

Pensions Audit Sub Committee

2.00pm, Tuesday, 24 September 2019

Risk Management Summary

Item number	5.6
Executive/routine	
Wards	All
Council Commitments	

1. Recommendations

The Pensions Audit Sub Committee is requested to:

- 1.1 note the Quarterly Risk Overview; and
- 1.2 highlight any points that it would like raised at the Pensions Committee on 25 September 2019.

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Risk Management Summary

2. Executive Summary

- 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

- 3.1 The Lothian Pension Funds' risk management procedures require the Fund to:
- 3.1.1 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
 - 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

- 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.
- 4.2 The Quarterly Risk Overview, as at 19 August 2019, is set out in Appendix 1 to this report for consideration.
- 4.3 A verbal update of the status of various IT projects will be provided as part of the separate paper specifically on the Fund's current and future ICT provision.
- 4.4 At its meeting in 26 June 2019, the Pension Committee requested that a separate risk to monitor cybersecurity be included in the risk register. Risk 35 'Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their

impact' has now been added to the register and will be monitored on a quarterly basis alongside all other risks.

- 4.5 From December 2019 Appendix 1 will include a three year graphic of the risks as requested at the Pension Committee on 26 June 2019.

5. Next Steps

- 5.1 Quarterly review and reporting of risk register.

6. Financial impact

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

7. Stakeholder/Community Impact

- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

8. Background reading/external references

- 8.1 None.



9. Appendices




Appendix 1 – Quarterly Risk Summary, as at 19 August 2019





QUARTERLY RISK OVERVIEW



19 August 2019



UPDATE ON MOST NOTABLE RISKS




Risk & Reference Number	Update	Trend / RAG
<p>Adverse Investment performance causes funding levels to fall requiring higher employer contributions. (1)</p>	<p>The fund is considering the outcomes from the Joint Investment Strategy Panel's investment strategy review with its partner funds, and prioritising implementation of resulting strategies to improve synergies across the portfolios of the three funds.</p>	<p>Static</p> 
<p>Adverse change in non-investment actuarial assumptions cause funding levels to fall requiring higher employer contributions (2)</p>	<p>The contribution stability mechanism will be reviewed towards the end of the year with training for the Pension Committee and Board Members taking place in November. A report will be presented to the Pensions Committee in December, and in advance of the 2020 valuation.</p> <p>The fund continues to review its communication with employers around comparative LGPS contribution rates, including on the longer-term implications and the potential benefits of LPF's unitisation strategy and internal investment approach. Effective communication regarding this is critical to the fund's wider strategy of ensuring the long-term sustainability of the scheme and that it is a destination of choice for employers.</p>	<p>Static</p> 
	<p>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>	

Risk & Reference Number	Update	Trend / RAG
<p>Failure of an employer to pay contributions causes funding levels to fall, requiring higher contributions from other employers (3)</p>	<p>The funding approach introduced in the 2014 actuarial valuation for employers that are close to exiting the scheme reduces the overall risk to the fund and the other employers.</p> <p>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>Decrease</p> 
<p>Failure of IT systems used in the Fund with serious consequences for investment management, benefit administration and oversight activities (7)</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.</p> <p>A further ICT update is being presented to the Committee as part of the private B agenda this quarter and will provide a more detailed overview of this risk. However, the risk has reduced due to the introduction of three new controls, (i) the digital strategy / ICT pathway (approved by Pensions Committee in June 2019) giving approval to exit the provision of ICT support from CEC and its provider CGI, (ii) the appointment of an IT oversight manager (August 2019) and (iii) the increased direct contact with CGI to further our aim of closer oversight and monitoring.</p>	<p>Decrease</p> 
<p>Elected members take decisions against sound advice (9)</p>	<p>The risk has reduced as a result of the governance review now being well underway as reported in March and in June 2019 and the reduced levels of external lobbying. The Committee and Board will continue to receive quarterly governance updates until December, when the substance of the review process is expected to conclude.</p> <p>In addition, the two non-elected Committee members, John Anzani and Richard Lamont have been reappointed for a further two years.</p>	<p>Decrease</p> 

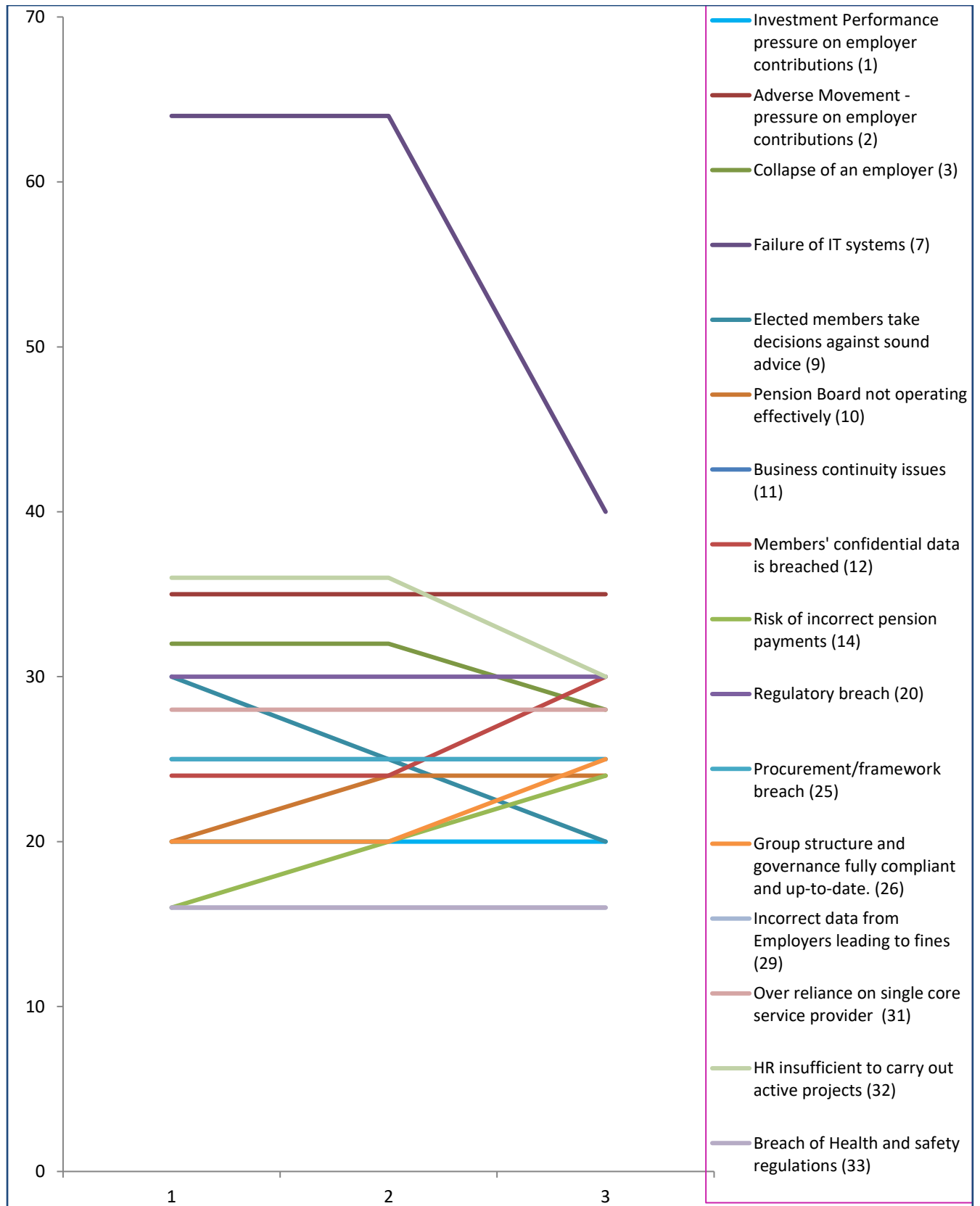
Risk & Reference Number	Update	Trend / RAG
Pension Board does not operate effectively to the detriment of the Fund. (10)	The vacancies on the pension board and the higher turnover of board members had raised this risk slightly last quarter. However, this has reduced again due to the appointment of an employer representative leaving only one vacancy on the Pension Board which is expected to be filled by the next Committee meeting in December.	<p style="text-align: center;">Decrease</p> <p style="text-align: center;"></p>
Business continuity issues (11)	<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 current ICT review process has highlighted the need to include more detail in the business continuity plan around the fund's directly managed third party ICT systems and specific systems architecture, business continuity options and future preferences. This will be picked up as the wider ICT project develops.</p> <p>The fund will present a report to Committee in September that provides an update on the review to assess its current and future accommodation requirements, as well as its wider organisational/staff requirements.</p> <p>The business continuity risk is expected to reduce once the ICT and office matters have been addressed, allowing those areas to be properly taken into account in the business continuity plan.</p>	<p style="text-align: center;">Static</p> <p style="text-align: center;"></p>
Members' confidential data is lost or made public. Breach of Data Protection Act. (12)	<p>In order to strengthen the Funds controls the it has requested that the Pensions Administration system provider set tolerance controls for employers to alert them when uploading data on to the system. Until the tolerance levels are in place the risk has been increased slightly. The fund will continue to mitigate this risk by continuing manual checks until automatic checks are in place.</p> <p>A new automatic mailing system is now in place, which has significantly reduced the amount of manual printing and mail compilation by LPF staff. This should reduce the risk of manual error in the mailing process, but currently remains under review to ensure there are no weaknesses in the automated process.</p>	<p style="text-align: center;">Increase</p> <p style="text-align: center;"></p>
Risk of incorrect pension payments (14)	<p>Closure of the outstanding management action in respect of the high rated Internal Audit finding is dependent upon the specific methodology for measurement of "Key Performance Indicator- 99% accuracy of pensions calculations" being defined and contractually embedded with the pensions administration software supplier. This had been expected in early 2019. Following restructuring of its operations and the departure of its Group Client Director in April 2019, however, the supplier withdrew its own proposal (of the KPI definition) at a point when LPF had already accepted such and the matter was in the</p>	<p style="text-align: center;">Increase</p> <p style="text-align: center;"></p>

Risk & Reference Number	Update	Trend / RAG
	<p>hands of the company’s legal officer for formal update to the core contract. LPF has been pursuing matters, as a priority, with the company’s new Chief Executive since then. At a meeting on 15 August 2019, the company reiterated its commitment to ensure compliance with its contractual obligations and a revised methodology is expected from the company imminently. The Chief Internal Auditor has been advised of expected implementation (including validation review) by 31 October 2019. Given the fundamental importance of assurance on this matter for LPF’s pensions administration service, our contractual stipulation of KPI embodying 99% threshold level of calculation accuracy, failure to meet such leading to the imposition of contractual Service Credit penalties, represents a critical advance. The supplier has advised that it does not have any other Local Government Pension Scheme (LGPS) administering authority client which has insisted upon such assurance incentivisation.</p> <p>Reflecting this position, together with risk 12 in respect of tolerance controls, the assessed risk has increased.</p>	
<p>Regulatory breach (20)</p>	<p>The fund continues to be engaged in a compliance readiness project to ensure it is well placed for additional regulations that will come into scope on LPFI providing extended services to collaborative partners. This also now includes the impact of the Competition Authority’s recent order around the investment consultancy industry/services, and the subsequent implementing regulations and guidance from the government bodies and regulators (TPR, FCA and HMRC).</p> <p>BDO (formerly Moore Stephens) continues to be instructed to carry out on-site regulatory compliance audits of LPFI in order to ensure assurance in this area.</p> <p>The fund has reviewed the implications of the Senior Manager and Certification Regime coming into force at the end of 2019 and a full compliance implementation programme is currently in process.</p>	<p>Static</p> 

Risk & Reference Number	Update	Trend / RAG
	<p>As above, the fund's ICT provision 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 (including any staff issues) in the lead up to a possible exit of the EU, but as a UK based pension fund, collaborating with other similar UK based funds, the direct and immediate impact is expected to be limited. The position therefore remains as reported in previous risk updates.</p>	
<p>Procurement/frame work breach (25)</p>	<p>The fund is liaising with CEC's procurement team to ensure that the processes and procedures are sufficiently streamlined for the fund's specific needs and circumstances where appropriate. The amendment of the Council's contract standing orders and terms of reference provide the Pension Committee with greater oversight and procurement processes to become more streamlined.</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. This continues to be addressed through the fund's Governance Review.</p>	<p>Static</p> 
<p>Group Structure and Governance not fully compliant and up to date (including integration of subsidiaries) or working effectively resulting in adverse impact on group strategy and business plan delivery (26)</p>	<p>As requested by the Pensions Committee, refresher training on the group structure will be provided in September 2019.</p> <p>The risk has slightly increased to reflect transitional risk in implementing both the organisational development review of the staff structure and also the changes being introduced by the governance review. In addition, LPF continues to monitor the resourcing of certain internal teams on which it relies for intra-group services.</p>	<p>Increase</p> 

Risk & Reference Number	Update	Trend / RAG
<p>Limited or incorrect data from Employers leading to incorrect valuation of liabilities /benefit payments / fines from Pensions Regulator (post April 2015) (29)</p>	<p>The Fund continue PAS monitoring and the process is now underway to address poor performance, the details of which will be presented to the Pension Committee under a private agenda in September 2019. Until the process is complete the risk has increased.</p>	<p>Increase</p> 
<p>Over reliance on single service provider for core functions, potential leading to loss of service on the collapse or withdrawal of that provider. or artificially inflated costs (31)</p>	<p>This risk remains at amber and is likely to do so until there is less dominance of key service providers and greater options available to the Fund.</p>	<p>Static</p> 
<p>Human resource within the LPF Group not sufficient to carry out core tasks in conjunction with active or anticipated projects (32)</p>	<p>The risk remains under close scrutiny 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. However, the risk has been significantly reduced following the successful recruitment to key roles identified in the Organisational Development Review. Implementation of this strategy nevertheless continues and requires to be bedded in.</p>	<p>Decrease</p> 
<p>Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact (35)</p>	<p>At its meeting on 26 June 2019 the Pension Committee asked that Cybersecurity be monitored by the Fund separately to the ICT risk (7) and the Business Continuity risk (11). At its management risk meeting on 19 August 2019 the Fund discussed and agreed monitoring and controls for the new risk with the help of the new ICT Oversight manager.</p>	<p>New Risk</p>

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

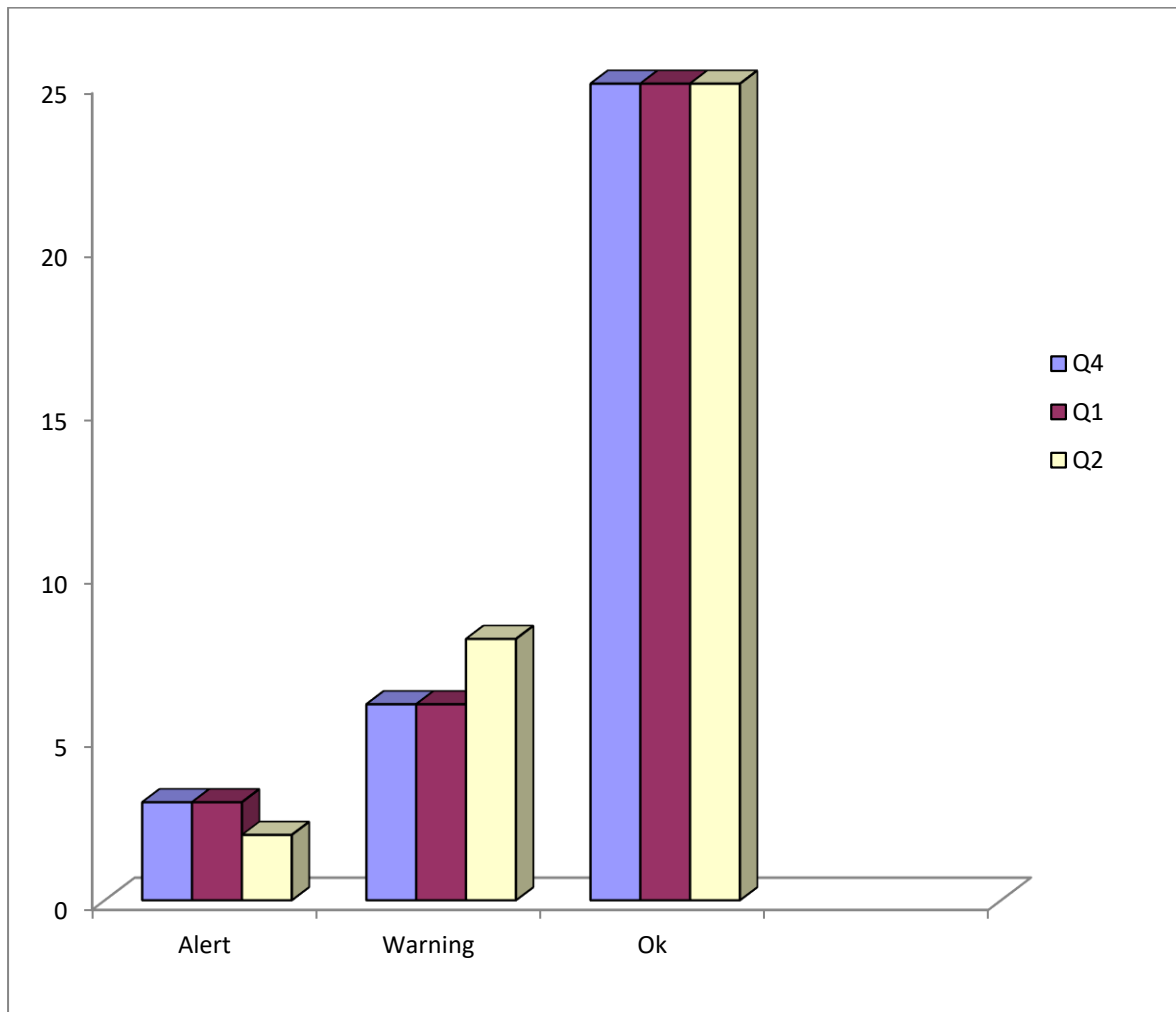


OTHER KEY POINTS

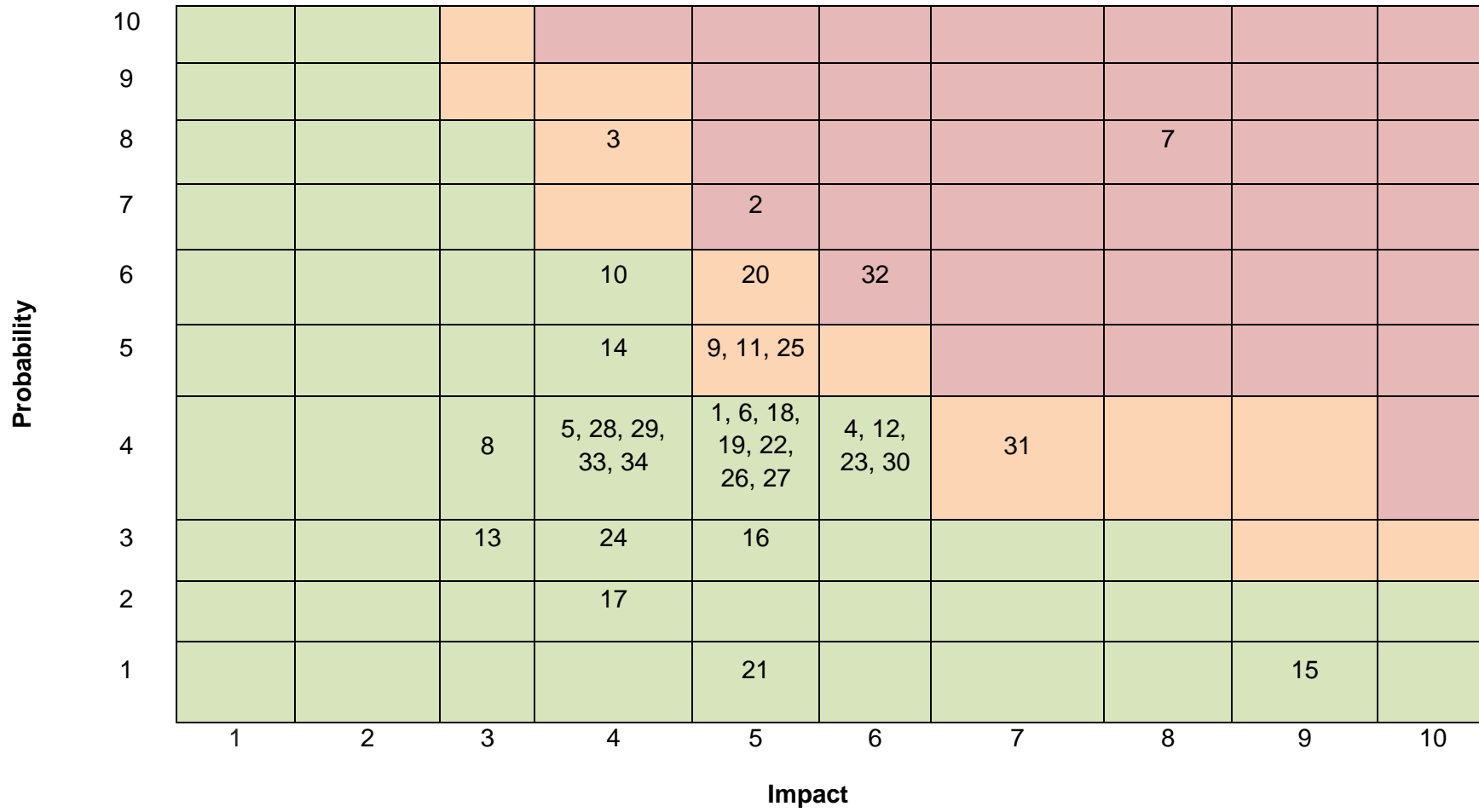
	Comments
New notable risks	Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact (35)
Other new risks	None.
New controls	<p>Investment management oversight model including reviews, policy statements and quantitative analysis (1)</p> <p>Ongoing management of staff data management on systems and manual inputs. (6)</p> <p>IT Oversight and Governance Manager appointed (August 2019). (7, 35)</p> <p>Increased direct contact with CGI to further our aim of closer oversight and monitoring. (7)</p> <p>Digital strategy / ICT pathway approved by Pensions Committee (June 2019) giving approval to exit CGI partnership. (7)</p> <p>Non-Elected members appointed. (9)</p> <p>Pending action from system provider to apply both tolerance limits and additional controls for bulk uploads of member data from employers through its i-Connect portal, LPF is undertaking its own validation each day on live system. (12, 14)</p> <p>Extended reminders as part of PAD approvals. (16)</p> <p>Compliance procedures. (35)</p> <p>Contract checks generally. (35)</p> <p>Third party supplier management process. (35)</p>
Eliminated risks	None.

	Comments
Notable initiatives / actions	<p>Admission agreement reviews and update following employer covenants review ongoing. (3)</p> <p>Implementing a 'whole of group' succession plan and SLT organisational review process underway. (4)</p> <p>2019 Governance Review and proposed outcomes. (4, 9, 12)</p> <p>Definition of KPI re accuracy of pensions calculations to be contractually agreed with the supplier (14)</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) Reviewing the fund's present and future accommodation requirements. (11)</p> <p>Detailed review of existing CGI and third-party supplier systems, controls, prevention measures and governance around cyber security and our own monitoring and transparency of this. (35)</p>
Material litigation	None.

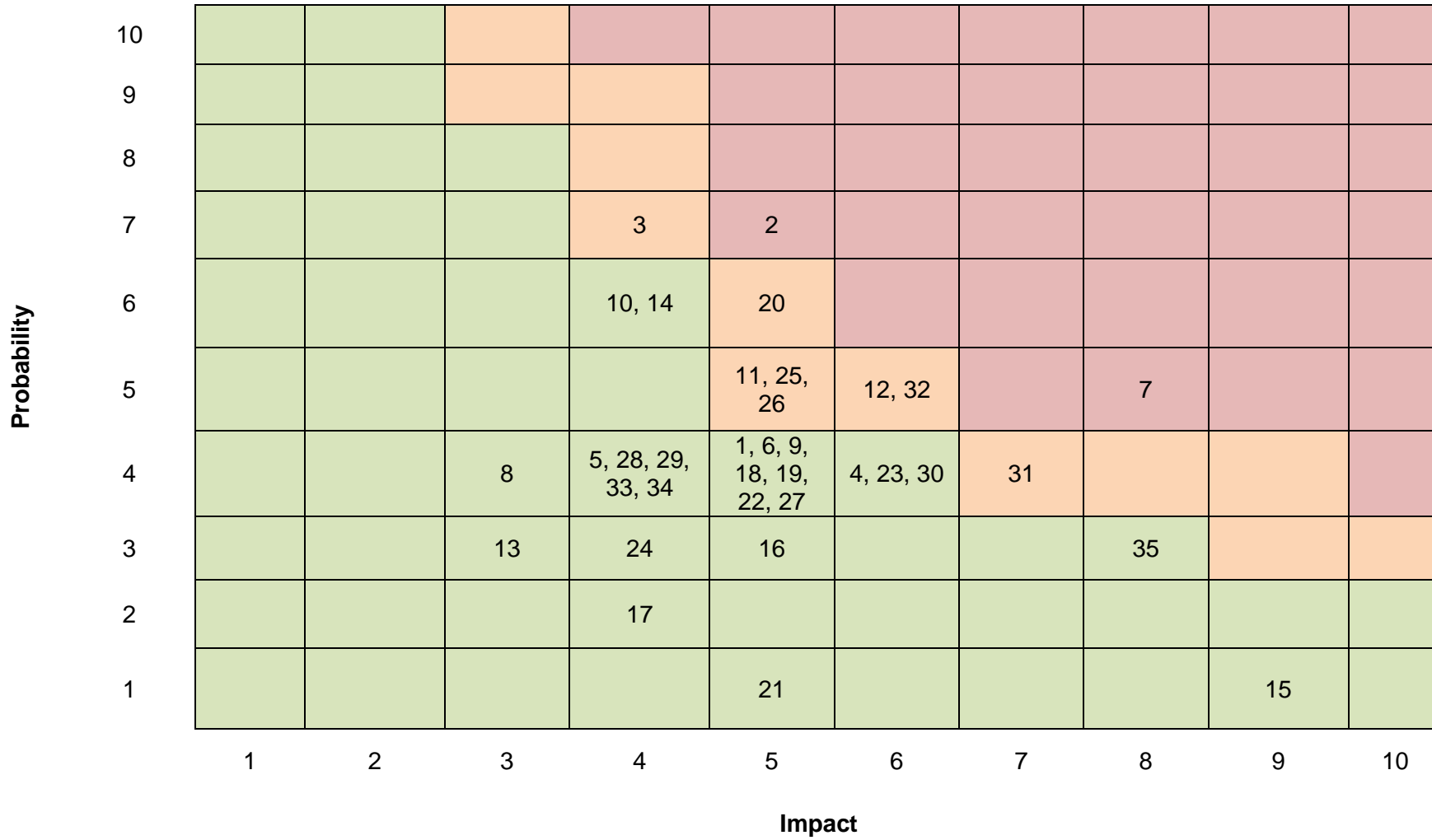
All Risks: Status Overview



Quarter 1
2019/20 All Risks: Impact and Probability Overview






Quarter 2
2019/20 All Risks: Impact and Probability Overview



Key: Risks by Number

1	Adverse Investment performance causes funding levels to fall requiring higher employer contributions	20	Regulatory Breach
2	Adverse change in non-investment actuarial assumptions cause funding levels to fall requiring higher employer contributions assumptions- pressure on employer contributions	21	FOI process not in accordance with law
3	Failure of an employer to pay contributions causes funding levels to fall, requiring higher contributions from other employers	22	Incorrect communication with members
4	Failure to recruit, engage and retain talent leads to workforce capability gaps with implications for oversight, control, administration and achievement of service plan goals	23	Acting beyond proper authority/delegations
5	Fraud or theft of Council/Pension Fund assets	24	Inappropriate use of pension fund monies
6	Staff Negligence	25	Procurement/framework breach
7	Failure of IT systems used in the Fund with serious consequences for investment management, benefit administration and oversight activities	26	Group Structure and Governance not fully compliant and up to date (including integration of subsidiaries) or working effectively resulting in adverse impact on group strategy and business plan delivery.
8	Employers make individual or collective employee decisions without considering the impact on the pension fund causing exceptional benefit entitlement or additional fund strain not able to be recovered at point of decision	27	Claim or liability arising from shared services
9	Committee members take decisions against sound advice	28	Unauthorised access to PensionsWEB
10	Pension Board not operating effectively	29	Incorrect data from Employers leading to finds etc
11	Business continuity issues	30	Inadequate contractual protection for services
12	Members' confidential data is breached	31	Over reliance on single core service provider
13	Loss due to stock lending default	32	Human resource insufficient to carry out active projects
14	Risk of incorrect pension payments	33	Breach of health and safety regulations
15	Failure to pay pensions as they fall due	34	Inadequate, or failure of, supplier and other third-party systems (including IT and data security)
16	Market abuse by investment team or others	35	Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact
17	Portfolio transition issues		
18	Disclosure of confidential information		
19	Material breach of contract		

Risk Status	
	Materially beyond appetite: resolve urgently where possible (probability and impact total 35 and above)
	Beyond appetite: resolve where possible (probability and impact total 25 to 34)
	Within appetite: monitor (probability and impact total 24 and below)

Risk Scoring

	Impact
0	(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

	Probability
0	(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