Pension Fund Risk Register — Item 9

Committee	Pension Committee
Officer Reporting	James Lake, Finance
Papers with this report	Pension Fund Risk Register

HEADLINES

The purpose of this report is to identify to the Pension Committee the main risks to the Pension Fund and to enable them to monitor and review going forward (see Appendix). There are two risks which are red.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Consider the Risk Register in terms of the approach, the specific risks identified, and the measures being taken to mitigate those current risks.**

SUPPORTING INFORMATION

The specific risk matrix for the Pension Fund allows better classification of the risks than would be possible through the Council's standard risk matrix. The significance of risks is measured by interaction of the likelihood of occurrence (likelihood) and by the potential damage that might be caused by an occurrence (impact). The risks are also RAG rated to identify level.

There are currently 13 risks being reported upon. Whilst there are many more risks which could be identified for the Fund, those identified are the most significant and those which are actively managed.

Each risk has been explained, along with details of the actions in place to mitigate that risk. The progress comment column provides the latest update in respect of the impact of those mitigating actions. The Direction of Travel (DOT) has also been included.

In the previous quarter the likelihood rating for 'Pen04-Inflation' was upgraded. Inflation continues to remain a concern with newsfeeds highlighting perturbation.

The risk to the Fund is driven by the nature of the liabilities, which are predominately linked to inflation (through salary growth, deferred revaluation and once in payment). Increases in pensions in payment are not capped against rises in CPI inflation, so a short burst of very high inflation can be equally damaging to funding as long-term higher inflation. The Fund will ultimately need to pay out more in pensions if inflation increases.

Alongside the impact of inflation on the liabilities (both the accrued liability value and future service cost), there could also be impacts on asset markets. Financial markets are currently underpinned by very low interest rates. Raising rates to choke off rising inflation could undermine market valuations, leading to a falling asset value. Whilst equity markets typically deliver inflation linked returns in the longer term, a burst of high inflation or rising rates could trigger a de-rating of the market.

Against this context, the risks from inflation are also increasing. The scale of QE following COVID, economies reopening, growing supply chain issues and the more local impacts arising from Brexit have all fuelled market concerns over inflation. Longer term CPI expectations have risen in recent months as economies have re-opened. Central banks believe the rise will be transitory as economies reopen and we recover from COVID, but the jury is still out on this and risks remain elevated.

The Committee has already taken a number of steps to mitigate the risks inflation poses to the Fund. Over the past few years, the Fund has moved to implement allocations to asset classes which provide direct exposure to inflation linked assets, recognising the potential risks ahead of time. This includes the allocations to Long Lease Property (5%) and Infrastructure Equity (8%). In addition, the bond allocation was shifted to focus on index linked gilts and the allocation increased (to 12%). The fixed income allocations with JPM and Permira (17% in total) are short duration and floating rate in nature, with less exposure to rising interest rates than more traditional portfolios. Whilst this may not offer direct inflation protection, these mandates should be less impacted than traditional bond portfolios in an environment where rates rise.

The target allocation to assets with direct inflation linkage within the strategy represents 31%. At present the infrastructure allocation is currently only just over 1% as funds, currently held in Ruffer wait to be deployed. Ruffer itself should offer some protection; Ruffer has been of the view that the financial crisis of 2008 must ultimately end in inflation and remains positioned for this.

At the time of writing this report a Pension Sub-Group meeting is being arranged to gain a better understanding and ascertain if what actions should be taken. The PEN04 risk rating remains unchanged subject to the meeting outcome.

FINANCIAL IMPLICATIONS

The financial implications are contained in the risk register attached.

LEGAL IMPLICATIONS

The legal implications are contained in the risk register attached.