

Building Risk Awareness for the Trustees of Occupational Pension Schemes



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Introduction

The IORP II Directive was introduced across the EU with a view to raising the bar around the governance of pension schemes with the ultimate aim of protecting members entitlements and ensuring that their needs are central to the decision making of trustees in the running of their schemes. Pension schemes in Ireland must now implement an effective internal control system whose purpose is to give trustees comfort that the scheme is complying with all applicable rules and laws, assets are safeguarded, operations are efficient/effective, records are accurate, policies are followed, members interests are safeguarded, and that reporting is reliable.

Internal Control System

Part of having an effective internal control system in a pension scheme involves the appointment of key function holders and in particular the appointment of a risk management key function holder. The risk manager is responsible for the implementation of a risk management system which sets out the policies, processes and procedures that must be followed for identifying, measuring, managing, monitoring and reporting on the risks that are relevant to the pension scheme.

Initially the risk manager will work with the Trustees on setting the scene for how the risk management system will work. Some of the first tasks will be around setting a vision statement for the scheme, setting objectives, considering the risk appetite that the trustees have for taking risk and agreeing the risk universe for the scheme which is the set of risks the scheme is exposed to.

The setting of objectives is important because when we consider the term “risk” which we can define here using the ISO 31000 definition which is “the effect of uncertainty on objectives” it becomes clear that if we have not set out what the objectives of the scheme are

then we cannot know what the risks to the scheme’s objectives are. Therefore, risks attach to objectives and objectives are owned by the trustees so the trustees in turn also own the risks that the scheme faces, and not the risk manager, which is an important distinction. Once we have set out the scheme’s objectives, we can consider that there is uncertainty that trustees will achieve their objectives and the essence of risk management is really managing this uncertainty so that it is more likely that the trustees will reach their objectives.

The risk register will hold all the risks (risk universe) that the risk manager and trustees consider are relevant to the scheme and which could impact on the ability of the trustees to reach their objectives i.e., compliance, strategic, investment, people and financial risks. Each risk will be assessed and assigned a risk score, considering likelihood and impact, on a gross basis which is without the application of any controls and then on a net basis, considering again likelihood and impact, on a net basis after the application of controls.

The idea of controls is an important one and if we consider an example such as cyber risk it will help to illustrate the point. Pension schemes by their nature are attractive targets for cyber-attacks as they hold lots of valuable data and if a pension scheme had no or little defences/controls (the gross basis) against sophisticated threats it is highly likely the scheme would be penetrated and the impact in turn would be very serious indeed depending on the level of penetration i.e., members data for sale on the dark web or the scheme cannot operate to fulfil its objectives. However, the trustees and service providers can manage this threat by implementing defences/controls such as cyber security measures and policies, taking regular training in cyber matters or consulting and retaining the necessary cyber expertise as ways to reduce the risk to the scheme and thus the net risk score will be much

reduced and within risk appetite. Controls are therefore vitally important in bringing the identified risks down to a level that trustees are comfortable with and regular monitoring of the effectiveness and design of controls is necessary to ensure that they are doing the job they are supposed to be doing.

Risk appetite is another important concept and is defined as “the amount and type of risk the scheme is willing to take in pursuit of its objectives” and this level will be agreed with the trustees at the outset for each category of risk and ultimately the net risk score for each risk in the risk register should be below the trustees’ risk appetite and, if not, an action plan should be put in place to bring it within risk appetite. Generally speaking, the risk appetite for pension schemes in Ireland is very low as they are conservative by nature and not risk seeking except perhaps around investments where some schemes are able to take enhanced risk to secure potentially better returns for members.

It’s not just the risks that have happened in the past or even in the present that are important and we must also look to the future to see what risks could emerge to impact the pension scheme’s objectives. Having an emerging risk register is one way of thinking about these risks and demonstrating that thought is going into what the risks of the future might be. For instance, if a major medical breakthrough occurred which meant that people could live much longer than previously predicted what might this mean for the funding position of Defined Benefit pension schemes if they suddenly had to find more money to fund their obligations to members living longer than expected.

Once the risk system basics are in place for the scheme the attention will turn to the regular risk monitoring and reporting that the scheme will receive and there

will also be an annual deep dive review of the risk register to ensure that any changes are caught and in this way the risk management system is dynamic in that it changes as the scheme changes its profile.

ORA

The risk register is a comprehensive list of the risks to the scheme, their potential impact to the scheme’s objectives and the mitigation strategies that have been applied to bring them within risk appetite. The ORA (Own Risk Assessment) is a new introduction which will need to occur at least every 3 years, which takes a broader view of the overall risk profile and the connections between individual risks.

Challenges

The burden of governance on trustees is higher now than before the introduction of IORP II with the result that already overstretched trustees to a scheme, who traditionally may have been employees of the sponsoring firm, are reviewing their participation as trustees and some are opting to resign rather than continue in the role. This leaves options such as the hiring of professional trustees to fill the void or more fundamental avenues such as migrating the scheme to a master trust. Formal risk management is a new concept for many lay trustees and getting them comfortable with risk management is important so time must be taken to bring them up to speed.

Conclusion

Risk management is here to stay for pension schemes and if embraced and managed properly it will lead to an enhanced risk awareness which will lead to better decision making by trustees as they learn to weave in risk considerations to their way of working. Better decision making will ultimately lead to better outcomes for members and ensuring the long-term sustainability of occupational pension schemes.

