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DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 25 OCTOBER 2023

Report of the Director of Finance & ICT

Derbyshire Pension Fund 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 Pension Board) also undertakes a detailed review of the Risk Register on an annual basis. Changes from the Committee's last consideration of the Risk Register are highlighted in blue font in the Summary and Main Risk Registers, which are attached to this report as Appendix 2 and Appendix 3 respectively.

2.2 Risk Score

The current risk score reflects a combination of the risk occurring (probability) and the likely severity (impact) after mitigation controls and procedures currently in place are taken into account. 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 provide additional context.

Following a discussion with the Pension Board, the format of the Main Risk Register has been amended to make it clearer that the current risk score is after mitigation controls and procedures currently in place have been considered and to highlight only the trend risk scores of the rolling previous four quarters in line with best practice.

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.

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.

Stephen Oxley, Derbyshire County Council's interim Assistant Director of ICT, and Paul Stone, the Assistant Director of Finance & Deputy Section 151 Officer at that time, attended the meeting of the Pension Board in June 2023 to set out planned changes to the delivery of the Council's ICT services, including changes to the compliance and security functions. Mr Oxley is due to provide a further update to the Pension Board at its next meeting in February 2024.

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 whole fund results from the 31 March 2022 actuarial valuation 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.

As part of the valuation exercise, the Pension Fund's Funding Strategy Statement (FSS) was reviewed, to ensure that an appropriate funding strategy and investment strategy are 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.

Whilst the Fund has a significant proportion of its assets in growth assets, the last two reviews of the Strategic Asset Allocation Benchmark (SAAB) 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. The SAAB is currently under review as part of the review of the Fund's Investment Strategy Statement (ISS), with an updated ISS due to be presented to Committee for consideration in December 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 12% of its assets into LGPSC active products and a further 5% into an LGPSC enhanced passive product. By March 2025, the Fund is forecast to have transitioned around 44% 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 final regulations to implement the McCloud remedy in the LGPS, The Local Government Pension Scheme (Amendment) (No. 3) Regulations 2023, were laid on 8 September 2023 and came into force on 1 October 2023.

The 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 gives eligible members the better of the 2014 Scheme CARE or 2008 final salary benefits for the eligible period of service.

The changes are 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. Locally it has been estimated that around 26,000 members of the Fund will likely fall into the scope of the proposed changes to the underpin.

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. It has now been reduced to 6, as set out later in the report, following publication of the final remedy regulations.

The administration risk relates to the enormous challenge 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. Information supplied to date by employers is currently being collated and uploaded to members' 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.

The Pension Fund's McCloud Project Board is overseeing the governance of this major project and initial training on the implementation of the remedy has been provided to relevant members of the Pension Fund team.

The Fund is continuing to collect any missing data and continuing to keep up to date with information related to the implementation of 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

No new risks have been added to the Risk Register since it was last presented to Committee and no risks have been removed.

There has been one change to an existing risk score:

Risk No. 37 Impact of McCloud judgement on funding.

Following final confirmation of the McCloud remedy for the LGPS and the Actuary's reflection of the remedy in the calculation of the liabilities for the March 22 Actuarial Valuation, the current risk score has been reduced from 9 to 6, with the impact score reducing from 3 to 2 and the probability score remaining at 3.

The target risk score has also been reduced from 9 to 6, reflecting the reduced impact score.

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

Following news of continuing budgetary pressures for local authorities, including for Derbyshire County Council, the administering authority of the Fund, any potential associated risks for the Pension Fund have been considered and discussed with the Pension Board with a number of risk narratives updated to reflect increased concerns about local authority finances.

3. Implications

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

4. Background Papers

4.1 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)

7.1 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.