FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 23 OCTOBER 2024

Report of the Director of Finance

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. 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 for the rolling previous four quarters provide additional context.

A further column indicates whether the target score is expected to be achieved in either the short, medium, or long term.

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.

The Fund's data map is continuing to be updated to ensure that it is understood where the Pension Fund's data is held, on what systems, how it is combined and how, and where, it moves; the related activities are continuing to be risk assessed and review of the information security arrangements of relevant suppliers to the Fund is ongoing.

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.

Following recent updates to Derbyshire Pension Board from the Council's Digital function on the planned changes to the delivery of the Council's ICT services (including changes to the compliance and security functions), the Fund is continuing to seek information and assurance with respect to the Council's cyber security and ICT business continuity 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.

At the last formal actuarial valuation at the end of March 2022, the funding level of the Pension Fund was 100%. This was an improvement on the funding level of 97% at the formal valuation at the end of March 2019. This improvement was consistent with the gradual increase in the Fund's funding level over the last decade from 82.5% at the end of March 2013 to 100% at the end of March 2022.

As part of the valuation exercise, the Pension Fund's Funding Strategy Statement (FSS) is 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 for the three years from 1 April 2023 was agreed and confirmed 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 was reviewed again in the final quarter of 2023, and in March 2024 Committee approved an updated SAAB as part of an updated Investment Strategy Statement. This included a further 5% switch from growth assets to income assets, reflecting the continued improvement in the Fund's funding position, whilst acknowledging that the Fund remains open to new members and continues to accrue additional future pension liabilities.

The Fund is currently preparing for the 2025 actuarial valuation which will include a review of the Pension Fund's funding strategy and the setting of employer contribution rates for the three years from 1 April 2026.

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 11% of its assets into LGPSC active products and a further 6% into an LGPSC enhanced passive product, with 2% of the Fund's assets committed to LGPSC private markets' vehicles. By March 2025, it is forecast that the Fund will have transitioned over 40% of its assets into LGPSC products/management arrangements.

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, came into force on 1 October 2023.

The remedy involves the extension of the 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 (career average revalued earnings) 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 is currently estimated that the Fund will need to investigate almost 28,000 in-scope cases, with the potential for this number to increase.

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 6 in October 2023 following publication of the final remedy regulations when the expected remedy was confirmed.

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 the Ministry for Housing, Communities and Local Government (MHCLG) and by the LGPS Scheme Advisory Board.

The McCloud functionality which allows new calculations to include the underpin protection calculation was switched on in Altair by the Fund in January 2024 and to date over 2,000 in-scope cases have been processed.

The Fund has now also developed manual processes for certain transfers pending the development of additional functionality on the Altair system, meaning all transfers are now able to be processed, albeit manual calculations are resulting in extended processing timescales.

The Pension Fund's McCloud Project Board is continuing to oversee the governance of this major project and ongoing training on the implementation of the remedy is being provided to relevant members of the Pension Fund team as required.

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 MHCLG, the LGPS Scheme Advisory Board, the Local Government Association, and from Aquila Heywood, the provider of the Altair pension administration system.

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 as set out below and the narratives for a number of risks have been updated with updates highlighted on the Risk Register in blue.

Risk No. 4: Pensions & Investments Committee/Pension Board members' lack of knowledge & understanding of their roles & responsibilities leading to inappropriate decisions The probability score has been reduced from 3 (Possible) to 2 (Unlikely) following the embedding of robust induction and ongoing training plans, reducing the total risk score from 9 to 6.

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.

Report Author:	**Dawn Kinley**	**Contact details:**	**dawn.kinley@derbyshire.gov.uk**

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