

HIGHLAND COUNCIL

Committee: Pensions Committee

Date: 16 February 2023

Report Title: Risk Management update

Report By: Head of Corporate Finance

1. Purpose/Executive Summary

- 1.1 This report provides an update on the Fund's risk register and compliance with the Pension Fund Regulator requirements on internal controls.

2. Recommendations

- 2.1 Members are asked:
- i. to note the updated risk register extract and compliance with the Pension Fund Regulator requirements
 - ii. to consider whether any additional risks need to be added to the register.

3. Implications

- 3.1 Resource - covered in report
- 3.2 Legal - none
- 3.3 Community (Equality, Poverty and Rural) – none
- 3.4 Climate Change / Carbon Clever – none
- 3.5 Risk – covered in report
- 3.6 Gaelic - none

4. Background

- 4.1 The Highland Council Pension Fund Risk Management Policy and Strategy was approved by the Pensions Committee in August 2018. The most recent update provided on the risk register was in September 2022.

5. Risk Management Policy and Strategy

- 5.1 The Fund has a commitment to maintaining a structured approach to risk management ensuring that the Fund effectively manages its risks in order to support the achievement of the Fund's strategy, aims and objectives. There is a Risk Management Strategy and policy in place and the risk register is reviewed regularly by officers and presented to the Pensions Committee.
- 5.2 The Risk Management Strategy and policy were approved by Pensions Committee in August 2018.

<https://www.highlandpensionfund.org/media/j0sla0gc/2018-08-09-risk-management-policy.pdf>

- 5.3 The Pension Fund Regulator requires that each Fund has internal controls and processes in place for managing risks.

<https://www.thepensionsregulator.gov.uk/en/public-service-pension-schemes/scheme-management/internal-controls-and-managing-risks>

6. Risk Register

- 6.1 The Fund's risk register was drafted by identifying the key objectives of the Pension Fund (key objective categories were Governance, Investments, Funding, Administration and Communications) and risks that would prevent these objectives being achieved. The next step was to score the risks as Red, Amber or Green depending on the impact and likelihood of the risk and considering any mitigating controls. The risk register was then circulated to the relevant officers for comment.
- 6.2 In order to manage risk on an ongoing basis, the risk register is regularly reviewed, and risks are added as required. Review of the risks is completed at the regular meetings between the Pensions Administration team and the Pensions Investments and Accounting team. Any red and amber risks on the risk register and action being taken to manage and address these risks will be reported to the Pensions Committee meetings on a regular basis. Members also have the opportunity to highlight any risks that they consider should be added to the risk register.

7. Review of Current Pension Fund Risks

- 7.1 As at January 2023, there were 11 risks which were identified on the Highland Council Pension Fund risk register as being the most significant for the Pension Fund. The extract from the risk register is at **Appendix 1**.

- 7.2 The risk regarding staffing (**1.Staffing**) highlights the potential regulatory impact of under-resourcing as well as the stakeholders who would be impacted. The impact of significant changes in pensions legislation, as well as investment changes planned by the Fund, also are factored into this risk on staff resources.
- 7.3 Another key risk is inflation (**8.Funding risk (rising inflation)**) which has continued to rise (rate was 10.5%, December 2022); increasing inflation would increase pension liabilities as these are inflation linked, with a potential increase to employer contributions. Rising inflation could also impact the market value of certain asset classes positively or negatively. As part of the triennial actuarial valuation to be completed by the Fund's Actuary as at 31 March 2023, assumptions about future inflation and its potential impact on liabilities and employer rates as well as on investment returns will be considered.
- 7.4 The gross risk status for all 11 risks is Amber, however considering mitigating controls, these risks are being actively managed and the residual risk status changes to Green apart from the risks relating to staffing which will remain as amber until the implementation of the proposed new structure.

Designation: Head of Corporate Finance

Date: 31 January 2023

Author: Catriona Stachan, Principal Accountant

Appendix 1 – Updated Risk Register as at 31 January 2023

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Governance and Administration Investments	<p>1. Staffing</p> <p>The potential staff turnover generally in this specialist area has associated risks.</p> <p>Increasing demands and complexity around pensions, the increased expectations of all stakeholders and statutory national requirements has created additional pressures on the Pension Administration team. Without adequate resourcing, there is a risk of non-compliance with regulations. The Fund must comply with regulations or could face investigation by the Pensions Regulator. If there is a lack of resource to meet these regulatory requirements this would have serious consequences (Risk 63).</p> <p>During the financial year 2022/23, in addition to the planned retirement of the Payroll and Pension Manager and the Assistant Payroll and Pensions Manager, the Finance Manager providing accounting support to the Pension Fund also retired. The Head of Corporate Finance (section 95 officer) is scheduled to leave in early March 2023.</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>A review of staffing structures, succession and workforce planning, and training has been completed. A proposed staffing structure to mitigate these risks is included in the 2023/24 Service Plan and to ensure the workforce meet the changing demands of the management of the Fund.</p> <p>Pensions fund performance will continue to be monitored through key performance indicators.</p> <p>Interim cover will be in place for the role of section 95 officer when the Head of Corporate Finance leaves.</p>	26 Jan 2023	A

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Governance	<p>2. Knowledge risk</p> <p>Ongoing risk of members and officers being unaware of changes to LGPS governance, administration and investment matters. Risk of non-compliance with Pension Fund Regulator requirements (Risk 4).</p> <p>Ultra vires pension fund actions lead to financial loss and damage to reputation (Risk 2).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	Members and officers will avail themselves of appropriate training opportunities. The Highland Council Pension Fund (HCPF) follow CIPFA Skills and Knowledge framework to ensure staff are adequately trained. Officers attend relevant LA peer group meetings (Pensions and Investment) and training. Investment advisor provides support as required. Self-audit being undertaken of the Fund's policies and processes against the Pension Fund Regulator requirements.	26 Jan 2023	G
Governance	<p>3. Government policy</p> <p>With the appointment of a new Pensions Minister in October 2022, there is the potential for future regulatory and policy changes.</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	Members and Officers keep up to date with regulatory and policy changes by reading regular bulletins and attending training	26 Jan 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Governance	<p>4. Support services</p> <p>Services are provided by the Highland Council to the Highland Council Pension fund for central support services some of which include the following:</p> <ul style="list-style-type: none"> • ICT support services • Payroll for staff who administer the Fund and Pensioners • Creditor payments • Property • Senior Management (section 95 officer) • Human Resources <p>The Highland Council has a potential funding gap of £40m in 2023/24. Due to need for cost savings to be made by Highland Council, there are the following potential risks:</p> <ul style="list-style-type: none"> • potential adverse impact on central support services provided by the Highland Council with lack of service or reduced quality. • increase in the central support charge charged by the Highland Council for these services. 	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>A review of staffing structures, succession and workforce planning, and training has been completed. The proposed staffing structure is included in the 2023/24 Service Plan.</p> <p>One of the aims of this structure is to build resilience and contingency within the Pension Fund section.</p>	26 Jan 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Governance	<p>5. Failure/loss of IT</p> <p>Organisations are being increasingly targeted by cybercrime with the risk of an attack which could potentially result in the loss or disruption to IT services and potential data breaches.</p> <p>With the reliance on IT by both the Pensions Administration and Investment teams, this would potentially have a significant impact on the delivery of service (Risk 89).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>ICT firewalls in place to quarantine emails.</p> <p>All potential virus emails should be logged with the ICT Helpdesk, who investigate and escalate to other users or introduce additional controls as appropriate. Users are regularly reminded to follow this process and not click on any attachments or files and not to disclose passwords.</p> <p>Data is backed up regularly and held securely to support business continuity.</p>	26 Jan 2023	G
Investments	<p>6. Funding risk (contribution rates)</p> <p>If the investment strategy is inconsistent with the funding plan, then it can lead to setting inaccurate employers contribution rates (Risk 29).</p>	Pensions Committee/Pensions Board/ ISC/Officers	A	<p>Triennial valuation for 2020 and further review of asset strategy was reported to Pensions Committee in March 2021. Asset Strategy review proposals were approved by Pensions Committee in March 2021 to reduce volatility in the portfolio. The majority of these changes to the portfolio have now been implemented.</p>	26 Jan 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Investments	<p>7. Funding risk (investment returns)</p> <p>If investment return is below that assumed by the actuary in funding the plan this could lead to an increasing deficit and additional contribution requirements. The larger the level of mismatch between assets and liabilities the bigger this risk.</p> <p>This risk might be increased by volatile markets created global uncertainty particularly the impact of Covid-19, Ukraine and other geopolitical events. There are also risks associated with rising inflation which will potentially impact certain asset classes (Risk 25).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>Diversified portfolio – ISC review portfolio performance quarterly. Investment Adviser provides ISC with advice.</p> <p>The Triennial Valuation 2020 (approved by Pensions Committee in March 2021) considers all risks as part of forecasting assets and liabilities. The Funding Strategy and the Statement of Investment Principles (set out strategic asset allocation) are completed alongside the Triennial Valuation process.</p>	26 Jan 2023	G
Administration Investments	<p>8. Funding risk (rising inflation)</p> <p>Inflation has continued to rise (rate was 10.5%, December 2022) and increasing inflation would increase pension liabilities as these are inflation linked, with a potential increase to employer contributions</p> <p>There is considerable uncertainty currently around both the level of future short-term inflation and how long the current period of higher inflation will last.</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>The Triennial Valuation 2023 (will be approved early 2024)) which will consider all risks, including inflation as part of forecasting assets and liabilities.</p> <p>The Funding Strategy and the Statement of Investment Principles (set out strategic asset allocation) are completed alongside the Actuarial Valuation.</p>	26 Jan 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
	Whilst higher inflation pushes up the value of the Fund's liabilities, the Fund's investment strategy includes many asset classes that would be expected to provide a good level of protection against sustained periods of higher inflation, e.g. growth assets such as equities are generally expected to perform better in an inflationary environment to provide similar levels of 'real' returns. However, other assets classes could be adversely impacted (Risk 84).			Diversified portfolio - ISC review portfolio performance quarterly and Strategic Asset Allocation is set alongside the Triennial Valuation process. Investment Adviser provides ISC with advice.		
Investments	9. Climate risk As long-term investors, climate risk may affect the value of the Fund's investments (Risk 87).	Pensions Committee/ Pensions Board/ ISC/Officers	A	Going forward, the Fund will look at developing TCFD reporting as part of work to implement the Responsible Investment policy.	26 Jan 2023	G
Investments	10. Responsible investment risks The risks associated with Responsible Investment are not managed which could potentially impact the long-term value of the Fund's investments. There is also risk that the Fund does not comply with statutory reporting requirements on Climate Change Related Disclosures (Risk 88).	Pensions Committee/ Pensions Board/ ISC/Officers	A	During 2022/23, Officers will work to implement the Fund's Responsible Investment policy and work with Fund Managers the Investment Advisor and the Fund's custodian to develop regular reporting and the necessary disclosures for the Annual Accounts.	26 Jan 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Governance Administration	<p>11. McCloud case - risk of increased future liabilities</p> <p>The outcome of the recent McCloud judgement will impact future liabilities of the Fund and potentially increase pressure on contributions.</p> <p>Implementation of the remedy for McCloud is likely to put increased pressure on the Pensions Administration team as it will require additional benefit calculations to be provided. Software will be implemented which will identify cases where additional calculations will be required and then the staff resource required to complete this can be quantified.</p> <p>This risk concerns the legal challenge (McCloud and Sargeant) made in relation to the transitional protections introduced to the unfunded schemes, as part of the public service pension reforms in 2015, which allowed those closest to retirement to either stay in their final salary scheme or move over to the CARE scheme on a tapered basis. The Court of Appeal agreed that the transitional protections do discriminate on the grounds of age and that there was no evidence to support there was objective justification for that discrimination. The UK Government sought leave to appeal that decision but on 27 June 2019 the Supreme Court rejected that request. The challenges were made on behalf of members of the Judicial and Firefighter schemes.</p> <p>The outcome of the recent McCloud judgement will impact future liabilities of the Fund and potentially increase pressure on contributions (Risk 85).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	The main risk is on the impact of administering the remedy. The impact of the financial risk has been mitigated by incorporating allowance for it in the 2020 valuation.	26 Jan 2023	G