FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 26 APRIL 2023

Report of the Director - Finance and ICT

Risk Register

1. Purpose

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

2. Information and Analysis

2.1 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
- Trend risk scores

The Risk Register is kept under constant review by the risk owners, with quarterly review by the Director of Finance & ICT. Derbyshire Pension Board (the Board) also undertakes a detailed review of the Risk Register on an annual basis. The Board's comments following its early April 2023 review of the Risk Register, have been taken into consideration during the Fund's recent update of the Summary and Main Risk Registers which 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.

2.2 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.

2.3 High Risk Items

The Risk Register currently has the following five 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 Limited related underperformance of investment returns (Risk No.31)

(4) Insufficient cyber-liability insurance relating to the pensions administration system (Risk No.41)

(5) Impact of McCloud judgement on administration (Risk No.45)

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 warned of a heightened cyber threat following Russia’s attack on Ukraine and 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.

The Fund's data mapping project is ongoing 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 are being risk assessed as part of this process and a review of the information security arrangements of relevant suppliers to the Fund is being 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 is included in the Council's self-insurance arrangements with respect to managing cyber security risks, while the Council's cyber liability cover is being reviewed.

Given the heightened cybercrime threat and the review of the Council's cyber liability cover, the probability scores for both of the cyber related risks were increased in April 2022 from 2 (unlikely) to 3 (possible). The impact scores for both risks remained at 4 (high), giving total risk scores for both risks of 12.

Derbyshire County Council's Assistant Director of ICT is due to attend the next meeting of the Pension Board to discuss cyber-security arrangements.

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 31 March 2022 actuarial valuation has now been completed. The whole fund results reported an improvement in the funding level of the Pension Fund from 97% at 31 March 2019 to 100% at 31 March 2022, with the 2019 deficit of £163m moving to a small positive surplus of £1m. The funding level provides a high-level snapshot of the funding position at a particular date and could 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.

As part of the valuation exercise, the Pension Fund's Funding Strategy Statement (FSS) was 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 method of setting contribution rates for different categories of employers was agreed and confirmed following a consultation on the FSS; the final FSS was approved by Committee in March 2023.

2.6 LGPS Central Limited

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. By March 2024, the Fund is forecast to have transitioned around 40% of its assets into LGPSC products.

The performance of LGPSC's active funds against their benchmarks has been mixed since the company 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 role in the development of LGPSC and has input into the design and development of the company's product offering to try 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 between 1 April 2014 and 31 March 2022 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.

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.

In early April 2023, DLUHC issued a response to the 2020 consultation on its proposed changes to the LGPS to address the discrimination found in the McCloud judgement. The response highlighted that the government intends to consult further on issues where it has not yet made final decisions on how the underpin will work and on a number of issues that have arisen in the course of developing the government's response to the McCloud case. Updated draft regulations are expected to be included in the further consultation which is due to be undertaken ‘in the coming months’. LGPS regulations to implement the remedy are expected to come into force in October 2023.

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 risk score for the impact of the McCloud judgement on funding was reduced to 9 in October 2022 following confirmation that for the March 2022 triennial valuation the benefits of members likely to be affected by the McCloud ruling would be valued in line with the expected remedy regulations. 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 and remains a high risk; this risk has been recognised by DLUHC and the LGPS Scheme Advisory Board.

While the Fund continued to require employers to submit information about changes in part-time hours and service breaks post the introduction of the new scheme in April 2014, the collection of information about casual hours was not continued. Employers have been asked to supply any missing data and to retain all relevant employee records.

The Fund has tested the McCloud related tools provided by Aquila Heywood on the Altair pension administration system which will be used to identify, and subsequently bulk load, any required additional service history. Aquila Heywood has also completed and released a number of further McCloud related developments, although the delay in the release of full statutory guidance from DLUHC has caused a knock-on delay to the completion of all the required development work.

A McCloud Project Board has been set up to formalise the governance of this major project. The Fund will continue to collect any missing data and continue to keep up to date with news related to the McCloud remedy from DLUHC, 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/Updated Risk Narratives

One new risk has been added to the Risk Register since it was last presented to Committee:

Risk No. 49: Failure to meet the required Pensions Dashboards deadlines.
Pensions Dashboards will enable individuals to access their pensions information from different schemes online, securely and all in one place to support better retirement planning. This will require multiple parties and systems to be connected to the Pensions Dashboards Programme (PDP) central digital architecture. There will be no central database holding personal information - the central digital architecture will function like a 'giant switchboard' connecting users with their pensions.

The Pensions Dashboards Regulations 2022 place a requirement on pension schemes to connect to the dashboard services and The Pensions Regulator has the power to issue a financial penalty for any breach of the regulations. In order to connect to the PDP central digital architecture, the Pension Fund will require the services of an Integrated Service Provider (ISP).

The staging deadline for the LGPS is 30 September 2024. Schemes will be expected to meet the required standards (connection, security and technical) by 30 September 2024. They must also, by that date, be able to respond to ‘find’ requests, complete matching and provide administrative data, signpost data, value data and contextual information on request.

The Fund has formed a Pensions Dashboards Programme Board to oversee the implementation of the PDP. Members of the team have attended information sessions on the PDP and investigations into the ISP options for connecting to the PDP have begun. Data cleansing is continuing to improve the quality of the Fund's data.

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.

One risk has been removed from the Risk Register since it was last presented to Committee:

The UK’s withdrawal from the EU results in high levels of market volatility or regulatory changes.
Three years after the UK’s withdrawal from the EU it is now appropriate to remove this risk from the Risk Register.

There has been changes to two existing risk scores:

Risk No. 12: Lack of appropriate procurement processes/procurement support leads to a failure to procure a provider/poor supplier selection/legal challenge.

The probability score has been increased from 1 (rare) to 2 (unlikely) to reflect recruitment and retention issues in County Procurement and the increasingly resource intensive nature of the procurement process. The impact score has remained at 3 (medium), giving a total risk score of 6.

Risk No 25: Covenant of new/existing employers. Risk of unpaid funding deficit.
The probability score has been reduced from 3 (possible) to 2 (unlikely) recognising the additional covenant work undertaken as part of the March 2022 actuarial valuation. The impact score has remained at 3 (medium), giving a total risk score of 6.

The narratives for a number of risks have been updated with updates highlighted on the Risk Register in blue.

3. Implications

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

4. Background 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(s)

That Committee:

a) notes the risk items identified in the Risk Register.

7. Reasons for Recommendation(s)

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.