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Integrated Risk Management

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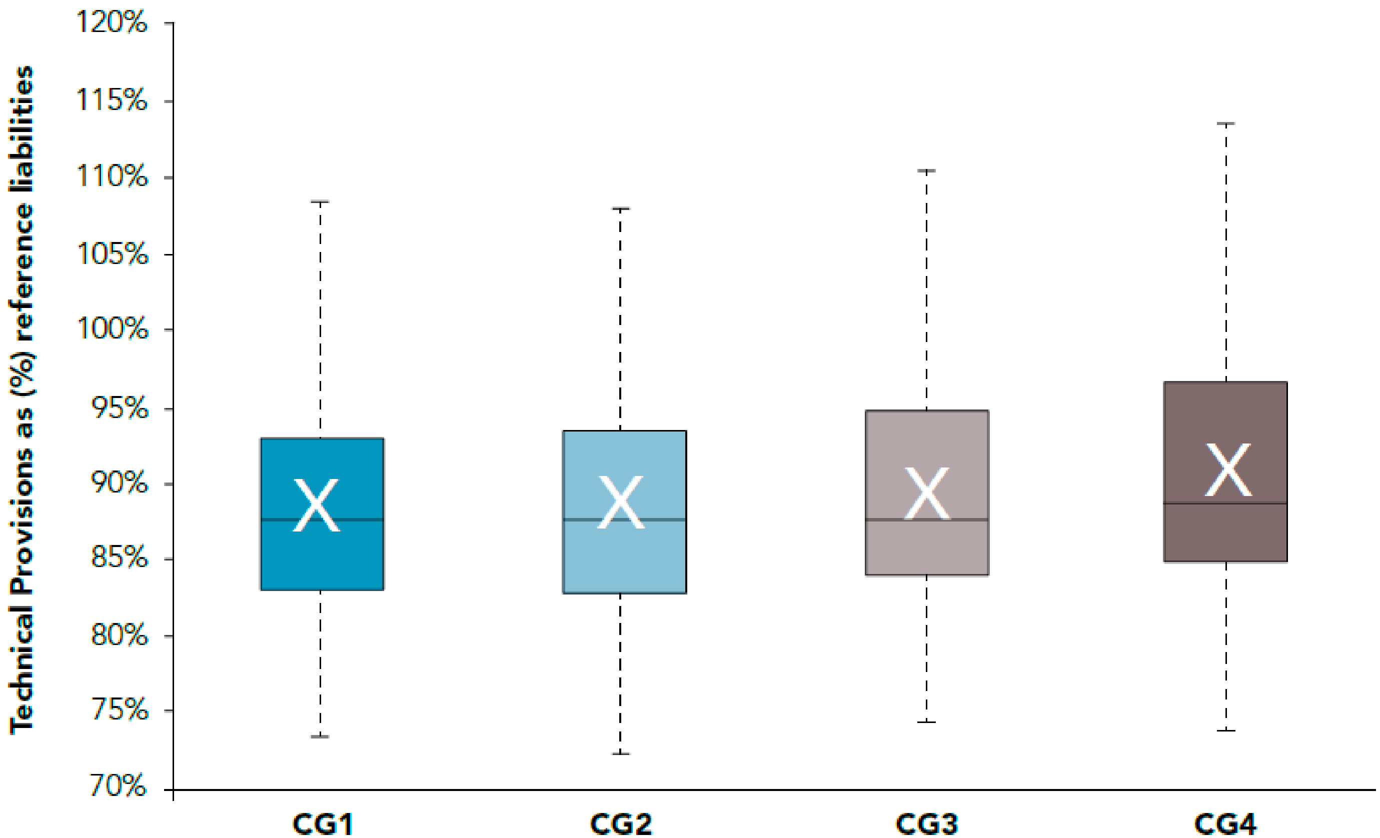
Agenda

- Background
- The 5 key stages of IRM

‘Scheme specific’ funding



Source: The Pensions Regulator

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Code of Practice

- Revised version in force from July 2014
- Introduced the concept of Integrated Risk Management (IRM)
- A statement of principles rather than a ‘how-to’ guide
- Focus on understanding risks posed to individual schemes
- Regulatory strategy updated
- Outcome focussed as opposed to trigger point based

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What is IRM?

Source: The Pensions Regulator

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Regulatory Guidance – IRM

- Published December 2015
- Practical guidance on how to apply Integrated Risk Management (IRM) principles
- Aimed at all trustees and employers, but tPR believes it will be of particular use to smaller schemes

5 key steps:

- Initial considerations
- Risk identification and initial risk assessment
- Risk management and contingency planning
- Documenting IRM framework and decisions reached
- Monitoring

The situation

ABC Ltd

- Supplies products to the building trade
- Hit hard by the recession
- As a result, made significant disposals of loss making parts of the business
- Owned by banks, who will be looking to exit over the short to medium term
- Currently stable, with difficult but achievable growth prospects

ABC Pension Scheme

- 70% funded on a fairly prudent basis at the last valuation
- Limited investment risk

1. Initial considerations

- Establish roles and responsibilities
- Understand employer’s risk capacity and appetite, and affordability constraints
- Consider advisers who should be involved in the process
- Establish budgets, taking into consideration proportionality

- Concepts can be difficult to grasp, especially for lay trustees
- Increasing need for IT?

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Risk appetite and affordability

ABC Ltd

- Appetite to take risks strategically
- Affordability is uncertain – business plans rely on growth

Trustees of the ABC Pension Scheme

- Believe that ABC Ltd has limited risk capacity
- Commissioned independent covenant review looking at what might be affordable

Recovery period in 3 years

Deficit in 3 years' time	5	7	10	15	
£60m	15	9	6	3	EXPECTED OUTCOME
£90m	21	12	9	6	
£120m	27	15	12	9	RISK SCENARIO
£150m	33	18	15	12	

Affordable
Stretch
Unaffordable

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2. Risk identification/assessment

- Examine current risks in terms of funding, investment and covenant
- Consider each in isolation, but also how they affect the other two
- tPR recommends starting with covenant

- Potentially difficult to explain with traditional actuarial tools
- Increasing focus on tech solutions to deliver affordable risk analysis tools

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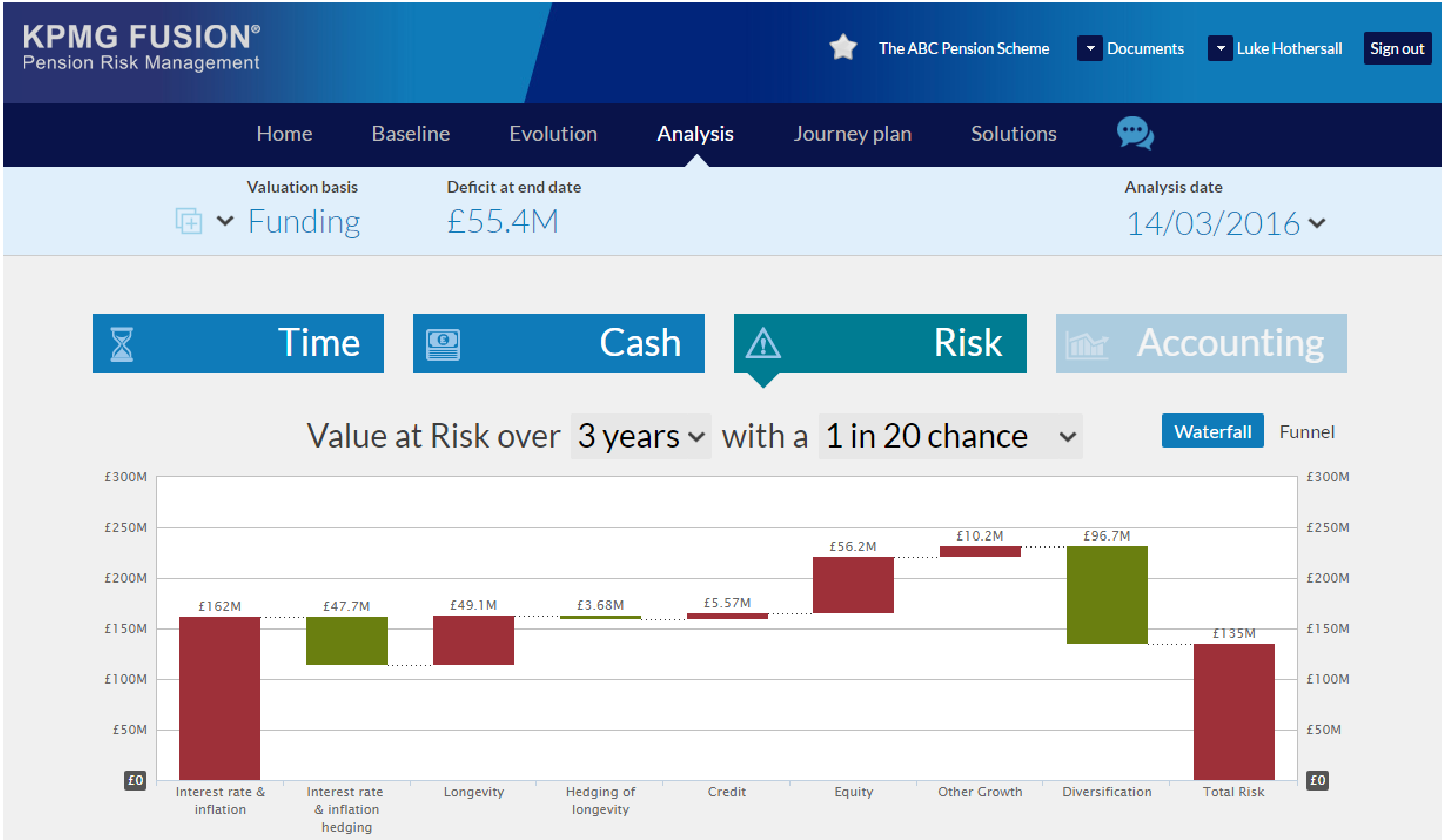

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Getting to grips with risk

- Our approach is to approach risk holistically looking at the business as well as the pension scheme
- Natural hedges

- The Trustees of the ABC Scheme were worried – the VaR analysis had shown that the Scheme
- was still exposed to significant equity risk.

- As a result, they wanted to investigate alternative growth asset classes. They proposed increasing the property allocation

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Getting to grips with risk

- But what happens to covenant if properties fall in value?
- Well, people stop building houses and therefore ABC Ltd receives fewer order
- So really, de-risking growth assets would have geared the risks the Scheme was exposed to

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3. Risk management and contingency planning

- Apply risk management strategies now (if applicable) and develop contingency plans
- Guidance focusses on risk mitigation
- Our view is that risk can and should be taken in appropriate circumstances

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Managing risk collaboratively

Employer

- Affordability not certain as depends on growth of business. Limited risk appetite but not happy with current ‘locked down’ strategy.

Pension scheme

- Identify key covenant risk in banks wishing to withdraw from business. Keen to see an increase in contributions. Unlikely to agree to taking any additional risk without additional security.

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Managing risk collaboratively

Prudent TP basis maintained
Focus discussions on investment and covenant risks

Baseline cash agreed. Expected to clear deficit in 15 years
Scheme Funding requirements met

Contingent cash contributions based on company profits
Sharing in good performance. Encouraging further collaboration

Re-risking of a proportion of the assets to provide growth engine
In return for additional contributions, modest re-risking to drive outperformance over prudent TPs

Introduction of requirement to obtain Trustee consent for any major business changes
Giving trustees additional powers to firm up intangible covenant

4&5. Documenting/monitoring

- Documentation should not be too onerous – tPR suggests making use of existing documents such as RP
- Challenge in setting a monitoring framework
- Every three years unlikely to be sufficient
- Again, use of tech solutions is likely to be key in delivery this to schemes of all sizes at an acceptable cost
- Employer input likely to be key in ongoing covenant monitoring

Developing solutions

- Ongoing independent monitoring of employer covenant
- Dashboard approach

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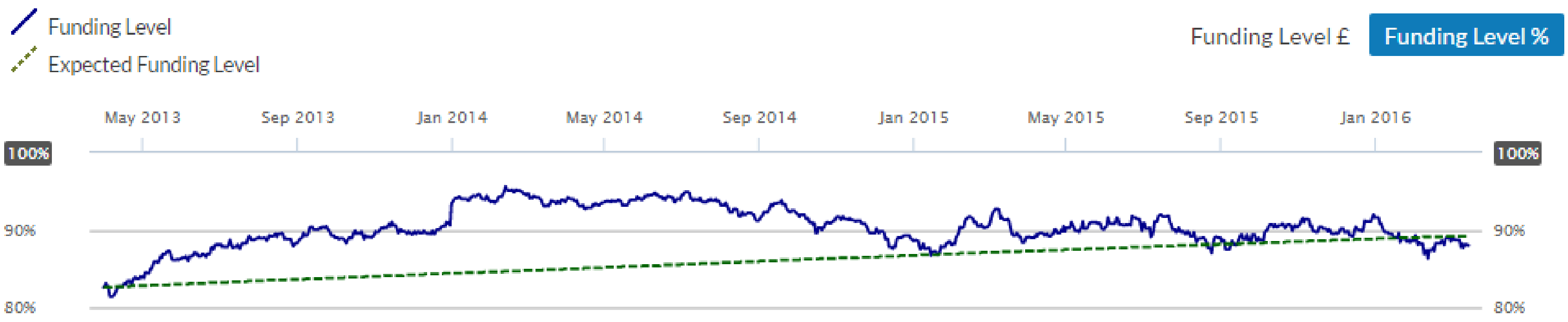
Monitoring and subsequent valuations



- The ABC Pension Scheme has reached its next valuation date
- The funding level has generally been better than expected over the period, but dipped below expected just as the valuation date arrived
- Both the Trustees and ABC Pension Scheme were happy with the approach they had been following and that the current plan remains appropriate
- No change to RP other than 'white noise' contribution added at the end of the Recovery Plan

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Issues to consider

- Cost
- The reality of decision making
- Distressed employers
- Disengaged employers

Conclusions

- In the worst case scenario, recent guidance and changes in regulation could increase costs for pension schemes and sponsors with little value added
- However, real value added can be obtained if all parties are willing to engage in collaborative decision making
- Recent guidance is a real opportunity to provide bespoke consultancy making full use of tech solutions

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.