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# London Pensions Fund Authority **Risk Appetite Statement**

March 2022



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# London Pensions Fund Authority

## Risk Appetite Statement

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### Introduction

**The Board (“the Board”) of the London Pensions Fund Authority (“LPFA”) has prepared this Risk Appetite Statement (“the Statement”) in respect of the London Pensions Fund Authority Pension Fund (“the Fund”).**

Risk management is an integral part of good governance and corporate management mechanisms. The Board acknowledges that LPFA cannot be inherently risk averse and be successful. Therefore, effective and meaningful risk management involves taking a balanced view of risk and opportunity in delivering our objectives. This Risk Appetite Statement articulates our attitude to taking managed risks in support of LPFA's strategic objectives.

The Board will review this Statement from time to time, at least every three years, and revise it as necessary.

### Purpose

The purpose of the document is to outline the areas of principal risk to which LPFA is exposed, and for each area to articulate an optimal and tolerable risk position. In doing this, the Board intends that this Risk Appetite Statement will:

- Set the parameters by which the LPFA officers will manage risk within the organisation.
- Inform resource allocation, balancing the need for effective risk management against the need to ensure value for money.

### Areas of principal risk

The principal risk areas facing LPFA are set out below:

- **Governance:** Risks associated with the policies, principles, processes, and resources used to govern LPFA.
- **Shareholder:** Risks associated with LPFA's ownership of the Local Pensions Partnership (LPP).
- **Funding:** Risks of LPFA having insufficient financial resources (assets) to pay its liabilities as they fall due.
- **Operational:** Risks associated with operational processes of LPFA to achieve its operational objectives and desired operational results.
- **Pensions Administration:** Risks associated with LPFA's interactions with members and employers, including record keeping.
- **Transitional:** Risks associated with short-term projects, likely to last for less than one year.

### Definition of risk appetite

LPFA's risk appetite is described by setting an optimal and tolerable risk position, which are defined as follows:

- **Optimal position:** the level of risk at which LPFA **aims** to operate. Achieving an optimal position does not imply that LPFA looks favourably on the risk. Risks at the optimal position may still represent a threat to LPFA, however the controls currently in place are considered sufficient to reduce the risk to an appropriate level. Additional risk controls are not considered necessary for risks at the optimal position.
- **Tolerable position:** the level of risk within which LPFA is **willing** to operate. Risks within the tolerance range may require further risk controls where suitable controls are available at a justifiable cost. Risks that are outside of tolerance represent the highest priority for further action.

In order to provide consistency across the LPFA's activities, we consider our risk appetite on the following scale:

Risk Appetite	Optimal position	Tolerable position	Description
Averse	Nil	Low	Avoidance of risk and uncertainty in achievement of deliverables or initiatives is the most important objective. We seek to remove any risks that could jeopardise our objectives. Residual risks will be tolerated only if they carry a "low" risk rating. Where necessary, significant cost can be justified in the interest of ensuring that the residual risk remains "low".
Minimalist	Low	Moderate (where unavoidable)	We seek to reduce our exposure to these risks as much as possible within the constraints of the organisation. Residual risks are considered optimal if they are rated as "low". Where multiple approaches are available, we have a strong preference for options that have a low degree of risk. The potential for benefit/return is not a key driver, and increased costs are justifiable in the interest of reducing risk. We will tolerate risks rated as "moderate" only where no reasonable controls are available.
Cautious	Low	Moderate (where opportunity exists, cost unjustifiable, or unavoidable)	We seek lower risk options, especially where the opportunity for upside is limited or the cost of lowering risk levels is acceptable. We are willing to tolerate residual risks rated as "moderate" where there is the opportunity for significant benefit, where the cost of reducing the level of risk is unjustifiable, or where no reasonable controls are available.
Open	Moderate	High (where opportunity is substantial)	We consider all options and choose one most likely to result in successful delivery while providing an acceptable level of benefit. We are comfortable accepting "moderate" risks in recognition of the potential benefits available. We are willing to tolerate activities that carry, or contribute to, a high degree of residual risk where the opportunity for benefit is substantial.
Eager	Moderate	High	We are eager to be innovative and to choose options based on maximising opportunities and potential higher benefit, even where this results in increased risk. The level of residual risk resulting from activities is less important in the decision-making process than the opportunities available. A very high degree of residual risk can be tolerated.

## Risk Appetite Statement

The LPFA's Risk Appetite for each area of principal risk is set out below.

### Governance

We have adopted a minimalist stance for governance risks. We recognise that effective decision-making processes and internal controls are essential for the long-term success of LPFA. Reductions in governance risks have a role in optimising positive outcomes for the Fund. Through the activities of the LPFA Senior Leadership Team, we ensure that the LPFA Board receives sufficient support to carry out its duties effectively. Compliance with all relevant legislation, regulation, and codes of practice is crucial, and LPFA maintains a Compliance Framework to ensure all statutory requirements are met. The Board receives regular assurance that compliance monitoring is in place so that compliance risks are promptly identified and mitigated where required.

### Shareholder

We have adopted an open stance for shareholder risks. We recognise that the continued success of LPP and its subsidiaries offers considerable potential benefits to LPFA, our members, and employers. Risks associated with our ownership of LPP must therefore be considered against the potential benefits associated with them. We seek to achieve a balance between value for money and a high likelihood of successful outcomes with a high degree of benefit. We partner with LPP to achieve mutually beneficial outcomes. We maintain oversight of LPP's activities as a business both through regular reporting to the LPFA Board, and by the presence of an LPFA appointed director on the LPP Board (and on the Board of Local Pensions Partnership Administration (LPPA)).

## Funding

We have adopted a varied stance on funding risks. Funding risks are central to the operation of a defined benefit pension scheme, and we note the wide range of risks captured by this category. We recognise the need for balance between the requirement to secure the solvency of the pension fund and the long-term cost efficiency of the Scheme.

Within this category:

- We have adopted an **open** stance on investment risk. We recognise that investing in assets that target a higher level of return can lead to improved outcomes for the Fund and lower contributions for employers, but also higher potential losses. We aim to optimise returns subject to an acceptable level of risk. Our [Investment Strategy Statement](#) sets out our investment objectives and the investment strategy we follow in order to achieve them. We also maintain a Funding Risk Management Framework, which sets out a range of metrics to assess the likelihood of our investment objectives being achieved in practice, and actions that may be taken if the level of funding risk exceeds tolerance levels.
- We have adopted a **cautious** stance on environmental, social, and governance (ESG) risk. Investments which exploit the environment or otherwise give rise to risk arising from poor or unsustainable business practices are not consistent with the investment goals of the Fund. We seek to reduce ESG risks primarily through engagement via the activities of our delegated investment manager. Our [Responsible Investment Policy](#) and [Climate Change Policy](#) set out our approach to managing these risks in more detail.

- We have adopted a **cautious** stance on employer-related risks. The employer-related risk is that individual employers are unable to make payments to the Fund when required, which could ultimately result in other employers needing to pay more. We seek to reduce this risk where possible, while seeking to ensure that contributions remain affordable for employers. Where there are circumstances which make it likely that a Scheme employer will become an exiting employer, we will prioritise the solvency of the Fund above the affordability of employer contributions. [Our Employer Risk Management Framework](#) outlines how LPFA identifies, assesses, and manages this risk for the benefit of employers as a whole.
- We have adopted an **averse** stance on liquidity risk. It is essential that LPFA maintains sufficient liquid assets to pay benefits as they fall due. LPFA will not tolerate any risks that could jeopardise our ability to access funds to pay benefits. LPFA maintains an allocation to cash within its investment strategy, and in addition a significant proportion of the Fund is invested in assets that can be realised at very short notice. LPFA's Treasury Management Group meets regularly to ensure that upcoming cashflows are managed appropriately.

### Operational

We have adopted a minimalist stance on operational risks. We recognise that operational risks (including asset security, data protection, business continuity, and cyber security) could threaten LPFA's ability to pay benefits as they fall due. We therefore seek to reduce our exposure to these risks as much as possible. These risks are managed on a day-to-day basis primarily through the activities of third parties (including our custodian, pensions administrator, and delegated investment manager). The LPFA Board and Senior Leadership Team maintain regular oversight of these third parties to ensure that operational risks managed appropriately.

### Pensions Administration

We have adopted a minimalist stance on pension administration risks. We recognise that pension administration risks (including the risk of poor data quality, incorrect benefit calculations, and poor-quality service and communications) could negatively affect members, employers, and regulatory compliance. These risks could also be detrimental to the good standing and reputation of LPFA.

Day-to-day pensions administration is carried out by our administrator, LPPA. The LPFA Board and Senior Leadership Team maintain regular oversight of LPPA to ensure that pensions administration risks are managed appropriately. We seek to ensure that benefits are administered to a high standard on our behalf, with a preference for processes and systems that reduce pensions administration risks as much as possible within the constraints of the organisation.

### Transitional

We have adopted a varied stance on transitional risks. These risks can result from projects initiated by LPFA or our service providers (for example, projects to improve systems or processes), or from external factors outside our direct control (for example, changes to legislation or the Covid-19 pandemic).

Within this category:

- We have adopted a **cautious** stance on projects initiated by LPFA or LPP. We recognise the benefits to LPFA of improving systems and processes and can tolerate moderate risks where significant opportunities are identified.
- We have adopted a **minimalist** stance on projects in response to external influences. We recognise that we have little control over the emergence of these risks and our focus is therefore on reducing their impact as much as is possible.

For more information, please contact:  
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