

## **Pensions Committee**

2.00pm, Wednesday, 27 September 2023

### **Risk & Compliance Update**

#### **Item number 6.9**

#### **1. Recommendations**

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The Pensions Committee (Committee) is requested to:

- 1.1 note the LPF group's Risk Register and Quarterly Update;
- 1.2 note a review of the existing group risk register has been undertaken and a revised risk register created;
- 1.3 note the ongoing strategy and development around the group's risk management framework; and
- 1.4 note the increase in capital request to LPFI board to meet FCA regulatory capital requirements

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# Risk & Compliance Update

## 2. Executive Summary

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- 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

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- 3.1 The programme of work on the Risk Management Framework ('RMF') is continuing to progress. A comprehensive review of the LPF group risk register has been undertaken, which has resulted in a clearer articulation and evaluation of current risks which the group is exposed to and how these are being managed. This re-alignment has been managed in a methodical and transparent way to ensure a proper audit trail of the changes is recorded. A summary of LPF key risks is noted in appendix 1, whilst the updated risk register summary is available in appendix 2 to this report. The register will continue to be reviewed and overseen by the LPF Risk Management Group (RMG), and is now also complimented by awareness and consideration of emerging risks.
- 3.2 Introduction of the revised risk assessment methodology as well as a full review and validation of the risks and controls themselves has led to some changes in risk ratings which are noted in appendix 1 and 2.
- 3.3 Following the review and simplification of LPF risk evaluation methodology, and development of common risk language, operational risk profiles have been developed for the Risk & Compliance (R&C), Legal and Governance teams. The programme to complete these for other business areas is expected to run until at least the end of 2023.
- 3.4 The purpose of the RMG has been reviewed and a revised terms of reference and membership has been implemented. The objectives of the RMG are more clearly and comprehensively articulated and the membership has been refined to support risk ownership and improve operational efficiencies with the meeting. In addition, review and oversight of several frameworks has been formally brought within scope of the RMG to ensure proper governance around these frameworks and arrangements.

## Key Risks

- 3.5 As noted above, both the risk register and the RMG have been reviewed and updated. The RMG operating under its updated terms of reference met on 1 August 2023 and considered the revised LPF group risk register and the key risks to which the LPF group are exposed.
- 3.6 The full review of the LPF risk register using the revised methodology has determined some changes in risk ratings shown in appendix 1 and 2. There are currently 2 high rated risks: Regulatory breach; and Supplier performance and oversight. Both risks are considered to be high at present due to observations made through the course of assurance work - the Investment Services Review and the Internal Audit on Third Party Supplier Management. LPF management are satisfied that the action plans established to address the noted weaknesses in both reviews will mitigate these risks, and which are expected to reduce shortly as actions are completed. At the time of writing, significant progress has been made on the Investment Governance Improvement Plan workstream on JISP and Governance, and individual actions have been completed in relation to the Internal Audit review.
- 3.7 Emerging risks are now also formally captured and the RMG will also actively review these, and consider the actions the LPF group need to implement or plan for depending on the timeline and certainty currently known regarding the risk.
- 3.8 Emerging risks:
- 3.8.1 Risk: Some employers may choose to crystallise their surplus to release capital for other projects and spending commitments and exit or cease contributions to the fund.  
Action: A working group has been set up to consider the implications and issues on the fund and remaining employers should an employer or employers choose this strategy in the current economic environment.
- 3.8.2 Risk: Structural review of the LGPS in Scotland might have implications on pension provision. This could include potential consolidation of multi-fund LGPS employers where there is a case for rationalisation.  
Action: LPF's membership of the Scheme Advisory Board ('SAB') helps ensure we can actively contribute to the role of this group in relation to advising on scheme design, other policy issues or regulation, and effective and efficient scheme administration and management. LPF also continues to follow the progress with LGPS pooling arrangements in England and Wales and the current consultation to introduce further changes and expand and accelerate pooling.
- 3.8.3 Risk: Creation of National Care Service may include a dedicated pension fund and consequently reduce member and employer numbers and efficiencies

gained from multi employer membership.

Action: After months of uncertainty, in July the Scottish Government ruled out transferring local authority care staff into new care boards and has agreed those employees will continue to be employed by councils. For LPF the status quo remains with no action currently required.

## **4. Monitoring & Assurance Summary**

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### **Compliance Monitoring Programmes (CMPs)**

All testing for Q2 2023 has been completed.

#### **4.1 Non-FCA Compliance Monitoring Programme – Findings & Recommendations**

4.1.1 Although no new issues were raised, poor or incomplete record keeping regarding pension errors was again noted in relation to one test. This finding has been linked to an already identified issue.

4.1.2 The Information Governance internal audit recommended introducing further compliance monitoring on key information governance policies and procedures. This will be considered as part of the Q4 LPF CMP, and additional tests may be introduced.

#### **BDO LPFI Compliance Monitoring Programme - Findings & Recommendations**

4.1.3 Two new issues were recorded following completion of testing by BDO, and both have since been actioned and closed:

- Communication and availability of Business Continuity Plans (BCP) to employees
- Client due diligence record keeping

#### **Spot Check**

4.2 Following several data and Freedom of Information (FOI) incidents reported by the media, the R&C team undertook a spot check on the processes and controls during Q2. This check concluded that:

- controls relating to data handling are adequate and protect data by design. Notwithstanding, the risk of human error is the most likely cause of an incident occurring and regular training and awareness activities should continue to support this.
- the process around handling FOIs is inconsistent and controls should be enhanced regarding clear documentation of the process to follow and a consistent central approval process introduced. The current incident reported in the media regarding the Police Service of Northern Ireland highlights some very severe consequences of inadequate processes and controls in this area.

- a by-product of the spot check also highlighted the need to review LPF's cyber security insurance coverage to ascertain in what scenarios our current insurance would cover. This is currently being followed up.

### **Internal Audit**

- 4.3 The CEC Internal Audit programme of reviews to be undertaken in 2023/24 commenced in July with the audit on People processes. This review has now completed with a green *substantial assurance* rating. The remaining audits in the plan are expected to begin during August and September.

### **Training**

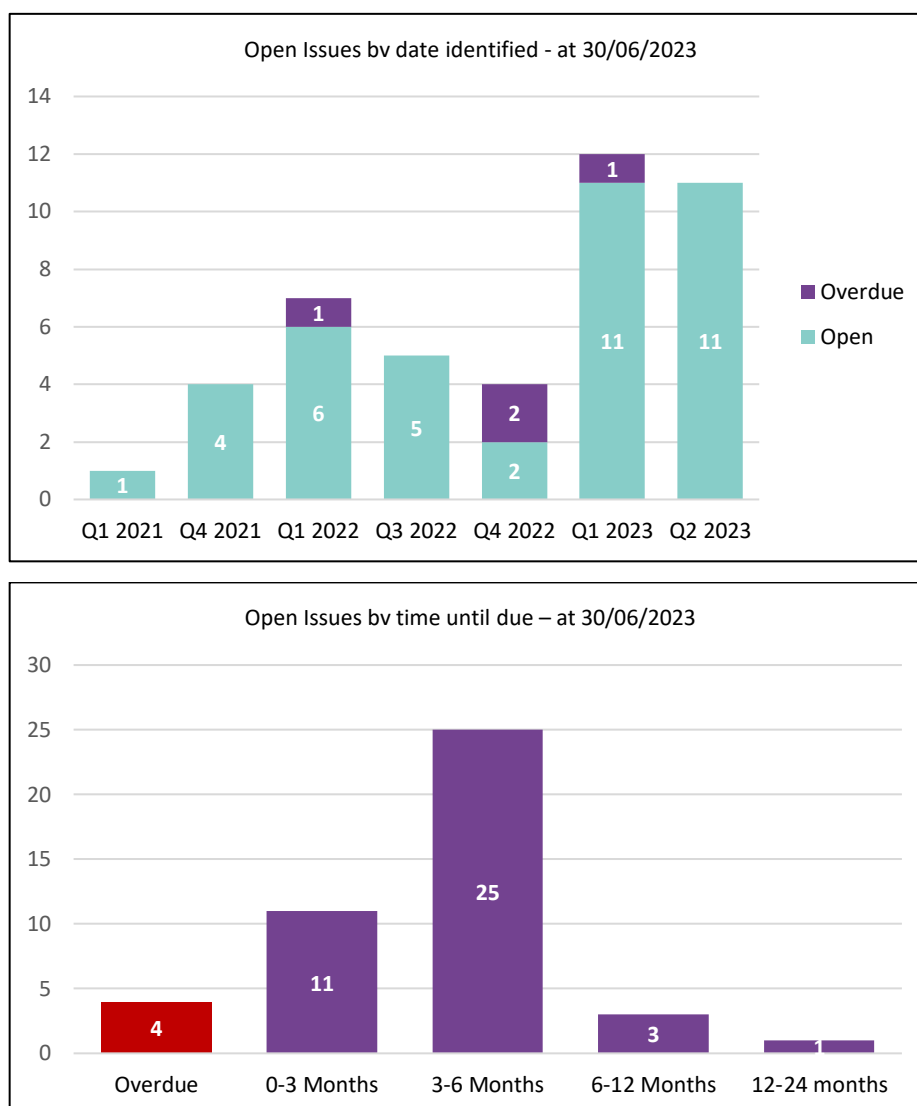
- 4.4 A R&C bulletin was issued to all staff in June covering incident management, data and conflicts of interest, as well as a follow up on the general risk management training delivered to all the teams during May. More detailed incident management training was delivered by the R&C team to all staff in July. Engagement from colleagues across the business was very encouraging and the R&C induction programme for new starts has been enhanced to cover this in more detail.

### **Issues & Incidents**

- 4.5 Improvements continue to be made to the processes, governance and reporting regarding LPF Issues and incidents. In Q2, two further enhancements have been introduced: setting a limit of three times an issue can have a due date extended; and rating each issue as low, medium, or high, defined as follows:
- 4.5.1 Low: Low Priority, actions will improve efficiency or effectiveness of existing controls.
  - 4.5.2 Medium: Medium priority, weakness may lead to moderate impact on LPF. Timely action required to mitigate.
  - 4.5.3 High: High priority, material weakness or failure in processes. LPF exposed to significant risk without action.

## Issues

### 4.6



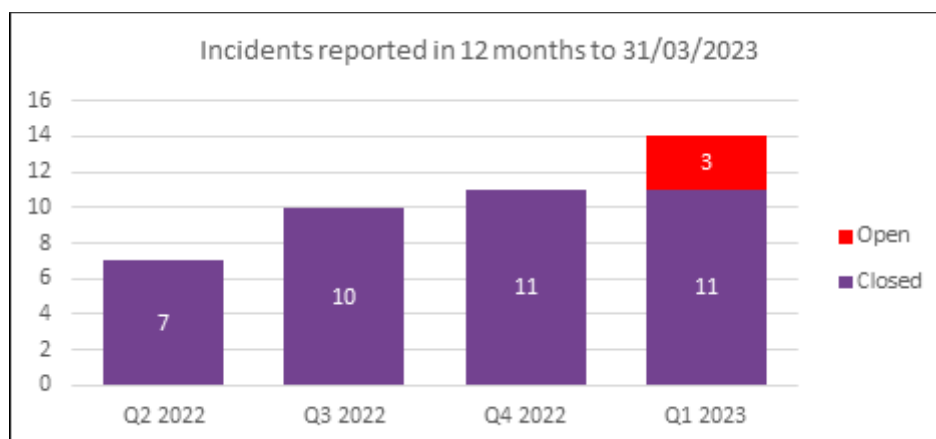
- 4.6.1 During Q2, 20 issues were closed and 15 new issues were raised. These issues comprise findings predominantly from the internal audit on Information Governance, the Financial Crime themed review and the Investment Services review.
- 4.6.2 Since end Q2, 2 further issues have been added, identified by the spot check review of data and FOI processes. At the time of writing, there are currently 41 open issues, 1 of which is overdue and a further 11 have a due date by the end of September.
- 4.6.3 The Risk & Compliance team continue to actively engage with issue stakeholders to ensure agreed actions are being taken by the due date. This table shows current open issues by rating and due date:

Issue rating	Overdue	Sep 2023	Q4 2023	Q1 2024	Total
High	1	1	6	1	9

Medium		6	5	1	12
Low		4	15	1	20
<b>Total</b>	<b>1</b>	<b>11</b>	<b>26</b>	<b>3</b>	<b>41</b>

## Incidents

- 4.7 Eighteen incidents were raised during Q2 2023, five of which were classified as non-reportable data breaches and 1 was classified as a non-reportable FCA regulatory breach. Required actions to remediate thirteen of these incidents were completed during Q2, and the incidents subsequently closed.



- 4.8 Following the end of Q2, 14 further incidents have been raised within LPF group.
- 4.9 The quality of information being recorded continues to be enhanced making analysis of any themes or trends more effective. A total of 7 incidents and near misses arising in Q2 related to pre- or post- trading activities. Identified causes included configuration or set-up of the Charles River system, set-up within Northern Trust system, and unclear processes or human error within LPF. Each of these areas is expected to improve from work within the IGIP project to clearly document investment processes, the new R&C hire, and a planned upgrade to the Charles River system.
- 4.10 Further information on issues and incidents is available on request.

## FCA Regulatory Compliance – ICARA

- 4.11 LPFI is required to hold adequate financial resources (also referred to as regulatory capital or capital adequacy) and to establish systems and controls to manage potential harms. These systems and controls must include a process to assess and allocate additional capital where a residual, material risk remains.
- 4.12 As part of the UK's financial services regulatory framework and as set out in the relevant prudential standards (MIFIDPRU), LPFI is required to establish and maintain an Internal Capital Adequacy and Risk Assessment (ICARA), which should be updated on an annual basis, or upon a material change.

- 4.13 The requirement for the ICARA arises from the FCA's IFPR, the purpose of which is to ensure investment firms remain viable on an on-going basis and are able to wind-down in an orderly manner. In practice, this means holding a minimum level of financial resources (capital and liquidity), and regularly assessing how much of each should be held.
- 4.14 The LPFI ICARA as at 31 March 2023 has been reviewed and updated, and will be / has been considered and approved by the LPFI board.
- 4.15 Approval was sought from the LPFI board to increase LPFI capital by £1,000k. The increase is due to consideration and evaluation of plausible scenarios through the harm-led risk assessment and significant increase in LPFI AuM since March 2022, the date of the previous ICARA.
- 4.16 As previously reported, due to the increase in AuM, with effect from 1 July 2023, LPFI ceased to meet threshold criteria for being a SNI firm (small non-interconnected firm) and will be required to update the ICARA as at 30 September 2023 as a Non-SNI firm to take account of additional regulatory reporting and methodology due to the change in category.
- 4.17 The R&C and Finance team have collaborated to review and update the ICARA as at 31 March and are developing a plan to complete the more extensive review and update required as at 30 September, which will be presented to the LPFI board at the December meeting.

## **5. Financial impact**

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- 5.1 To ensure that LPFI remains adequately capitalised the LPFI board was recommended to review and approve the injection of £1,000k from Lothian Pension Fund. This change in capital should be noted by the Pension Committee.

## **6. Stakeholder/Regulatory Impact**

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- 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**

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7.1 None.

## **8. Appendices**

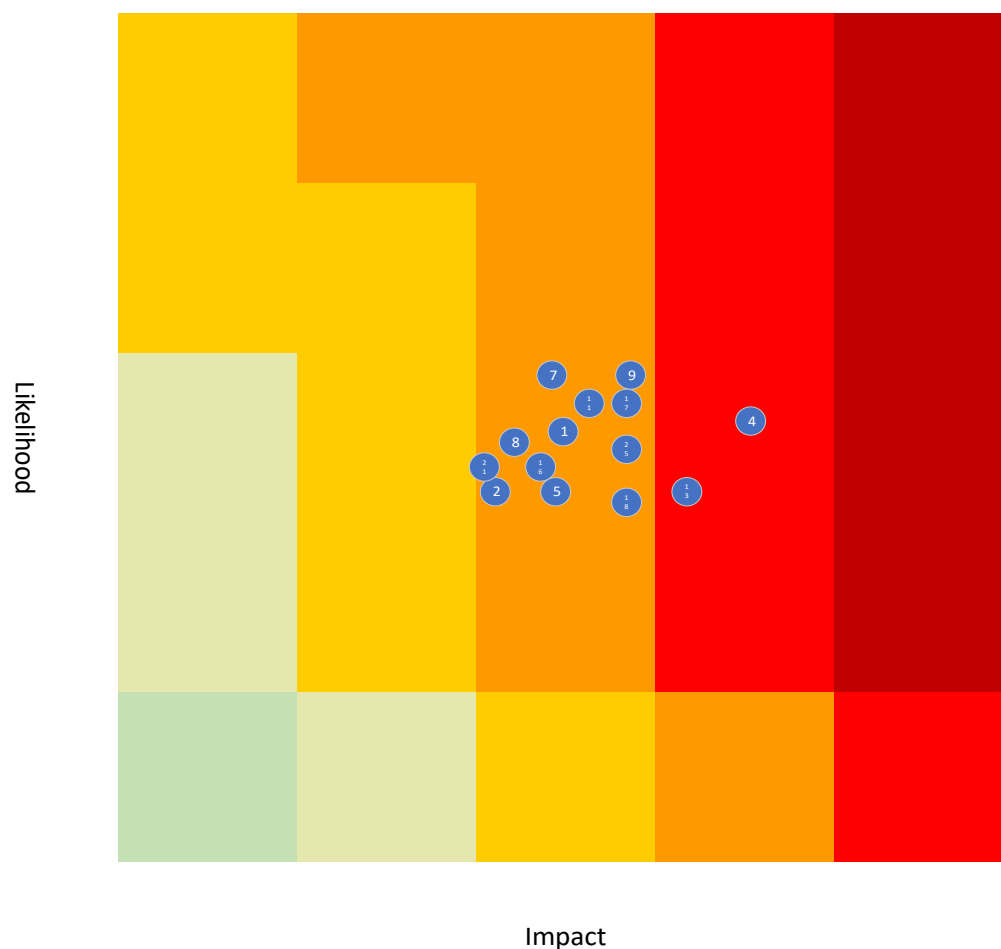
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Appendix 1 – LPF Key Risks

Appendix 2 – Risk Register Summary

## Appendix 1

### LPF Key Risks



Ref	Type	Name	Rating
4	Governance Legal & Compliance	Regulatory breach	
13	Business Operations	Supplier performance and oversight	
1	Investment Management	Investment Performance	
2	Information Security IT & Data	Data Management	
5	Scheme	Employer contributions payment failure	
7	Governance Legal & Compliance	Discharge of responsibilities and accountabilities	
8	Business Operations	Investment services delivery	
9	Business Operations	Business Interruption	
11	Information Security IT & Data	Cybersecurity	
16	People & Culture	Recruitment & retention	
17	People & Culture	Resources	
18	Strategy	Climate change & Responsible Investing	
21	Strategy	Strategic Goals	
25	Governance Legal & Compliance	Best practice governance	

	Very High
	High
	Medium
	Low
	Insignificant

## Risk Register Summary

## Appendix 2

Risk Ref	Level 1 Risk	Level 2 Risk	Risk name	Risk Description	Entity	Current Risk
4	Governance Legal & Compliance	Regulatory Compliance	Regulatory breach	LPF do not meet regulatory obligations leading to enforcement action or fines and reputational damage	All	
13	Business Operations	Third Party	Supplier performance and oversight	Sub-optimal service performance/delivery, management and oversight of third party suppliers could lead to lack of resiliency and/or material errors and breaches	All	
1	Investment Management	Investment Management	Investment Performance	Investment returns are less than expected due to fall in fair price of securities including equities, bonds, real assets could impact value of the fund and consequently funding levels and liabilities	All	
2	Information Security IT & Data	Data	Data Management	Mis-management or poor maintenance and protection of data could lead to operational errors, regulatory breaches/fines or reputational damage	All	
5	Scheme	Employer Contributions	Employer contributions payment failure	Failure of an employer to pay contributions leads to a fall in funding or balance to be met by higher contributions from remaining employers	LPF	
7	Governance Legal & Compliance	Governance	Discharge of responsibilities and accountabilities	Pension Committee or Board don't effectively discharge their responsibilities and accountabilities to the fund and decisions are taken against sound advice, beyond delegated authorities, on political grounds or due to lack of knowledge or attendance	LPF	
8	Business Operations	Processing & Execution	Investment services delivery	Delivery of LPFI's investment services do not meet client expectations or requirements or regulatory obligations	LPFI	
9	Business Operations	Business Continuity	Business Interruption	Significant and/or extended business interruption (including third party suppliers) leading to a failure or inability to complete key LPF processes	All	
11	Information Security IT & Data	Information Security & Cyber	Cybersecurity	Inadequate cyber and data security arrangements to protect LPF from information security threats and cyber-attacks could prevent key operational processes from being undertaken and lead to financial losses and reputational damage	All	
16	People & Culture	People & Culture	Recruitment & retention	Ability to attract, recruit, engage and retain talent leading to workforce capability gaps could affect LPF's ability to meet strategic objectives and legal and regulatory requirements and expectations	All	
17	People & Culture	People & Culture	Resources	Key person dependencies (particularly in significant roles or small teams) and resourcing could affect LPF's ability to meet strategic objectives and legal and regulatory requirements and expectations	All	
18	Strategy	Climate	Climate change & Responsible Investing	LPF don't adequately address Environmental, Social and Corporate Governance factors within the company, with service providers, and through underlying investments, due to lack of climate or sustainability strategy. This could lead to missed opportunities, regulatory scrutiny, financial loss and reputational or stakeholder damage	All	
25	Governance Legal & Compliance	Governance	Best practice governance	Failure to operate within corporate governance best practice and principles could impact strategic decision making and may lead to project failure, increased costs, poor morale and/or regulatory censure	All	
21	Strategy	Strategic	Strategic Goals	Strategic goals are unclearly defined and/or inconsistently implemented	All	
6	Business Operations	Processing & Execution	Operational errors	Material or systemic operational errors, in relation to members, employees or clients (such as trading errors or pension payment errors) could result in operational losses, regulatory breaches or reputational damage	All	
10	Information Security IT & Data	Technology	IT systems	LPF's IT does not meet operational requirements due to inadequate IT hardware or software leading to material or extended service delivery issues	All	
12	Business Operations	Business Change	Project and change activities	Ability to deliver internal or regulatory change in line with strategic or legal/regulatory expectations could overwhelm business areas through pressure on BAU processes, causing delivery delays or failures, and/or change fatigue and impacting organisational culture	All	
14	Business Operations	Internal Fraud	Fraud by LPF staff or relating to members	Challenges due to general cost of living increases could drive both employees and members to attempt to acquire assets or monies not belonging or due to them	All	
23	Scheme	Funding	Unexpectd drop in funding	Unexpected drop in funding levels may require higher employer contributions	LPF	
24	Information Security IT & Data	Data	Data integrity and quality	Data used to fulfil member, employer, client, regulatory or reporting requirements, and trigger actions or inform decision making, comes from multiple sources and systems and may contain errors	All	
15	Business Operations	Communication & Digitalisation	Member engagement, servicing and reporting	Member engagement, servicing and reporting does not meet LPF's expected standards and corporate values contributing to operating inefficiencies, member di-satisfaction or complaints and reputational damage	LPF	
19	Investment Management	Investment Management	Investment Strategy	Investment strategy does not deliver investment objectives due to incorrect implementation, investments falling outside agreed risk parameters or inadequate JISP governance. This could lead to a fall in funding levels and inability to meet liabilities.	LPF and LPFI	
20	Business Operations	Communication & Digitalisation	Communications	Unclear, misleading or out of date member or client communications compromises the quality of their decision-making, leading to member or client complaints and reputational damage as well as regulatory censure	All	
22	Scheme	Funding	Meeting liabilities or capital requirements	Insufficient funds and liquid assets to meet liabilities or capital requirements	All	
26	Scheme	Funding	Increase in future liabilities	Increase in future liabilities due to rising inflation and other external factors	All	
3	Conduct	Conduct	Unauthorised activity or poor conduct	Unauthorised activity or poor conduct behaviours by employees representing themselves or the firm could fall short of legal and regulatory standards and requirements	All	