Leicestershire County Council PENSION FUND

LOCAL PENSION BOARD – 25 JUNE 2025

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RISK MANAGEMENT AND INTERNAL CONTROLS

Purpose of the Report

1. The purpose of this report is to inform the Local Pension Board of any changes relating to the risk management and internal controls of the Pension Fund, as stipulated in the Pension Regulator's Code of Practice.

Policy Framework and Previous Decisions

2. The Local Pension Board's Terms of Reference state that the responsibility and role of the Board is to secure compliance with the LGPS Regulations and other legislation relating to the governance and administration of the LGPS, securing compliance with the requirements imposed in relation to the LGPS by the Pensions Regulator, and such other matters as the LGPS regulations may specify.

Background

3. The Pension Regulator's (TPR) Code of Practice on governance and administration of public service pension schemes requires that administrators need to record, and members be kept aware of, risk management and internal controls. The Code states this should be a standing item on each Local Pension Board and Local Pension Committee agenda.

4. In order to comply with the Code, the risk register and an update on supporting activity is included on each agenda for this Board.

Risk Register

5. The 19 risks are split into six different risk areas. The risk areas are:

- Investment
- Liability
- Employer
- Governance
- Operational
- Regulatory

6. Risks are viewed by impact and likelihood and the two numbers multiplied to provide the **current risk score**. Officers then include future actions and additional controls, and the impacts and likelihoods are then rescored. These numbers are multiplied to provide the **residual risk score**.

7. The current and residual risk scores are tracked on a traffic light system: red (high), amber (medium), green (low).

8. The latest version of the Fund's risk register was approved by the Local Pension Committee on the 14 March 2025.

9. Officers meet quarterly to discuss the risk register and there has been a handful of changes to three existing risks since the previously approved risk register. These changes are highlighted below, alongside broader discussions on reasoning behind some of the remaining risk scores.

10. To meet Fund Governance best practice, the risk register has been shared with Internal Audit, who have considered the register and are satisfied with the current position.

11. The risk register is attached to the report at Appendix A and Risk Scoring Matrix and Criteria at Appendix B.

Revisions to the Risk Register

Risk 4: Risk to Fund assets and liabilities arising from climate change.

12. This risk reflects that the Fund will be affected by any impact on global markets and investment assets from the transition to a low carbon economy, or the failure to achieve an orderly transition in line with the Paris Agreement. This risk continues to be rated 'amber' due to the potential impact and likelihood of climate change. These risks are posed through both physical impacts such as extreme weather, but also transitional risks which include policy, legal, technological, market and reputational risks for underlying companies.

13. This risk has been updated to reflect work progressing in reviewing the Net Zero Climate Strategy which will start with a report to the Local Pension Committee in June 2025. Further actions have been updated to reflect that the Fund will also receive climate scenario analysis as part of the actuarial valuation. This should support the Fund's approach to risk identification, understanding of the Fund's exposure to climate-related risk and the funding

strategy's resilience, which will further feed into the Net Zero Climate Strategy Review. Climate considerations have also fed into triennial valuation considerations for longevity.

Risk 10: Sub-funds of individual employers are not monitored to ensure that there is the correct balance between risks to the Fund and fair treatment of the employer

14. This risk reflects potential of insolvency or financial difficulties for an individual employer, and the impact that may have on the Fund. Part of managing this risk relates to engaging with employers as part of setting new employer contribution rates, as well as employer risk profiling. One key contributor to this risk relates to 'high-risk' employers where potentially a closure of an employer could result in liabilities reverting to the Fund.

15. Following updated guidance from the Department for Education the Fund now has assurance that if a further education body, including sixth form colleges and bodies established under the Further and Higher Education Act 1992 close. The assets of the further education body would be used to pay-off any liabilities, with any shortfall paid for through the DfE's guarantee. As a result, both the residual impact and residual likelihood risks have reduced taking the residual risk score down to 3 and rated 'green'.

16. This risk has been considered as part of the 2025 triennial valuation, with this group of employers having their risk rating reduced.

Risk 11: Investment decisions are made without having sufficient expertise to properly assess the risks and potential returns.

17. While a lot of work has been undertaken in training Committee and Board it is recognised that the levels of training will be cyclical due to council elections. As a result, this residual risk has increased to reflect changes in membership after the County Council's election in May 2025. This has changed the residual risk rating to 'amber'. To mitigate this risk new members have had induction training in line with the Training Policy and have been invited to training as per this year's training plan.

<u>Other considerations</u>

18. During the review officers discussed all risks, and while not at a point requiring further updates to the remaining risks officers felt it was relevant to provide this wider information and context to the Board for a selection of these risks.

Risk 1: Market investment returns are consistently poor, and this causes significant upward pressure onto employer contribution rates.

19. This risk remains 'amber' and reflects the potential for poor market returns due to poor economic conditions and/or shocks, such as a global recession which would result in needing to increase employer contributions upwards.

20. While the Fund has had strong investment returns over the past few years, which has contributed to the mid-point funding level reported of 150% as at 30 June 2024 It is recognised that funding levels can easily shift, noting the Fund was 76% funded in 2016. This risk, alongside the medium-term outlook for different asset classes continues to be considered as part of the Strategic Asset Allocation agreed every January.

Risk 3: Failure to take account of ALL risks to future investment returns within the setting of asset allocation policy and/or the appointment of investment managers.

21. This risk remains ‘amber’ following the ‘Fit for the Future’ consultation outcome as set out in more detail in relation to <u>Risk 18: Proposed changes to LGPS regulations and guidance requires changes to the Fund’s investment, pooling and governance processes.</u>

22. Currently the Local Pension Committee considers and agrees the Strategic Asset Allocation annually which is reviewed by the officers and the Fund’s Investment Advisor. This risk will need to be carefully managed following the outcome of the Fit for the Future consultation that will require the Fund to use the pool as the source of principal investment advice, with investment manager appointment to be undertaken by the pool. It will be important that the appropriate risks are considered when working with the pool and this risk will continue to be reviewed as officers work through the implications of the consultation outcome.

23. To date the Fund has received reasonable assurance on the controls taken to manage this risk from Internal Audit, however given these risks can never fully be protected against the Fund is looking to undertake a review following the January 2025 SAA with the Fund’s Investment Advisor on whether a tail risk strategy could manage this further.

Risk 5: Assets held by the Fund are ultimately insufficient to pay benefits due to individual members.

24. This risk remains ‘amber’. As set out in paragraph 16 the Fund has had a positive direction of travel over the past few years with increasing assets under management by the Fund. However, it has been agreed to not change the risk scoring at this time, given this could reverse just as quickly as the current position of the assumed positive future investment returns.

25. As part of the 2025 valuation Hymans and Officers have considered calculating monetary contributions alongside employer percentages of salaries and decided not to use this for this valuation. The Actuary and Officers are comfortable employer percentages of salaries will be sufficient to ensure that any employer contribution rates set are effective, and do not negatively impact on employer financial situations by requiring large increases in future.

Risk 6: If the pensions fund fails to receive accurate and timely data from employers, scheme members pension benefits could be incorrect or late. This includes data at year end; and **Risk 7 If contribution bandings and contributions are not applied correctly, the Fund could receive lower contributions than expected.**

26. Both risks are ‘green’ and have a residual risk of three due to the low likelihood of the risk at this time due to the ongoing work by the Pensions Section. These risks are tolerated; however, it was considered important to retain them on the risk register as fundamental risks to the pensions section. These risks are also exposed to potential issues outside of the Fund’s direct control if there are changes to employers' staff who provide information to the Fund, or changes to payroll systems.

Risk 13: If immediate payments are not applied correctly, or there is human error in calculating a pension, scheme members pensions or the one-off payments could be wrong.
Risk 14: If transfer out checks are not completed fully there may be bad advice challenges against the Fund.
Risk 15: Failure to identify the death of a pensioner causing an overpayment, or potential fraud or other financial irregularity.

27. These risks are also rated ‘green’ and represent business as usual processes for the Pensions Section. These are managed through clear processes, training, as well as additional verification processes. These risks are kept on the register given the importance of continuing to apply processes correctly and the impact not doing so may have.

Risk 16: The resolution of the McCloud case and 2016 Cost Cap challenge could increase administration significantly resulting in difficulties providing the ongoing pensions administration service.

28. The McCloud case requires Fund Officers to review and calculate in scope member’s benefits, backdated to April 2014 when the LGPS commenced the career average revalued earnings scheme. Final system changes have been loaded onto the systems and work continues. Manual checking was completed by March 2025. Further details will continue to be provided to the Board.

Risk 18: Proposed changes to LGPS regulations and guidance requires changes to the Fund’s investment, pooling and governance processes.

29. On 29 May Government published the outcome of the Fit for the Future consultation which seeks to strengthen the management of LGPS investments in three areas:
    a. Reforming the LGPS asset pools
    b. Boosting LGPS investment in their localities and regions in the UK
    c. Strengthening the governance of both LGPS AAs and LGPS pools

30. It is still too early to truly assess the potential implications from these proposals. Officers will continue to work with its investment advisor, LGPS Central and

partner funds in relation to proposals and appropriate mechanisms. More detail is elsewhere on today's agenda.

Risk 19: Gaps in knowledge, caused by a significant number of Pensions Section staff deciding to retire over the next five years, could emerge if succession planning is not in place.

31. This risk was added in the previous risk register update and therefore there are no significant updates. Training has now been put in place with the first tranche to be undertaken starting April and second for September.

Recommendation

32. The Local Pension Board is asked to note the report.

Equality Implications

33. There are no equality implications arising from the recommendations in this report.

Human Rights Implications

34. There are no human rights implications arising from this report.

Background Papers

None

Appendix

Appendix A – Risk Register
Appendix B – Risk Scoring Matrix and Criteria

Officers to Contact

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