

LGPS Central Joint Committee Meeting Friday 29th June 2018

LGPS Central Pool Risk Register Report from the Practitioners' Advisory Forum (PAF)

Purpose of the Report

To provide the Joint Committee of LGPS Central Pool (the Pool) with a draft Pool Risk Register and to seek feedback on areas for further consideration.

Background

Pension Funds will typically maintain a risk register to identify the key risks faced by the Funds themselves and how these might feed into the overarching Administering Authority risk management process. For each Fund, it is likely that the individual risk registers will include risks surrounding investment pooling for them as it applies to the operation of their Fund.

As members of this Committee will recognised the management of risks is key to delivery of wider strategic objectives, but also recognising that risks also bring opportunities. Risk management is the process of identifying risks which impact on the achievement of objectives. The evaluation of their probability/ likelihood and potential consequences/ impact determine the most effective actions to take and how risks can be managed falling into 5 broad categories:

- Control;
- Minimise;
- Eliminate;
- Transfer the risk exposure;
- Accept

As the investment pool was being established, the risks around delivery of the project were captured as part of the implementation plan and included risks such as recruitment of key staff, FCA approval and IT systems development. Whilst some of these risks might still apply, the management of many of these risks will now be covered by the company's own risk register. We understand that a comprehensive risk register is currently being developed by the company that better meets their needs as a regulated entity going forwards.

The Pool Risk Register under consideration by the Joint Committee has been developed to capture key risks surrounding pooling that could impact across all parties involved in LGPS Central Pool. Reflecting on their governance role as both shareholders and clients for LGPS Central, it is important for members of this Committee to consider the high level strategic risks that could impact on the successful delivery of investment pooling and how these risks can be managed or mitigated.

The risks covered in the attached risk register have been divided into 5 categories to identify the types of risk that the pool might face as it moves forward. The risks have therefore been categorised as:

- Governance – risks that arise due to failures of the governance structure or lack of proper oversight
- Investment – risks that arise from poor performance, transition risks, failure to transfer assets or lack of suitable investment opportunities to meet partner funds strategic asset allocation requirements.
- Company – risks that are more company specific covering recruitment and retention, third party providers not able to deliver,
- Finance and Operational – risks covering the management of the budget, poor financial management and lower assets under management putting pressure on resourcing
- Wider Pooling – risks surrounding the wider political arena, challenges to pooling more generally including problems at other pools.

The magnitude of risks within the register are assessed along two dimensions:

- Likelihood – the probability that a risk will materialise
- Impact – the consequences if the risk were to materialise

These are scored on a matrix, which indicates overall levels of risk as follows:

- High risk (red) – need for early action / intervention where feasible,
- Medium risk (amber) – action is required in the near future
- Low risk (green) – willing to accept this level of risk or requires action to improve over the longer term

The Practitioners Advisory Forum have considered the key risks that could impact on the strategic development of the LGPS Central Pool (to be clear this is not the company but the wider Central Pool) and these have been compiled into the risk register attached as an appendix to this report. It is recognised that this is a living document and that the risks need to be regularly reviewed and assessed, particularly in the early phase of development. It is anticipated that as pooling progresses, some of the current risks identified as high risks will be regraded, as new controls and processes are put in place and as the level of confidence and assurance increases. As with any developing project, it is possible that unforeseen risks will arise through the development phase and these will be captured. PAF will continue to keep the risk register under review and will provide updates to the Joint Committee and highlight any new or increased risks. PAF will liaise closely with LGPS Central Ltd to capture any risks they identify which should be captured as part of the overarching Pool Risk Register.

Key Risks

Of the risks identified within the risk register, 7 have initially been identified as high level or red risks with the remainder currently being assessed as medium risk or amber. However, it is recognised that the pool is in the early stages of full operational implementation phase meaning that whilst controls may be in place to manage a

number of these risks, until they have been fully tested, it is prudent to adopt a higher level of risk classification as both the likelihood and impact of those risks are higher at this stage of development. The high risk identified within the register are:

- I3 (Investment) – Delivery of investment products to meet the strategic requirements of Partner Funds
- C1 (Company) - Partner funds transition of AUM is slower or delayed than in business plan
- C2 (Company) - Recruitment and Retention
- C4 (Company) - Market volatility leading to drop in AUM and impact on income / significant rise in AUM impact over recovery of costs leading to tax leakage
- F3 (Finance & Operational) - AUM lower than forecast leading to lower income than required
- P3 (Wider Pooling) - Pooling not perceived to be delivering cost savings or infrastructure investment
- P4 (Wider Pooling) - Speed of delivery in terms of scale, delayed implementation and infrastructure investment not seen as fast enough leading to intervention

Whilst a number of the high-level risks are currently attributed to the company from a pool perspective, this is an assessment undertaken by Partner Funds pending the more comprehensive assessment of company risks against their regulatory requirements, a process which is underway and it is anticipated will lead to the identification of controls not yet fully captured by Partner Funds within the risk register at this stage. The Company were keen to do the full analysis of their own risk register prior to commenting on the high-level overarching pool risk register, which is understandable given the regulatory regime in which they operate.

Conclusion

The risk register attempts to identify a series of risks that apply across the pool and are the risks which PAF have identified at this stage. The risk register is coming before the Joint Committee for consideration and comment. As noted earlier the risk register is very much seen as a live document and will be considered as part of the ongoing work of PAF with updates being brought before the Joint Committee for review and consideration.

Recommendation

It is recommended that the report on the LGPS Central Pool Risk Register be reviewed and feedback provided on areas further development.

LGPS SC POOL RISK REGISTER

			Control	Risk Impact	Review frequency	Risk owner
Risk ref.	RAG Rating	Risk event		Financial Operational Regulatory Reputational		
Governance						
G1		Governance structure is not effective	1. Clear understanding of roles and responsibilities - clear terms of reference	FORRp	Bi-annual	LGPSC Ltd / Partner Funds
			2. Company Board setting strategy and oversight of effectiveness of Exco and company			
			3. Shareholder Forum review and approval of shareholder matters e.g. annual accounts and budget			
			4. Joint Committee oversight of effectiveness of the pool in delivering pool objectives			
			5. Effective 2-way communications between pool operator and partner funds			
			6. Shareholder and other Legal agreements in place, regular reviews			
			7. Clear business plan with delivery timetable and KPIs / KOs including monitoring and reporting quarterly			
			8. Effective decisions making process			
			9. PAF regular meetings to review progress			
G2		Oversight Mechanisms are insufficient to provide	1. Effective reporting to Company Board, Joint Committee, Shareholder Forum and PAF	FORRp	Quarterly	LGPSC Ltd / Partner Funds
			2. Transparency and openness - timely, clear and effective communication			

		confidence	3. Knowledge, skills and training for decision makers 4. Information and reporting requirements set and agreed 5. Client services agreement and escalation process for Information and reporting requirements 6. Performance targets and benchmarks reporting both investment and company 7.PAF Governance Working Group - dedicated time to consider legal and governance issues 8. Intelligent Client / Resourcing at the fund			
G3		Insufficient Systems and controls of pool operator	1. Assurance that the operator is adhering to FCA standards, (COND, PRIN, SYSC). 2. Internal controls reporting - internal audit 3. Assurance of conflicts on interest policy (Personal Dealing) procedures are monitored. 4. Assurance of compliance monitoring (Second Line of Defence). 5. Assurance of breach reporting to relevant regulators and the fund. 6. Sufficient resources (financial and personnel) to ensure they are able to build robust systems and controls 7. Open and transparent reporting 8. Internal Audit 9. Internal Controls Reports from LGPS Central plus oversight of external providers reports	FORRp	Quarterly	LGPS Ltd
G4		Change in government policy/LGPS reforms	1. Keep abreast of developments, participating in consultation and calls for evidence. 2. Collaboration with other funds 3. Maintain effective communication with key government departments	FORRp	Quarterly	LGPS Ltd / Partner Funds

Investment Risk						
11		Transition Risks including cost over-runs and issues with transition	1. Regular monitoring against business plan	FORRp	As Required on transitions	LGPSC Ltd / Partner Fund
			2. Appointment of transition managers - use of National LGPS Framework			
			3. Detailed transition planning			
			4. Partner Fund resourcing to co-ordinate transition plans			
			5. Transparent reporting on transition - use of transition advisory services			
12		Investment Cost savings - failure to deliver reduction in manager costs leading to lower net returns	1. Oversight and scrutiny of budgets and cost savings	FRp	Quarterly	LGPSC Ltd
			2. Benchmarking costs and cost transparency reporting			
			3. Appointed managers - signatories of the Transparency Code			
			4. LGPS Central Ltd procurement process and assessment of cost and value for money			
13		Ability to deliver Investment strategy - Products / Services to meet strategic asset allocation requirements	1. Planning and product development programme	FORRp	Quarterly	LGPSC Ltd / Partner Fund
			2. Agreed priorities between Partner funds and company			
			3. Asset allocation/strategy reviews			
			4. Quarterly monitoring and reporting			
			5. PAF investment working group			
			6. Partner Fund access to new investment opportunities and ideas - LGPSC Ltd, external advisers, external managers			
			7. Development of suitable investment vehicles for illiquid asset classes			
14		Performance deterioration leading to lower investment returns	1. Performance monitoring including use of external independent provider	FRp	Quarterly	LGPSC Ltd
			2. Quarterly meetings with operator			
			3. Oversight of external managers to ensure meeting targets			
			4. Clear deliverables against benchmarks and targets			
15		Unable to identify	1. Performance monitoring to include detailed attribution on asset allocation/manager selection within the Company	FRp	Quarterly	LGPSC Ltd / Partner

		performance attribution or accurately measure performance	<ul style="list-style-type: none"> 2. Performance monitoring to provide strategic asset allocation measures 3. Management and monitoring of transition management costs and impact on performance 4. Cost transparency to ensure performance is net of all costs 			Fund
16		Failure to integrate Responsible Investment	<ul style="list-style-type: none"> 1. Clear RI Framework and Policies - LGPS Central Ltd and Partner Funds 2. Monitoring and reporting on RI included within quarterly reporting 3. Sufficient resource to integrate RI and report 4. RI integrated into procurement process for all asset classes 5. PAF Responsible Investment Working Group 	FRp	Quarterly	LGPS Ltd / Partner Fund
17		Ability to challenge investment performance	<ul style="list-style-type: none"> 1. 2-way communication - ongoing dialogue 2. Open and transparent reporting 3. Resource and oversight capability of partner funds (both collectively and individually) 4. Effective investment performance reporting - use of external performance analytics 5. Partner funds access to external advisers 	FRp	Quarterly	Partner Funds

Company						
C1		Partner funds failing to commit AUM	1. Agree high level principles on investment strategy	FRp	Quarterly	LGPSC Ltd/ Partner Funds
			2. Understanding Partner asset allocation and investment strategy requirements and maintaining communications and understanding			
			3. Monitoring of investments quarterly			
			4. Regular meetings and working groups to agree investment requirements and changes to strategy			
C2		Recruitment and Retention	1. Remuneration & benchmarking	FORRp	Quarterly	LGPSC Ltd
			2. Development opportunities			
			3. HR policies and procedures			
			4. Training, professional qualifications, compliance training			
			4. Cultural fit			
C3		External Providers not meeting requirements	1. Robust oversight & controls	FORRp	Quarterly	LGPSC Ltd
			2. Regular benchmarking			
			3. Contract Monitoring			
C4		Market volatility leading to drop in AUM and impact on income / significant rise in AUM impact over recovery of costs leading to tax leakage	1. Regular review of charging mechanism	FORRp	Quarterly	LGPSC Ltd
			2. Strategic oversight and monitoring market conditions			
			3. Budget controls and communications with partner funds on cost charging model			
			4. Professional tax advice and internal expertise to ensure appropriate measures in place to avoid impact of tax leakage			

Finance & Operational						
F1		Budget overspend and allocation of costs	1. Cost sharing agreement	FORRp	Quarterly	LGPSC Ltd / Partner Funds
			2. Budget discussion & shareholder approval			
			3. Tight financial management controls and reporting/monitoring (quarterly)			
			4. Assets have independent valuation by external sources			
			5. Annual report & accounts			
			6. Internal Audit			
			7. PAF Finance Working Group			
F2		Poor Financial Management	1. Quarterly monitoring and reporting	FORRp	Quarterly	LGPSC Ltd
			2. Experienced financial resource			
			3. Internal audit			
			4. Board oversight Committee - Audit, Risk, Compliance Committee			
			5. Professional advice including the use of tax advisers to avoid tax leakage			
			6. External Audit			
F3		AUM lower than forecast leading to lower income than required	1. Quarterly monitoring and reporting	FORRp	Quarterly	LGPSC Ltd / Partner Funds
			2. Cost sharing agreement mechanisms to review quarterly			
			3. Product development plan delivery - sub-fund development and opening and Partner Fund transitioning assets			
			4. Effective management of costs			
F4		Inequitable Cost Sharing - leading to tensions and impact on decision making	1. Identification of issues in planning process - transparency of cost sharing	FORRp	Quarterly	LGPSC Ltd / Partner Funds
			2. Cost sharing agreement			
			3. Transition management agreement on mechanism for meeting transition costs			

			4. PAF Finance Working Group			
F5		IT and Cyber Security - Heavy reliance on IT systems for managing, monitoring and reporting of investments	1. Data Management and breach controls	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Specialist security software including reliance on external providers systems and controls			
			3. Internal audit			
			4. Board oversight Committee - Audit, Risk, Compliance Committee			
			5. Business Continuity Plan - regular review and testing			
			6. External Audit			
F6		LGPS DB Pension Obligations - impact on cost savings and liability risk on company balance sheet	1. Triennial actuarial valuation setting contribution rates	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Regular monitoring of funding position on both actuarial and accounting basis			
			3. Pension supplementary agreement between Partner Funds and company			
			4. DC pension benefits in place for higher earners limiting risk of escalating liabilities for high earners			

Wider Pooling						
P1		Failure of an LGPS pool	1. Monitoring developments	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Collaboration with other pools			
			3. Feed into wider government policy			
P2		Political Risk - Change of Government Policy	1. Demonstrable benefits from pooling	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Collaboration with other pools and Central Government			
			3. Proactive communication with local and national politicians			
P3		Pooling not perceived to be delivering cost savings or infrastructure investment	1. Transparency on reporting and managing expectations	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Collaboration with other pools particularly on infrastructure			
			3. Feed into wider government policy			
P4		Speed of delivery in terms of scale, delayed implementation and infrastructure investment not seen as fast enough leading to intervention	1. Managing expectations locally and nationally	FORRp	Quarterly	LGPS Ltd / Partner Funds
			2. Collaboration with other pools sharing best practice			
			3. Monitoring other sector developments e.g. supranational funds			
			4. Benchmarking			