

Pensions Committee

2.30 p.m., Tuesday, 23 September 2014

Risk Management

Item number	5.10
Report number	
Executive/routine	
Wards	All

Executive summary

The pension funds' risk management procedures require us to:

- (i) 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
- (ii) 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**").

The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub-Committee.

The Quarterly Risk Overview, as at 20 September 2014, is set out in the appendix to this report.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Report

Risk Management

Recommendations

- 1.1 We recommend the Committee notes the Quarterly Risk Overview and highlights any points it wishes to raise at the Pensions Committee on 23 September 2014.

Measures of success

- 2.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Pensions Committee and Pensions Audit Sub-Committee should increase general awareness and allow productive analysis/feedback by the Pensions Committee/Audit Sub-Committee members on these fundamental issues.
- 2.2 Ultimately, risk management should lead to less third party exposure, an improved financial position and have a positive impact on the reputation of the pension funds.

Financial impact

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

Risk, policy, compliance and governance impact

- 4.1 Please see the Quarterly Risk Overview appended to this report.

Equalities impact

- 5.1 None.

Sustainability impact

- 6.1 None.

Consultation and engagement

- 7.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None.

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Links

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Appendices Appendix 1 - Quarterly Risk Overview, as at 20 September 2014

QUARTERLY RISK OVERVIEW

20 September 2014

UPDATE ON MOST NOTABLE RISKS

Risk	Update
Investment performance leading to pressure on employer contribution	<p>The new lower volatility investment strategy continues to be implemented to mitigate this risk and more detailed reporting on the Investment Strategy has been produced for the Pensions Committee.</p>
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	<p>Progress on the 2014 actuarial valuation is being made. Experience against funding assumptions and employer contributions will be assessed.</p>
Collapse/restructuring of an employer body leading to pressure on other employers	<p>As reported to the Pensions Committee, we have concluded our covenant analysis and will look to prioritise the actions arising from this and implement them accordingly. The employers will be made aware of their results as part of the engagement process leading up to the 2014 valuation and we will look to build on this analysis and continue to monitor employer covenant on an ongoing basis.</p>
Recruitment and retention of key staff	<p>This risk remains high due to the continued improvement in UK economic and market conditions in the private sector and despite Scottish Widows Investment Partnership (SWIP) having recently laid-off a substantial number of Edinburgh based investment managers. Options to mitigate this risk have been proposed to Committee. In the meantime, contingency plans have been considered for the internal investment portfolios in the event of significant staff turnover.</p> <p>We have now recruited a permanent Finance Manager and an Investment Analyst to provide further resource in the Real and Other Asset team. We have also recruited a Portfolio Manager on a temporary basis to manage the Asia Pacific portfolio which we have brought in-house from Baillie Gifford.</p> <p>We are also looking to recruit a newly qualified solicitor to assist with progressing with the authorisation by the Financial Conduct Authority and provide appropriate cover for the Legal & Risk function in anticipation of our having to meet increased compliance requirements should we receive such authorisation. In addition, a legal trainee has joined the division for 6 months as part of the ongoing trainee rotation.</p>
Risk of incorrect pension payments	<p>Progress to achieve full integration/automation to reduce reliance on manual intervention in some processes is ongoing and a review of processes by internal audit will be undertaken. Once these are completed we would anticipate this risk being further reduced to the extent that it would not be worthwhile highlighting to the Committee.</p>

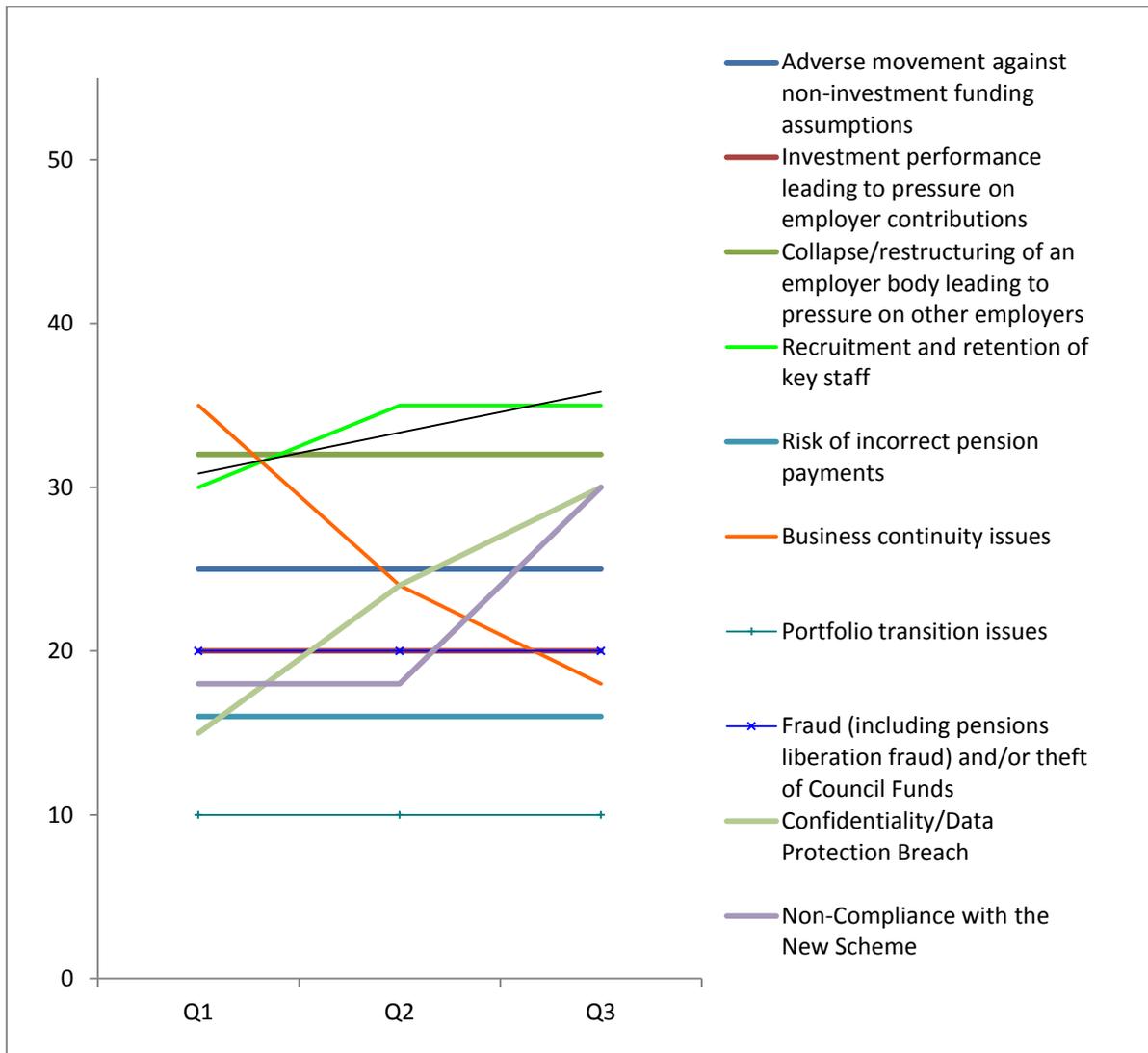
Members' Confidential Data is lost or made public / breach of Data Protection Act	<p>This risk has been increased due to our having a further, minor, data protection breach arising from an error in a bulk print run. This breach has been reported to the Data Protection team in the usual way and we are in the process of reviewing our internal printing systems, and the longer-term option of outsourcing bulk printing of this nature, in order to assess the best means of mitigating this risk.</p> <p>Separately, we are continuing to liaise with the Council's ICT and Data Protection teams regarding an overall review of our systems and processes. Initial feedback has been that our systems and processes are robust and fit for purpose, but we await more detailed feedback.</p>
Acting out-with proper authority / delegations	<p>We now have a more detailed set of sub-delegations in place for the division and so would not anticipate the need to highlight this risk in future reports.</p>
Fraud (including pensions liberation fraud) and/or theft of pension fund monies	<p>The risk around Fraud remains the same, as we are currently defending an IDR/P/appeal process, where a scheme is challenging our refusal to transfer one of our member's benefits to them. We will update the Committee on the outcome of this process and continue to monitor our transfer-out procedure to ensure that it does not have a disproportionate impact on our timescales and process for completing more routine requests.</p>
Adverse assumptions leading to pressure on employer contributions; Fraud.	<p>We are also closely monitoring the levels of transfers-out to determine whether there will be an increase in light of increased flexibility in Defined Contribution (DC) pensions and the decision to allow transfers from the LGPS to Defined Contribution schemes. This could have implications for funding and cashflow and investigations on the potential implications will be taken forward. We also anticipate that transfer requests are more likely to involve an element of personal investment of pension benefits by members and so may lead to requests for transfers within more demanding timescales. An increase in the volume of transfer requests, and an accompanying shift in expectations for timescales for such transfers, may also have an impact on our assessment of risk with respect to potential pensions liberation fraud cases.</p>
Breach of Contract	<p>The initial contract review is nearing completion and has not identified any material concerns. However, we are in the process of refining our review and so this risk should remain static until that process has been completed and we have liaised with the CEC procurement team to ensure that our early warning systems for contract terminations/extensions are robust.</p> <p>We anticipate that this risk should be significantly reduced once this review has been completed.</p>
Business continuity	<p>The Pensions Audit Sub-Committee, at its meeting on 16 June 2014, requested that the Director of Corporate Governance considers whether a test of the disaster recovery system (of the pensions administration system) was necessary to establish sufficient assurance. The software system for pensions administration is hosted by the supplier, Heywood Limited (part of the aquilaheywood group). In 2013, the company advised Lothian Pension Fund that it was outsourcing its hosting and disaster recovery provision to Blue Chip Limited in order to enhance these services. Migration of live data took place on 4 November 2013. Whilst the company is committed to an annual disaster recovery test, this is not scheduled until the anniversary of the data migration, that is November 2014. The rationale for this is that "aquilaheywood effectively carried out a full recovery of services as part of the migration of services from aquilaheywood's data centre in Redhill to Blue Chip's data centres in Bedford during November 2013". The company has stated its willingness to disclose the results of the annual test, on request, to its clients. Lothian Pension Fund has confirmed that it wishes to see the disaster recovery test report in full. The Fund, however, is not comfortable with the delay in the live</p>

testing and would have preferred that this would have been undertaken sooner. Pending the outcome of this test in a few months time, the Fund has requested that the company provide more detail as to the basis of selection of Blue Chip Limited as the hosting services provider and also a statement confirming its continued confidence in the disaster recovery facility.

Non-compliance with the new LGPS Scheme in Scotland / Public Service Pensions Act 2013

Benefit regulations have been finalised but the timetable for producing the draft regulations for the governance of the new scheme has slipped. Implementation of the systems required to administer the new scheme and accompanying governance changes remain challenging. While this will likely present resource and other pressures as we move closer to the deadline for implementation in April 2015, feedback from funds in England and Wales (having worked to an extremely tight implementation timescale) suggests that this will be manageable. We will continue to be actively involved in the national discussions and closely monitor the position.

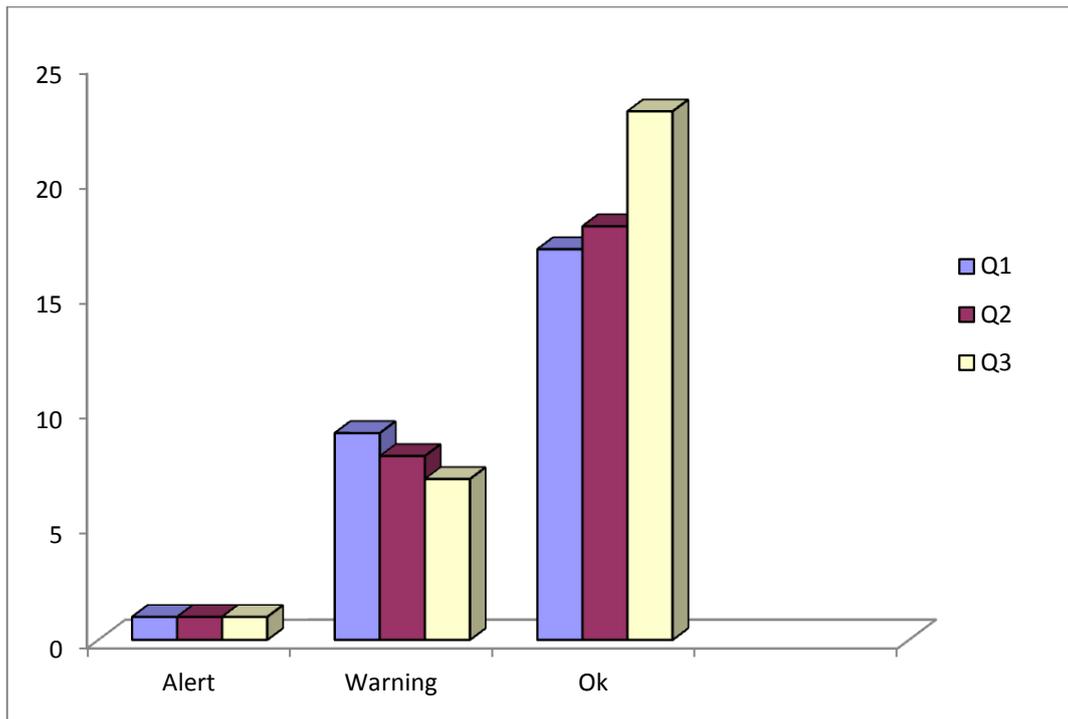
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



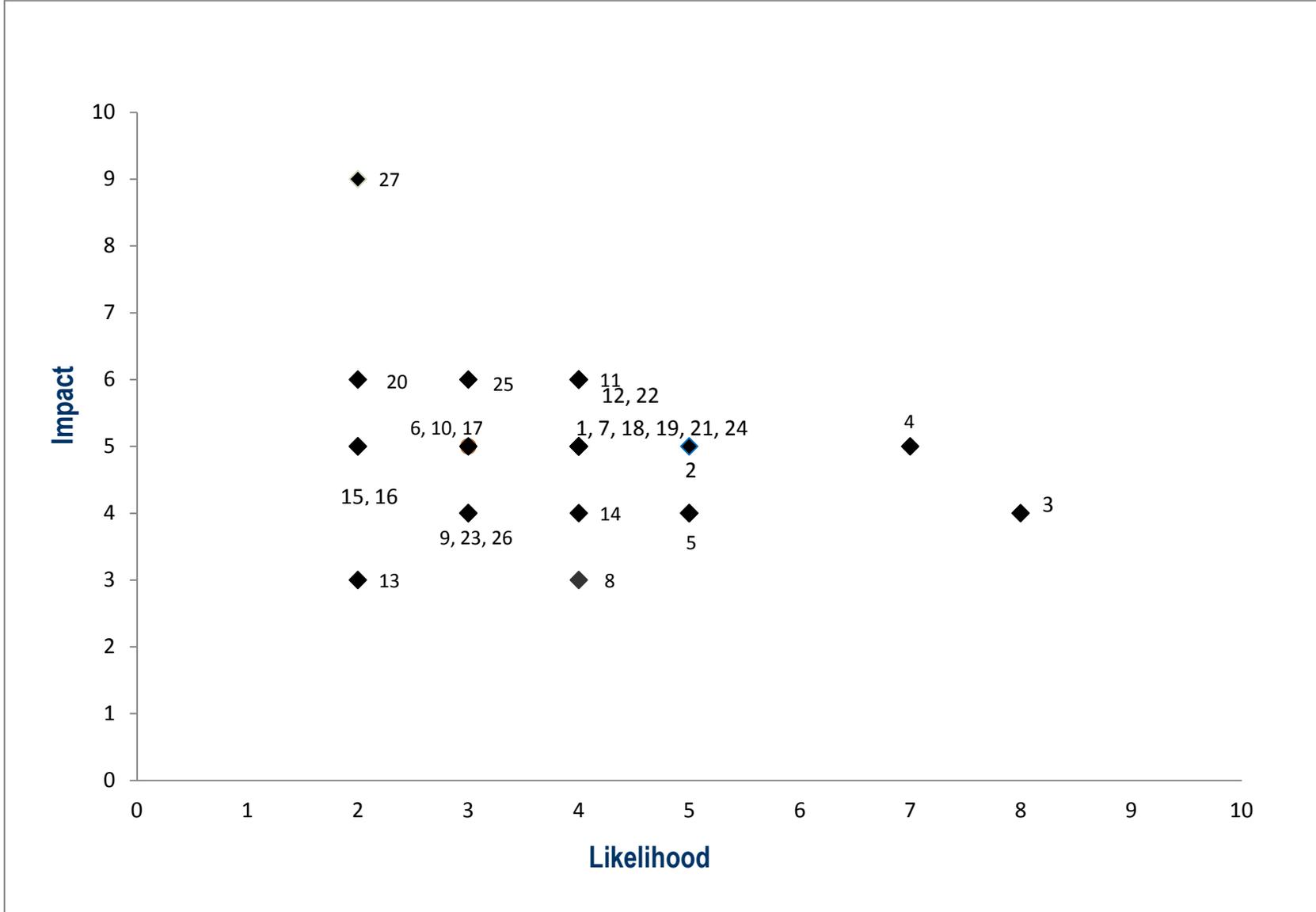
OTHER KEY POINTS

	Comments
New significant risks	None
Other new risks	<p>Receiving services without adequate contractual protection: arising from our identifying the need to ensure that we have robust contract termination and extension processes in place.</p> <p>Over reliance on a single service provider for core functions, potentially leading to loss of service or artificially inflated costs: arising from our recognition of the need to monitor our key service providers.</p> <p>Unauthorised access to the PensionsWEB employer online system allowing access to member records</p> <p>The receipt of limited or incorrect data from employers leading to incorrect valuation of liabilities / benefit payments (potentially leading to fines from the Pensions Regulator from April 2015).</p>
New controls	Recruitment of a permanent Finance Manager, Investment Analyst and temporary Portfolio Manager.
Eliminated risks	None
Notable initiatives / actions	<p>Working closely with the Information Compliance and ICT teams to implement a review of our systems, procedures and contracts from a Data Protection and Information Security perspective.</p> <p>Options to manage the HR risk associated with the internal investment function have been considered and presented to Committee.</p> <p>Researching a Council controlled corporate entity which will facilitate FCA authorisation for the purpose of good governance of our in-house investment function and to achieve further efficiencies with other Local Government Pension Funds.</p> <p>Employer engagement with Lothian Buses and Scottish Government as part of the 2014 actuarial valuation. Initial outcomes of the employer covenant review due to be shared with employers and guarantors.</p> <p>The Scottish Information Commissioner has recently reinforced our decision not to disclose certain information in relation to a private equity fund, due to the particular circumstances for that fund, by deciding in our favour in a recent appeal case. The decision, which has previously been circulated to the Committee, supports our current procedures and engagement on these sometimes difficult matters.</p>
Material Litigation	None.

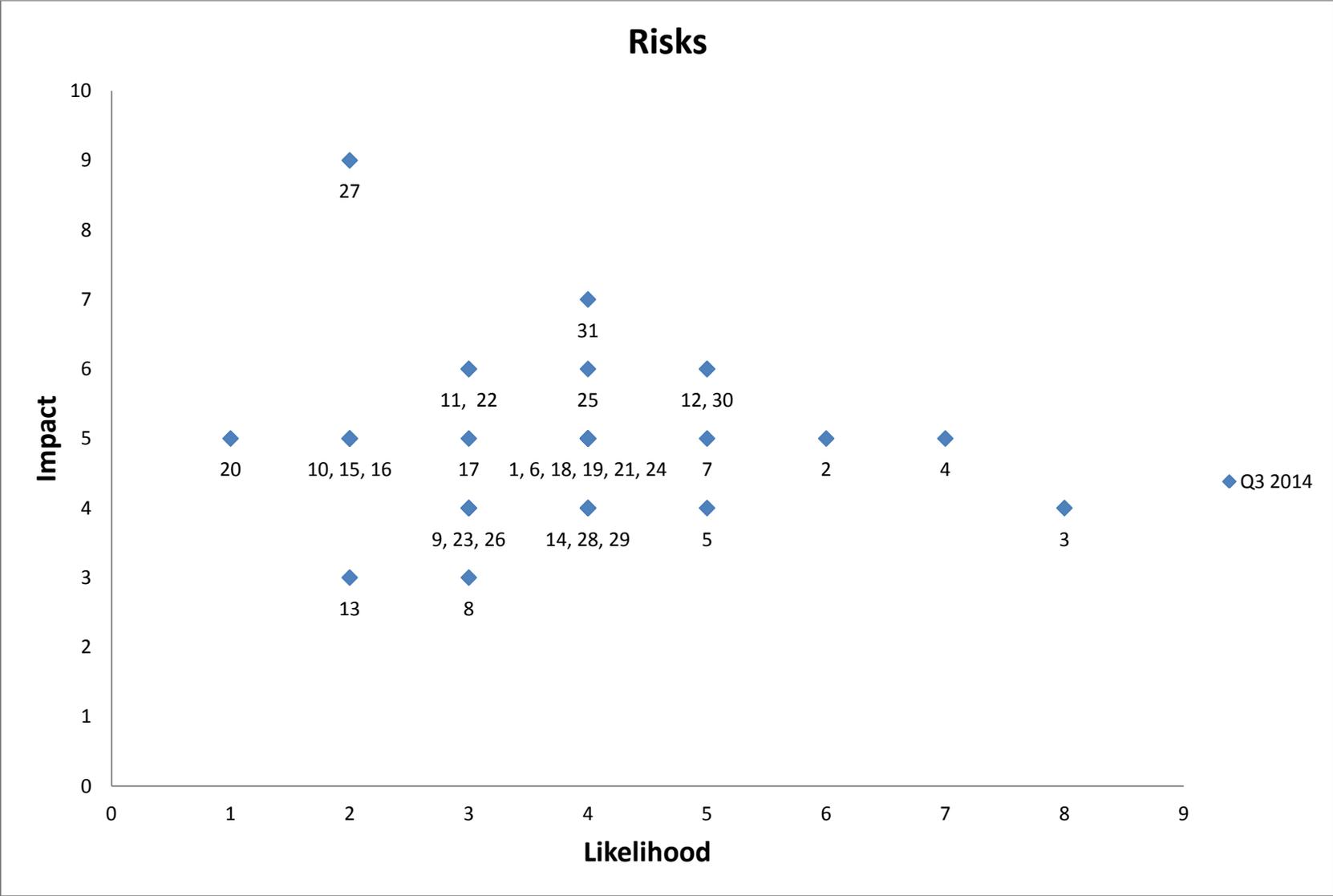
All Risks: Status Overview



Q2 (2014) All Risks: Impact and Likelihood Overview



Q3 (2014) All Risks: Impact and Likelihood Overview



Key: Risks by Number

1	Investment Performance pressure on employer contributions	15	Market abuse by investment team
2	Adverse Movement - pressure on employer contributions	16	Portfolio transition issues
3	Collapse of an employer	17	Disclosure of confidential information
4	Retention of key staff	18	Material breach of contract
5	Fraud or theft of Council/Pension Fund assets	19	Regulatory breach
6	Staff negligence	20	FOI process in accordance with law
7	Failure of IT systems	21	Incorrect communication with members
8	Employers HR decisions without consideration of fund	22	Not acting in accordance with proper authority/delegations
9	Elected members take decisions against sound advice	23	Inappropriate use of pension fund monies
10	Failure to complete annual accounts	24	Procurement/framework breach
11	Business continuity issues	25	Non-compliance with the new LGPS
12	Members' confidential data is breached	26	Claim or liability arising from shared services
13	Loss due to stock lending default	27	Late Payment of Pensions
14	Risk of incorrect pension payments	28	Unauthorised access to PensionsWEB
29	Limited or incorrect data from Employers	30	Receiving services without adequate contractual protection
31	Over-reliance on single service provider		