Are trustees managing pension risk effectively?

Crowe's risk management survey 2018 reveals the biggest risks facing UK pension arrangements. Are trustees really managing their pension risks and are they doing enough?

In conjunction with *Pensions Age,* Crowe surveyed 108 pension schemes to understand their views on pension risk management practices relating to occupational trust based defined benefit (DB) and defined contribution (DC) pension arrangements. Set out below are the key findings.

Almost 90 per cent of respondents told us that they believe pension risk management has become more challenging in the past 12 months. This is primarily due to increased complexity of DB risks and the increasing number of DC risks. This perception may be in response to trustees becoming more aware of the risks facing their pension scheme, due to having to respond to initiatives such as 21st century governance, data protection and integrated risk management (IRM). It also highlights that more work needs to be done to reassure trustees that their pension scheme's risks are being managed appropriately.

Are trustees really managing their risks or do they just think they are?

There seems to be a disconnect between trustee perception versus reality when it comes to controlling pension risks.

With the exception of cyber risk and fraud risk, the responses clearly demonstrate that trustees are very confident that their risk controls are helping to manage their risks appropriately. In fact, confidence levels have increased dramatically in the past 12 months.

Contrast this with our general experience when reviewing risk controls where, in too many cases, the controls associated with specific risks are just not appropriate, such as:

• they do not reduce 'impact' or 'likelihood' scores
• they provide more commentary rather than focused actions
• they tend to be too subjective
• they have not been reviewed in detail in years
• no documentation exists confirming that the controls are actually being actively applied.

Combine this with the fact that only one-third of pension schemes have appointed an independent audit firm as internal auditors to help them review their risks/controls and we then have a problem.

Trustees need to reassure themselves that any controls identified continue to be appropriate, effective and applied.

What are the biggest risks facing UK pension arrangements?

Trustees of DB schemes continue to focus primarily on managing financial risks, with concerns relating to employer covenant being a clear winner. Whereas, trustees of DC schemes see the greatest risks being those potentially resulting in members not being treated fairly or making the wrong decisions.

Trustee concerns over DB administration risks (particularly for large schemes) have increased considerably in the past 12 months. In terms of DC risks, there was a difference in views. Trustees of hybrid schemes were concerned with poor communication/default fund design whereas trustees of DC-only schemes were concerned with meeting regulatory requirements and cyber-risk.

Are trustees doing enough when it comes to integrated risk management?

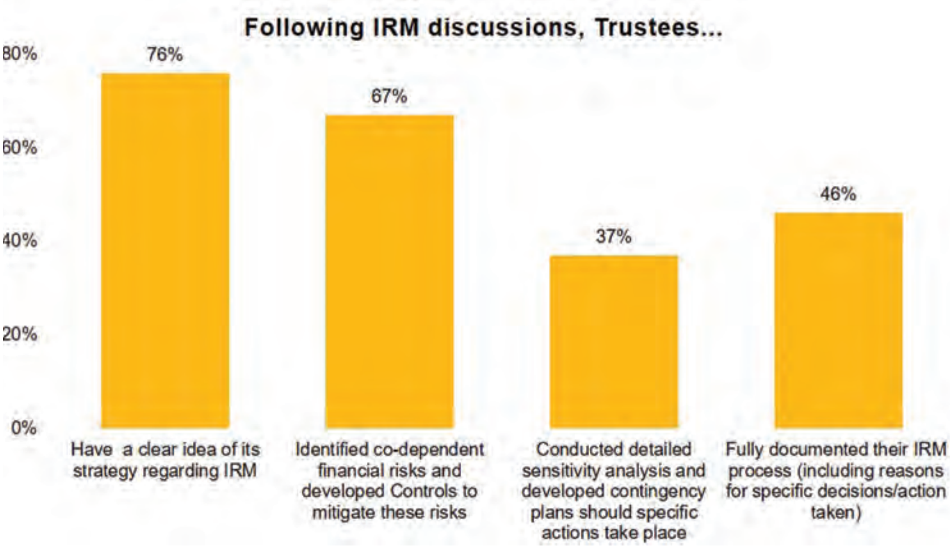
The results highlight that most pension arrangements are taking IRM seriously, with 60 per cent of pension schemes spending more than three hours each

Top 10 risks facing DB schemes

Position	Risks	Importance score
1	Employer Covenant	3.10
2	Funding volatility	2.05
3	Inappropriate Investment strategy	1.68
4	Investment under-performance	1.62
5	Administration	1.12
6	Meeting regulatory/compliance requirements	0.82
7	IT/Cyber risk	0.80
8	Sponsor/Trustee relationship	0.80
9	Trustee capabilities/governance	0.58
10	Quality of risk management	0.58

Top 10 risks facing DC schemes

Position	Risks	Importance score
1	Poor investment performance	2.13
2	Design of default fund/Inappropriate investment strategy	2.05
3	Poor communications	1.97
4	Inappropriate decision making by members	1.51
5	Meeting regulatory/compliance requirements	1.46
6	Administration	1.23
7	IT/Cyber risk	1.18
8	Fraud/scams	1.03
9	Inadequate Controls	0.69
10	Quality of risk management	0.51



year considering IRM and related topics. However, of concern is the 14 per cent of pension arrangements who have spent less than one hour on this subject; this includes the 22 per cent of large pension arrangements.

A successful IRM discussion by trustees should result in the trustees having developed a suitable IRM strategy, being clear about their co-dependent risks and being prepared for various scenarios. In the chart below, we set out the proportion of respondents who feel their IRM discussions have resulted in them meeting these specific objectives.

With approximately two-thirds of pension schemes not developing contingency plans and one-third not being clear regarding co-dependency risks, there is clearly further work required by trustees in this area. This is reinforced with 30 per cent of pension schemes not using the trustees' appetite for risk to help them manage their risks effectively.

And finally…

Too much of trustees' valuable time continues to be spent focusing on risk scoring/prioritisation and not enough time on discussing quality risk solutions and reviewing the appropriateness and effectiveness of the risk control mechanisms. This can unfortunately give trustees the perception that everything is OK when in reality it is not.

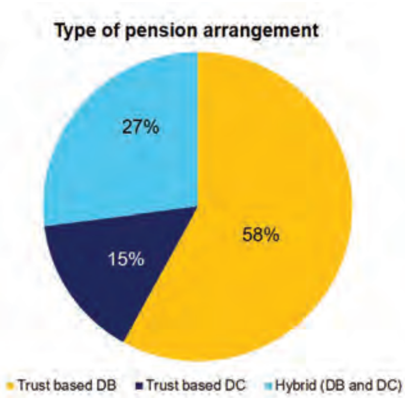
Trustees should ask themselves three very simple questions at the beginning of each trustee meeting:

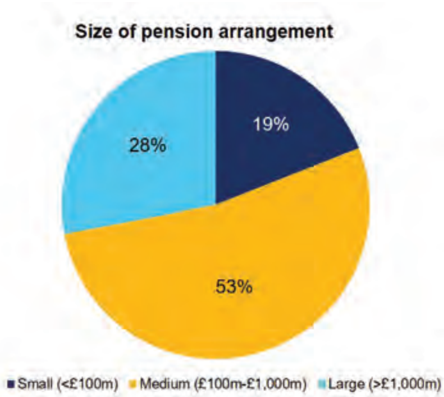
1. What are the scheme's top three risks and what are we doing about them?
2. Are we within our risk appetite/tolerance parameters?
3. Are our risk controls working well?

Trustees should then rely on their pension manager or advisers to manage the risk programme (consistent with the risk management policy) outside of the trustee meeting, and allow the trustees to take an oversight or strategic role towards risk management going forward.

If you would like further information regarding our survey results or to find out more about how Crowe are helping pensions schemes manage their risks effectively, please contact Andrew Penketh on 0207 842 7355.

Participants represented a broad range of different types of UK pension schemes, both in terms of size and by type of arrangement.





About Crowe

Crowe is a national audit, tax, advisory and risk firm with global reach and local expertise. We are an independent member of Crowe Global, the eighth largest accounting network in the world. With exceptional knowledge of the business environment, our professionals share one commitment, to deliver excellence.

Written by Andrew Penketh, national head of pension funds, Crowe UK

In association with Crowe