Pensions Authority Risk Conference 2023

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The Pensions Authority

Agenda

Time	Activity	Speaker
09:00	Welcome and introduction from conference chair	Brendan Kennedy
09:10	Risk management – insights from financial services firms	Tim O’ Hanrahan
09:40	Risk management – a friendly view from across the water	Alan Pickering
10:15	**Coffee / tea break**	
10:40	International lessons on risk management for pension schemes	Will Price
11:15	Irish pension scheme risk management	Grace Guy
11:50	Closing comments from conference chair	Brendan Kennedy
12:00	**Finish**	

Welcome and introduction

Brendan Kennedy

The Pensions Regulator
The Pensions Authority

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Risk management – insights from financial services firms

Tim O’ Hanrahan

Head of Insurance Supervision
The Central Bank of Ireland

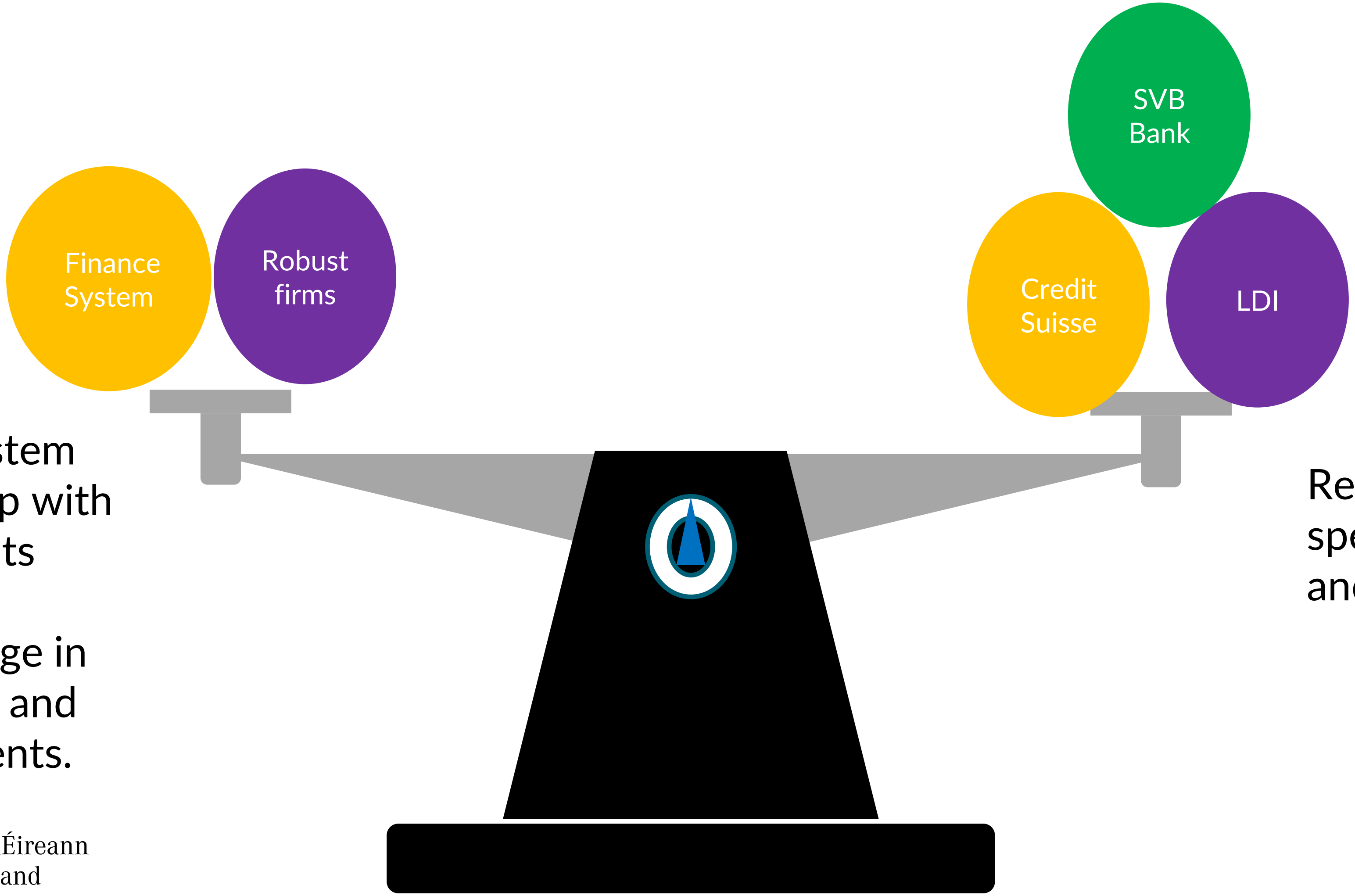
Overview

- Introduction.
- Risk Management in Financial Services.
- Lessons from Insurance.
  - Board.
  - Risk Management Function.
  - ORSA.
- Conclusion.

Risk Management Requirements in Financial Services

Area	Requirements	Banking	Insurance	Investment firms
Governance	Explicit risk management responsibilities for the Board of Directors & Senior Management	√	√	√
Risk Framework	Specific requirements for a risk management framework	√	√	√
Risk Assessment	Enterprise Risk Management – assessment of risk and capital requirements	√ ICAAP & ILAAP	√ ORSA (incl liquidity risk)	√ ICAAP (incl liquidity risk)
Regulatory Capital	Supervisors ability to impose additional 'Capital Add Ons'	√ *As part of supervisory review*	√ *But only in exceptional circumstances*	√ *As part of supervisory review*

So has it made a difference?



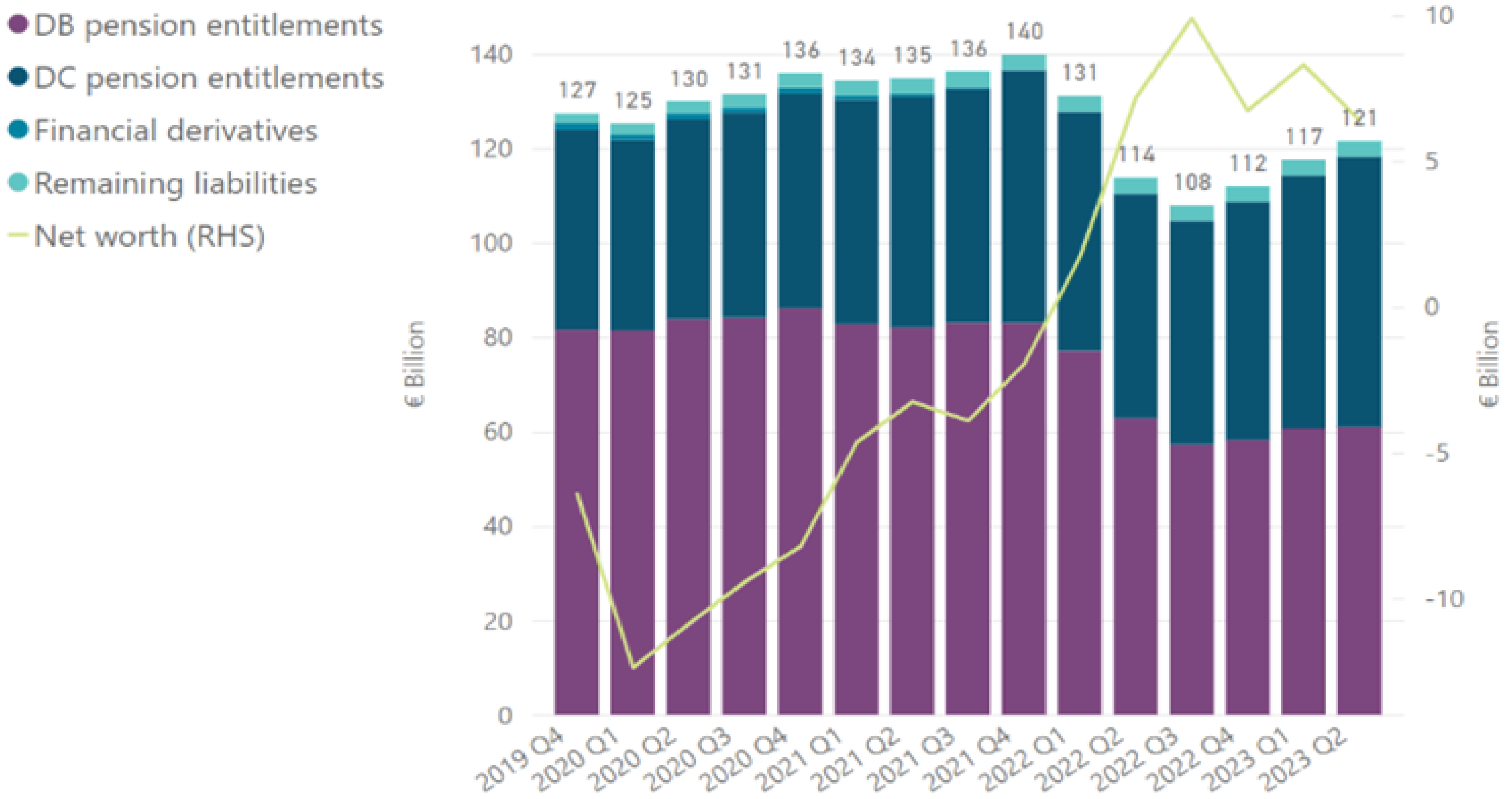
How has the system and firms held up with the recent events including the pandemic, change in monetary policy and geo-political events.

Recent challenges in specific companies and sectors?

The size and structure of Irish Pensions schemes

Liabilities of Irish Pension Schemes.

Net Worth of Irish Pension Schemes.



Source: Central Bank of Ireland Pension Funds Statistical Release Q2 2023

Size and context

- There are a very large number of Pension Schemes (>85k end 2022). The total assets at Q2 2023 were €128bn.
- The largest (circa 450 schemes) report quarterly to the Central Bank and report total assets of €104bn.
- Within this - a smaller number of large schemes;
  - Less than 40 hold circa 50% of total pension assets.
  - Less than 300 hold circa 80% of total pension assets.
- There is currently a significant amount of change in structures.

Total Pension schemes	
Number of Pension schemes Q4 2022	
DB	636
DC	85,228
Total	85,864

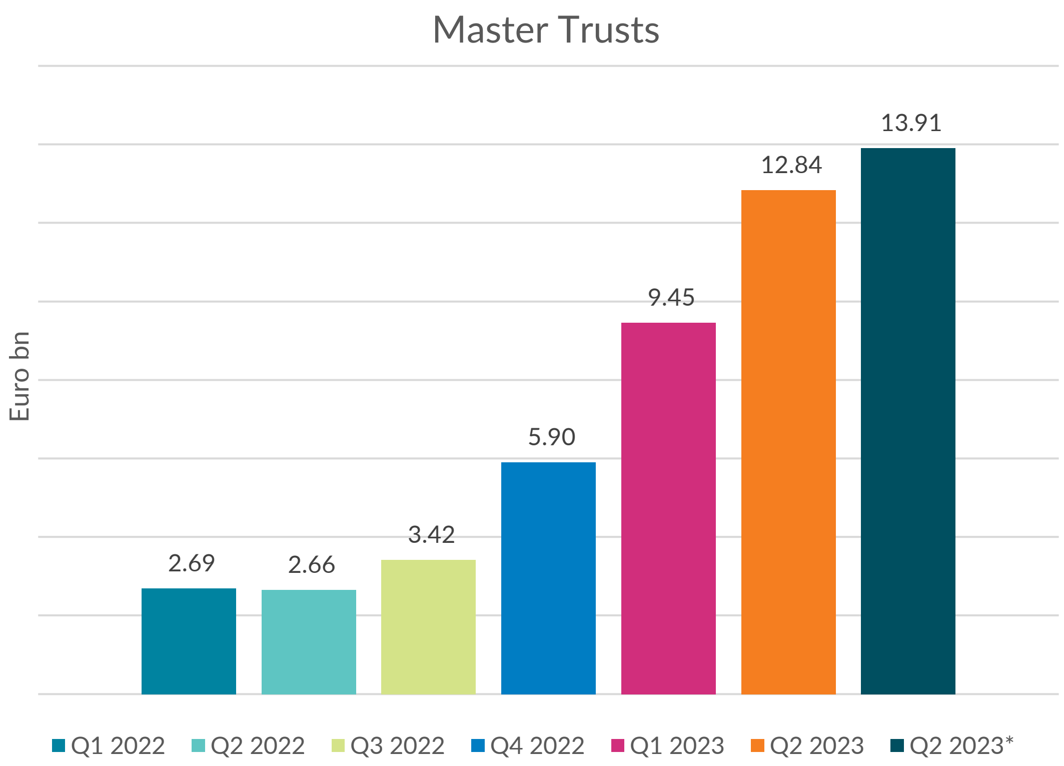
Of whom report 1/4ly to the Central Bank		
Number of Pension schemes Q2 2023		
DB		252
DC		205
Total		457
Total Assets Q2 2023 BN		
DB	€	69
DC	€	35
Total	€	104

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Source: Total Number of Pension Schemes – Pensions Authority Annual Report 2022
All other data Central Bank of Ireland Pension Funds Statistical Release Q2 2023 and/or Statistics Division of the Central Bank of Ireland.

Size and context

- How might trustees be implementing these requirements in an appropriate way?
  - Structural changes – Examples – Master Trusts, Bulk Annuities.
  - Additional Support – Training and getting service providers to more support to Trustees.
  - Look at others – e.g. Insurance companies Solvency and Financial Condition Reports on Central Bank Website.



Source: Central Bank of Ireland Pension Funds Statistical Release Q2 2023 and analysis from Statistics Department.

Q2 2023 – Master Trusts who filed reports for Q2 2023.
Q2 2023* - A number of additional master trusts due to report from Q3 2023 – this figure an estimate of Q2 2023 position for those master trusts.

Risk Governance – Key Principles for Boards

- A clear understanding of the material risks to which the entity is exposed.
- Effective oversight of risk management, including receipt of relevant, timely information.
- Promote discussion and challenge at board level.
- Establishing and promoting an appropriate risk culture.
- Adequate, relevant risk experience –or access to expert advice.
- Establish and document a risk appetite - expressed in qualitative terms, but with measurable quantitative metrics.
- Ensure a robust risk management function – adequate resources, expertise, policy and processes.

Risk Management Function – Key Principles

- A CRO and a risk management team.
- An effective risk-management system and good reporting – management and board.
- Risk management strategy which is consistent with the undertaking's overall business strategy.
- Risk management is embedded in decision making.
- Stress and scenario testing.
  - Recession/strong economy, Interest rates, Mass Lapse.
  - Climate and Sustainability.
  - Cyber Security and Digitalisation.
  - Reverse Stress Testing.

Selected ORSA Best Practices

ORSA - An ORSA is an internal process undertaken by an insurer or insurance group to assess the adequacy of its risk management and current and prospective solvency positions under normal and severe stress scenarios.

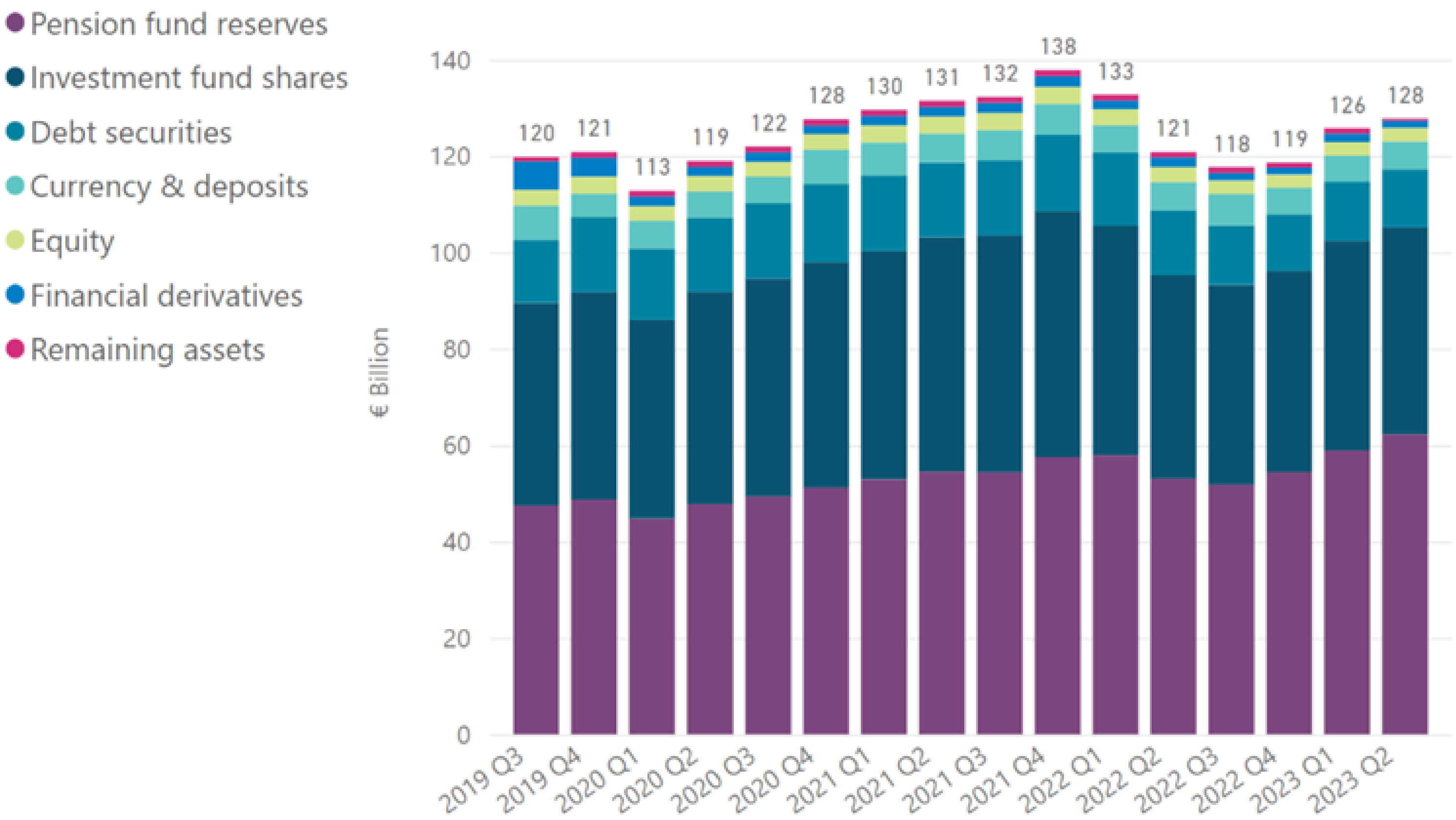
- Embedding the ORSA process within the wider risk management framework.
- Effective discussion and challenge at board level.
- Consideration of all material risks and vulnerabilities, including interlinkages between risks.
- Inclusion of a wide range of (appropriately severe) stress tests or scenario analyses in respect of material risks. This may also include a 'reverse stress test' scenario, i.e. quantifying how severe a stress is required to be, in order to breach capital requirements.
- Consideration of possible management actions that could be taken, in the event of a material shock to the capital or liquidity position.
- Adopt a forward looking approach: leading firms take lessons and data from historical events but also look ahead to new risks that might emerge.

Conclusion

- Introduction.
- Risk Management in Financial Services.
- Lessons from Insurance.
  - Board.
  - Risk Management Function.
  - ORSA.
- Conclusion.

Appendix 1 - The size and structure of Irish Pensions schemes

Assets of Irish Pension Schemes



Source: Central Bank of Ireland Pension Funds Statistical Release Q2 2023

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Risk management – a friendly view from across the water

Alan Pickering
President
BESTrustees, London

Coffee/ Tea break

International lessons on risk management for pension schemes

William Price

CEO

D3P Global Pension Consulting

Overview

- Global and regional context
- Risks and outcomes
- Risk identification and action
- Quantification and benchmarking
- Risk over time
  - Governance
  - Investment returns, risks and costs: Mix of persistence and rapid change but already a huge amount of useful information available
  - Climate (ESG) and cyber and role of national, regional and global action
- Conclusions

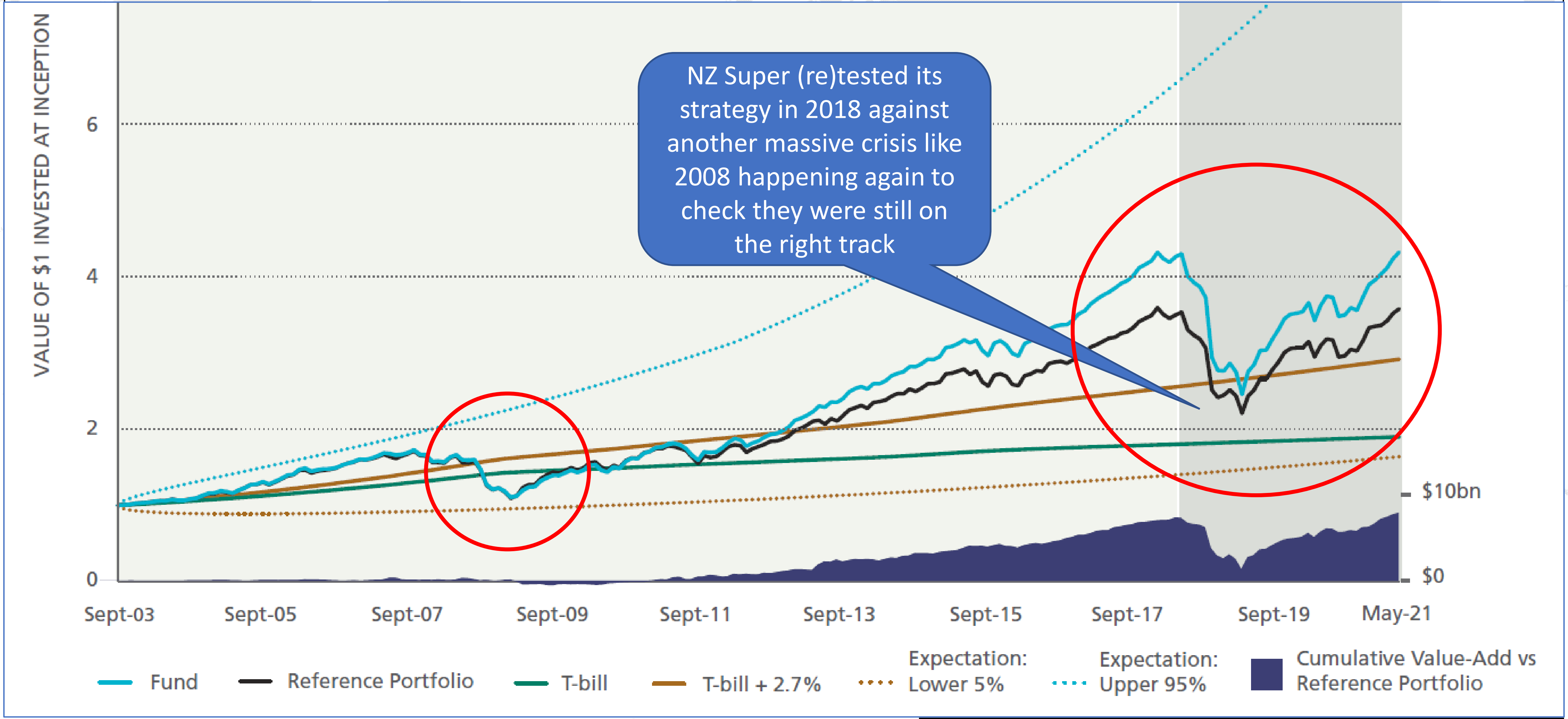
But the critical issue is whether the risk identification led to any action to prepare for it

2017	2018	2019
	0-3 years	
Return of inflation	Emerging geopolitical risk	Digital tech meets legacy hardware
Reduced market access	Erosion of risk diversification	Genetic testing and adverse selection
Cloud risk accumulation		
Regulatory fragmentation		
	>3 years	
Underestimated infectious diseases	Asbestos losses	5G mobile networks
Growing water stress	Cyber risks	Fiscal and monetary policy balance at risk
	Algorithms – opaque, biased, misled	Climate change and life & health

Source: [SONAR 2019: New emerging risk insights | Swiss Re]

Scenario testing and simpler 'What-if?' discussions can be vital to improve risk management – even when the shock is not the exact one predicted

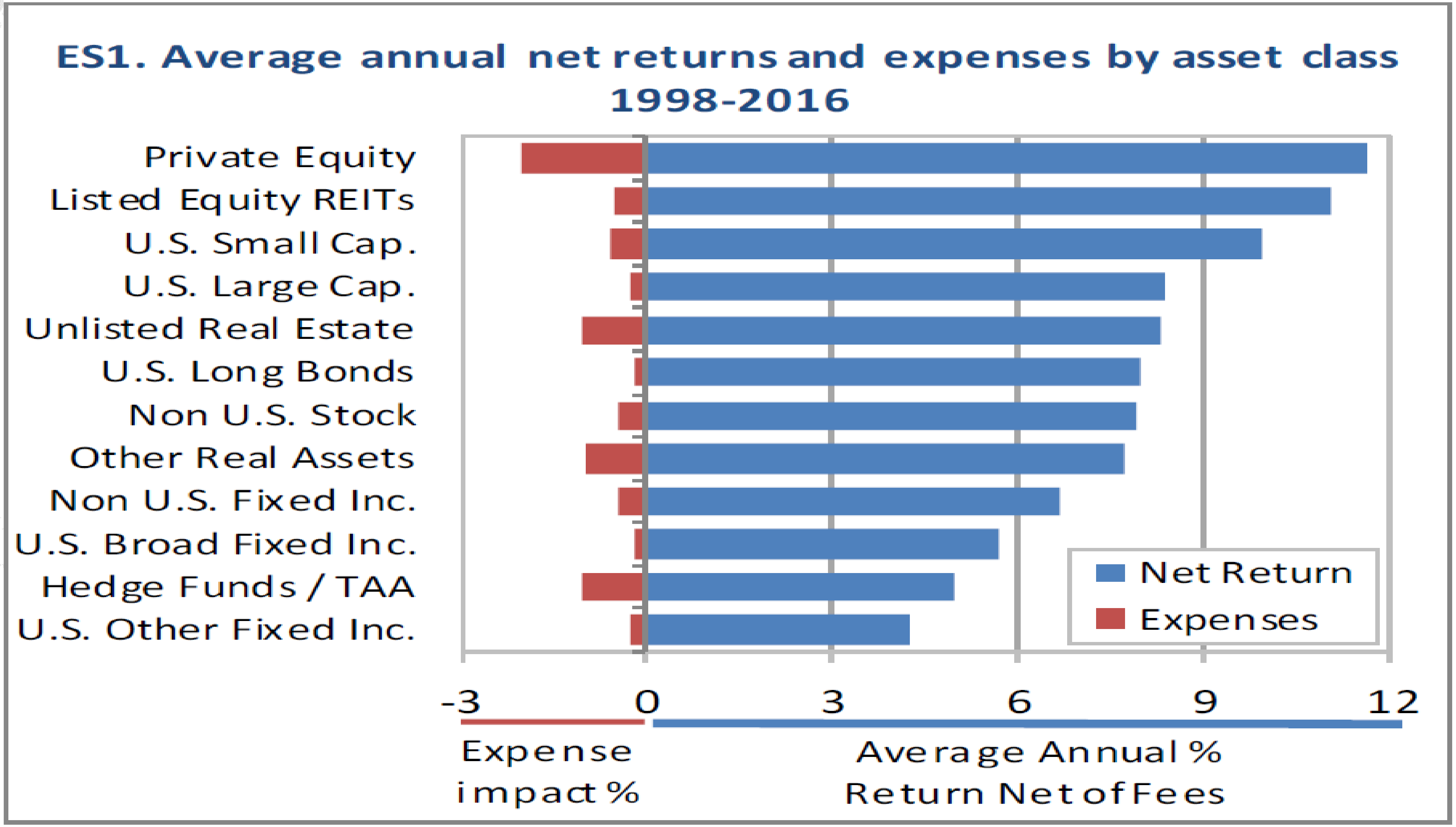
NZ Super scenario analysis of major shocks



Source: New Zealand Superannuation Fund Monthly returns

Quantification

Quantification can be very complex – but a focus on outcomes can cut through the noise and crystalise key risks



Trustees need to insist on clear benchmarked data for their investment returns gross and net of fees, relative to other assets and relative to other providers. Too much focus on short-run volatility compared to long-run risk of poor outcomes

Source: CEM Benchmarking

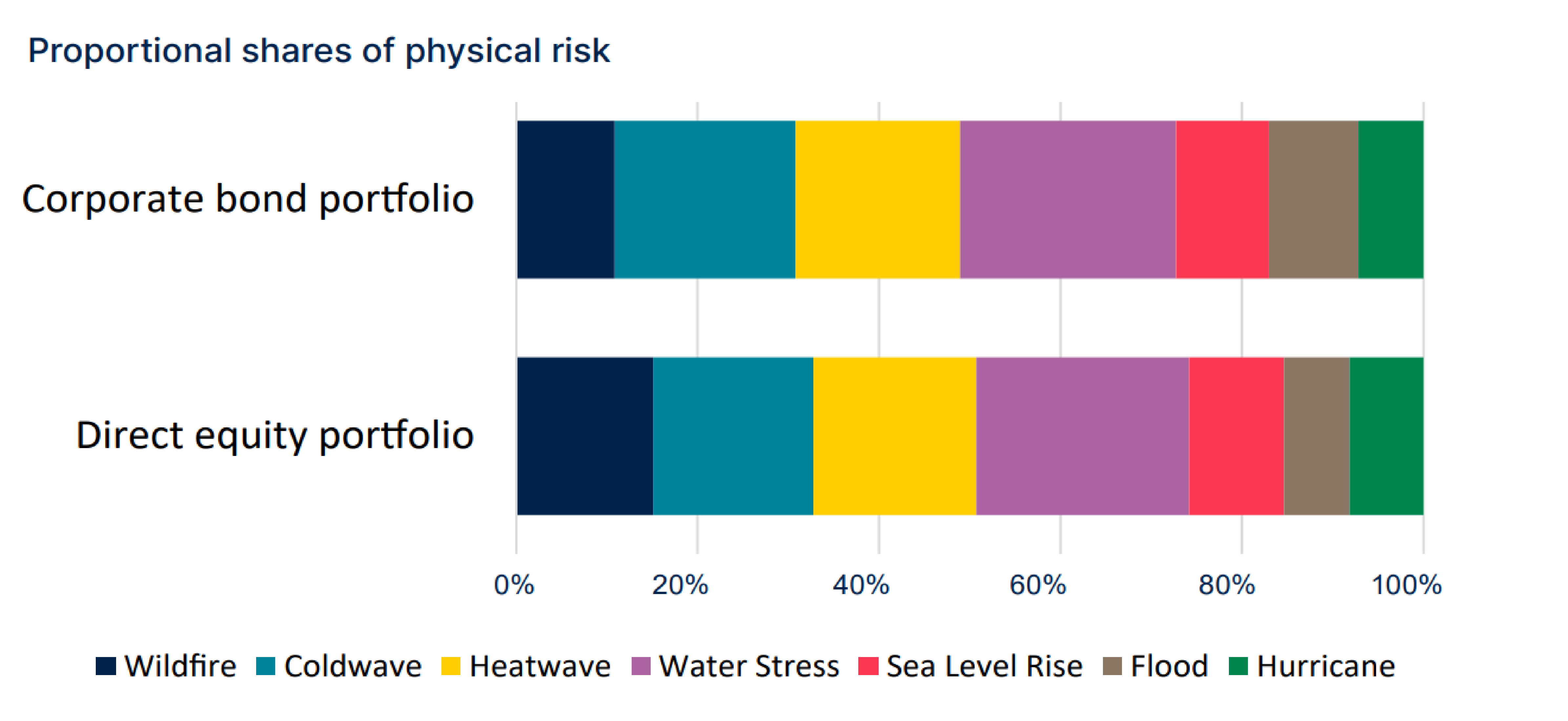
(Bad) governance is perhaps the most important and most longstanding risk factor – after the 2008 crisis the FSB identified the following risk factors for poor practice which are still relevant

Leadership	Decision-making	Values and behavioural norms
• Lack of accountability for misconduct • Lack of attention, skills and knowledge regarding misconduct risk • Domineering leadership style • Mismatch between leaders' words and actions (e.g. not leading by example) • "Tone from the middle" inconsistent with the tone from the top • Mindset/ambition that does not take account of all relevant stakeholders, including customers, markets and society • Failure to resolve staff engagement issues • Lack of will to cooperate or to share information	• Failure to resolve competing priorities • Lack of challenge and debate • Confusion regarding strategy or risk appetite • Weak connections between leadership levels • Poor communication • Decision-making dominated by the business lines • Lack of diversity and inclusion, resulting in "groupthink"	• Normalisation of misconduct • Lack of psychological safety within the firm • Reluctance to accept bad news • Limited adverse consequences for misconduct • Ineffective identification of, and response to, errors • Lack of transparency upwards

Source: Financial Stability Board

Climate and ESG

Climate and ESG risk receiving ever increasing attention. Potential for very sophisticated quantification – but anyone can ask the right question



Cyber

Risk and regulatory action

Longstanding risks like investment returns and costs are always important for members, but may only be critical for schemes following regulatory action (Australian example)

MySuper Product Heatmap								
	Investment performance		Fees and costs				Sustainability of member outcomes	
MySuper product name	6 year Net Investment Return (NIR) p.a.	6 year NIR relative to Simple Reference Portfolio p.a.	Administration fees disclosed ($10,000 account balance)	Administration fees disclosed ($50,000 account balance)	Total fees disclosed ($10,000 account balance)	Total fees disclosed ($50,000 account balance)	RSE Adjusted Total Accounts Growth Rate (3 year average)	RSE Net Cash Flow Ratio (3 year average)
MySuper A							-3.00%	-8.00%
MySuper B	7.30%	1.00%	0.95%	0.35%	1.45%	0.85%	0.00%	4.00%
MySuper C	7.00%	-0.60%	1.30%	0.65%	2.00%	1.35%	-3.00%	1.50%
MySuper D	6.00%	-0.15%	0.50%	0.10%	1.40%	1.00%	1.00%	4.00%
MySuper E	7.90%	2.00%	1.10%	0.50%	1.50%	0.90%	5.00%	-15.00%
MySuper F	9.00%	0.10%	1.30%	0.80%	1.65%	1.15%	-2.00%	3.00%
MySuper G	7.80%	0.35%	1.10%	0.35%	1.90%	1.15%	8.00%	5.00%
MySuper H	8.20%	1.00%	0.90%	0.25%	1.70%	1.05%	10.00%	9.00%
MySuper I	7.70%	0.20%	1.00%	0.40%	1.70%	1.10%	9.00%	8.00%

Source: APRA

Conclusions

1. Risk based approach (nearly) ubiquitous globally and definitely for the EU
2. Risk only really make sense with clarity on objectives
3. Too much focus on (exact) prediction than practical preparation
4. Every scheme can do useful risk exercise now – just the form will differ
5. Benchmarking critical input particularly for costs and investment
6. Some risks never change and governance always central
7. Others changing rapidly e.g. climate (ESG) and cyber
8. Regulator focus can increase salience of risks as well as help mitigate

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Irish pension scheme risk management

Grace Guy

Head of Supervision and Enforcement
The Pensions Authority

Overview

- Background
- Pensions Act on risk management
- The own-risk assessment (ORA)
- Roles and responsibilities – trustees and risk key function holders (KFHs)
- Key messages from the Pensions Authority on risk

Background

- IORP II Directive – catalyst for change
- Drive to introduce ‘modern risk-based pension scheme governance’(recital 6)
- Over 150,000 plus schemes in Ireland – majority small one-member arrangements (OMAs), many inactive
- Effective supervision, proper governance and value for money challenging
- Many Irish schemes unable to meet new IORP II requirements

Background

- Consolidation – Government roadmap, Pensions Authority objective
- Irish pensions in transition – significant movement underway by schemes into master trusts and personal retirement savings accounts (PRSAs)
- Inherent uncertainty in providing for retirement saving means structured approach to risk essential
- Pension schemes remaining need to embed fit for purpose risk management practices

Pension scheme risk management

- … But comprehensive risk management new for many Irish pension schemes
- Pensions Authority expects trustees to give sufficient time and attention to how they approach risk management within their schemes
- Cannot be mechanistic, no checklist or tick box formula

Pensions Act provisions

- Pensions Act provides a template of a risk management framework:
- Risk and effective system of governance – S64AB
- Risk and remuneration policy – S64AG
- Risk management function that supports an ongoing risk management system – S64AI
- ORA – S64AL

Pensions Act key take aways

- **Pensions Act envisages an ongoing and dynamic approach to risk**
- **Trustees must have a risk management function in place at all times which is well integrated into the decision-making processes of the scheme**
- **Risk KFH important for supporting delivery of risk management function but trustees are responsible**

The own-risk assessment (ORA)

- ORA is a periodic, structured, thorough assessment by trustees of risks faced by their scheme
- ORA requires trustees to draw conclusions from findings and decide on appropriate follow up actions
- ORA process should be sufficiently considered and flexible to work with individual scheme risk profile
- ORA is not a mechanistic process – it must be comprehensive, data driven, objective and implemented

The own-risk assessment (ORA)

- ORA is a specific task within wider risk management function
- ORA every three years minimum or when significant change occurs
- ORA must identify, measure and evaluate risks
- Based on ORA findings, trustees must decide how to deal with risk (avoid, reduce, transfer, accept…)
- PA guidance on ORA – not a checklist, trustees are in charge
- April 2024 ORA deadline

Trustees and risk KFHs

- Quality and integrity of the risk management function (including ORA) is unambiguously the responsibility of trustees
- Trustees can engage professional advice to support them with risk management function BUT trustees remain responsible
- Trustees must enable the risk management KFH to perform function in an objective, fair and independent manner
- Trustees must make call on sufficient knowledge and experience of risk management KFH

Trustees and risk KFHs

- **Risk management KFH must satisfy knowledge and experience requirements**
- **The risk management KFH must support trustees in an objective and independent manner**
- **The risk management KFH must, if appropriate, be prepared to challenge a scheme's risk management and related decision-making processes including trustee decisions**
- **Risk management KFH needs to remember whistleblowing and reporting obligations under the Pensions Act**

Key messages on risk

Structured risk management approach for pensions schemes essential to deal with inherent uncertainty in providing retirement benefits

Approach to risk should not be mechanistic

ORA is one of trustees most important responsibilities

ORA must be comprehensive, data-driven, objective and implemented

PA focus on risk and risk culture of trustees – 2024 SRP programme

Good member outcomes are the desired result of effective risk management

All schemes need to upskill and embed effective risk management

Buck stops with the trustees


QUESTIONS

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Closing comments from chair

Brendan Kennedy

The Pensions Regulator

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