

OUR INDUSTRY IS CHANGING. ARE WE?

“Rights and obligations in an evolving Retirement Funds environment”

Risk management in retirement funds – are we exposed?

PENSION LAWYERS

A S S O C I A T I O N

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Agenda

- Why is understanding and managing risk so important?
- What are risks?
- What is risk management?
- What does legislation say about risk?
- We are all in the risk management business
- How is the industry doing on risk management?
- What does the risk profile of a typical fund look like?
- What does a risk management program for a fund look like?
- Risk management - best practice
- Conclusion

Why is understanding and managing risk so important?

- The stakes in managing retirement funds have always been high
- The risks that we all face in our personal capacities have increased
- Trustees can be held personally liable
- Increased scrutiny from regulators – risk based supervision
- Focus on governance
- Member activism
- Increased transparency – new AFS
- More accountable for our actions

How safe is trustee fidelity cover if you can't demonstrate that you identified, understood and managed all the fund's risks?

What are risks?

- Risks are actual or potential events that could prevent a fund from achieving its objectives
- This presupposes that the fund has clearly articulated objectives
- Risks can also be seen as opportunities missed.

What is risk management?

- Risk management is defined as the process that decides which risks to avoid, control, transfer or accept
- Risk management is therefore a process that utilizes internal controls to mitigate and control risk
- Risk management should be practiced at all levels within the operation of the fund it is ultimately the trustees responsibility
- Roughly 80% of listed companies have appointed a Risk Officer

■ Laypersons definition of risk management

Hindsight is an exact science
Risk management is converting hindsight into foresight
And then controlling the variables that could cause the event to occur

■ What does legislation say about risk?

- Good corporate governance practices dictate that those charged with governance should understand and manage the risks that their entities face.
- It is interesting to note that Sections 7(c) and (d) of the Pension Funds Act that sets out the **Object of board** and **Duties of Board** does not refer to risk management directly

What does legislation say about risk?

- Circular **PF 98** refers to risk as follows:
 - board should not assume risk without talking cognisance of the consequences
 - maintaining effective risk management systems
 - investment returns more than adequate relative to the risks of the investment
 - risks with regard to all outsourced activities are identified and properly supervised.

■ We are all in the risk management business

-but who manages what risk?
- Trustees are responsible for managing all the fund's risks
- Common fallacy that auditors, actuaries, administrators, consultants and other service providers manage the fund's risks
- These providers primarily manage **their own risk**
- Trustees cannot outsource overall responsibility for risk management

Do trustees understand all the fund's risks, how they are managed and controlled and by whom?

Has this been formalised and is it defensible?

How is the industry doing on risk management? Deloitte results

- **87%** of boards accepted responsibility for risk management (71% formally)
- **29%** of funds have appointed a risk sub-committee
- **29%** of funds had developed a board approved risk management policy (14% formally)
- **26%** of funds communicate the policy to service providers
- **37%** of funds undertake annual risk assessments (13% formally)

How is the industry doing on risk management? Deloitte results

- **23%** of funds stated that their trustees understood the inherent and specific risks facing the fund
- **34%** of funds confirmed that controls are in place to manage risk (this includes service provider controls)
- **35%** of boards monitor the effectiveness of internal controls and takes corrective action
- **17%** of funds inform their members on how they manage risk

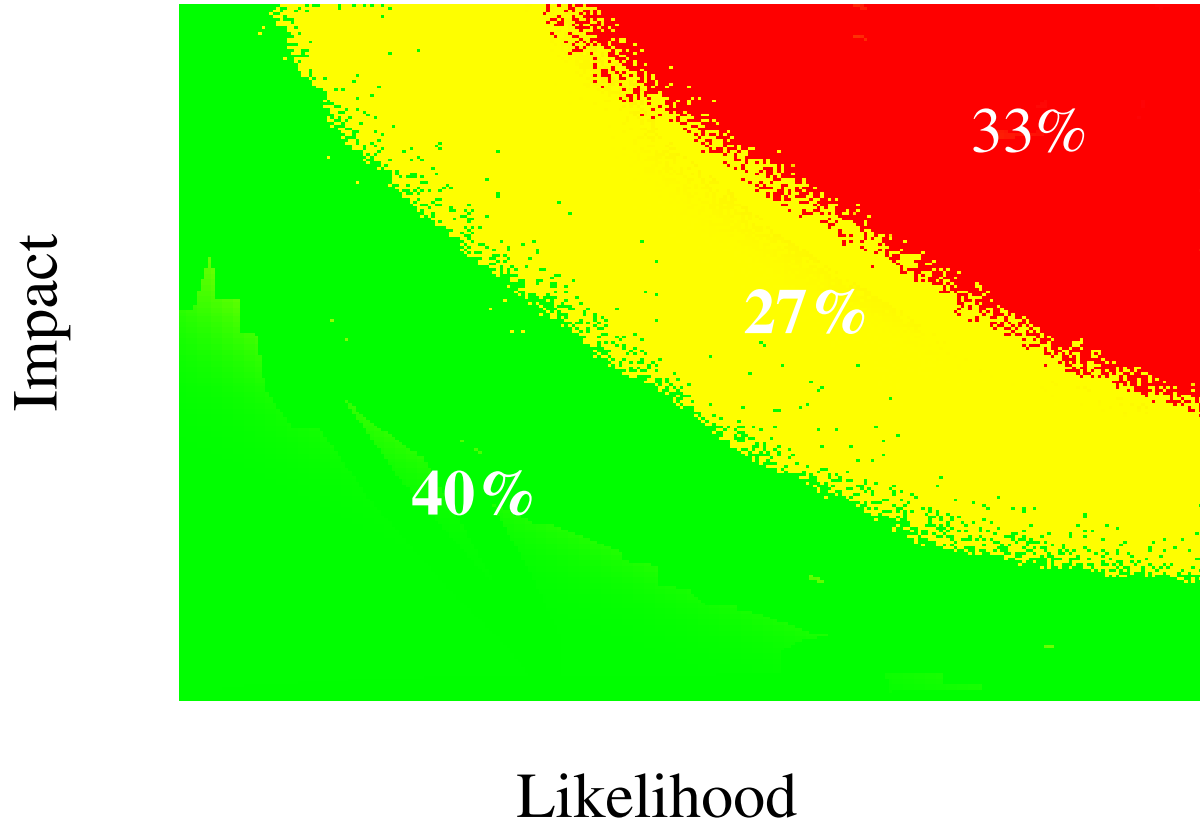
How is the industry doing on risk management? Deloitte results

- Investments highlighted as the major risk facing the fund
- Many trustees consider investment risk to be the only risk
- Trustees rated the adequacy of the risk identification and management processes at **5.7** (ps 5.4)
- Deloitte have assessed this to be high
- Risk management within retirement funds requires improvement

Incentive – *can trustees reduce the cost of insurance cover with effective risk management?*

What does the risk profile of a typical fund look like?

Risk Rainbow (generic fund)



■ What does a risk management program for a fund look like?

- Identify all fund risks (from all key participants)
- Rank the risks in terms of
 - **Impact** - what the Rand value of loss will be if the risk occurs
 - **Likelihood** – what are the chances of the risk occurring in a pre and post control environment
- Consider risks that have biggest movement in likelihood between pre and post controls

■ What does a risk management program for a fund look like?

- Document controls in place to mitigate risk
- Assess the effectiveness of existing controls
- Assign responsibility for the controls
- Who monitors that the activity is occurring?
- Evaluate whether or not controls operated effectively throughout the period
- Develop action plans to address
 - Inadequate or ineffective controls
 - Alternative actions for risks that are not directly controllable

■ Risk management - best practice

- Board to formally accept responsibility for risk management
- Formally adopt and implement a risk management plan
- Perform a risk identification and assessment program
- Develop the risk management and monitoring plan
- Update risks annually
- Quarterly monitoring of operation of controls

Conclusion

- Risk management will be an integral part of the future management of retirement funds
- Trustees have work to do to improve risk management

Trustees will find it difficult to demonstrate that they have discharged their fiduciary duties without having actively identified, understood and managed their fund's risks