Division(s): N/A

PENSION FUND COMMITTEE – 15 SEPTEMBER 2017

RISK REGISTER

Report by the Director of Finance

Introduction

1. At their meeting on 11 March 2016, the Committee agreed that the risk register should form a standard item for each quarterly meeting. A copy of the report also goes to each meeting of the Pension Board for their review. The comments from the Pension Board are included in their report to this meeting and the Committee are invited to consider the current risk ratings in respect of the risks queried by the Board.

2. The risk register presented to the March 2016 Committee meeting was the first produced in the new format, which introduced the concept of a target level of risk and the need to identify mitigation action plans to address those risks that were currently not at their target score. This report sets out any progress on the mitigation actions agreed for those risks not yet at target, and identifies any changes to the risks which have arisen since the register was last reviewed. Since the June meeting, the column previous headed direction of travel has been amended to provide a narrative statement which hopefully sets out a clearer position in terms of the mitigation plan.

3. A number of the mitigation plans are directly linked to the key service priorities identified in the Annual Business Plan, and this report should therefore be considered in conjunction with the report which reviews progress against the business plan elsewhere on this agenda.

Comments from the Pension Board

4. As noted in the report from the Pension Board, the members of the Pension Board queried the current risk scores given to risks 4, 8 and 10. In respect of risk 4, the Board were concerned about the likelihood score given to the risk of Fund Managers under-performing their targets and therefore the pension fund deficit not being reduced as planned. Their concern resulted from the current performance reports which indicate a number of managers are behind targets over both the short and longer terms, and therefore felt that the likelihood score should be increased to either 3 (likely) or 4 (very likely) from the current score of 2 (possible).

5. In considering any change in likelihood score, the Committee also need to consider the impact score, which is currently shown as 3 moderate, which indicates a financial risk of £1m to £10m, or a risk of an adverse story in the

local media. The combination of both scores gives an overall risk score of 6, which is seen as the target score for this risk.

6. The latest performance report at the time the Board considered the risk register did indeed show that as a whole the Fund Managers had under-performed against their benchmarks in the most recent quarter, and over the last 10 years. Over 5 years, the managers had collectively met the benchmark and they had exceeded benchmark over the last three years, but by less than the target out-performance. However over the most recent year, the Fund Managers had collectively out-performed their target. This indicates a key issue in determining a risk score in terms of the timescale any performance should be viewed.

7. Timescale is also important in determining the impact score as any financial loss only materialises at the point any investment is realised. A large element of the current under-performance figures in the overall portfolio can be attributed to the value style global equity managers who have suffered through a period where value has consistently been out-performed by growth managers. However, if value comes back into favour as expected before the investments need to be sold, any paper under-performance can be recovered such that there is no overall loss against target.

8. Based on the view that whilst the Fund remains cash positive any current under-performance can be recovered and the fact that there has been no adverse media interest to date, it is difficult to support a case that the likelihood score needs to increase from 2, unless the impact score is reduced accordingly.

9. If the Committee do agree to amend the likelihood score, they also need to consider the target risk score and the appropriate mitigating actions. It would not seem appropriate to target a high likelihood that the Fund Managers will consistently under-perform. That leaves two potential mitigations, being either to switch from active to passive management, or to change fund managers.

10. Both these mitigating actions involve a new element of risk. Switching to passive management will reduce the potential investment return for the Fund so increasing the risk that a higher proportion of the pension liabilities will need to be funded by employer contributions. Changing Fund Managers (accepting that these will change as part of the transition to Brunel) will incur additional transition costs without any guarantee of improved performance going forward (the Brunel business case did not include assumptions on improved performance, but did assume lower fee levels achieved through economies of scale would allow payback of transition costs).

11. The second risk queried by the Board was risk 8 where the Board again felt that the likelihood score of inaccurate or out of date pension liability data as a result of late or incomplete employer returns was understated. This view was again based on current knowledge on the number of late or incomplete returns.

12. As covered elsewhere on the agenda, it has been possible to issue a higher level of Annual Benefit Statements by the deadline this year than in the past two years. This in part is a result of improved returns from scheme employers as well as improved resources and processes within the pension services team for working with scheme employers to correct data. At the time of writing this report though there was still concern about the data from two of the larger employers and whether we would be in a position to load the data and issue the statements by the end of August. The risk therefore remains that we will need to report a further regulatory breach to the Regulator which may lead to fines or adverse media coverage. As such it is proposed to increase the likelihood score to 3 whilst maintaining the impact score at 4.

13. The third risk score questioned by the Board was that for the risk of insufficient resources to deliver the Fund's regulatory responsibilities. This risk was scored at 4 – major impact, and 3 - likely. This score reflected that current pressures on the team resulting from the issues of data quality and a backlog of queries. The impact score reflected the risk of action to be taken by the Pension Regulator in the event of another reported statutory breach.

14. As covered elsewhere on the agenda, the figures for issued annual benefit statements show an improvement, and contracts are currently being finalised to bring in external resources to address the backlog of work. It is therefore arguable that the likelihood score should be adjusted to 2 now to reflect the improved ABS position, with a further reduction to 1 as the work to clear the backlog progresses.

Risks Covered by the Annual Business Plan

15. Of the 17 risks identified within the risk register, 8 are showing at target in the Register (subject to the Committee's consideration of risk 4 above). Of the remaining 9 risks, the mitigation plan for 6 is covered by the work in delivering the 2017/18 business plan.

16. Risks 1, 2 and 17 are all impacted by the cash flow model which we are currently seeking to develop with the Fund Actuary. This work has slipped against the initial deadlines set out in the risk register largely as a requirement to prioritise the work associated with developing the Brunel Pension Partnership. These are all long term risks, and there is some mitigation in place in the short term. The results of the 2016 Valuation alongside the on-going cash flow monitoring have indicated that recent investment returns have exceeded those assumed in the valuation, thereby leading to a reduction in the funding shortfall. Cash flow continues to be positive, with a monthly average of just under £0.75m more by way of contributions than is paid out in benefits, reducing the risk of emergency sales of assets.

17. Risk 7 is related to the overall work on cash flow modelling and improving our understanding of the future position on scheme employers in that it relates to the risk of financial failure by scheme employers. We are currently awaiting receipt of an updated report from the Fund Actuary on the level of deficits attributed to each scheme employer, and the strength of their financial

covenant. We would hope to bring a full report on this item to the December meeting of this Committee.

18. Risks 3, 8 and 9 relate to the work associated with data quality and are all in progress. Whilst improved monitoring arrangements have been introduced to ensure we are getting timely and accurate data from employers, the impact on resources as a consequence of the work on annual benefit statements and the backlog of queries mean there is a lack of resource to complete all the escalation work necessary to follow up with employers. We also need to develop improved management reports to highlight any issues with the data held by the Fund before we can reduce the likelihood of these risks.

Other Risks

19. The other two risks currently not reported at target are risk 10 – staff resources which is covered above, and risk 11 – skills and knowledge of the Pension Fund committee itself. On this latter risk, officers are currently putting together a full day's training programme for members of both the Committee and Board to increase the levels of skills and knowledge held across the two bodies.

RECOMMENDATION

20. **The Committee is RECOMMENDED to:**

(a) note the current risk register;
(b) consider the risk scores for risks 4, 8 and 10 as requested by the Pension Board; and
(c) note the proposed full day's training programme to be held for all members of the Pension Committee and Pension Board.

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