

HIGHLAND COUNCIL

Committee: Pensions Committee

Date: 21 September 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 – as covered in report.
- 3.2 Legal – as covered in report.
- 3.3 Community (Equality, Poverty, Rural and Island) – none.
- 3.4 Climate Change / Carbon Clever – as covered in report.
- 3.5 Health and Safety (risks arising from changes to plant, equipment, or people) – none.
- 3.6 Risk – as covered in report.
- 3.7 Gaelic – none.

4. Background

- 4.1 The Highland Council Pension Fund Risk Management Policy and Strategy was approved by the Pensions Committee and the most recent update provided on the risk register was in February 2023.

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.
<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 September 2023, there were 12 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. The staffing structure in the Service Plan 2023/24 (approved by Pensions Committee 16 February 2023) is in the process of being implemented and this risk will remain as amber, until the new structure is fully embedded.
- 7.3 Another key risk is inflation (8. Funding risk (rising inflation) though the rate has reduced to 6.8% compared to 10.5% in December 2022; high levels of inflation would increase pension liabilities as these are inflation linked, with a potential increase to employer contributions. High inflation rates 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 There is an additional risk (11. Altair Member Self Service and Pensioner payroll/Tech One implementation) which highlights that any delays in the Altair Member Self Service (MSS) and Pensioner payroll system and Tech One financial ledger implementation could have a significant impact due to key dependencies between the two projects.
- 7.5 The gross risk status for all 12 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 new structure in the Service Plan 2023/24 is embedded.

Designation: Head of Corporate Finance
Date: 11 September 2023
Author: Catriona Stachan, Principal Accountant

Appendix 1 – Updated Risk Register as at 8 September 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 and the Head of Corporate Finance (section 95 officer) left early March 2023. The Head of Corporate Finance role is currently being covered on an interim basis.</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>A review of staffing structures, succession and workforce planning, and training was completed in late 2022/23. In February 2023, the Pensions Committee approved the Service Plan 2023/24 which included a staffing structure to mitigate these risks. Until the approved structure is implemented, this risk will remain as amber.</p> <p>Pensions fund performance will continue to be monitored through key performance indicators.</p> <p>Interim cover is currently in place for the role of Head of Corporate Finance (section 95 officer).</p>	8 Sept 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.	8 Sept 2023	G
Governance	<p>3. Government policy</p> <p>There is the potential for future regulatory and policy changes. For example, the March 2023 budget changes to annual allowance which was increased to £40,000 to £60,000 from April 2023.</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	8 Sept 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 • Human Resources <p>The Highland Council has a potential funding gap of £60-70m in 2024/25. 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. (Risk 90) 	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>A review of staffing structures, succession and workforce planning, and training was completed in late 2022/23. In February 2024, the Pensions Committee approved the Service Plan 2023/24 which included a staffing structure to mitigate these risks. Until the approved structure is implemented, this risk will remain as amber.</p> <p>One of the aims of this structure is to build resilience and contingency within the Pension Fund section. The structure is in the process of being implemented.</p>	8 Sept 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 are 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 must complete cyber security training and are regularly reminded not to click on any attachments or files or disclose passwords.</p> <p>Data is regularly backed up and held securely to support business continuity.</p>	8 Sept 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>Changes to the portfolio have been implemented (following 2020 actuarial valuation) to reduce volatility in the portfolio as approved by Pensions Committee in March 2021.</p> <p>Work on the triennial valuation as at 31 March 2023 is underway with final report to be approved early 2024.</p>	8 Sept 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> <p>Work on the triennial valuation as at 31 March 2023 is underway with final report to be approved early 2024.</p>	8 Sept 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Administration Investments	<p>8. Funding risk (inflation)</p> <p>The inflation rate has reduced to 6.8% compared to 10.5% in December 2022 but is still considerably above the Bank of England target of 2%. High levels of 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> <p>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).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	<p>The Triennial Valuation 2023 (will be approved early 2024)) 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> <p>Diversified portfolio - ISC review portfolio performance quarterly and Strategic Asset Allocation is set alongside the Triennial Valuation process. Investment Adviser provides ISC with advice.</p>	8 Sept 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Investments	<p>9. Climate risk</p> <p>As long-term investors, climate risk may affect the value of the Fund's investments (Risk 87).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	Going forward, the Fund will look at developing reporting as part of work to implement the Responsible Investment policy.	8 Sept 2023	G
Investments	<p>10. Responsible investment risks</p> <p>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).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	During 2023, 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.	8 Sept 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
Administration	<p>11. Altair Member Self Service and Pensioner payroll/Tech One implementation</p> <p>The implementation of the Altair Pensioner payroll must be completed after the implementation of the Tech One financial ledger and before the Tech One payroll system implementation. Therefore, the implementation of the Tech One financial ledger is a key dependency for the Altair Pensioner payroll project and the implementation of the Altair Pensioner payroll is a key dependency for the Tech One payroll system.</p> <p>Also, to note that the pensioners payroll has been excluded from the scope of the Tech One payroll specification, so any delays to these projects could significantly impact the processing of pensioner payroll payments (Risk 91).</p>	Pensions Committee/ Pensions Board/ ISC/Officers	A	Progress of the implementation of both the Tech One and Altair project will be regularly monitored by the People and Finance Systems Programme Board.	8 Sept 2023	G

Objective area	Description	Risk owner	Gross risk rating (RAG)	Current controls	Date of assessment	Residual Risk status (RAG)
<p>Governance</p> <p>Administration</p>	<p>12. 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>	<p>Pensions Committee/ Pensions Board/ ISC/Officers</p>	<p>A</p>	<p>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 and this will also be incorporated in the 2023 valuation.</p>	<p>8 Sept 2023</p>	<p>G</p>