A Blueprint For Integrated Risk Management

Introduction

• The guidance on Integrated Risk Management is now over two years old but the profession has struggled to articulate a model to help trustees and employers to fully embrace it.

• The Risk Bowtie is risk management model that is widely used to provide a simple and intuitive way of visualising and managing risks.

• If widely adopted, this model could provide a common framework to be used trustees and employers in the financial management of schemes.
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How would it work in practice

<table>
<thead>
<tr>
<th>Risk Events</th>
<th>Preventative controls</th>
<th>Levels</th>
<th>Benefit security</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding</td>
<td>Prudence margin</td>
<td>Low</td>
<td>Better</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>Med</td>
<td>No change</td>
</tr>
<tr>
<td>Covenant</td>
<td>Investment in employer</td>
<td>High</td>
<td>Worse</td>
</tr>
<tr>
<td>Investment</td>
<td>Insurance specific liabilities</td>
<td>Low</td>
<td>No action</td>
</tr>
<tr>
<td>Risk inter dependencies</td>
<td></td>
<td>Med</td>
<td>No change</td>
</tr>
<tr>
<td>Concentration risk</td>
<td></td>
<td>High</td>
<td>No change</td>
</tr>
<tr>
<td>Monitoring</td>
<td>Frequency of monitoring</td>
<td>Low</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Med</td>
<td>No action</td>
</tr>
<tr>
<td></td>
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<td>High</td>
<td>No change</td>
</tr>
</tbody>
</table>

Financial support Funding level + Covenant

<table>
<thead>
<tr>
<th>Corrective controls</th>
<th>Levels</th>
<th>Benefit security</th>
</tr>
</thead>
<tbody>
<tr>
<td>Covenant improves</td>
<td>Low</td>
<td>Better</td>
</tr>
<tr>
<td>No change</td>
<td>Med</td>
<td>No change</td>
</tr>
<tr>
<td>Covenant falls</td>
<td>High</td>
<td>Worse</td>
</tr>
</tbody>
</table>

Timescale to report

Monitoring

The lower the level of financial support, the greater the level of controls that are required to maintain benefit security.
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How would it work in practice

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Funding Case study - 2015
In this case study the controls are mostly at medium, except transfer value reductions, member options and currency hedging.

A key element in this scheme is the guarantee/contingent asset provided by the parent company which also provides insolvency insurance.
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Funding Case study - 2015

- On the contingency plan side, a much simpler picture!
- In this case there is no formal contingency plan. i.e. Controls are Low.
- This means any actions are agreed as/when required
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Funding Case study – three years later 2018

- Changes to investment strategy increased expected return and reduced var
- Prudency margin improved
- Investment risk reduced
- Risk affordability improved
- Increase in hedging ratio reduced interest and inflation risk
- But new controls around collateral management required
- Increased diversification in manager structure
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Funding Case study – three years later 2018

- Improvement on contingency planning to medium – triggers for action agreed but actions to be decided
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Funding Case study – three years later 2018

As a visual representation of IRM

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Uses of bowtie

As a way of summarising existing controls

As a model scheme to look at the impact of different economic scenarios

As a way of summarising existing controls
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Why to use bow-tie model to explain IRM

• Visual
• Simple and the flow from left to right is intuitive
• Summarises key controls on one page
• Stresses importance of security of member’s benefits
• Emphasises the need for and balance between Preventative and Corrective controls
• Aligns pension scheme risk management with risk management generally
• If widely adopted this model could provide a common framework to be used trustees and employers in the financial management of schemes