

# Pensions Committee

2.00pm, Wednesday, 27 March 2019

## Risk Management Summary

|                     |   |
|---------------------|---|
| Item number         | 5.11  |
| Executive/routine   |   |
| Wards               | All   |
| Council Commitments | <a href="#">Delivering a Council that works for all</a> |

### 1. Recommendations

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The Pensions Committee (**Committee**) is requested to:

1.1 **note** the Quarterly Risk Overview.

**Stephen Moir**

Executive Director of Resources

Contact: Struan Fairbairn, Chief Risk Officer, Lothian Pension Fund

E-mail: [struan.fairbairn@edinburgh.gov.uk](mailto:struan.fairbairn@edinburgh.gov.uk) | Tel: 0131 529 4689

## Risk Management Summary

### 2. Executive Summary

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- 2.1 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.

### 3. Background

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- 3.1 The pension funds' risk management procedures require the it to:
- 3.1.1 manage 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
  - 3.1.2 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**).

### 4. Main report

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- 4.1 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. On an annual basis, the register is reviewed by the Pensions Audit Sub Committee
- 4.2 The Quarterly Risk Overview, as at 13 February 2019, is set out in Appendix 1 to this report for consideration.

## **5. Next Steps**

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- 5.1 To continue to ensure the fund's risks are monitored and reported to the Committee and Pensions Audit Sub Committee.

## **6. Financial impact**

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

## **7. Stakeholder/Community Impact**

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- 7.1 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.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.
- 7.3 There are no adverse sustainability impacts arising from this report.

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

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- 8.1 None.

## **9. Appendices**

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Appendix 1 – Risk Overview as at 19 February 2019



## QUARTERLY RISK OVERVIEW

19 February 2019

### UPDATE ON MOST NOTABLE RISKS

| Risk & Reference Number   | Update  | Trend / RAG   |
|---|---|---|
| <p><b>Adverse Investment performance leading to pressure on employer contribution (1)</b></p>                               | <p>Implementation of the Lothian Buses Pension Fund strategy and the merger documentation is now finalised, effective from 31 January 2019. The target completion of the merger by 31 March 2019 has therefore been met.</p> <p>The strategy review for Lothian Pension Fund has commenced in tandem with our collaborative partners and was presented to Committee in December 2018. The fund is now considering what action arises from the outcome of the review with its partner funds, and prioritising that implementation.</p>   | <p>Static</p>    |
| <p><b>Adverse movement against non-investment funding assumptions leading to pressure on employer contributions (2)</b></p> | <p>The contribution stability mechanism will be reviewed again in advance of the 2020 valuation. Monitoring of funding levels is also ongoing, as is engagement with employers to put in place bespoke arrangements to help manage affordability issues <i>See below for risk 3</i>.</p>  | <p>Static</p>  |
| <p><b>Collapse/restructuring of an employer body leading to pressure on other employers (3)</b></p>                         | <p>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.</p> <p>The draft revised funding strategy statement will be presented to the Pensions Committee this quarter (March 2019). The fund continues to engage with employers regarding any potentially adverse financial impact of the funding strategy and will consult with employers on the newly revised Strategy.</p> <p>Funding agreements for payment of cessation debt are being put in place where relevant for employers exiting the fund. As above, the fund continues to pursue guarantees and securities from employers (where appropriate) and updated admission agreements in order to further mitigate this risk, which is becoming more applicable as the fund considers exits from larger employers.</p> <p>The fund continues to work with some employers to improve affordability by adopting a higher risk investment strategy in consideration for additional security being provided by those employers to off-set any additional risk to the fund and its other stakeholders.</p> | <p>Static</p>  |

| Risk & Reference Number   | Update  | Trend / RAG  |
|---|---|--|
| <p><b>Ineffective recruitment and retention of key staff (4)</b></p>  | <p>The fund has successfully implemented a new performance and reward strategy following agreement by the LPFE Board and Committee. Positive initial feedback has been received from staff.</p> <p>Also, recent successful recruitment to the investment team, and feedback received during those processes, has further supported the positive impact of the new strategy, and so the reduction of this risk.</p> <p>Although the risk has been reduced this remains one of the most critical risks for the fund and so will continue to be managed and monitored closely on an ongoing basis. <i>See also risk 32 below.</i></p>  | <p><b>Decrease</b></p>  |
| <p><b>Staff negligence or inability to carry out duties leading to Maladministration / lack of specialist knowledge (6)</b></p> | <p>The staff training programme in the accounting team, being implemented to increase cover for key procedures, is now complete. As this has now been addressed, the risk has been reduced.</p> <p>The annual refresher of key policies took place in December and January. Certain new policies were introduced and all group policies were reviewed and updated to reflect an LPF focus, including the new HR strategy, FCA requirements and the recent staff transfer. With the exception of one member of staff (who is on long term sickness absence) all members of staff have completed this refresher and submitted a signed acknowledgement to the HR Manager.</p> <p>The review of all staff profiles has commenced to ensure greater consistency and clear understanding of roles and training requirements for each role within the fund (<i>see also risk 32 below</i>).</p> <p>As part of the fund's ongoing regulatory compliance monitoring programme, it is looking to ensure enhanced linkage between the compliance and HR functions around staff regulatory compliance processes.</p> | <p><b>Decrease</b></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 across a number of areas. Operational issues are, to some extent, being dealt with by liaising directly with the fund's ICT relationship manager in the Council and notifying CGI of delays and disruptions experienced. There has been limited progress on key strategic priorities, except that the lap-top refresh and software upgrade is now in progress and the fund is currently testing the hardware that has been provided. It is hoped that this refresh will be complete by the time of the Committee meeting and a verbal update will be provided.</p> <p>Separately, the fund's appointed external consultant has provided a report on the initial desktop exercise to inform the fund in scoping, and determining the viability of, a separate service arrangement with an external provider, transitioning away from the CEC group provider. That interim report has been provided to the Audit Sub-Committee (out of cycle) and a verbal update will therefore be provided to Committee at the meeting.</p>             | <p><b>Static</b></p>  |

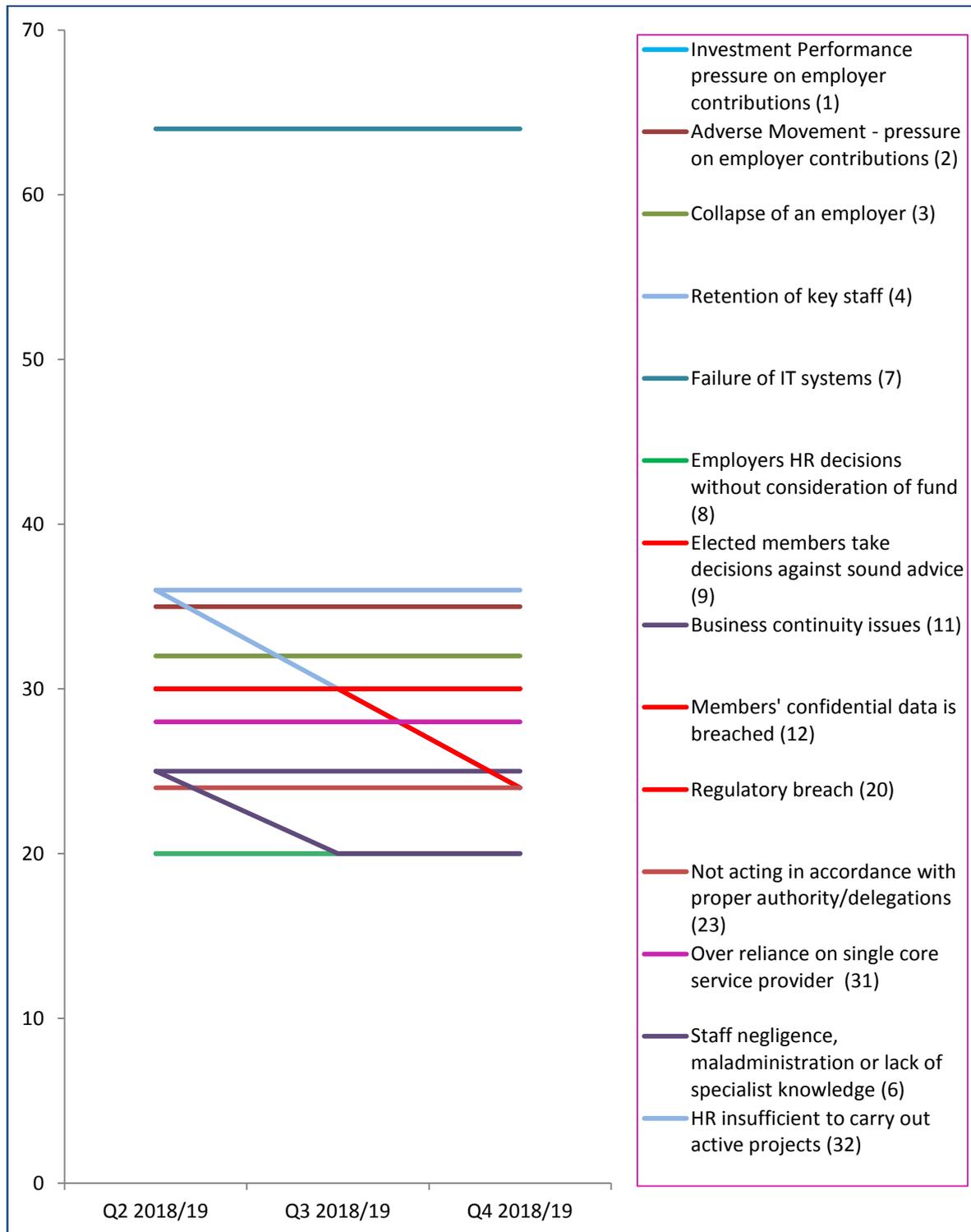
| Risk & Reference Number  | Update   | Trend / RAG   |
|--|--|---|
| <p><b>Employers make HR decisions without considering the impact on the pension fund (8)</b></p> | <p>Although the SPPA has issued a letter of comfort around errors and omissions within the new and transitional regulations, this risk has remained static because the fund continues to carry the technical risk around administration until such time as amended legislation comes into force.</p> <p>Employers will need to update their discretions policy in line with the new scheme regulations. The fund will provide guidance to employers on receipt of amended regulations to ensure that all employers have a policy in place on key discretionary provisions.</p> <p>The fund is also raising awareness of authorised signatories and employer policies in staff training sessions.</p>                           | <p>Static</p>    |
| <p><b>Elected members 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 other socio-economic and environmental matters. Lothian councillors and MPs have signed up to the Divest Lothian campaign to divest from fossil fuel companies and Scottish Futures Trust is exploring LGPS funding in infrastructure projects. The risk therefore remains on warning given the extent and nature of these approaches.</p> <p>A governance review is underway with with recommendations submitted to the Committee for approval in March. Accompanying training is scheduled to be provided to the Committee and Board on 13 March 2019.</p>   | <p>Static</p>    |
| <p><b>Business continuity issues (11)</b></p>  | <p>Business continuity has been discussed with other key third party providers and procedures added to the fund's business continuity plan. It is also being addressed as part of the pensions administration system contract and with others as opportunities prevail.</p> <p>The fund has also commenced a review to assess its current and future accomodation requirements, as well as its wider organsiational/staff requirments.</p> <p>The current ICT review process has highlighted the need to include more detail in the business continuity plan around the fund's specific systems architectur and business continuity options and future preferences, and so this will be picked up as the project develops.</p> | <p>Static</p>  |

| Risk & Reference Number   | Update  | Trend / RAG  |
|---|---|--|
| <p><b>Members' confidential data is lost or made public. Breach of Data Protection Act (12)</b></p> | <p>This risk has been reduced due to the work done in relation to GDPR and the staff policy refresher and communications around best practice information governance.</p> <p>The fund continues to implement its best practice compliance programme following the introduction of new Data Protection legislation (the General Data Protection Regulations – GDPR) and with a recent particular focus on staff training and file management, to minimis the prospects of inadvertant email disclosure of files (or otios information in files).</p> <p>The 2019 Governance Review includes a proposal for implementing an electronic portal and tablets for Pension Committee/Board/Corporate papers and also in-housing the administration of these oversight bodies to, among other things, minimis disclosure risk.</p> <p>The review also looks at putting in place appropriate intra-group arrangements to manage the service provision from CEC's Information Governance team to the fund, and equally the extent and nature of parent oversight of LPF's information governance activities.</p> <p>The fund is also reviewing several key processes which include confidential waste service provision, Iron Mountain services and staff training for manual processes for transfers of data as part of the pensions administration/employer service.</p> <p>The fund continues to monitor cybersecurity risks with its key third party service providers, and as part of the ICT transformaton project.</p> | <p><b>Decrease</b></p>  |

| Risk & Reference Number   | Update  | Trend / RAG  |
|---|---|--|
| <p><b>Regulatory breach (20)</b></p>                            | <p>The fund completed its MiFiD II compliance programme on schedule and that is also the case for LPFI's processes and clients. The fund is now moving to phase 2 compliance which will be applicable on the onset of LPFI providing extended services to collaborative partners.</p> <p>The fund is engaging with the Pension Regulator on a monthly basis until the end of March to enable the Regulator to have oversight of its systems, controls and compliance to the Pension Regulator code of practice. A full report on the feedback from these meetings will be provided to the Pensions Committee and Audit Sub Committee in June 2019, but initial feedback has been positive.</p> <p>Moore Stephens (now BDO) continues to be instructed to carry out on-site regulatory compliance audits of LPFI in order to ensure best practice regulatory assurance and that it is suitably gearing up for the extension of service delivery to likeminded Scottish LGPS funds.</p> <p>The fund is reviewing the implications of the senior management and certification regulations coming into force at the end of 2019 and a full compliance implementation programme around this will likely take place in Q2 and Q3 2019.</p> <p>As above, the fund's IT platform is a critical aspect of its ongoing compliance with existing and enhanced data protection and financial services regulations, and so this risk will remain amber until such time as the fund has sufficiently addressed its key ICT strategies. In particular, the ICT transformation will support key strategic initiatives, including the separation of the financial ledger system/accounts from CEC and the implementation of a new document management system.</p> <p>The fund has reviewed any necessary Brexit contingency planning in the lead up to 29 March 2019, but as a UK based pension fund, collaborating with othe similar UK based funds, the direct and immedaite impact is expected to be limited. Nevertheless, the fund has one EU based external manager that it has been liaising with to obtain the necessary comforts around post-Brexit service continuity. The fund will also be impacted by financial services regulatory uncertainty (e.g. its exemption from clearing derivatives will techically fall away post-brexit if nothing is done) but the industry as a whole is fully reliant on technical releases/letters of comfort from the regulator to address these areas, and the fund is not realistically in a position to put in place a contingency for this level of regulatory uncertainty - beyond mainting a close awareness of the position and any such releases.</p> <p><i>Post-date note: the UK Government has now looked to provide a release giving comfort for UK pensions schemes that the derivative clearing exemption will continue – a link to the release is <a href="https://www.gov.uk/government/publications/emir-pension-scheme-arrangements-clearing-exemption/emir-pension-scheme-arrangements-clearing-exemption">here</a> (https://www.gov.uk/government/publications/emir-pension-scheme-arrangements-clearing-exemption/emir-pension-scheme-arrangements-clearing-exemption).</i></p> | <p><b>Static</b></p>    |
| <p><b>Acting out-with proper authority/delegations (23)</b></p> | <p>The fund's delegations have been revised to take into account recent staffing changes, including the appointment of the new Chief Executive Officer.</p> <p>The Governance paper, which will be presented to the Committee in March 2019, provides recomendations to take forward the necessary updates required to the scheme of delegation, contract standing orders and other committee terms of reference to ensure that these continue to reflect the separate governance and established practices of the fund and the Pensions Committee as its regulated oversight body.</p>   | <p><b>Static</b></p>  |

| Risk & Reference Number   | Update   | Trend / RAG  |
|---|--|--|
| <p><b>Procurement/framework work breach (25)</b></p>  | <p>The fund and CEC procurement team are liaising to ensure that the processes and procedures are sufficiently streamlined for the fund’s specific needs and circumstances where appropriate.</p> <p>Procurement compliance is an important and necessary part of the fund’s obligations, but the governance around this continues to be a material inefficiency for the fund - with a direct impact on resource and adverse reputational implications with critical suppliers and the wider business sector.</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>The risk remains on alert due to the continuing resource drain attributable to the significant time spent on wider strategic initiatives, including collaboration, employer initiatives, other national initiatives and liaison with CEC services to manage service provision and/or provide assurance for oversight functions. To reduce this risk the SMT are conducting a critical review of the LPF group’s organisational structure and development, to ensure the fund effectively resources its current and future business strategy. This will also include ongoing resilience and succession planning and the effective use of external support/assurance where required.</p> <p>Since the last quarter the fund has recruited a Chief Executive Officer, three new Trainee Pensions Administrators, one Portfolio Manager and an additional Customer Support Administrator.</p> <p>The fund continues to consider other requirements to further support any ICT transformation and, more generally, for an expanded central support function.</p> | <p><b>Static</b></p>  |

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



**\*PLEASE NOTE THAT:  
RISK 9 AND 20 SHARE THE SAME SCORE**

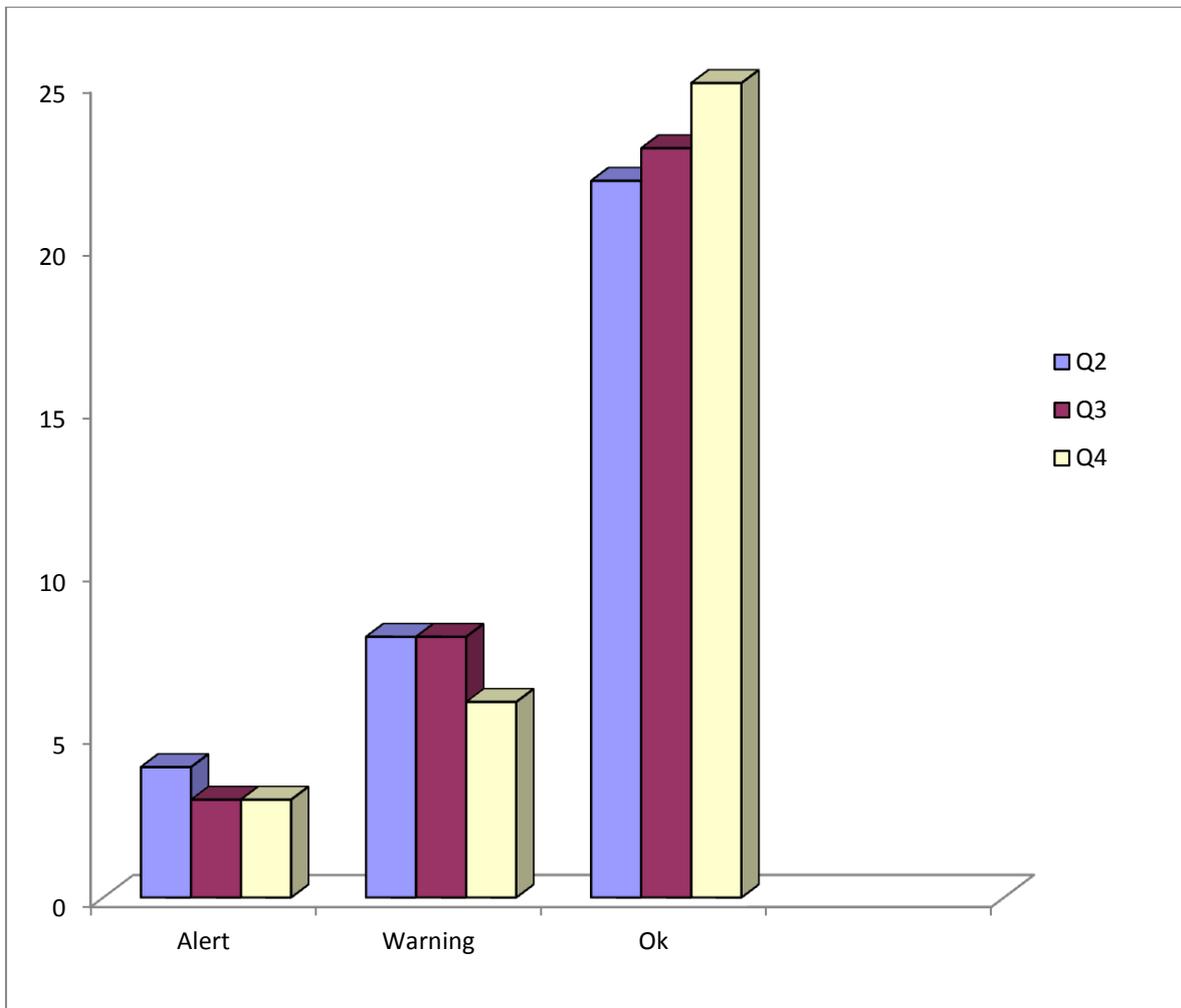
**OTHER KEY POINTS**

|                                      | Comments   |
|--------------------------------------|--|
| <b>New notable risks</b>             | None.  |
| <b>Other new risks</b>               | None.  |
| <b>New controls</b>                  | <p>Supplier management now considered on a quarterly basis by SMT. (34)</p> <p>Affordability confirmation built into 2017 actuarial valuation process and Funding Strategy Statement. (3)</p> <p>Ongoing best practice information governance project (as extension to GDPR implementation). (12)</p> <p>Stock lending policy, parameters and risk appetite in place to support management of the outsourced arrangement with NTC. (13)</p> <p>Legal, risk and compliance oversight of LPFI client communications and advisory papers. (20)</p> <p>Participation in LGA Communications Group. (22)</p> <p>Contract with Heywood now includes terms placing LPF on a better commercial basis (e.g. including service credits and more detailed operational terms and protections). (31)</p>   |
| <b>Eliminated risks</b>              | None.  |
| <b>Notable initiatives / actions</b> | <p>Lothian Buses merger documentation and implementation now finalised. (1)</p> <p>Admission agreement reviews and update following employer covenants review ongoing. (3)</p> <p>Implementing a 'whole of group' succession plan and SMT organisational review process underway. (4)</p> <p>2019 Governance Review and proposed outcomes. (4, 9, 12)</p> <p>Weekly reporting to check processing/checking not done by same administrator. Pursue system changes to control access. Altair report now auto scheduled to run every Monday. This is then imported to an excel spreadsheet which using formula makes the validation straightforward. (5)</p> <p>Review CEO queries on LPF AML process. (5)</p> <p>Review of all staff role profiles to ensure greater consistency, clear understanding of roles and training requirements for each role within the fund. (6)</p> <p>Enhanced cross-team training and CPD to continue to be developed. (6)</p> <p>Reviews ICT consultant's report to determine project plan for a separate ICT provision and transition away from CGI. (7,11)</p> <p>Delayed laptop refresh now due to be completed by the end of February 2019. LPF has hardware for testing. (7)</p> <p>Reviewing Fund's present and future accommodation requirements. (11)</p> |

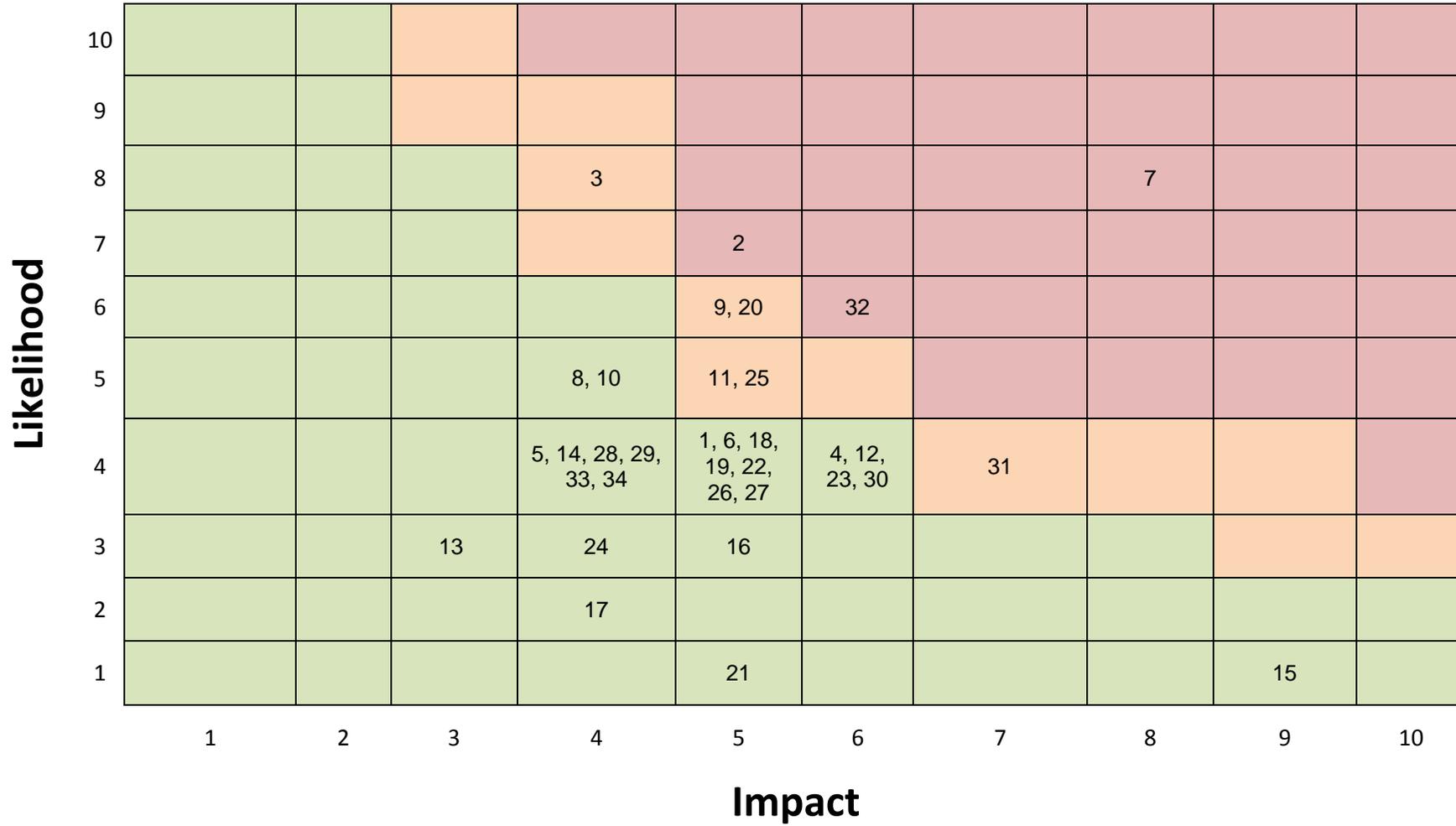
|                            | Comments |
|----------------------------|----------|
| <b>Material Litigation</b> | None.    |

The circumstances reported last quarter around the fund being involved in providing a witness in relation to a criminal action by the Procurator Fiscal in the Sheriff Court in Edinburgh have now fallen away without the fund's witness having to participate in the process.

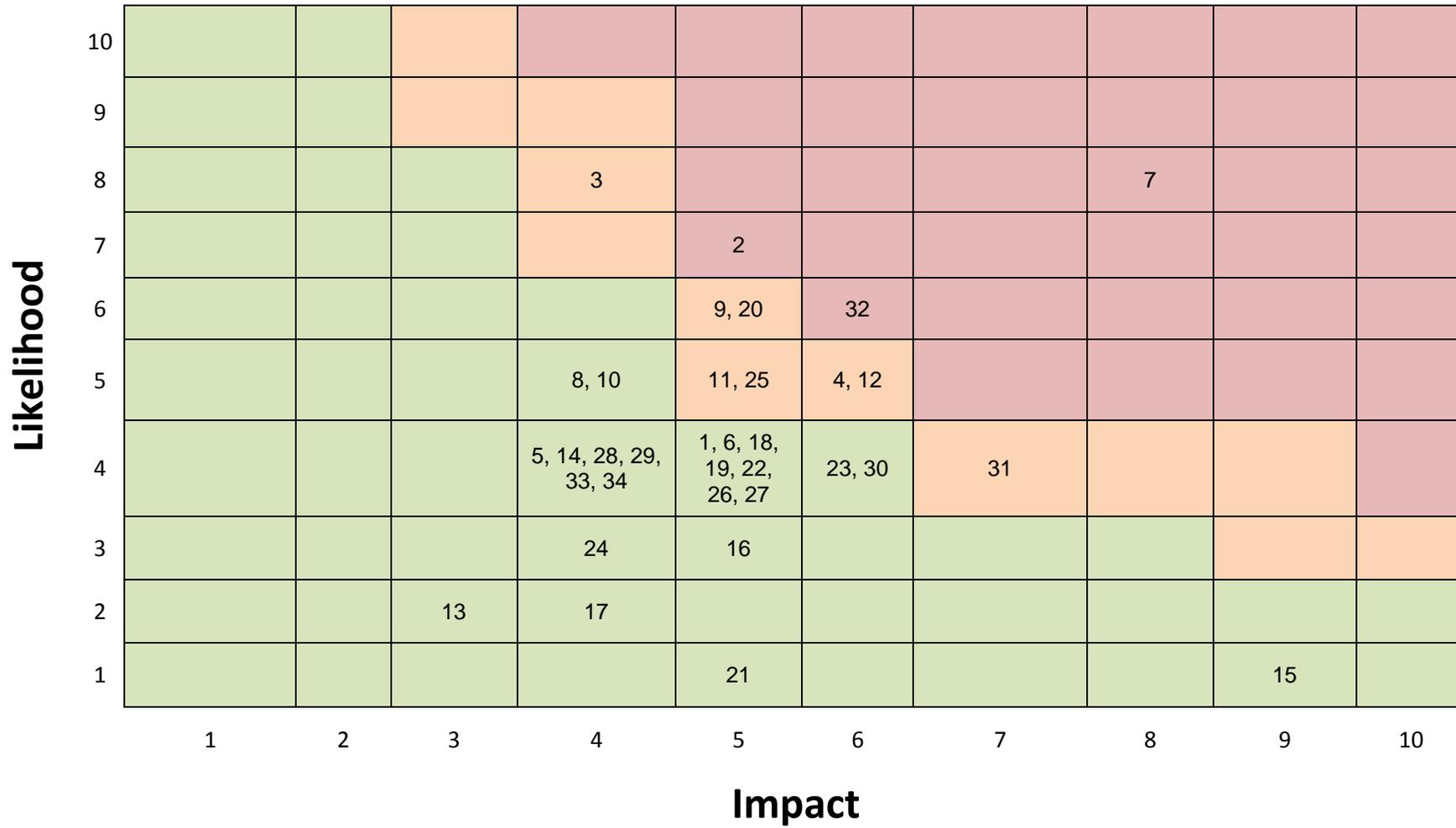
**All Risks: Status Overview**



# Q4 2018/19 All Risks: Impact and Likelihood Overview



# Q3 2018/19 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
- 34 Inadequate, or failure of, supplier and other third-party systems (including IT and data security)

| Risk Status   |  |
|---|--|
|  | Alert (likelihood and impact total 35 and above) |
|  | Warning (likelihood and impact total 25 to 34)   |
|  | OK (likelihood and impact total 24 and below)    |

### Risk Scoring

|    | Impact                                 |
|----|--|
|    | (None)                                 |
| 1  | No discernible effect                  |
| 2  | Little discernible effect              |
| 3  | Some effect noticeable                 |
| 4  | Some effect on service provision       |
| 5  | Noticeable effect on service provision |
| 6  | Some disruption of service             |
| 7  | Significant service disruption         |
| 8  | Material disruption to services        |
| 9  | Major service disruption               |
| 10 | Catastrophic                           |

|    | Likelihood                    |
|----|-------------------------------|
|    | (None)                        |
| 1  | Virtually impossible          |
| 2  | Extremely unlikely            |
| 3  | Remotely possible             |
| 4  | May occur                     |
| 5  | Fairly likely to occur        |
| 6  | More likely to occur than not |
| 7  | Likely to happen              |
| 8  | Probably will happen          |
| 9  | Almost certainly will happen  |
| 10 | Already happening             |