Key – Highlighted red text is the amendments to the document.

Lancashire County Pension Fund

Risk Management Framework

Review Date: April 2022

Introduction

This is the Risk Management Framework of Lancashire County Pension Fund, administered by Lancashire County Council, the administering authority. The Fund must establish and operate internal controls which must be adequate for the purpose of securing that the scheme is administered and managed in accordance with the scheme rules and with the requirements of the law. The Risk Management Framework forms part of the internal controls.

Lancashire County Pension Fund's administration and investment provision is carried out by the subsidiaries of Local Pension Partnership Limited (LPP), Local Pension Partnership Administration Limited (LPPA) and Local Pension Partnership Investment Limited (LPPI) respectively.

Purpose of the Framework

This framework sets out how the Fund intends to manage risk, with the aim of:

- Integrating risk management into the culture and day-to-day activities of the Fund;
- Raise awareness of the need for risk management by all those connected with the management of the fund;
- Establish and maintain a robust framework and procedures for identification, analysis, assessment and management of risk;
- Ensure consistent application of risk management across the Fund;
- Comply with guidance, regulation and legislation:
    - CIPFA – Managing Risk in the LGPS (2018);
    - Pensions Act 2004;
    - The Public Service Pensions Act 2013 and LGPS Regulations 2013;
    - The Pensions Regulator's Code of Practice 14. (Due to be replaced by the Single Code of Practice).
    - LGPS (Management and Investment of Fund) Regulations 2016

Risk Management

Risk can be identified as 'the chance of something happening which may have an impact on the achievement of an organisation's objectives.' The objectives of the Fund are summarised in appendix 1.

Risk Management is the process of identification and assessment of risks (the 'inherent risks') and responding to them.

The response to a risk may involve one or more of the following:

- Tolerating risk;
- Mitigating the risk in an appropriate way to constrain the risk to an acceptable level;
- Transferring the risk;
- Terminating the activity giving rise to the risk.

The purpose of risk management is to ensure that LCPF is aware of and understands the risks involved in carrying out its activities and takes positive action to reduce and/or mitigate them where appropriate and possible.

Principles of the Risk Management Framework

- The informed acceptance of risk is an essential element of good business strategy;
- Risk management is an effective means to enhance and protect the Pension Fund over time;
- Common definition and understanding of risks is necessary in order to better manage those risks and make more consistent and informed business decisions;
- All risks are to be identified, assessed, measured, monitored and reported on in accordance with the Administering Authority's risk management strategy;
- All business activities are to adhere to risk management practices which reflect effective and appropriate internal controls;
- Supports the achievement of Fund objectives - understanding potential risk outcomes can allow the Fund to reduce uncertainty which may affect the achievement of key objectives;
- Effective risk management provides the framework to identify and respond to risks and ultimately inform Fund decision-making.

Types of Risk

The risks for the Fund are grouped into five specific categories:

1. Investments & Funding Risks – investment strategy, returns on investment, custody of Fund assets, actuarial valuation and funding, cash flow and admitted bodies arrangements;
2. Operational Risks – committee and Fund governance, risk management, compliance, business and IT continuity, information security, fraud risk and so on;
3. Member Risks - benefit payments, member communications, data quality and contribution;
4. Transitional Risks – investment transition, administration transition, external drivers, and new client on-boarding;
5. Emerging Risk – an evolving, new risk that is difficult to characterise or assess at this point in time, as the cause and / or how the risk will impact the organisation is unclear.

Transitional risks are risks which are deemed to be temporary due to its inherent nature.

Risk Management Process

The risk management process is a continuous cycle as detailed below:

1. **Risk Identification** – this is the process of recognising risks and opportunities that may impact on the Funds objectives. The process is both proactive and reactive. It involves horizon scanning for new or emerging risks and hazards; and learning from review of how past and current risks have manifested.

2. **Risk Analysis** - Having identified potential risks, the next stage of the process is to analyse and profile each of them.

   For this the LCPF use a standard methodology and template

   - Each risk is scored from 1 to 4 for Probability and 1 to 4 for Impact.

     The risk matrix table below demonstrates the criteria used for rating and assessing LCPF risks:

			LIKELIHOOD OF RISK OCCURRING			
			1	**2**	**3**	**4**
			1 in 20 years/ 5%	1 in 5 years/ 20%	1 in 2 years / 50%	1 in1 years / 95-10%
	Financial Impact	Qualitative Impact	Unlikely Could occur once in 20 years	Possible Could occur once in 5 years	Likely Could occur in next 24 months	Happening Happening already or highly likely
4	>£150m	• Critical impact on operational performance (>10% of membership affected recovery time > 1 year); • Critical breach in laws and regulations that could result in material fines or consequences; • Critical impact on the reputation of the Fund which could threaten its future viability, adverse national media coverage; • Affect such that it undermines the ability to achieve key Fund goals and objectives (survival).	4	8	12	16
3	£75m-£150m	• Significant impact on operational performance (5 – 9% of membership affected/ recovery time 8–12 months); • Significant breach in laws and regulations resulting in significant fines and consequences; • Significant impact on the reputation or Fund (some national media coverage); • Potential to have high impact on Fund goal and objectives.	3	6	9	12
2	£5m–£75m	• Moderate impact on operational performance (1 – 4% of membership affected/ recovery time 3 – 7 months); • Moderate breach in laws and regulations resulting in fines and consequences; • Moderate impact on the reputation or brand of the organisation (some media coverage); • Potential to have moderate impact on Fund goal and objectives.	2	4	6	8
1	<£5m	• Minor impact on operational performance (<1% of membership affected/ recovery time <3 months); • Minor breach in laws and regulations with limited consequences; • Minor impact on the reputation of the organisation; • Comparatively less impact on Fund goal and objectives.	1	2	3	4

Each risk is subsequently recorded on a 'Risk Register'. For each risk the following is recorded:

- Risk Reference;
- Risk Title;
- Risk Description;
- Risk Drivers;
- Risk Owner;
- Inherent Risk Score/Rating;
- Controls;
- Residual Risk Score/Rating;
- Risk Actions.

3. **Risk Control** – describes actions taken to reduce the likelihood and adverse consequences of a risk event occurring. Control and mitigation mechanisms will vary depending on the type of risk and the activity involved. Key mechanisms include:
    - Governance and decision making structures;
    - System procedures and controls;
    - Resource allocation and management;
    - Separation of duties;
    - Actuarial/Audit/Regulatory Reviews.

4. **Risk Monitoring** – regular reviews of the risk register is a central component of effective risk management:

   - Reviewed by the Pension Fund Committee every six months and every quarter by the Local Pension Board;
   - Reviewed by LCPF Officers, Independent Investment Advisers, LPPA and LPPI Risk Teams every quarter;

   The review would consider whether:

   - The nature of the risk has changed;
   - The control environment has changed;
   - The probability of the risk occurring has changed;
   - The impact of the risk occurring has changed;
   - Any new or emerging risks need to be considered.

5. **Reporting –** documentation is required to ensure adequate monitoring as described above.

   - Each quarter risks are assessed, reviewed and rated using a standard risk template (this is used to record updates from various stakeholders for each risk);
   - A full risk register is produced using the content of each risk template;
   - A heat map is produced which gives a visual representation of where each risk 'sits' on the risk matrix. An example of this is provided in appendix 2.

Risk Appetite/tolerance

Risk appetite is the amount and type of risk that the Fund is willing to accept, tolerate or avoid 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 is willing to and can feasibly cope with.

LCPF 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.

These concepts are considered when the Officers update the ongoing risk register.

Investment Risk Framework

In addition to the Risk Register, monitoring of investment and funding risk takes places within the Investment Panel. A Risk Framework Report is prepared for the Investment Panel quarterly and references the LCPF Investment and Funding Risk Appetite Statement.

The Investment and Funding Risk Appetite Statement covers warning levels and limits for a range of measures in four key areas:

- Funding Level;
- Contributions;
- Liquidity/Cashflow Capacity; and
- Asset Allocation.

The report is prepared quarterly by LPPI and monitors risk tolerance in these areas using a traffic light assessment (red, amber, green) status. These two major risk reports currently received by the Pension Fund Committee (Risk Register and Risk Framework), albeit with differing frequency and different origination are appropriate and linked by consideration of the Fund investment objectives.

Roles & Responsibilities

Head of Fund/Governance Team:

- Maintenance of the risk register;
- Monitoring and reporting progress against identified action to manage/reduce risk;
- Risk scoring to facilitate analysis of risks across the Fund and 'Direction of Travel' for known risks;
- Identification of new /emerging risks via the use of internal knowledge of the Fund as well as external sources;
- Engagement with the Pension Fund Committee and Local Pension Board to update/report on the status of existing of existing and new/emerging risks.

Pension Fund Committee:

- Risk management falls within the Pension Fund Committee's overall responsibility for management of the Fund;
- Receive updates / reporting for review every six months. Reporting detailed in Risk Management Process – point 5;
- Review and monitor the effectiveness of controls in place for each risk, ensuring these remain appropriate;
- Use the risk reporting to inform decisions in respect of actions required to manage/mitigate risk.

Local Pension Board:

- Review of the Lancashire County Pension Fund Risk Register as it relates to the Scheme Manager function of the Authority;
- Review the Pension Fund Committee's formal periodic assessment of Fund risks, providing support and challenge to the assessment;
- Evaluate and challenge the way in which the Head of Fund/Governance Team and the Pension Fund Committee carry out their risk management roles;
- Review the Pension Fund Committee's periodic assessment of risk reporting and the appropriateness of decisions made in respect of risk management and mitigation;
- Review and challenge the Pension Fund Committee's controls in place, ensuring the Committee implements risk mitigation plans where appropriate.

LCC Internal Audit and Information Governance Team

- Provide expert guidance on risk management as required;
- Carry out periodic audits of the Fund's risk management process.

Local Pensions Partnership Limited

- Provide regular and accurate updates on risks they are managing;
- Ensure that appropriate organisational risk management procedures are in place for the services that they provide;
- Carry out both internal and external audits of all organisational risk management processes at least annually;
- LPP have a separate organisational Risk Management Framework and Risk Register.

Appendix 1: Fund objectives

Within each group below, strategic objectives have been identified. These are summarised below and full details of objectives are provided in other Fund documentation.

Governance - to ensure that the Pension Fund is effectively managed, and its services are delivered by highly motivated people who have the appropriate knowledge and expertise, and with access to appropriate systems;

Funding and Investment - Funding is the process of ensuring that the Fund has sufficient assets to provide benefits as they fall due –encompassing (amongst other things) setting contributions at an appropriate level, monitoring the progression of liabilities and managing changes in their value, and managing employer risk;

Administration - to deliver a high quality, cost-effective, user-friendly and informative service to all members, potential members and employers at the point where it is needed and demonstrate compliance with all relevant regulatory requirements;

Communication - to provide good pension information, promoting pensions in the workplace and to actively promote the Fund to prospective members and their employers.

Appendix 2: Heat Map

			LIKELIHOOD OF RISK OCCURRING			
			1	2	3	4
			1 in 20 years / 5%	1in 5 years / 20%	1 in 2 years / 50%	1 in 1 years / 95-100%
			Unlikely	Possible	Likely	Happening
FINANCIAL IMPACT	4	>£150m	4 I2 I4 O10	8	12	16
	3	>£75m	3 I1 I5	6 I3 O1 O6 O7 O9 M5 O3	9	12
	2	>£5m	2 M2 M3 M4	4 M1 O2 (2) O4 I6 I7	6 O2	8
	1	<£5m	1 O8 T2	2 O5	3	4 E1

Key		Risk		Risk	
Investment		I1	Investment Strategy	O1	LCPF Committees and Fund Governance
Member		I2	Construct, Implement and Perform	O2	Reliance on key persons and expertise (LCPF)
Operational		I3	Custody of Fund assets	O2 (2)	Reliance on key persons and expertise (LPP)
Transitional		I4	Actuarial Valuation and Monitoring of Funding	O3	Risk Management
Emerging		I5	Cash-Flow Management	O4	Compliance
		I6	Management of Scheme Employer Risk	O5	Cost Management
		I7	Inflation – investment only	O6	Business and IT Continuity
		M1	Benefit Payments	O7	Information Security
		M2	Member Comms	O8	Fraud Risk
		M3	Data Quality	O9	Decision Making
		M4	Contributions	O10	External Drivers
		M5	Service Level Agreement with LPP	E1	Pension Scam
		T2	Risks highlighted as part of the PWC Audit Report 2021		