North East Scotland
PENSION FUND

Risk Management Policy

October 2019

Contents

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Introduction

This policy has been prepared on behalf of Aberdeen City Council as the administering authority for the North East Scotland Pension Fund (the 'Fund').

The Fund's risk management framework sets out the Fund's strategic approach to effective risk management including:

- the Fund's risk philosophy, attitude to and appetite for risk
- how risk management is implemented
- risk management responsibilities
- the procedures that should be adopted in the risk management process

In preparing this Fund specific framework, guidance has been taken from:

- CIPFA 'Managing Risk in the LGPS' publication;
- CIPFA 'Delivering Good Governance in the Local Government: Framework (2016 Edition);
- The Pensions Regulator Code of Practice 14;
- LGPS (Scotland) Regulations; and
- Aberdeen City Council's Risk Management Framework

The Fund adopts a structured and focused approach to managing risks and ensures risk management is an integral part in the governance of the Fund at both a strategic and operational level.

Purpose

Risk, uncertainty and change create challenges for the Fund in meeting its objectives. The administering authority recognises effective risk management as an essential element of good governance and key for the Pension Fund to meet its strategic objectives.

With this purpose, the Fund will seek to:

- embed risk management in the day to day activities and culture of the Fund
- raise awareness of the need for risk management by all those connected with the management of the Fund
- manage risk in accordance with best practice and support well considered risk taking, with the aim of reducing overall cost of risk to the Fund
- maintain a robust framework and processes for identifying risks and their likely impact to inform decision making of the Fund

This Policy applies to all members of the Pensions Committee and Pension Board as well as senior officers within the Pension Fund management team.

Less senior officers involved in the day to day management of the Fund are also integral to managing risk for the Fund and will need to have an understanding of this policy.

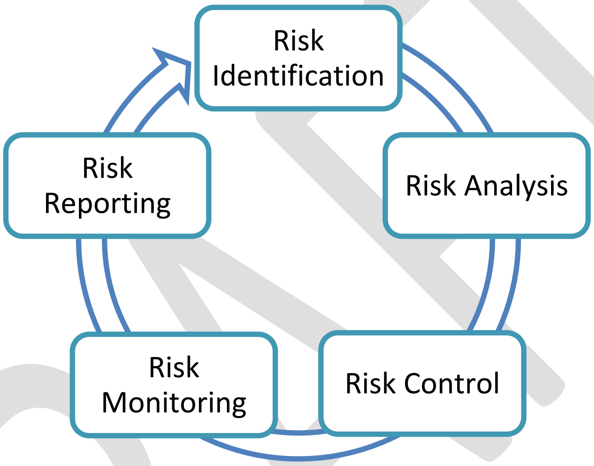
Advisers and suppliers to the Fund are also expected to be aware of this policy, and assist officers, Committee and Board members as required, in meeting its objectives.

The Fund's Approach to Risk Management

Risk can be defined as the combination of the probability of an event and its consequences.

In all types of undertaking, there is the potential for events and consequences that constitute opportunities for benefit (upside) and threats to success (downside). ***ISO/IEC Guide 73***

The Fund's risk management process is in line with that recommended by The Chartered Institute of Public Finance & Accountancy (CIPFA).



Source: CIPFA

Risk management is the approach to identifying, evaluating and managing risks with the aim of minimising or mitigating the impact of these risks on the Funds service delivery. Risk management is critical to the overall management of the Pension Fund, including the management of staff, physical assets and financial resources.

Risk management is not about being risk averse, it is about being risk aware. The Fund recognises that it is not necessary or sometimes possible, to fully eliminate risk as some risks are necessary to achieve the objectives of the Fund e.g. investment return targets. Rather the aim is to reduce this residual risk to an appropriate level with which the Fund is comfortable.

Effective risk management has numerous benefits for the Fund:

- An established and reliable basis for decision making that can be justified
- Improved governance
- Enhanced financial control
- Strengthened ability to meet key objectives and targets
- Improved member service
- Improved reputation

The Pensions Regulator Code of Practice No.14 *Governance and Administration of Public Service Pension Schemes* requires the scheme manager of a public service pension scheme to establish and operate internal controls. As per the Code these internal controls should address significant risks which are likely to have a material impact on the scheme. Scheme managers should employ a risk-based approach and ensure that sufficient time and attention is spent on identifying, evaluating and managing risks and developing and monitoring appropriate controls.

In order to ensure compliance with the Code, the Pension Fund operates a range of internal controls, which are reflected in scheme documentation, including:

- Investment Policy
- Statement of Investment Principles
- Funding Strategy Statement
- Annual Report and Accounts

1. <u>Risk Identification</u>

Risk identification is a systematic effort to identify and document the Pension Fund's key risks, which in turn results in the creation of the risk register. It is both a proactive and reactive process i.e. horizon scanning for potential risks and learning lessons from previously manifested risks.

Identification can take place through, but is not limited to:

- Internal and external audit findings
- Pension Fund staff and management team meetings
- Feedback and/or liaison with stakeholders and other external organisations such as Scottish Pensions Liaison Group (SPLG), Investment & Governance Group etc
- Advice from scheme advisors e.g. actuarial, legal and investment

The key risks of a pension fund have been identified as:

Financial	Market fluctuations, investment returns, pay and price inflation
Demographic	Increased longevity, cost of early retirements and death in service
Regulatory	Changes to the regulations, national requirements and/or HMRC rules
Governance	Lack of awareness of structural changes in employers membership, not advised of employers closing to new entrants, employers ceasing to exist with insufficient funding, poor data quality
Employers	Sustainability of an employer or their ability to meet their liabilities

Once identified, risks are documented on the Fund's risk register (see 4 & 5. Monitoring and Reporting).

2. <u>Risk Analysis</u>

Risk analysis looks at the potential impact of a risk as well as the likelihood of occurrence. By multiplying impact by likelihood, a risk score is produced which can be used to determine an appropriate response by the Fund.

For example, a risk which scores 1 for likelihood i.e. almost impossible and 1 for impact i.e. negligible, is unlikely to require any action by the Fund, whereas a risk which scores 6 for likelihood i.e. very high and 4 for impact i.e. very serious, will require immediate action.

However, it is worth noting that just because a risk achieves a low scoring that doesn't necessarily mean it can be discounted e.g. where likelihood may be almost impossible but the impact may be very high if it did occur.

Scoring will mirror that of the administering authority to allow the NESPF risk register to feed directly into the Council's corporate risk register.

Risk Matrix

Very Serious	**4**	4	8	12	16	20	24
Serious	**3**	3	6	9	12	15	18
Marginal	**2**	2	4	6	8	10	12
Negligible	**1**	1	2	3	4	5	6
Impact		**1**	**2**	**3**	**4**	**5**	**6**
	Likelihood	Almost impossible	Very Low	Low	Significant	High	Very High

Low	Fund will tolerate this level of risk
Medium	Fund will seek to contain risk, requires active monitoring
High	Fund is adverse to this level of risk and will look to eliminate or contain immediately

A risk can be closed on completion of mitigating actions, achievements of targets and/or when the pensions committee is satisfied that there is no longer a risk to the organisation.

3. Risk Control

In its fiduciary role, the Fund will take a cautious approach to risk, ensuring risks are carefully considered and controls are in place. Risk controls are those actions taken to reduce the likelihood of a risk event occurring, its frequency and the severity of the consequences should it occur.

Methods of risk control include:

Risk Approach

- Terminate: for example, if the risk cannot be reduced to an acceptable level only option may be to stop the activity or course of action or find a different way of doing it
- Treat: for example, putting mitigating controls in place to reduce the likelihood of the risk occurring or the impact if it does arise . Unlikely to eliminate the risk.

- Tolerate: for example, deciding to carry the risk as part of normal operations where the risk in unavoidable or more tolerable than alternatives, where impact is assessed as minimal or at disproportionate cost
- Transfer: for example, move or let another party take on the risk such as an insurance company

In practice most risks will be treated, by introducing controls and mitigating actions to **reduce** the likelihood of the risk occurring and the impact if it does (residual risk). Examples of common controls include diversification of investments, separation of duties, internal/external audit assurance, robust governance framework and procedures.

The key to effective risk management is the effectiveness of mitigating controls. For example, a preventative control such as training would not be considered fully effective if it was not kept up to date or attendance was not mandatory.

4. & 5. <u>Monitoring and Reporting</u>

The NESPF risk register covers a broad range of risks including strategic, investment and operational risks. Once identified, the risk register is the the primary control document for subsequent analysis, control and monitoring of those risks.

Risk ranking has been based on the RAG (Red, Amber, Green) system and each risk is ranked based on existing risk controls in place, likelihood of the risk occurring, impact if the risk did occur and the effectiveness of any risk controls which may mitigate current likelihood and/or impact.

Risk assessment and monitoring is a continual process, the risk register is reviewed quarterly by the NESPF senior management team and reported to the Pensions committee and Pension Board for consideration (as a standing item within the main strategy report) to allow opportunity for consideration and discussion.

In monitoring risk management activity, senior officers and the Pensions Committee and Board will consider whether:

- the risk control approach taken has achieved the desired outcomes
- the procedures adopted and information gathered for undertaking the risk assessment were appropriate
- there are any lessons to be learned for future assessment and management of risks

and ultimately continue to identify new and emerging risks.

Risk Appetite & Responsibility

Risk appetite is the amount and type of risk that the Fund is willing to accept or is comfortable with in order to achieve its strategic objectives.

Some risk is inevitable and unavoidable for the Pension Fund, particularly relating to LGPS investments.

Risk tolerance is the amount of risk that the Pension Fund can feasibly cope with.

In its fiduciary role, the Fund will not accept risks which are assessed as having a high likelihood of causing substantial impact on its financial position or services and/or lead to widespread member or employer complaints. Any such risk identified will need to have a risk reduction plan implemented to return the risk to a tolerable level within an acceptable timescale.

Responsibility and accountability for managing the risks within the Fund lies with the Pensions Committee. However day to day management of the NESPF risk register will be the responsibility of the Pension Fund Manager. The senior management team will be responsible for identifying and managing risks in their respective areas and for alerting the Pension Fund Manager to risks which may need escalation.

Officers involved in the daily management of the Fund are also integral to managing risk for the Fund, and will be required to have appropriate understanding of risk management relating to their roles.

Communication

The risks associated with the Fund will be clearly communicated to those who may be adversely affected by failure to manage those risks effectively, in line with the Fund's Communication Policy. For example, all Fund employers are exposed to the potential effects of investment risk since failure to manage investment risk may lead to higher employer contribution rates.

Review

The risk management framework will be reviewed annually, taking into account changes to guidance.

Further information

If you have any questions relating to this statement please contact the **Governance Team**:

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