

# Pensions Committee

2.00pm, Tuesday, 12 December 2017

## Risk Management Summary

Item number	5.6
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### Executive Summary

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In line with the pension funds' ongoing risk management procedures, this paper provides an overview of the Fund's risk analysis for consideration by the Committee.

## Risk Management Summary

### 1. Recommendations

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Committee is requested to:

- 1.1 Note the Quarterly Risk Overview.

### 2. Background

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- 2.1 The pension funds' risk management procedures require the Fund to:
  - 2.1.1 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
  - 2.1.2 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").

### 3. Main report

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- 3.1 The Operational Risk Register is issued to the conveners of the Pensions Committee and the Pensions Audit-Sub Committee and the Independent Professional Observer on a quarterly basis.
- 3.2 The Quarterly Risk Overview, as at 7 November 2017, is set out in the appendix to this report for consideration.

### 4. Measures of success

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- 4.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Committee should increase general awareness and allow productive analysis/feedback by the Committee members on these fundamental issues.
- 4.2 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.

## **5. Financial impact**

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

## **6. Risk, policy, compliance and governance impact**

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6.1 Please see the Quarterly Risk Overview appended to this report.

## **7. Equalities impact**

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7.1 There are no equalities implications as a result of this report.

## **8. Sustainability impact**

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8.1 There are no sustainability implications as a result of this report.

## **9. Consultation and engagement**

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9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

## **10. Background reading/external references**

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10.1 None

### **Stephen S. Moir**

Executive Director of Resources

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## **11. Appendices**

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

Appendix 1 – Quarterly Risk Summary, as at 7 November 2017








## QUARTERLY RISK OVERVIEW

7 November 2017

### UPDATE ON MOST NOTABLE RISKS

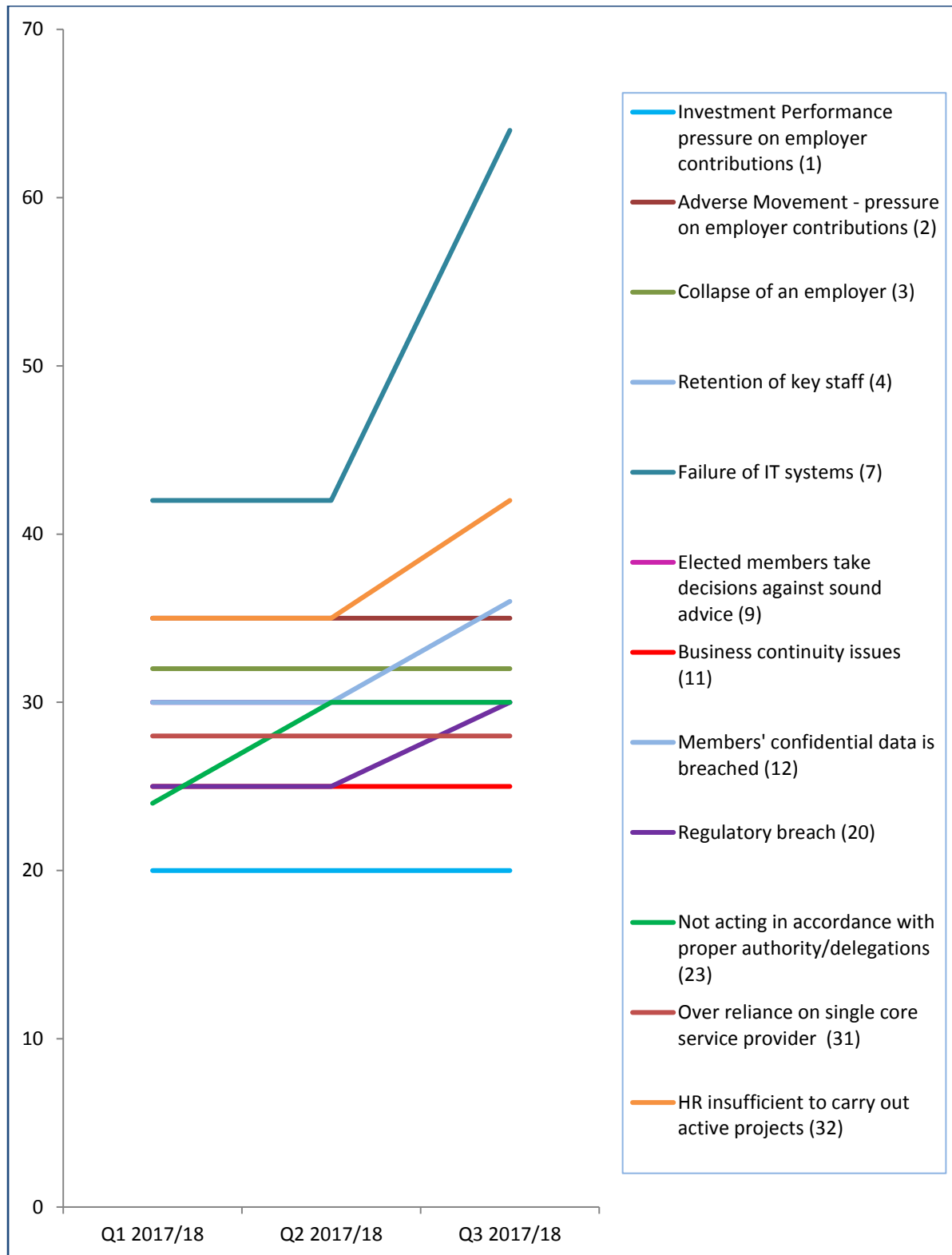
Risk & Reference Number	Update	Trend / RAG
<b>Adverse Investment performance leading to pressure on employer contribution (1)</b>	Implementation of the Lothian Buses Pension Fund strategy is being planned with the Investment Strategy Panel, together with the review of the merger of the Fund with Lothian Buses Pension Fund. Consultation with Employers on the Funding Strategy Statement is underway and the third Investment Strategy will be implemented on 1 April 2018.	<b>Static</b> 
<b>Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)</b>	The 2017 actuarial valuation is in progress with the results of the LPF valuation being presented to employers on 2 November 2017. LBPF and SHPF results are awaited and employer consultation will follow. The contribution stability mechanism will be reviewed again in advance of the 2020 valuation.	<b>Static</b> 
<b>Collapse/restructuring of an employer body leading to pressure on other employers (3)</b>	The funding approach introduced in the 2014 actuarial valuation for employers close to exiting reduces the overall risk to the Fund and the other employers. The Fund continues to engage with a number of smaller employers regarding the potentially adverse financial impact of the revised funding strategy and to implement the outcomes from the appeals process and the Pensions Committee decision in this regard. Funding Agreements for payment of cessation debt are now in place with most of the appellants, and the few remaining are in the process of being finalised. Where appropriate, the Fund will be pursuing guarantees and securities from the employers and updated admission agreements in order to further mitigate this risk.	<b>Static</b> 

Risk & Reference Number	Update	Trend / RAG
<p><b>Recruitment and retention of key staff (4)</b></p>	<p>The Fund continues to assess resourcing in light of future collaborative initiatives and the increasingly complex nature of the its business. The Fund is also continuing to closely monitor, in the shorter term, the impact on senior management resource during the negotiation and implementation of these wider collaborative initiatives in addition to increasing levels of business as usual.</p> <p>The Bond Portfolio Manager post has been vacant since March 2017. The management team continues to engage with the LPFE Limited (<b>LPFE</b>) board on this specifically and as part of the wider review. A Human Resource consultant has been appointed to support LPFE to more effectively recruit and generally to build the Fund’s profile in the market.</p> <p>The Fund’s management team are also engaging with the LPFE board as part of the HR relaunch to coincide with all LPF’s staff being employed within LPFE following the phase 2 transfer. Unfortunately, due to operational issues, the Fund has required to delay the transfer of Phase 2 staff until these have been sufficiently addressed. Phase 2 staff will therefore continue to be employed by, and paid by, the City of Edinburgh Council until such time as the transfer is completed. The intention is to do so as soon as possible.</p> <p>The Fund continues to be aware of external interest in its team from LGPS investment pools setting up south of the border, external managers and consultants.</p> <p>Leslie Robb, the non-executive director of LPFI Limited (<b>LPFI</b>) is also to be appointed as a non-executive director of LPFE in order to support the work of that body, provide best practice governance and act as an independent link between LPFI and LPFE’s activities and separate responsibilities within the group.</p>	<p>Increase</p> 
<p><b>Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications (7)</b></p>	<p>The Fund continues to experience delays and service disruption. It continues to liaise directly with CGI to ascertain options around it having a separate service arrangement to allow for it to have an IT service provision tailored to the Fund’s requirements, as well as continuing to notify CGI on delays and disruptions experienced. An improvement plan is being discussed with CEC’s Head of ICT as the senior contract owner for the service.</p> <p>Due to the issues described, the Fund continues to experience problems with the Redbox call recording system, which also continues to be pursued as a priority.</p> <p>More specific details of the IT systems will be presented to the Audit Sub Committee as part of its more detailed review of the risk review this quarter. Due to the potential impact of these issues and the lack of progress in addressing them this risk has been raised.</p> <p>As described above, an alternative HR &amp; Payroll system for LPFE staff payroll is being sought as a matter of urgency.</p>	<p>Increase</p> 

Risk & Reference Number	Update	Trend / RAG
<p><b>Elected member take decisions against sound advice (9)</b></p>	<p>The Fund continues to receive an increasing number of queries or approaches regarding both its investments and on other socio-economic and environmental matters, most recently including a petition to the wider Council. The risk therefore remains on warning given the extent of these approaches and their converging with the introduction of several new members to the Pensions Committee and Pension Board.</p> <p>The Fund will also commence the procurement process for a new Independent Professional Observer, as the current Observer, Sarah Smart's contract will cease at the end of February 2018.</p>	<p>Static</p> 
<p><b>Business continuity issues (11)</b></p>	<p>The Fund's business continuity plan has been updated and testing of the plan took place in October 2017 with the help of the City of Edinburgh Council's resilience team. The Fund is also ensuring that home-working and relevant health and safety procedures are adhered to across the board and, where necessary, continue to be enhanced in line with current practice.</p> <p>Internal Audit is finalising a report on the business continuity measures in place with the suppliers of key services, for example the pension administration system and investment custody, and the results are in the process of being implemented by the Fund.</p> <p>As above, the position around LPF's IT systems and services is being progressed as a priority.</p>	<p>Static</p> 
<p><b>Members' confidential data is lost or made public. Breach of Data Protection Act (12)</b></p>	<p>The Fund continues to prepare for the introduction of new Data Protection legislation (the General Data Protection Regulations – GDPR) coming into force in May 2018. The project is targeting the completion of its impact analysis and development of a project plan by the end of the calendar year, with implementation of any actions or improvements to be done during January and February 2018. The Fund is already implementing certain improvements in this area as part of its ongoing compliance processes, for instance putting in place up to date document retention policies and procedures.</p>	<p>Static</p> 

Risk & Reference Number	Update	Trend / RAG
<p><b>Regulatory breach (20)</b></p>	<p>The implementation of MiFID II within the UK raises the spectre of LGPS funds stepping down to Retail Investor status. The Fund has now contacted all its external counterparties to “opt-up” to Professional Investor status. It has, to date, received confirmations of its treatment as an Elective Professional Client from a significant portion of those contacted and will continue to chase those who have not yet provided this. The Fund believes that it is well placed to obtain the remaining opt-up confirmations by the 3 January 2018 deadline. The Fund, through LPFI, is also liaising with its collaborative partners to obtain all relevant information to allow LPFI to opt them up to Elective Professional Client status (where appropriate).</p> <p>Moore Stephens continues to be instructed to carry out on-site regulatory compliance audits of LPFI in order to ensure that it is geared up for best practice compliance at this early stage in its trading. More detailed feedback on the compliance audits is included in the Pensions Controls and Compliance paper this quarter.</p> <p>The Fund is dedicating material amounts of resource to its compliance at present, with the convergence of the implementation of new investment, money laundering, data protection, derivatives and financial services senior management regulations coming into force from 2018. As above, the Fund’s IT platform is a critical aspect of its ongoing compliance with existing and enhanced data protection (GDPR) and financial services (MiFID II, new management permissions) regulations and so this risk has been raised until such time as the Fund has sufficiently addressed this risk to its satisfaction, including that of the board of LPFI.</p>	<p><b>Increase</b></p> 
<p><b>Acting out-with proper authority/delegations (23)</b></p>	<p>Regular updates of the Fund’s delegations are required to take into account the staffing changes occurring within the Fund’s governance. The most recent of which was the arrival of Stephen Moir as the Executive Director of Resources for CEC. The Fund is liaising with Committee Services to put in place revised delegations to reflect this new appointment.</p> <p>Further, the Fund is liaising with CEC’s governance team in relation to an update to the scheme of delegation to ensure that the reserved powers relating to CEC subsidiaries does not cut across the otherwise overarching delegation of authority for pension fund matters (including those in relation to LPFE and LPFI Limited) to the Pensions Committee.</p>	<p><b>Static</b></p> 
<p><b>Human Resource within the Division not sufficient to carry out core tasks in conjunction with active or anticipated projects (32)</b></p>	<p>In light of the significant collaborative, employer and other national initiatives that the Fund is currently involved in, we are closely monitoring the risk that senior management time and other resource is stretched to the point where this adversely impacts on the ‘business as usual’ processes within the Fund.</p> <p>The delay of the phase 2 transfer and the retendering of the HR and Payroll system, alongside the significant time spent trying to resolve the issues with the IT provider and procurement teams, is placing a further strain on the Fund’s human resources. To reflect this the risk has been increased accordingly.</p>	<p><b>Increase</b></p> 

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

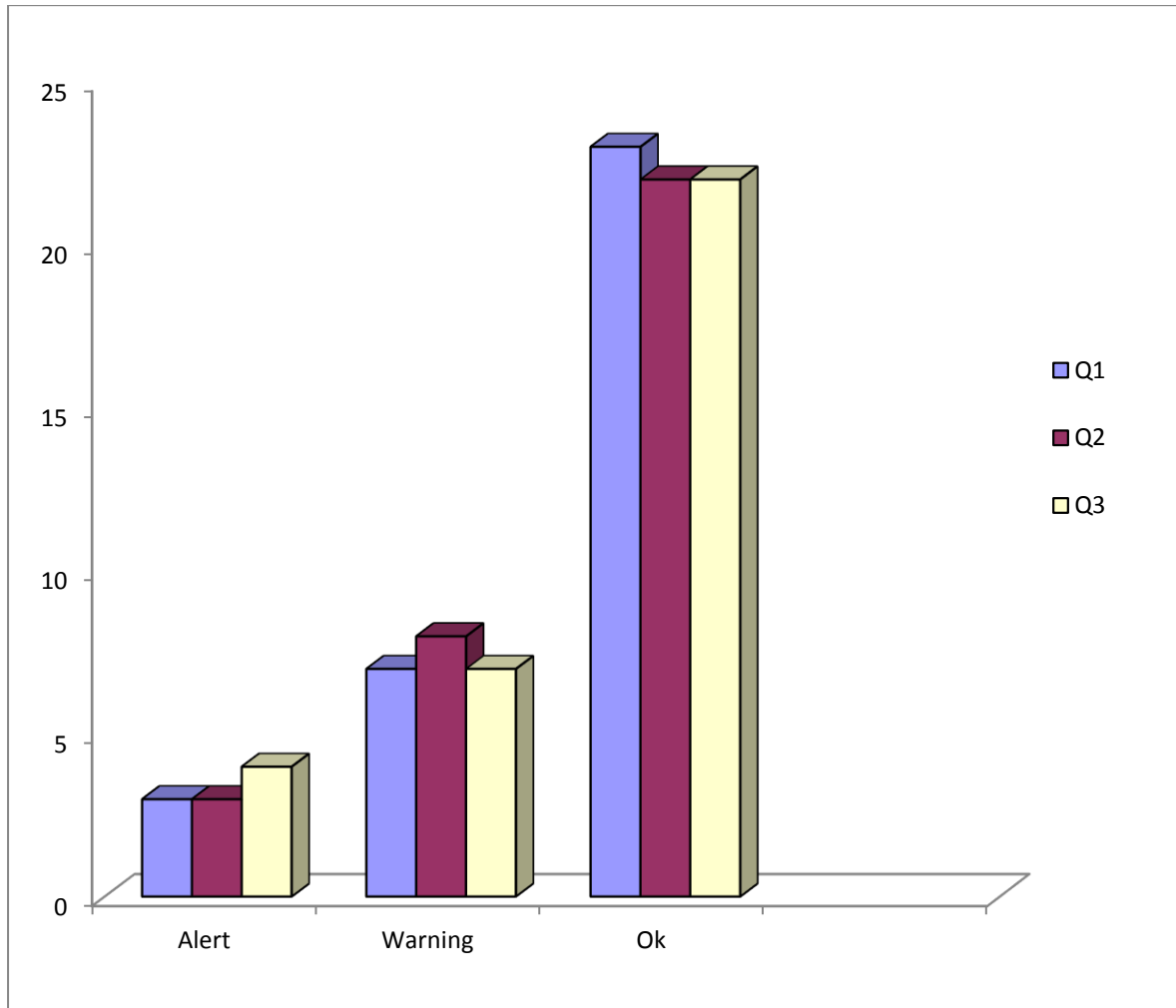




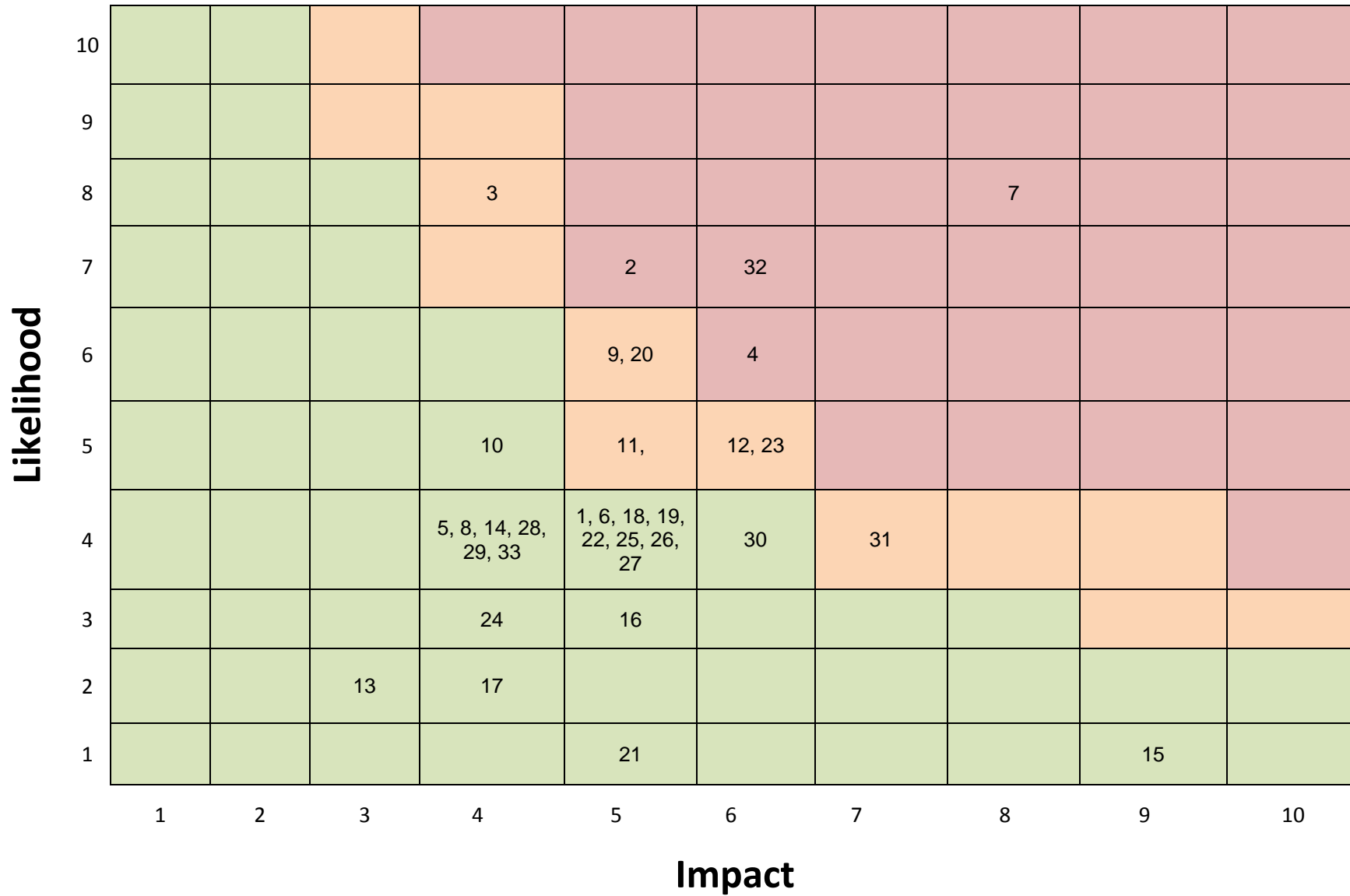
**OTHER KEY POINTS**

	Comments
<b>New notable risks</b>	None.
<b>Other new risks</b>	Inadequate, or failure of, supplier and other third party systems (including IT and data security) (to be added next quarter as 34)
<b>New controls</b>	Business Continuity Plans updated and scenario testing undertaken. (11) Regular diarised review of access to the Fund's shared files in place. (12) Legal advice on the application of Community Benefits, Fair Working Practices and Zero Hours Contracts for future LPF procurement exercises. (25) Non-executive director to be appointed on LPFE. (26) Compliance review of third party systems reliance introduced. (new 34)
<b>Eliminated risks</b>	None.
<b>Notable initiatives / actions</b>	<p>Moore Stephens is engaged on a rolling regulatory compliance audit and the Fund is working to enhance certain of its compliance processes and procedures. An action plan based on audit finding has been created and the LPFI board will be provided with regular updates. (20)</p> <p>The Fund is carrying out detailed impact analysis in relation to MiFID II and GDPR. It is also engaging with its relevant manager(s) and custodian to ensure ongoing compliance and readiness for the EMIR margining requirements in relation to it carrying out Forward FX to mitigate risk in its portfolios. (20)</p> <p>The Fund continues to monitor the position in relation to the following new regulation: GDPR, MiFID II, new anti-money laundering regulations and changes in the margin requirements for certain derivative transactions. (12, 20)</p> <p>The Monthly Contribution Reconciliation (MCR) process for secure data is nearing completion with the second last employer uploading monthly files, retrospective to April 2017. (29)</p> <p>The Fund is also engaging with CGI and CEC's head of ICT in order to mitigate the risk highlighted around its ICT. (7, 11, 18, 20)</p> <p>The Fund is looking to ensure continuity around access to HR files and other critical business systems and to ensure that each member of staff has two emergency contacts on the system and that there are processes to ensure this remains up to date and accessible to key persons. A test for the business continuity plan has been completed to check whether the plans are robust. (33)</p> <p>The Fund is looking to recruit HR support to develop HR function and report in to the Fund's senior management team. (32)</p> <p>The Fund is looking into whether a defibrillator can be made available on the ground floor of Atria One for general use of all units. It could otherwise look to obtain its own defibrillator for LPF's office and use. The relevant training of staff will then require to be carried out. (33)</p>
<b>Material Litigation</b>	None. However, the Fund has recently worked with the Falkirk Council to win an appeal made to the Information Commissioner to reinforce the position of both funds in not disclosing confidential and commercially sensitive details in relation to certain secondary market fund transactions that would have been to the detriment of their stakeholders and those of their business partners/counterparties. (21)

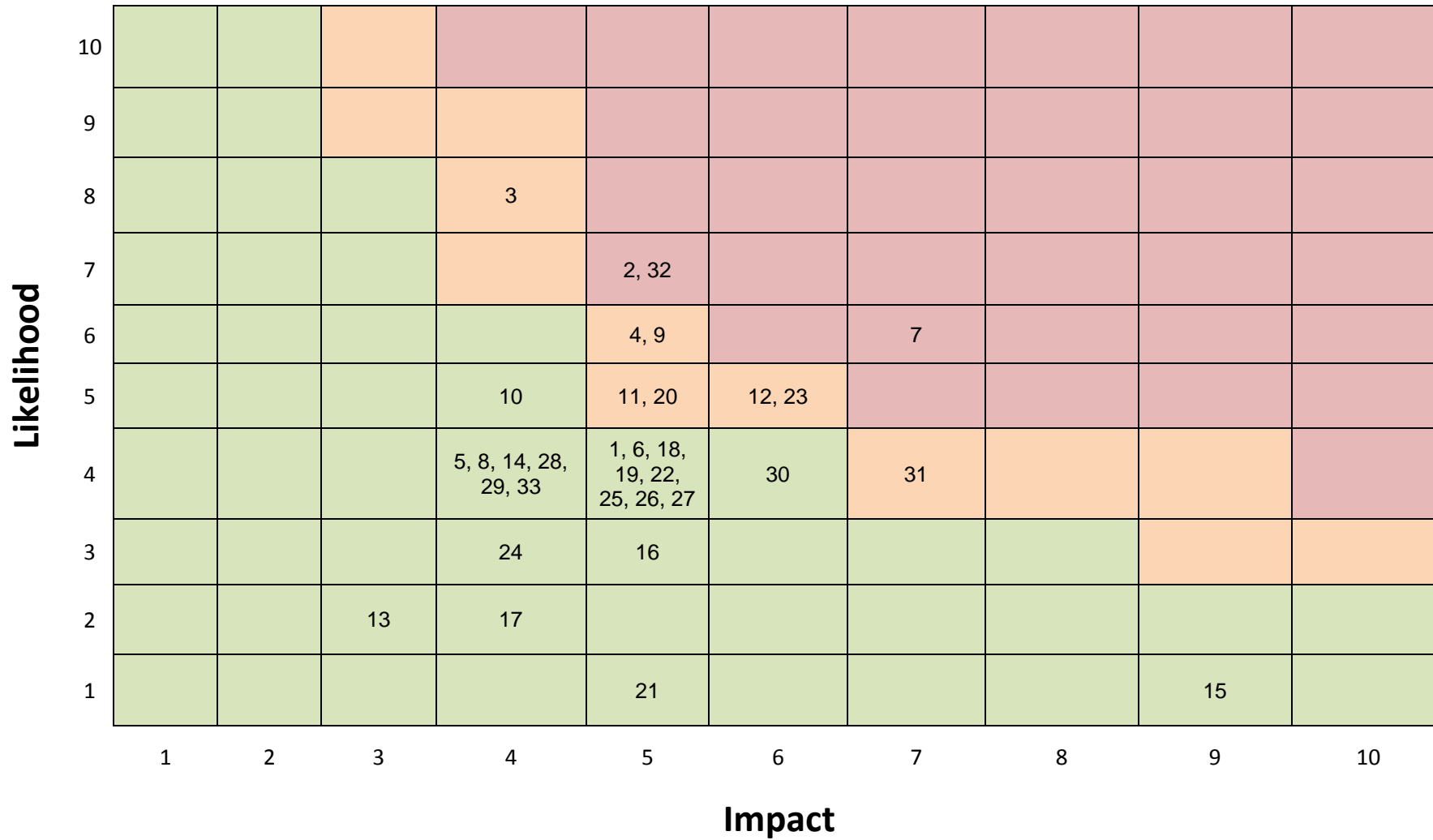
## All Risks: Status Overview



# Q3 2017/18 All Risks: Impact and Likelihood Overview



## Q2 2017/18 All Risks: Impact and Likelihood Overview



## Key: Risks by Number

- 1 Adverse Investment Performance - pressure on employer contributions
- 2 Adverse Movement of non-investment funding assumptions- pressure on employer contributions
- 3 Collapse of an employer
- 4 Recruitment and retention of key staff
- 5 Fraud or theft of Council/Pension Fund assets
- 6 Staff negligence
- 7 Failure of IT systems
- 8 Employers HR decisions without consideration of fund
- 9 Committee members take decisions against sound advice
  
- 10 Pension Board not operating effectively
- 11 Business continuity issues
- 12 Members' confidential data is breached
- 13 Loss due to stock lending default
- 14 Risk of incorrect pension payments
- 15 Late payment of pension
- 16 Market abuse by investment team or others
- 17 Portfolio transition issues
  
- 18 Disclosure of confidential information
- 19 Material breach of contract
- 20 Regulatory breach
- 21 FOI process not in accordance with law
- 22 Incorrect communication with members
- 23 Not acting in accordance with proper authority/delegations
- 24 Inappropriate use of pension fund monies
- 25 Procurement/framework breach
- 26 Group Structure and Governance not fully compliant and up to date (including integration of subsidiaries)
- 27 Claim or liability arising from shared services
- 28 Unauthorised access to PensionsWEB
- 29 Incorrect data from Employers leading to fines etc.
- 30 Inadequate contractual protection for services
- 31 Over reliance on single core service provider
- 32 HR insufficient to carry out active projects
- 33 Breach of Health and safety regulations