

Pensions Audit Sub Committee

2.00pm, Thursday, 23 March 2023

Risk Management Summary

Item number 6.10

1. Recommendations

The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the LPF group's Risk Register and Quarterly Risk Overview, and raise any relevant points arising from the review with the Pensions Committee on 23 March; and
- 1.2 note that exploratory work and analysis has commenced regarding the creation of a single integrated audit programme for LPF, however due to governance complexities and ambiguities with existing arrangements, no changes will be made in the 2023/24 cycle arrangements, and the proposed scope of CEC's Internal Audit plan for the next year will be extended to provide coverage to LPFE and LPFI.

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Risk Management Summary

2. Executive Summary

- 2.1 This paper provides an overview of monitoring and assurance undertaken in LPF since the last meeting, noting any material observations or exceptions.
- 2.2 This paper also provides a summary of the work to enhance current risk management arrangements.

3. Risk Management Arrangements

- 3.1 Having noted the intention to review the risk management arrangements in the previous report, a detailed paper and operating plan have been created to support the proposed changes to LPF's existing risk management arrangements. The proposed improvements and additions to existing arrangements will create a framework based on the following principles:
 - focus on managing risk across the business in a proportionate and pragmatic way, and which acknowledges finite resources across the business and within the R&C team;
 - ensure arrangements are scalable with an emphasis on investing for the future and building resiliency; and
 - reduce complexity by standardising processes wherever possible and
 - appropriate and not doing different things within different parts of LPF group.
- 3.2 The proposed enhancements can be broken into three key parts which will be delivered through a two year programme:
 - Risk Management Framework review;
 - Procurement of a Governance Risk & Compliance system; and
 - Operating model of the Risk & Compliance team.
- 3.3 The programme of work has already commenced. A key part of the operational plan will be an evaluation of the effectiveness of changes as they are introduced and embedded, through observation, feedback and testing. Willingness and flexibility to adapt, change, modify or remove aspects is critical to the successful implementation and embedding of the new risk management framework and any changes will need business support and engagement. Training and awareness will underpin the programme and ensure that staff understand their role in the framework. Specific training sessions, attendance at team meetings, drop in sessions and lunch and learns will all be considered for raising staff awareness and understanding around

risk management. Regular updates will be provided to the Committee on the programme.

4. Monitoring & Assurance Summary

Themed Reviews

4.1 Investment Services Review

4.1.1 A themed review on Investment Services commenced in Q4 2022, to evaluate LPFI's regulated activities to ensure LPFI is continuing to meet ongoing FCA regulatory requirements and demonstrate good business practice. This review has now concluded, noting several material findings requiring prompt remediation. The themes include:

- Governance & Conflicts
- Client Management (and presentation of 'advice')
- Documentation & Record-keeping
- Risk Management Framework
- Middle Office
- Supplier Management

4.1.2 The review was undertaken by external consultants, Derek Pennor and Andrew Johnstone, pulling on their extensive industry knowledge and experience and time served at the FCA.

4.1.3 A remediation programme is being developed to address the observations. Coincidentally, the FCA issued a Dear CEO Letter (a standard regulatory communication) to all asset management firms on 3 February on their Asset Management Supervision Strategy. This communication highlights the areas and themes that FCA will focus on throughout 2023 and beyond, and explains that it expects all regulated firms to consider how the risks of harm highlighted are being managed. Themes contained in the letter relevant to LPFI around operational resiliency and managing suppliers, as well as aspects of the risk management framework resonate with some of the themes observed in the Investment Services review. Consequently, we are confident that LPFI will be well placed to address these FCA focus areas due to the proposed risk management framework improvements already identified, and the programme anticipated to remediate gaps and weaknesses highlighted through the Investment Services review.

4.2 Financial Crime Review

A themed review of Financial Crime has commenced and the first part is expected to complete by end Q1 2023. This review is split into two parts, the first covering Anti-

Money Laundering, Counter Terrorist Financing and Sanctions, with the second part covering Anti-Bribery and Corruption, Market Abuse and Fraud. The purpose of this review programme is to evaluate the adequacy and effectiveness of the arrangements in place to manage the risks of financial crime, and consider if there are appropriate systems and controls to ensure we continue to meet relevant legal requirements and regulatory guidance.

BDO Compliance Monitoring Programme (CMP)

- 4.3 All testing scheduled for the Q4 2022 period was satisfactorily completed. A total of 7 new issues were identified and are noted below.

Best Execution review

- 4.4 A one-off Best Execution themed review was completed in December 2022 by BDO. This review by BDO was commissioned earlier in 2022, to evaluate the effectiveness of LPFI's processes and controls in relation to best execution – which is the obligation to execute client orders on terms most favourable to them.
- 4.5 The review concluded that LPFI should formalise execution monitoring procedures across equity and fixed income portfolios, to be better able to evidence consistent best execution for clients. The report noted that:
- There is a clear order execution policy setting out LPFI's approach to best execution. This policy is issued to clients and is publicly available on LPFI's website.
 - There is a good understanding across both fixed income and equity teams on the best execution obligations and the need to obtain best possible results in the execution of orders.
 - However, there are no documented procedures describing how monitoring of these results is carried out. There is also insufficient evidence of internal review and sign off of monitoring done, outcomes and resolution.

Findings & Recommendations

- 4.6 The following enhancements were recommended by BDO:
- consistent onboarding training modules for new joiners;
 - identify material risk takers, in line with remuneration code requirements;
 - improve version control records for committee terms of reference and policies;
 - conflicts of interest documentation, including how they are mitigated;
 - registering NEDs as FCA Directory persons;
 - establishing a BCP testing schedule, with appropriate reporting to senior management; and

- Enhanced best execution procedures, and consistency across equity/fixed income.

Non-FCA Compliance Monitoring Programme ('CMP')

- 4.7 As reported previously, a broader reaching CMP has been developed to provide more substantive oversight and assurance in respect of non-FCA regulatory requirements, predominantly covering The Pensions Regulator ('tPR') requirements. We expect to develop this complimentary monitoring further during the course of 2023 and meanwhile the highlights from Q4 results are noted below.
- 4.8 75 tests were undertaken, with 51 of these assessed as 'fully compliant'. The remaining tests were not fully compliant primarily due to:
- 4.9 Poor or incomplete record keeping. A number of tests showed no documentary evidence existed for processes. Follow-up verbal discussions provided some comfort that processes had been carried out – but unable to independently verify.
- 4.10 Processes not clearly defined or repeatable. This is consistent with findings raised in other assurance by audit or BDO – general lack of written processes and procedures.
- 4.11 All issues identified above through monitoring and assurance work will continue to be recorded and tracked through the standard issue management process.

Internal Audit

- 4.12 Details of recent and current internal audit engagements are noted below:

4.12.1 Project Forth Governance

A review in respect of Project Forth governance was completed in Q4 2022. The findings did not highlight any material observations and have raised some recommendations regarding project management best practice and change control. These items have been added to the LPF issue log and will be tracked and reported on in line with standard procedures.

4.12.2 Third Party Supplier Management

The objective of this review was to assess the adequacy of design and current operating effectiveness against industry good practices to ensure LPF has appropriate arrangements in place to manage its third-party suppliers. This review has concluded and we await the final report.

4.12.3 Information Governance

This review is in progress. It's objective is to assess the adequacy of design effectiveness of the key controls over data strategy and information governance, including how the roles and responsibilities of LPF stakeholders fit together to ensure that the data is managed well, as well as reviewing data classification and ownership, and data content management.

4.12.4 Adequacy of Technology Security Assurance Arrangements

This audit has been delayed but due to start in late February. The purpose of this audit is to perform a high-level review of the relevant IT policies, standards and procedures that have been developed during 2022 to prevent, respond and manage cybersecurity information security across LPF, as well as ensuring these are aligned to IT strategy.

- 4.13 Noting earlier support from the Pensions Committee and Audit Sub-Committee, as well as the LPFI & LPFE Boards in December to extend the scope of LPF internal audit arrangements to include LPFI and LPFE, exploratory work and analysis has commenced. Although there is a clear appetite to create a single integrated audit programme, and to engage directly with an internal audit service provider (preferably PwC to leverage existing LPF relationship and knowledge), rather than through CEC arrangements, the steps required to do so are ambiguous. There are also conflicting views regarding the governance steps required to remove LPF from the existing CEC arrangements and connected co-source agreement with PwC, with a view to engaging directly with PwC on a wider LPF 'group' scope. Therefore, no changes will be made to arrangements for the forthcoming audit cycle.
- 4.14 Meanwhile, we have discussed possible reviews for the 23/24 period with CEC Internal Audit, acknowledging a desire to extend the current LPF arrangements to ensure the scope of these reviews are relevant to, and appropriate for, LPFI and LPFE, to provide some independent 3LoD assurance for these entities. Presented to the Committee separately, CEC Internal Audit will propose and seek approval for the following reviews to be covered in their 23/24 plan:
- **Project Forth:** a follow up review to the governance review undertaken during Q4 22, with scope to be agreed as the merger progresses
 - **Business Continuity & Incident Response:** the audit will consider general business continuity controls as the organisation transitions to post pandemic operations
 - **Senior Managers & Certification Regime:** to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR
 - **People Processes:** to provide assurance on the people processes supporting the employee lifecycle.

Issues & Incidents

- 4.15 Improvements continue to be made to the processes, governance and reporting regarding LPF Issues and incidents. A summary status of issues and incidents from Q4 2022 is noted below.

4.15.1 Issues

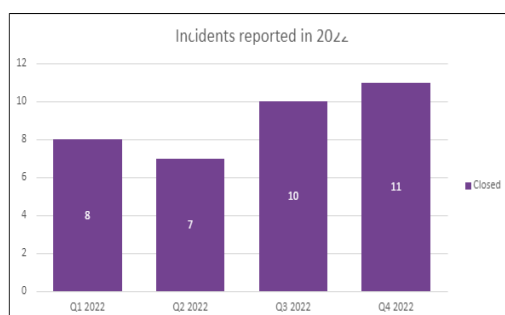
During Q4, 40 issues were closed and 19 new ones were raised. At the close of the quarter, there were a total of 49 open issues. These issues comprise findings from internal audit and 2LoD (including BDO CMP) monitoring and assurance work, as well as any other self-identified items.



- 4.15.2 At the time of writing, there are currently 49 open issues. For those open issues, 15 of these are overdue, the majority of which are in relation to information security/technology related findings. 27 issues have a due date by the end of March 2023 and the Risk & Compliance team continue to actively engage with issue stakeholders to ensure agreed actions are being taken.

4.15.3 Incidents

Eleven incidents were raised during Q4 2022, 4 of which were classified as FCA regulatory breaches, and one as a non-reportable data breach. Required actions to remediate these incidents were completed during Q4, and all incidents were subsequently closed.



- 4.16 As the quality of information being recorded continues to improve, over time, more meaningful reporting will be developed that will support identification of common

themes or trends. Meanwhile, 3 further incidents have been raised within LPF 'group' in Q1, and remain under investigation.

4.17 Further information on issues and incidents is available on request.

5. Financial impact

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

6. Stakeholder/Regulatory Impact

6.1 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.

6.2 Except as otherwise stated in the report itself, there are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 – Quarterly Risk Summary as at 7 February 2023

Lothian Pension Fund Pensions Discretions Policy

Appendix 1

This is the Pensions Discretions Policy of Lothian Pension Fund ("the Fund"). It is prepared and maintained by the City of Edinburgh Council, the Administering Authority for the Fund. This statement was agreed by the Pensions Committee on 23 March 2023.

Lothian Pension Fund's policy where discretion is applicable is shown in the table below. Where further discretion is required, officers' over-riding priority will be to act in the best the interests of the Fund by taking into account advice (where applicable) and rulings on similar cases from the Pensions Ombudsman.

	Local Government Pension Scheme Administering Authority Discretions/Decisions	Current Policy
1	Whether to agree to an admission agreement with a body applying to be an admission body.	Funding Strategy Statement
2	Agree terms of admission agreement	
3	Whether to agree to an admission agreement with a NHS Scheme employing authority.	
4	Whether to terminate a transferee admission agreement in the event of <ul style="list-style-type: none"> • insolvency, winding up or liquidation of the body; • breach of its obligations under the admission agreement; • withdrawal of approval by HMRC to participate in the scheme; and • failure to pay over sums due to the Fund within a reasonable period of being requested to do so. 	
5	Agree method for paying additional pension with employer	
6	Whether to set up a separate admission agreement fund.	
7	Decide on Funding Strategy for inclusion in funding strategy statement for approval by Pensions Committee.	
8	Whether to obtain revision of employer's contribution rate on termination of an admission agreement where underfunding not met by insurer, bond or indemnity.	
9	Whether to obtain revision of employer's contribution rate if there are circumstances which make it likely a Scheme employer will become an exiting employer	
10	Whether any strain on Fund costs be paid up front by employing authorities following redundancy, early retirement, flexible retirement, or the waiver (in whole or in part) of any actuarial reduction on flexible or discretionary retirement.	
11	Agree to bulk transfer payment	

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Lothian Pension Fund

Administering Authority Discretions Policy

12	<p>Governance compliance statement must state whether the administering authority delegates their function or part of their function in relation to maintaining a pension fund to a committee, a sub committee or an officer of the administering authority and if they do so delegate, state:</p> <ul style="list-style-type: none"> the frequency of any committee or sub committee meetings the terms of reference, structure and operational procedures appertaining to the delegation whether representatives of employing authorities or members are included and, if so whether they have voting rights <p>The statement must also state</p> <ul style="list-style-type: none"> the extent to which a delegation, or the absence of a delegation, complies with guidance from Scottish Ministers and the extent it does not comply, state the reasons for non-compliance and the terms, structure and operational procedures appertaining to the local Pensions Board 	Annual Governance Compliance Statement
13	Decide frequency of payments to be made over to the Fund by employers and whether to make an administration charge.	Pensions Administration Strategy
14	Decide form and frequency of information to accompany payments to the Fund.	
15	Recover additional costs arising from employing authority's level of performance.	
16	Whether to charge interest on payments by employers which are overdue.	
17	Whether the Fund should appeal against employer decision (or lack of decision).	
18	Specify information to be supplied by employers to enable administration. Authority to discharge its functions.	
19	Whether to have a written pensions administration strategy and if so the matters it should include.	Lothian Pension Fund will decide the form in which pension accounts are kept based on any published advice or best practice and in the most efficient manner that can be devised.
20	A pension account may be kept in such form as the administering authority considers appropriate	

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Administering Authority Discretions Policy

21	Decide, in the absence of an election from the member within 12 months of ceasing a concurrent employment, which ongoing employment benefits from the concurrent employment which has ceased should be aggregated (where there is more than one ongoing employment).	If no option is received Lothian Pension Fund will aggregate the terminated concurrent employment to the active account that is most beneficial to the member.
22	Whether to obtain a satisfactory medical certificate before agreeing to an application to pay Additional Pension Contributions (APCs) or Shared Cost Additional Pension Contributions (SCAPCs).	Members will be required to produce medical evidence in support of an application to purchase additional pension, unless SCAPCs are being paid in respect of lost pension due to short-term absence such as career break, child-related leave or reserve forces leave. Where that evidence incurs costs, these will be met by the member.
23	Whether to accept an application to pay an APC/SCAPC if not satisfied that the member is in reasonably good health.	Where satisfactory medical evidence cannot be obtained in support of the member's application, the request will not be granted.
24	Whether to turn down a request to pay APCs or SCAPCs over a period of time where it would be impractical to allow such a request.	In view of the administration costs involved for both the Fund and the employer, requests to pay APCs or SCAPCs over a period of time to make up lost pension for an absence of less than 10 working days will be refused. Members will still be able to proceed but will be required to make APCs or SCAPCs as a lump sum payment.
25	Whether to charge a member for provision of estimate of additional pension that would be provided by the scheme in return for transfer of in-house AVC funds.	Member is entitled to one free estimate within a 12-month period. If a further estimate is to be provided within a 12-month period, then a charge will be made.
26	Whether to extend the 3-month election period that allows a member on leaving employment (by reasons of redundancy) to capitalise their added years contract.	Lothian Pension Fund will not extend the election time period of three months for capitalisation except where a member was not made aware of this right.

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27	Make an election on behalf of deceased member with a certificate of protection of pension benefits.	Lothian Pension Fund will determine the pay figure and make an election on behalf of a deceased person.
28	Allow extension of period within which a scheme member must submit election for benefits or alter the date from which they elect to have pension paid.	Members may make an election for payment of benefits up to three months before their intended retirement date.
29	<p>Can pay death grant due to personal representatives or anyone appearing to be beneficially entitled to the estate without the need for confirmation, grant of probate/letters of administration.</p> <p>Decide to whom a death grant is paid.</p>	As required Lothian Pension Fund will use its absolute discretion in accordance with the regulations and in the first instance consider the member's expression of wish form. Where no valid nomination exists or is considered inappropriate, before deciding to whom the death grant should be paid the fund will gather background information including any valid will. Where a will has been made consideration will be given to the deceased's wishes. Where no valid will exists, payment may be made to obvious beneficiaries i.e. spouse, children, dependant, relative, executors or any other person who makes a valid claim. In cases where a number of potential beneficiaries exist, dependency and intestate law will be considered as a guide to determining claims
30	Decide to whom any Additional Voluntary Contributions or Shared Cost Additional Pension Contributions monies (including life assurance monies) are to be paid on the death of the member.	Lothian Pension Fund will decide, based on the circumstances of the individual case, who should receive payment of the member's monies, having full regard for the fact that they must be applied for the benefit of the member's nominee, personal representative or any person appearing to have been a relative or dependent of the member.
31	Approve medical advisors used by employers (for ill-health retirement)	Lothian Pension Fund approves and maintains a list of medical advisors.

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Administering Authority Discretions Policy

32	Whether to extend six-month period to lodge a stage 1 Internal Dispute Resolution Procedure appeal.	The “appointed person”, as nominated by Lothian Pension Fund in accordance with Scheme Regulation 69(7)(b), under its Internal Dispute Resolution Procedure, may extend the time limit depending on the merits of the case.
33	Date to which benefits shown on annual benefit statements are calculated.	Benefit statements will show benefits calculated as at 31 March for active members. Deferred and pension credit members will show benefits calculated to the most recent pension increase date.
34	Decide policy on abatement of pensions following re-employment.	Lothian Pension Fund will not abate pensions of pensioner members on re-employment (This excludes the abatement of Compensation Pensions where no such discretion exists).
35	Allow transfer of pension rights into the Fund	Transfer in of previous pension rights is restricted to Public Sector Transfer Club (PSTC). Applications must be made within twelve months of joining the pension scheme.
36	Decide whether deferred beneficiary meets permanent ill-health criteria	Lothian Pension Fund will pay early payment of deferred on health grounds subject to ill-health medical certification.
37	For pre 1 April 2009 deferred members, decide whether to allow access to deferred benefits on compassionate grounds between age 50 and 55, where the former employer has ceased to be a scheme employer.	Lothian Pension Fund will not grant early payment of benefits between age 50 and 55 unless there are exceptional extenuating circumstances.
38	Decide evidence required to determine financial dependence of co-habiting partner on scheme member or financial interdependence of co-habiting partner and scheme member	Lothian Pension Fund will require at least one of the following types of evidence from at least two years prior to the date of death: <ol style="list-style-type: none"> 1. Joint tenancy agreement/mortgage statement 2. Council tax charges 3. Joint bank account that shows regular utility payments i.e. rent,

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Administering Authority Discretions Policy

		mortgage, shopping etc 4. Utility bills
39	Decide to treat a child who commences full-time education or vocational training after the date of the member's death as an eligible child after the child attains age 18 until age 23.	At the time of a member's death, a child over age 17 who is in full-time education having not having had a break of over one year will be treated as an eligible child.
40	Decide to treat child as being in continuous education or training despite a break.	A break of one year will be disregarded so long as there is a clear intention to return to education or training following the break.
41	Decide to suspend child's pension during a break in education or training.	Lothian Pension Fund will suspend a child's pension during a break in education or training.
42	Decide to treat a child who is disabled within the meaning of the Equality Act 2010 as being an eligible child.	Lothian Pension Fund will rely on medical certification. Where that evidence incurs costs, these will be met by the child's guardian.
43	Decide whether to commute a small pension.	While Lothian Pension Fund's general policy is to commute small pensions in accordance with the provisions of the Finance Act 2004, should a member not wish such and request otherwise, then a small pension will be paid.
44	For members <i>subject to the provisions of earlier regulations</i> , decide whether to commute pension on grounds of serious ill-health	Subject to the member's wishes and medical certification that life expectancy is less than one year, Lothian Pension Fund will commute pension on grounds of serious ill-health.
45	Decide, in the absence of an election from the member, which benefit is to be paid where the member would be entitled under 2 or more regulations in respect of the same period of membership	Lothian Pension Fund will award the benefit that produces the best benefit for the scheme member.
46	Decide valuation day for pension sharing order	The valuation day for pension sharing orders shall be the date of divorce. The implementation date for the pension sharing order will be the last day of the four-month implementation period from the date of decree.

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Administering Authority Discretions Policy

47	How to discharge Pension Credit liability	Lothian Pension Fund will discharge pension credit liabilities by conferring appropriate rights under the Scheme on the ex-spouse or ex-civil partner. The ex-spouse or ex-civil partner may request a transfer of pension rights to another qualifying arrangement.
48	Decide charges to be levied in Pension Sharing cases	Charges are set with reference to the National Association of Pension Funds schedule of charges and are increased in line with the cost of living each year.
49	Agree to pay annual compensation on behalf of employer and recharge payments to employer	Lothian Pension Fund on behalf of the City of Edinburgh Council pays compensation on behalf of employers and recharges payments to the employer, subject to any future reviews of the process.
50	Extend the time limit for repayment of a previous refund (16/5/74 to 05/04/1978)	Lothian Pension Fund will extend the time limit indefinitely.
51	Intervals at which instalments of annual compensation are payable (may agree different to LGPS pension date)	Lothian Pension Fund on behalf of the City of Edinburgh Council pays annual compensation in line with the LGPS pension date i.e. in arrears on the 15 th of each month, subject to any future reviews of the process.
52	Early payment of deferred benefits on ill-health grounds	Lothian Pension Fund will not make early payment of deferred benefits on ill-health grounds without a certificate completed by an IRMP unless there are extenuating circumstances, or an end-of-life certificate has been received.
Other Discretions (not covered under the provisions of the LGPS)		
53	For upheld complaints, consider any financial awards in line with Lothian Pension Fund's Policy relating to compensation for distress or inconvenience.	When considering financial awards, consideration will be given to the levels of compensation awarded by the Pensions Ombudsman for similar cases.

Lothian Pension Fund Administering Authority Discretions Policy

54	Where a member elects to make Additional Pension Contributions (APCs) by lump sum; take steps to reduce risk of money laundering	Lothian Pension Fund will require members to complete a source of funds check in cases where a member elects to make a lump sum APC. If the information provided raises suspicion of money laundering, the application will be refused and a Suspicious Activity Report (SAR) will be submitted to the National Crime Agency
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