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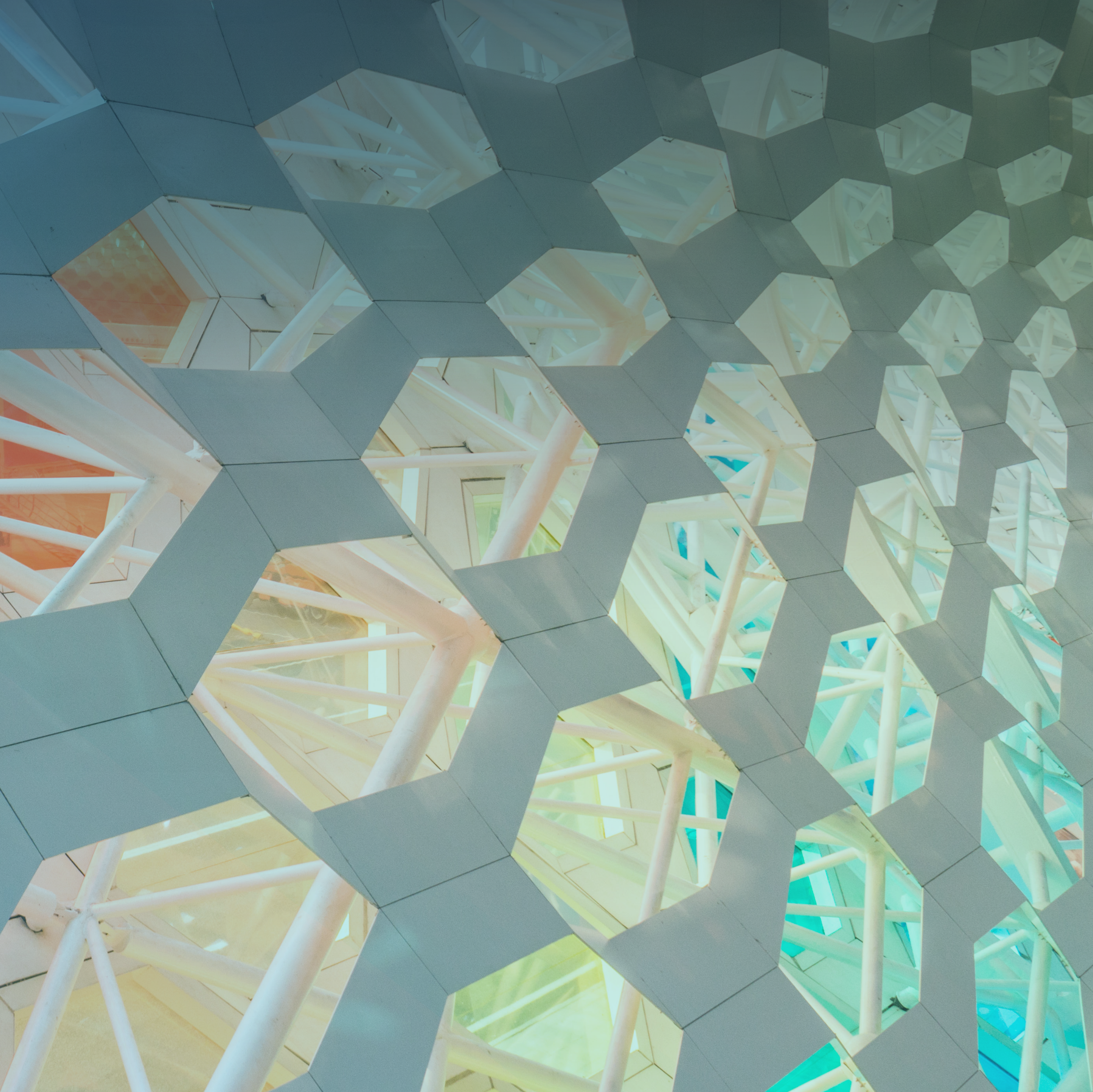
Risk Management and the LGPS – It's simple physics!



No matter what you do for a living, or how you spend your time, you manage risk every single day.

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From the moment we wake, we're making decisions and weighing up risk – it's what makes me not have chocolate for breakfast. However, when you work in the LGPS you have the added complication of having to make decisions which impact the livelihoods of millions of people.

- How do you make good decisions?
- How do you know you are making good decisions?
- How do other interested parties know you are making good decisions?
- And, how do you do all this and save time?

The answer is simple physics...

Advocates of a holistic approach to physics look at a specimen in its ecosystem before breaking it down into its parts, to understand the physical interactions. In this way the scientist is not just an observer but a participant. A good example of a holistic approach to science is climate change. To understand climate change, scientists look at the whole of the environment and the interactions between numerous physical systems.

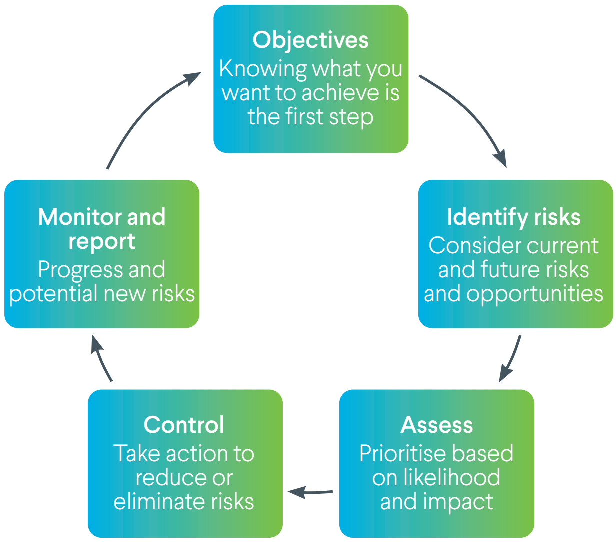
You don't need to be a physicist to understand the analogy with the LGPS. Funds have a seemingly clear objective: to ensure the long-term sustainability of the scheme to keep providing pension benefits to members in the future. But funds don't operate in a controlled environment, rather a huge ecosystem. When preparing a business plan in 2018, did Funds plan for a pandemic in 2019, increased cyber threats due to the war in Ukraine and unprecedented market volatility in 2022?How much time was spent making decisions because of these events and how will those decisions be viewed when the dust settles? Let's look at three questions:

1. What is holistic risk management?
2. Would holistic risk management save time?
3. Would holistic risk management drive demonstrably better decision-making?

1 What is holistic risk management?

There are lots of definitions but in effect its:

- the approach an organisation takes to identify and quantify all the uncertain events which may prevent it's objectives being achieved; and
- the things the organisation does to manage those risks to ensure the objectives can still be met.



So, if the main objective of funds, is to ensure the long-term sustainability of the scheme to keep providing pension benefits to members in the future, how on earth would a pandemic, market volatility and a war have been identified as risks? A structured approach to risk identification and assessment is the answer.

Using prompts of different types of risks and doing some horizon scanning might have meant that these types of events, or similar events, would have been considered.

Let's look at 4 different approaches:

Fund A has a risk register which a single officer updates based upon her view of the risks which are already captured. The risk register is presented to committee periodically and if they ask for a change to the risk register, it's made.

Fund B has an annual workshop as part of the business planning cycle which considers the things that might happen to prevent the business plan being achieved. A single officer is responsible for making changes to the risk register based upon the views of the other officers at the workshop. When the committee makes a decision, the officer will look at the risk register and see if it should be amended as a result of that.

Fund C does all the things that Fund B does but some of the committee members are invited to the workshop too. The facilitator uses a list of risk types to prompt people to think about new and different types of risk. The facilitator also uses a PESTLE (PEST analysis) to drive some long-term thinking. The officer who looks after the risk register captures all the feedback and updates the risk register.

Fund D does all the things that Fund C does but also uses some voting software to make sure that everyone is getting to say how likely they think a risk is. They really don't just want everyone to agree with the Head of the Fund. They also decide that when the committee is presented with a paper to make a decision, they're given some details about the potential impacts on the risk register up front. The committee's discussion and consideration of the risks will then be recorded and the risk register updated.

Would holistic risk management save time?

Each of these funds have different levels of time and resource, as well as different attitudes and exposure to risk, so none of them are wrong. When it comes to risk management, a little is better than none, and more is better than a little. The trick to saving time is being proportionate and balancing the time spent up front with the time spent dealing with risks when they happen.

Would holistic risk management drive demonstrably better decision-making?

Let's take cyber risk as an example. Which fund would be in the best place to deal with a cyber-attack? If the officer leading the risk register is really into risk, they might be in a great place but that is a key person risk in itself! What if the officer at Fund A isn't interested?

The first inadvertent cyber-attack was way back in 1988 when a Cornell student tried to find out how big the internet was and accidentally brought it to its knees. By the time the WannaCry ransomware attack hit the whole globe in 2017, UK hospitals were unable to provide emergency services within hours of it hitting their systems. Arguably, by the time of the war in Ukraine, the management of cyber risk should have been high on the risk agenda within funds. Can we be sure that the officer at Fund A has thought about cyber risk?

We can be a bit more confident that Fund B will have thought about it because a few more officers are involved.

Funds C and D use tools and prompts which should make sure lots of different risk types, like cyber, are included. Fund D has probably also mentioned cyber risk throughout the year when they have presented decisions to the committee which related to new suppliers, going to procurement or system upgrades.

Funds C and D have spent more time on it but if there's a cyber incident or a request for information from an auditor or regulator, will they be able to deal with it more quickly and with less disruption? Will the committee in Fund A and Fund B feel as equipped and confident to deal with a cyber risk actually happening?

It's important to bear in mind that the example above of cyber risk is just one example of risk, which could equally apply to risks associated with people, investment, funding or change.

So back to simple physics. If the fund better understands the risks it has identified and assessed, what is it doing to control those risks? Clearly articulating and reporting on these risks can lead to different, better-informed decisions:

- If at some point in the year the fund realises it's running higher investment risk, then it can change direction.
- If a fund realises that the cyber risk environment is higher, it could decide to divert resource to deal with its oversight of suppliers who deal with fund data, whilst accepting that that could impact other service delivery risks.
- If having to explain an administration backlog in the future, the fund will know it stemmed from a decision made to safeguard member data – a holistic decision.

The fund will be able to explain that a butterfly flapping its wings in the server produced a backlog in aggregations.... simple (holistic) physics.

Webinar on-demand

We recently hosted the second webinar in our LGPS risk management series. In this session, Andrew McKerns was joined by Susan Black, and Neil Mason from Surrey County Council, to discuss:

- Why risk management is important
- How good risk management can make life easier
- Why looking at risk holistically can help with decision-making

Watch on-demand here

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