	Local pension Board **29th November 2017**
Title	**Review of Pension Scheme Investment Risks**
Report of	Assistant Chief Executive
Wards	n/a
Status	Public
Urgent	No
Key	No
Enclosures	Appendix A – Investment risk register
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Summary

Part of the role of the Local Pension Board is to:

Ensure the effective and efficient governance and administration of the Pension Scheme, and Ensure that the Pension Fund's internal Risk Register is in place and reviewed at least annually.

The report considers the section of the risk register relating to investments and discussed the procedures in place to manage these risks and the residual risk being carried by the Fund and employers.

Recommendations

The Local Pension Board is invited to review the report and identify any recommendations or questions it wished to direct to the Pension Committee.

1. WHY THIS REPORT IS NEEDED

1.1 Part of the role of the Local Pension Board is to (a) ensure the effective and efficient governance and administration of the Pension Scheme, and (b) ensure that the Pension Fund's internal Risk Register is in place and reviewed at least annually

This report reviews the procedures in place for managing investment risk and the residue risk that is carried by the fund and the contributing employers. It is intended that each section of the risk register will be reviewed annually at one of the Board's meetings.

1.2 The format of the risk register follows the LB Barnet approach, in which impact and probability are rated 1-4 as being:

4 = major / likely
3 = medium / possible
2 = small / unlikely
1 = trivial i.e. fully mitigated

1.3 Risks are mainly considered at a monetary level. However risks can also be reputational or create inconvenience to employers and scheme members. When considering investments, the risks are normally considered in a monetary context

1.4 The one obvious omission is defining the various risk ratings. For example, what is a major impact on investments? Is it £10 million, £100 million etc. For risks that impact on scheme members, just how many members need to be impacted for the impact to be major? Similarly, when rating probabilities is major greater than 50% or some other probability. The Pension Committee is due to review the risk register at their March 2018 meetings and will be asked to quantify risk ratings.

1.5 The management of each of the four investments risks is reviewed below.

The investment Strategy has a low chance of delivering returns sufficient to meet the funding objective

1.6 The returns generated by the pension fund can be analysed into three segments.

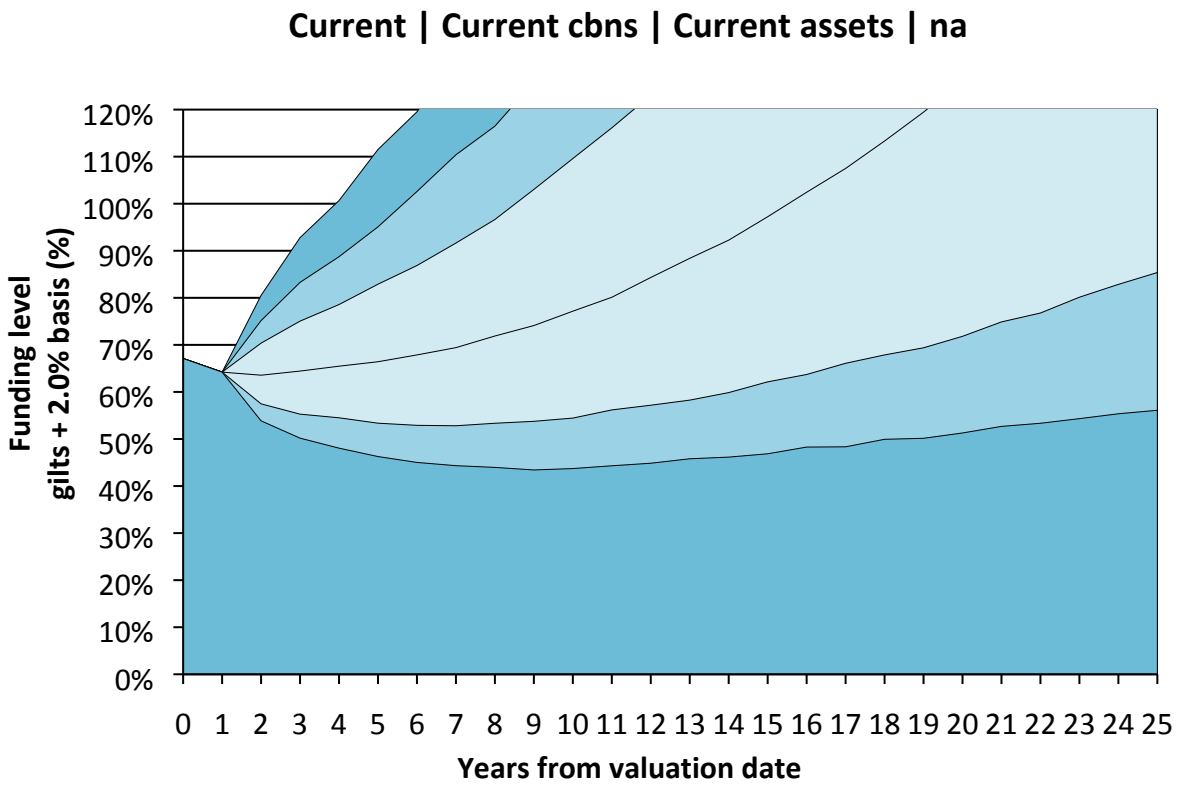
a) The returns from the strategic benchmark.
b) The returns above or below the strategic benchmark derived from the mandates (benchmarks) awarded to investment managers.
c) The performance of the individual investment managers compared with their individual benchmarks.

1.7 This risks looks at a combination of (a) and (b) above.

1.8 The investment strategy risk has the highest rating of 16 (both impact and likelihood of 4) before mitigating action and 8 after, with probability reduced to unlikely (2). The mitigating factors are the increased diversification of the investment policy and regular reviews of strategy.

1.9 The previous agenda item on the procedures in place to set and monitor investment strategy are relevant to this discussion. In particular the modelling undertaken by Hymans to illustrate the range of outcomes that can arise from different combinations of each asset class. This modelling is used by the

Pension Committee to identify a combination of asset classes that optimises the expected outcome – likelihood of achieving full funding and the degree of discomfort from poorer outcomes. The graph below is extracted from the modelling presented to the October 2017 Pension Committee



1.10 The modelling indicated that the average funding level outcome from the current investment strategy after 20 years is in excess of 120%. The top of the lower 25% of outcomes is closer to 80% funded and the average of the 5% worst outcomes is mid 30s funding level.

1.11 The above analysis is updated when the Pension Committee reviews strategy. It supports the actuary's view that the current strategy has a reasonable probability of meeting the scheme funding objective. The modelling and the frequency of review is central to designing and monitoring a strategy that manages this risk of poorer funding levels.

Investments managers underperform relative to their benchmarks over the medium term.

1.12 The risk that investment managers will underperform their benchmarks is rated as medium high both before and after mitigating action, with high impact and possible (medium) likelihood. Mitigation action are:

- Manager appointments take into consideration advice received from Hymans Robertson, the appointed investment advisor.
- Quarterly reports on manager performance include Hymans manager ratings and a discussion on any significant developments relating to the manager.

- Performance v benchmark reporting covers both current and longer term periods.
- Meetings are held with the investment manager if concerns are raised either due to organisational developments or returns generated.

1.13 Depending on the definition of risk categories, the impact of manager underperformance may be overstated. The impact of managers' underperformance against their benchmarks is typically much less significant than that of the strategy compared with the scheme liabilities.

Fund assets fail to deliver returns in line with actuarial assumptions

1.14 This risk is a combination of the above two risks. The actuarial assumptions used to calculate the value of the scheme liabilities, which together with asset values determine the funding level. The risk rating of medium high (12) is consistent with the above two risks. The mitigating actions described above are relevant to this risk.

1.15 The prudence of the actuarial assumptions will be discussed as part of the management of funding risks.

Rebalancing of portfolios will be delayed due to market volatility

1.16 Rebalancing is concerned with aligning the portfolio with the agreed or revised strategic allocations. Currently there is no policy in place for rebalancing. The Pension Committee review the portfolio allocations each quarter and have the opportunity to move funds between investment managers. The Fund has invested in illiquid asset classes (current target is 19%) which cannot be rebalanced in the short-term. At present, funding of new mandates is used to rebalance the portfolio by taking money out of the most overweight asset classes. Recently, maximum allocations have been set at asset class level that will prompt rebalancing action.

1.17 The rating for this risk of medium high (12) appears high in relation to the rating for strategic risks. The procedures in place enable rebalancing action to be considered quarterly. Frequent rebalancing can incur transaction costs and unless maximum allocations are breached, annual rebalancing has been shown to be the most efficient.

<u>Conclusion</u>

1.18 The procedures in place to mitigate the investment related risks are strong. The residual risks are derived from the current funding level and the desire to target an investment return that protects employers from significant increases in contribution levels in the short term.

2. REASONS FOR RECOMMENDATIONS

2.1 The Pensions Board's terms of reference include ensuring that a risk register is in place and reviewed regularly.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The paper discussed the mitigating actions in place. The Board is able to comment on any aspect of the risk register.

4. POST DECISION IMPLEMENTATION

4.1 Recommendations and comments will be forwarded to the Pensions Committee.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 There are no direct resources issues for the council however changes in the financial performance of the pension fund affects the pension fund deficit reflected in the Authority's accounts.

5.3 Social Value

5.3.1 The Public Services (Social Value) Act came into force on 31 January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

5.3.2 Before they start the procurement process, commissioners should think about whether the services they are going to buy, or the way they are going to buy them, could secure these benefits for their area or stakeholders.

5.3.3 The Act is a tool to help commissioners get more value for money out of procurement. It also encourages commissioners to talk to their local provider market or community to design better services, often finding new and innovative solutions to difficult problems.

5.3.4 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long term financial health of contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 The LGPS Regulations 2013 place responsibility for the local administration of pensions and other benefits under these Regulations on the administering authority, which is LB Barnet. The Local Government Pension Scheme Regulations 2015 requires the Council to establish a Pension Board, whose role is to assist the Council in securing compliance with legislation, regulation

and best practice, including as set out in the Pension Regulator's Code of Practice.

5.4.2 This paper considers the risk management arrangement of the LGPS pension scheme that form part of the remit of the Local Pension Board.

5.5 **Risk Management**

5.5.1 Risk management is central to the LGPS. LGPS pension funds are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 The paper is concerned with managing the investment risks faced by the Fund.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 **Consultation and Engagement**

5.7.1 Where relevant, consultation and engagement is discussed in the paper.

5.8 **Insight**

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 None