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# Integrated Risk Management

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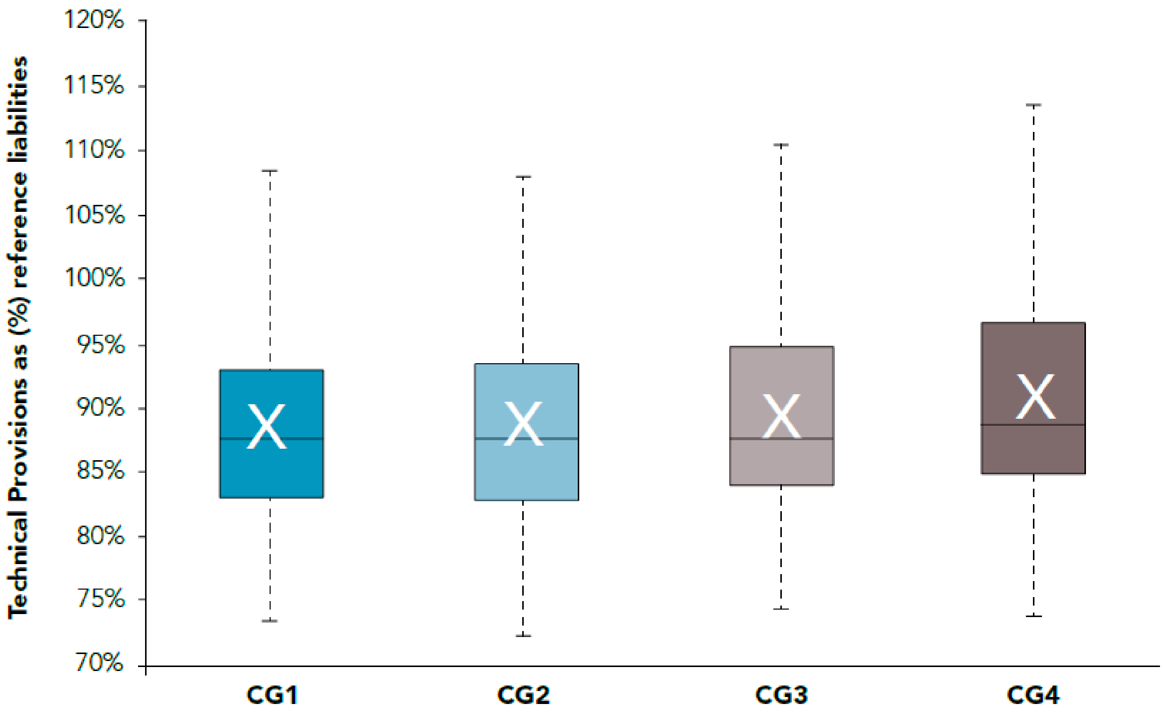
# 'Scheme specific' funding




*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

# What is IRM?


*Source: The Pensions Regulator*

# Regulatory Guidance – IRM

5 key steps:

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

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# 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

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# 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?

# 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

# 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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# Getting to grips with risk

- 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

# 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
***Modest re-risking to drive outperformance over prudent TPs***

Requirement to obtain Trustee consent for any major business changes
***Giving trustees additional powers to firm up intangible covenant***

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# 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

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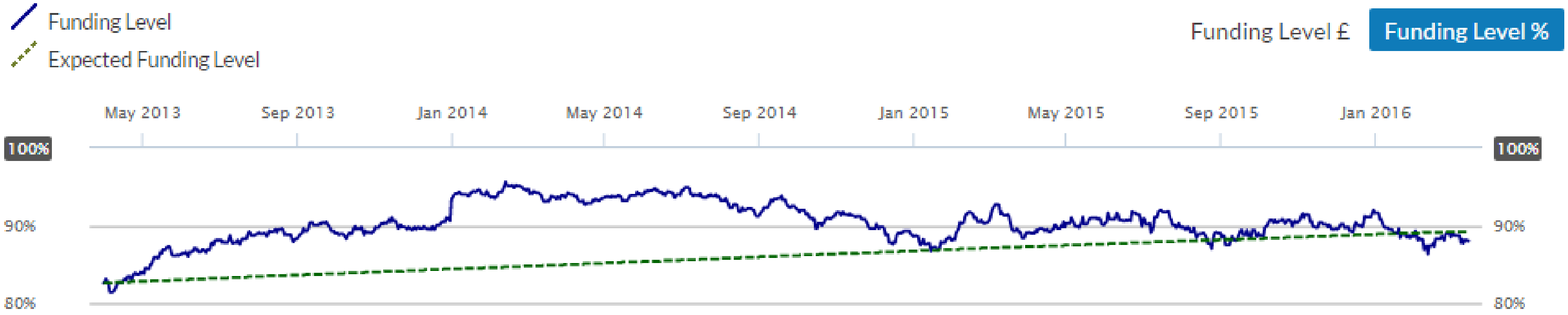
# Monitoring and subsequent valuations




- Funding level has generally been better than expected, but dipped at the valuation date
- Both parties happy with the approach they had followed and concluded that the current plan remains appropriate
- No change to RP other than 'white noise' contribution

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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

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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.

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