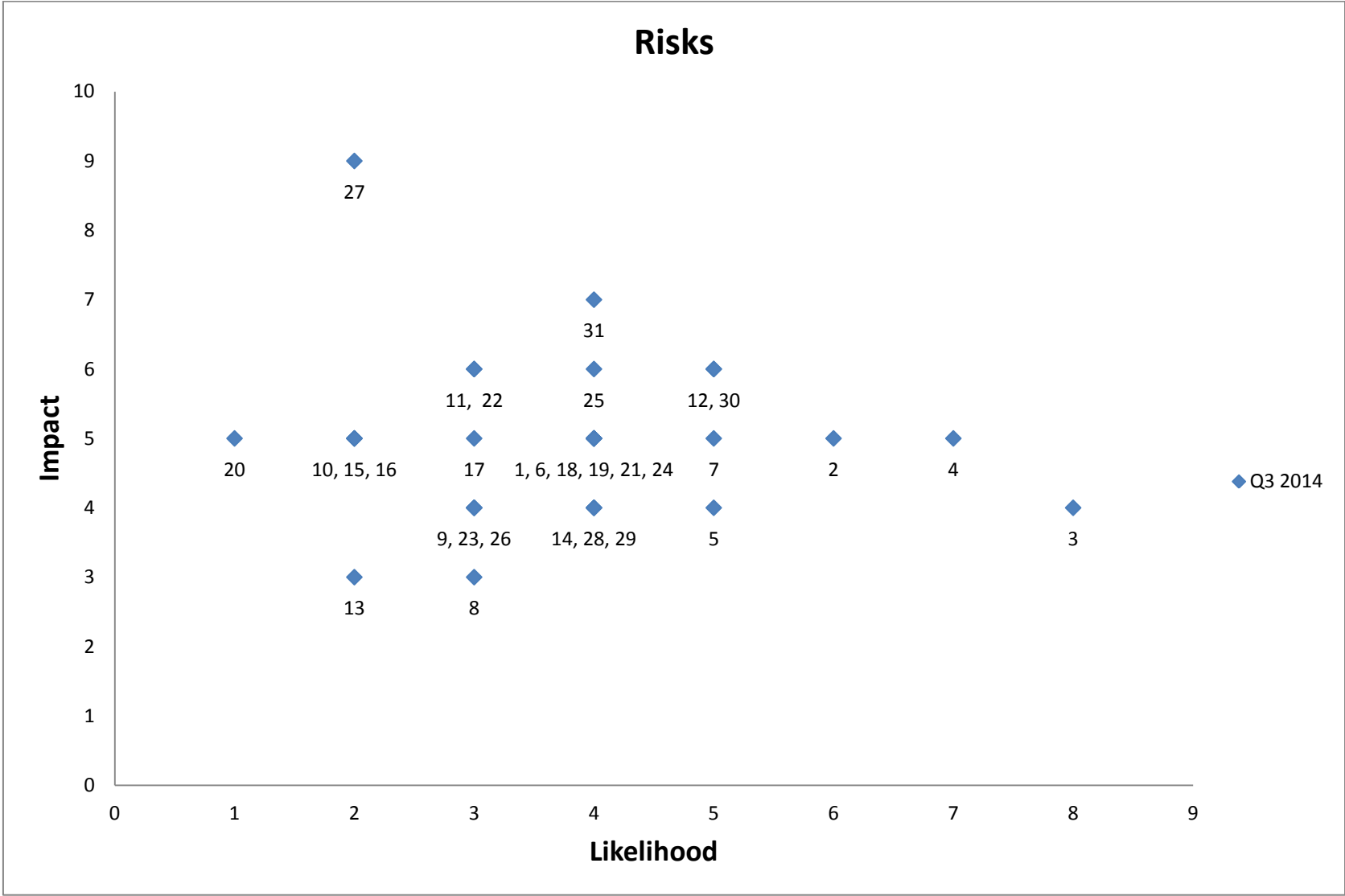
OTHER KEY POINTS

	Comments
New significant risks	None
Other new risks	We are currently monitoring the resource within the division to ensure that key project receive sufficient and dedicated time.
New controls	Additional HR resource is in place for FCA and Staffing project.
Eliminated risks	None
Notable initiatives / actions	<p>Following Council approval on 23 October 2014, progressing continues with the establishment of a Council controlled structure for the purposes of facilitating FCA authorisation and to mitigate the identified staffing risk.</p> <p>The arrangement with Falkirk Council will shift from a services arrangement to a pooled secondment arrangement in December 2014 which will reduce the risk to Lothian Pension Fund, subject to Council approval.</p> <p>Initial outcomes of the employer covenant review are being shared with guarantors and used as part of the 2014 actuarial valuation.</p> <p>The National Framework for Legal Services has now been completed, providing LPF with enhanced and more streamlined access to specialist legal firms in the pensions and investment sectors.</p>
Material Litigation	None.

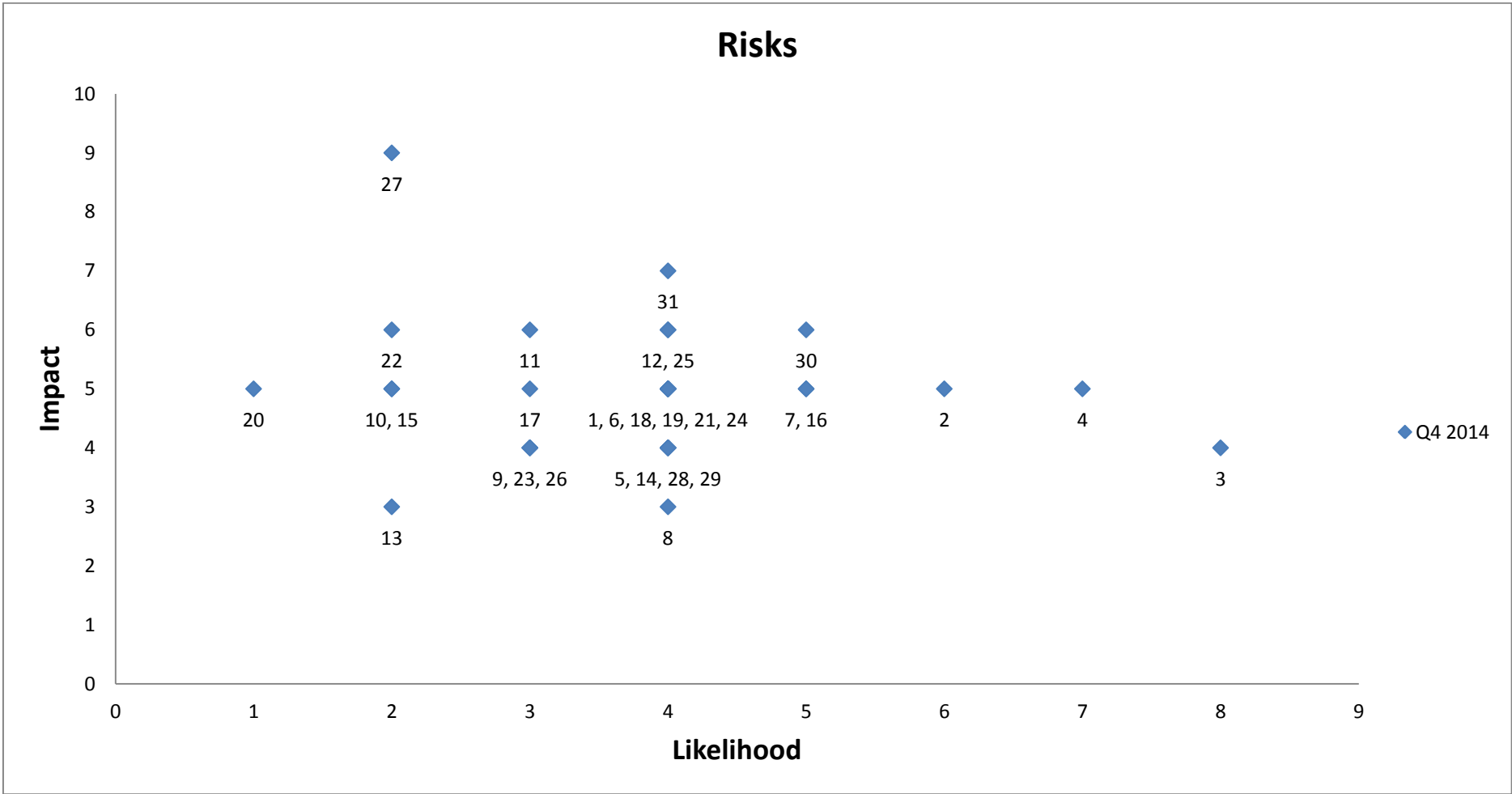
All Risks: Status Overview



Q3 (2014) All Risks: Impact and Likelihood Overview



Q4 (2014) All Risks: Impact and Likelihood Overview



Key: Risks by Number

1	Investment Performance pressure on employer contributions	15	Market abuse by investment team
2	Adverse Movement - pressure on employer contributions	16	Portfolio transition issues
3	Collapse of an employer	17	Disclosure of confidential information
4	Retention of key staff	18	Material breach of contract
5	Fraud or theft of Council/Pension Fund assets	19	Regulatory breach
6	Staff negligence	20	FOI process in accordance with law
7	Failure of IT systems	21	Incorrect communication with members
8	Employers HR decisions without consideration of fund	22	Not acting in accordance with proper authority/delegations
9	Elected members take decisions against sound advice	23	Inappropriate use of pension fund monies
10	Failure to complete annual accounts	24	Procurement/framework breach
11	Business continuity issues	25	Non-compliance with the new LGPS
12	Members' confidential data is breached	26	Claim or liability arising from shared services
13	Loss due to stock lending default	27	Late Payment of Pensions
14	Risk of incorrect pension payments	28	Unauthorised access to PensionsWEB
29	Limited or incorrect data from Employers	30	Receiving services without adequate contractual protection
31	Over-reliance on single service provider		