

Managing pension risks effectively

✓ **All pension funds have risks – the challenge is identifying, prioritising and managing them in a consistent manner which adds value to both trustees and sponsor. Eddie Hodgart describes below some options for trustees to consider**

When it comes to dealing with pension risks, trustees can choose to:

- **accept the risk** if the value associated with the activity exceeds the potential consequences
- **avoid the risk** and do not proceed with the associated action
- **transfer the risk** to someone else
- **mitigate the risk** through specific actions and ongoing monitoring.

Decisions regarding the above are usually recorded in the scheme's Risk Register, along with information for each identified risk such as: a risk score, actions taken to mitigate the risk, steps taken to monitor ongoing risks, etc. Therefore, an effective Risk Register is, in

theory, ideally positioned to support trustees to proactively manage their risks. However, are Risk Registers really being used in this manner? Are trustees seeing the value?

Are Risk Registers adding value to trustees?

Probably not for many trustees. The quality of Risk Registers and the frequency with which they are being reviewed varies enormously from scheme to scheme. There is just too much information – what is the likelihood that a corporate board would review a 12 page Excel document at a meeting? Trustees should not have to bury themselves in detail at trustee meetings. Risk Registers need to be sharper, more focused, relevant and

shorter. Trustees also want their Risk Register to be a robust, flexible tool to accommodate and analyse future risks as and when they occur (if not before) rather than simply a statement of fact at a point in time.

What could be done differently?

In actual fact, some relatively simple actions taken could radically improve how Risk Registers are perceived, adding real value to both the trustees and sponsor. In the table below, we set out five important elements of a Risk Register and how they could be improved.

Risk Registers are the front line of managing risk and they need to be used effectively with all parties seeing value in the process. Rather than focusing too much time on the details, trustees should be focusing on value-added discussions on the appropriateness of risk monitoring and mitigation.

Small steps in the right direction can make all the difference.



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Elements of a Risk Register	Commentary
1. Expand the purpose of the Risk Register	<ul style="list-style-type: none"> • The Risk Register should be the 'go to' document for all aspects of Risk Management. • The Introduction should describe the Trustees' long term strategy and risk philosophy, provide a description as to how risks are measured / assessed, identify who is accountable for pension risk management and provide a summary of the current key risks.
2. Assessing Risks	<ul style="list-style-type: none"> • Risk factors such as likelihood and impact should continue to be the most commonly used risk factors. However, other risk factors should be explored from time to time including: vulnerability, timing, tolerance for risk and risk contagion.
3. Demonstrating value	<ul style="list-style-type: none"> • Most Risk Registers currently only 'score the risk' after steps have been taken to mitigate the risk • Going forward, Trustees should produce two risk scores for each risk – pre and post mitigating actions. The difference between the scores is the value that the risk mitigation has added (some pension arrangements do this already using the concept of 'gross' vs 'net' risks).
4. Prioritising risks and subsequent actions	<ul style="list-style-type: none"> • Two approaches are commonly used – forced ranking using risk scores and heat map analysis (using likelihood / impact scores). • Further work is required to consider how best to deal with rare / unusual / extreme events and heat map designs. • The focus having identified the key risks, however, should be on 'what happens next?'
5. Controls	<ul style="list-style-type: none"> • Trustees need to review the effectiveness of their designated control mechanisms more frequently.