FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY 4 MAY 2022

Report of the Interim Director of Finance & ICT

Derbyshire Pension Fund Risk Register

1. Purpose of the Report

To consider the Derbyshire Pension Fund (the Fund) Risk Register.

2. Information and Analysis

The Risk Register identifies:

- Risk item
- Description of risk and potential impact
- Impact, probability and overall risk score
- Risk mitigation controls and procedures
- Proposed further controls and procedures
- Risk owner
- Target risk score

The Risk Register is kept under constant review by the risk owners, with quarterly review by the Director of Finance & ICT. A detailed annual review of the Risk Register by Derbyshire Pension Board (the Board) was also introduced in early 2021. The Board reviewed the Risk Register at its February 2022 meeting and the narratives of a number of risks have been updated to reflect the Board's feedback. A copy of both the Summary and Main Risk Registers are attached to this report as Appendix 2 and Appendix 3 respectively. Changes from the Committee's last consideration of the Risk Register are highlighted in blue font.

2.1 Risk Score

The risk score reflects a combination of the risk occurring (probability) and the likely severity (impact). Probability scores range from 1 (rare) to 5 (almost certain) and impact scores range from 1 (negligible) to 5 (very high). A low risk

classification is based on an overall risk score of 4 or less; a medium risk score ranges between 5 and 11; and a high risk score is anything with a score of 12 and above.

The Risk Register includes a target score which shows the expected risk score once the proposed additional risk mitigation controls and procedures have been implemented. The difference between the actual and target score for each risk item is also shown to allow users to identify those risk items where the proposed new mitigation and controls will have the biggest effect. Trend risk scores going back to the first quarter of 2020-21 provide additional context.

2.2 Covid 19

The Fund's activities have continued to be maintained and the services to employers and members have continued to be delivered while the majority of the Pension Fund team have been working from home. The processes set up to accommodate remote working will remain under review as the proportion of the team working in the office is increased following the opening up of workspaces at County Hall to their pre-Covid capacity levels (the Fund now has around 60% of its pre-Covid space work as part of the Modern Ways of Working initiative).

2.3 High Risk Items

The Risk Register has the following six high risk items:

(1) Systems failure/Lack of disaster recovery plan/Cybercrime attack (Risk No.13)

(2) Fund assets insufficient to meet liabilities (Risk No.20)

(3) LGPS Central related underperformance of investment returns (Risk No.31)

(4) Impact of McCloud judgement on funding (Risk No.38)

(5) Insufficient cyber-liability insurance relating to the pensions administration system (Risk No. 42)

(6) Impact of McCloud judgement on administration (Risk No.46)

2.4 Systems failure/Lack of disaster recovery plan/Cybercrime attack & Insufficient cyber-liability insurance relating to the pensions administration system.

The National Cyber Security Centre has warned of a heightened cyber threat following Russia's attack on Ukraine and has advised organisations to bolster their online defences. Pension schemes hold large amounts of personal data

and assets which can make them a target for cybercrime attacks. The trusted public profile of pension funds also makes them vulnerable to reputational damage.

Robust procedures are in place for accessing the systems used by the Fund and the Pension Fund's Business Continuity Plan includes the Business Continuity Policy and Business Continuity Incident Management Plan of Aquila Heywood (the provider of the Fund's pension administration system, Altair).

Detailed Data Management Procedures have been developed for the Fund which set out why members' data needs to be protected, how it should be protected (including a section on protecting against cybercrime) and what to do when things go wrong. These procedures have been rolled out to the Pension Fund team in a number of briefing sessions providing the opportunity for discussion and feedback.

A project has been started to map and document the Fund's data to ensure that it is understood where it is held, on what systems, how it is combined and how, and where, it moves; the related activities will be risk assessed as part of this process and a review of the information security arrangements of relevant suppliers to the Fund will be undertaken.

The contract with Aquila Heywood limits a cyber liability claim to a specified limit, unless a claim is based on an event caused by the contractor performing its services in a negligent manner. Separately, the Pension Fund has been included in the Council's cyber liability cover which is currently being reviewed.

Given the current heightened cybercrime threat and the review of the Council's cyber liability cover, the probability scores for both of the cyber related risks have been increased from 2 (unlikely) to 3 (possible). The impact scores for both risks remain at 4 (high), giving total risk scores for both risks of 12.

2.5 Fund assets insufficient to meet liabilities

There is a risk for any pension fund that assets may be insufficient to meet liabilities; funding levels fluctuate from one valuation to the next, principally reflecting external risks around both market returns and the discount rate used to value the Fund's liabilities. Every three years, the Fund undertakes an actuarial valuation to determine the expected cost of providing the benefits built up by members at the valuation date in today's terms (the liabilities) compared to the funds held by the Pension Fund (the assets), and to determine employer contribution rates. The last valuation was completed in March 2020 based on the assets and liabilities at 31 March 2019. Initial

preparatory work is currently being undertaken for the 31 March 2022 actuarial valuation.

As part of the valuation exercise, the Pension Fund's Funding Strategy Statement (FSS) is reviewed, to ensure that an appropriate funding strategy is in place. The FSS sets out the funding policies adopted, the actuarial assumptions used and the time horizons considered for each category of employer.

The Fund was 97% funded at 31 March 2019, with a deficit of £163m, up from 87%, with a deficit of £546m at 31 March 2016. The funding level provides a high-level snapshot of the funding position at a particular date and can be very different the following day on a sharp move in investment markets.

Whilst the Fund has a significant proportion of its assets in growth assets, the last two reviews of the Strategic Asset Allocation Benchmark have introduced a lower exposure to growth assets and a higher exposure to income assets with the aim of protecting the improvement in the Fund's funding position.

2.6 LGPS Central Pool

The Fund is expected to transition the management of a large proportion of its investment assets to LGPS Central Limited (LGPSC), the operating company of the LGPS Central Pool (the Pool), over the next few years. The Fund has so far transitioned around 10% of its assets into LGPSC active products and a further 5% into an LGPSC enhanced passive product.

LGPSC is a relatively new company which launched its first investment products in April 2018. There is a risk that the investment returns delivered by the company will not meet the investment return targets against the specified benchmarks.

The Fund continues to take a meaningful role in the development of LGPSC, and has input into the design and development of the company's product offering to ensure that it will allow the Fund to implement its investment strategy. The company's manager selection process is scrutinised by the Pool's Partner Funds and the Fund will continue to carry out its own due diligence on selected managers as confidence is built in the company's manager selection skills.

The performance of LGPSC investment vehicles is monitored and reviewed jointly by the Partner Funds under the Investment Working Group (a sub-group of the Partner Funds' Practitioners' Advisory Forum) and by the Pool's Joint Committee.

The Fund is also likely to maintain a large exposure to passive investment vehicles in the long term which will reduce the risk of total portfolio underperformance against the benchmark.

2.7 McCloud Judgement

The McCloud case relates to transitional protections given to scheme members in the judges' and firefighters' schemes which were found to be unlawful by the Court of Appeal on the grounds of age discrimination. The Department for Levelling Up, Housing and Communities (DLUHC, formerly MHCLG) published its proposed remedy related to the McCloud judgement in July 2020.

The proposed remedy involves the extension of the current underpin protection given to certain older members of the Scheme when the LGPS benefit structure was reformed in 2014. The underpin will give eligible members the better of the 2014 Scheme CARE or 2008 final salary benefits for the eligible period of service.

The changes will be retrospective, which means that benefits for all qualifying leavers since 1 April 2014 will need to be reviewed to determine whether the extended underpin will produce a higher benefit. This will have a significant impact on the administration of the Scheme. Analysis by Hymans Robertson (the Fund's actuary) suggested that around **1.2m** members of the LGPS, roughly equivalent to a quarter of all members, may be affected by the revised underpin. Locally it has been estimated that around **26,000** members of the Fund would likely fall into the scope of the proposed changes to the underpin.

Any increase in benefits for members will need to be funded by scheme employers. At a whole scheme level, Hymans estimated that total liabilities might increase by around **0.2%**, equivalent to around **£0.5bn** across the whole of the English and Welsh LGPS.

Hymans forecast that the impact of the remedy might be to increase average primary contributions by around **0.2%** of pay, with an increase in secondary contributions of around **0.1%** of pay. Whilst the impact at the whole scheme level is expected to be small, it may be material at an individual employer level. The impact on employers' funding arrangements is expected be dampened by the funding arrangements they have in place, however, it is likely there will be unavoidable upward pressure on contributions in future years.

An amendment included in the Public Service Pensions and Judicial Offices Act 2022 (received Royal Assent in March 2022), the enabling legislation for the implementation of the McCloud remedy, has subsequently increased the number of records that will need to be reviewed. It brought the LGPS into line with the other public service pension schemes by extending the scope of the

McCloud remedy to include members who were not active on 31 March 2012 but who have LGPS membership before that date and returned within five years and meet all other qualifying criteria. The criteria for a disqualifying break in service was also relaxed.

The uncertainty caused by the McCloud judgement is reflected on the Risk Register under two separate risks for clarity, one under Funding & Investments and one under Administration, although the two risks are closely linked.

The funding risk relates to the risk of there being insufficient assets within the Fund to meet the increased liabilities. In line with advice issued by the LGPS Scheme Advisory Board (SAB), the Fund's 2019 actuarial calculations made no allowance for the possible outcome of the cost cap mechanism or McCloud. However, an extra level of prudence was introduced into the setting of employer contribution rates to allow for the potential impact of the McCloud case.

A March 2022 letter from DLUHC to all LGPS administering authorities set out an expectation for how the McCloud remedy should be allowed for when valuing past service liabilities and setting employer contribution rates at the March 2022 triennial valuation.

In the short term, the impact of the uncertainty caused by the McCloud case is greatest for exit payments and credits as at a cessation event the cost of benefits is crystallised. The Funding Strategy Statement includes an allowance for a **1%** uplift in a ceasing employer's total cessation liability for cessation valuations that are carried out before any changes to the LGPS benefit structure are confirmed by regulations. The funding risk score will be reviewed when DLUHC's remedy is confirmed. LGPS regulations are expected to be finalised within the next six months and are expected to come into force in autumn 2023.

The administration risk relates to the enormous challenge that will be faced by administering authorities and employers in backdating scheme changes over such a significant period; this risk has been recognised by the SAB. Whilst the Fund already requires employers to submit information about changes in part-time hours and service breaks, the McCloud remedy may generate additional queries about changes since 1 April 2014; employers have, therefore, been asked to retain all relevant employee records. Information has also been requested from employers on the data supplied to the Fund since 2014 with respect to changes in part-time hours and service breaks.

Aquila Heywood has provided the Fund with McCloud related tools for testing on the Altair pension administration system which would be used to identify, and subsequently bulk load, any required additional service history.

A McCloud Project Board has been set up to formalise the governance of this major project. The Fund will continue to keep up to date with news related to the McCloud remedy from the Scheme Advisory Board, the Local Government Association, the Government Actuary's Department and the Fund's actuary and with the development of relevant tools by Aquila Heywood.

2.8 New & Removed Risks/Changes to Risk Scores
No risks have been removed from the Risk Register since it was last presented to Committee in October 2021 and there has been two changes to existing risk scores as detailed above; two new risks have been added:

Risk No: 19 Electronic information delivered or made available in formats which fail to meet accessibility requirements. The Public Sector Bodies (Websites and Mobile Applications) (No. 2) Accessibility Regulations 2018 (2018 Regulations) came into force on 23 September 2018 and set out that a public sector body must make its website or mobile app more accessible by making it 'perceivable, operable, understandable and robust.'

Making a website or mobile app accessible means making sure it can be used by as many people as possible including those with: impaired vision; motor difficulties; cognitive impairments or learning disabilities; and deafness or impaired hearing. The 2018 Regulations included the requirement for a public sector body to include and update an accessibility statement on its website.

The Central Digital and Data Office (CDDO) monitor public sector bodies' compliance with the 2018 Regulations with enforcement the responsibility of The Equality and Human Rights Commission (EHRC). Organisations that do not meet the accessibility requirement or which fail to provide a satisfactory response to a request to produce information in an accessible format, will be deemed to be failing to make reasonable adjustments. This means they will be in breach of the Equality Act 2010 and the Disability Discrimination Act 1995. The EHRC can use its legal powers against offending organisations, including investigations, unlawful act notices and court action.

To mitigate this risk, Fund officers liaise with specialist digital communications colleagues within the Council to ensure that the Fund's electronic platforms meet the requirement for being as accessible to as many people as possible. The Fund also utilises accessibility testing software from Silktide. The Fund's website and My Pension Online both include an accessibility statement. The risk has been attributed an impact score of 3 (medium) and a probability score of 3 (possible), giving an overall risk score of 9.

Risk No 41: Insufficient controls relating to the governance of pension administration system. The risk of insufficient controls relating to the governance of the pension administration system (Altair) undermining

confidence in the integrity of the system was raised by internal audit in relation to the Fund's process for testing on Altair. Robust procedures are in place with respect to accessing the system and the Fund undertakes rigorous testing of any updated calculations or new functionality. To bolster these controls, procedures relating to test records are currently being revised to take account of the risks highlighted by audit. Internal procedure notes are currently being updated to reflect the revised procedures and will subsequently be rolled out to the team. The risk has been attributed an impact score of 3 (medium) and a probability score of 3 (possible), giving an overall risk score of 9.

3. Implications

Appendix 1 sets out the relevant implications considered in the preparation of the report.

4. Background papers

Papers held by the Pension Fund.

5. Appendices

5.1 Appendix 1 – Implications

5.2 Appendix 2 – Summary Risk Register

5.3 Appendix 3 – Main Risk Register

6. Recommendation

That the Committee notes the risk items identified in the Risk Register.

7. Reason for recommendation

One of the roles of Committee is to receive and consider the Fund's Risk Register.

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Appendix 1

Implications

Financial

1.1 None

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 None

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None