PSIT Independent Trustees

Briefing note – July 2014

Integrated risk management plans: how new are they?

The Pensions Regulator's (tPR) recently revised code of practice for funding defined benefit (DB) schemes states **'a strong ongoing employer alongside an appropriate funding plan provides the best support for a well-governed scheme'**.

The code focuses on trustees adopting an integrated approach to three key areas of risk:

1. the employer covenant
2. investment
3. funding

DB scheme risks are interlinked

These three risk areas interact so each must be assessed before trustees can make informed decisions about any individual area, such as investment or funding strategies. For example, **the strength of the employer's covenant and their ability to meet any funding shortfall should impact the level of investment risk trustees are willing to take**.

This is not new - and many trustee boards will already be considering all these factors when managing risk in their DB scheme.

To check whether they are taking an integrated approach to covenant, investment and funding risks, trustees should ask themselves:

- Is the scheme's investment strategy appropriate given the strength of the employer covenant?
- Is the funding plan, i.e. the speed of deficit recovery payments, appropriate given the strength of the employer covenant?
- Are the actuarial valuation assumptions appropriate given the investment strategy and strength of the employer covenant?

Risk management

TPR expects trustees to identify and assess risks before setting investment and funding strategies. These risks should then be monitored, so suitable actions can be taken in the event of any significant changes. We believe **a risk management framework should be proportionate to the size of scheme and budget available** - something that can all too easily be overlooked in the 'drive to comply'.

Risk management is not simply a case of **protecting against negative events**. Monitoring investment and funding risks enables trustees to **plan de-risking strategies**.

For example, trustees may decide to de-risk their investment strategy in the event of investment outperformance or funding level increases, thus locking in gains and reducing the risk of future volatility in the scheme's funding level. An effective risk management framework can also **assist trustees with their decision making**; for example, when choosing between different recovery plans.

For many trustee boards, tPR's new code will not change the fundamental considerations they make when managing their scheme. As is often the case in the pensions world, it is the terminology that is changing. This increased focus on 'integrated risk management' by tPR is also changing the way we need to present, explain and document our approach to managing and monitoring pension scheme risks.

To highlight whether there are any gaps in the trustees' risk management planning, ask yourself:

- Do the trustees fully understand the risks faced by the scheme?
- Are the trustees comfortable with the level of risk being taken?
- If any risk is excessive, have the trustees considered what action could be taken to reduce the risk?
- Is there a framework in place to monitor investment, employer covenant and funding risks?
- What would happen in the event of a significant change in investment returns, employer covenant or funding level? Is there a strategy in place to take mitigation actions?

Find out more

As a professional independent trustee company, PSIT can help guide trustee boards and employers in understanding and assessing pension scheme risks.

To find out more about setting up an appropriate, proportionate risk management framework for your scheme, please contact James Double:

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