HEALTH WEALTH CAREER

STRIVING FOR INTEGRATED RISK MANAGEMENT

THE INTEGRATED RISK MANAGEMENT REVOLUTION?

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EVOLUTION OF REGULATORY GUIDANCE

February 2006 – Regulatory Code of practice 03, Funding defined benefits

"It is essential for the trustees to form an objective assessment of the employer's financial position and prospects as well as his willingness to continue to fund the scheme's benefits (the employer's covenant). This will inform decisions on both the technical provisions and any recovery plan needed."

April 2012 – TPR statement Pension scheme funding in the current environment

"We expect trustees to adopt an integrated approach to scheme funding and to complete valuations on time. As part of their due diligence, trustees should be bringing together information and advice on the investment, covenant and actuarial strands to inform a complete financial management plan."

July 2014 – Revised Code of practice 03, Funding defined benefits

"Managing risk**:** Trustees should implement an approach which integrates the management of employer covenant, investment and funding risks; identifying, assessing, monitoring and addressing those risks effectively."

EVOLUTION OF REGULATORY GUIDANCE

August 2015 – Press release accompanying revised covenant guidance

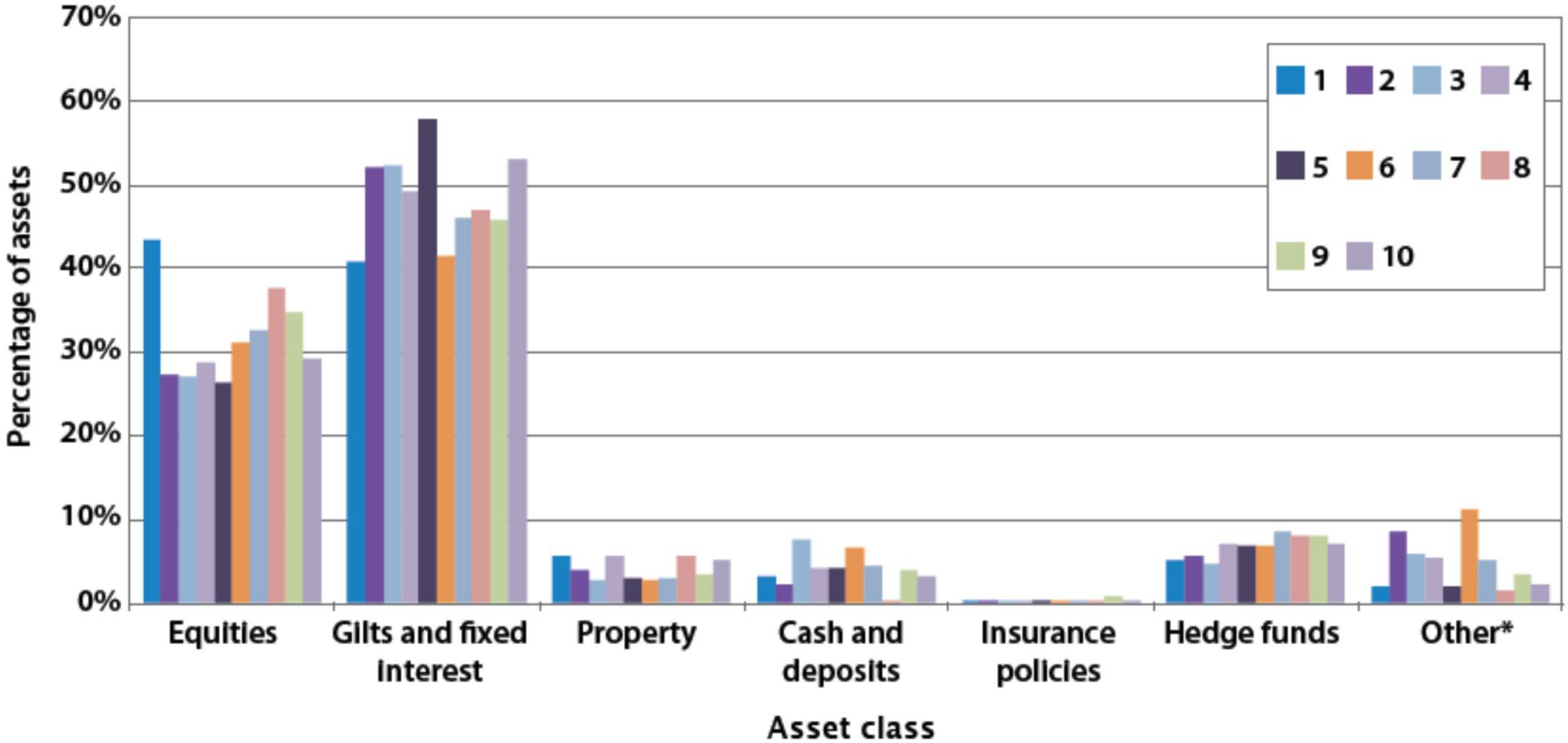
> "Later this year, the regulator intends to produce further guidance to help trustees navigate the DB code, including guides on integrated risk management and investment strategy."

Integrated risk management has been much heralded and guidance was published on 8 December 2015.

Further guidance on setting investment strategy is now anticipated later in 2016.

ARE SCHEMES SHOWING EVIDENCE OF ADOPTING IRM?

Weighted-average asset allocation of schemes by Experian levy band (Purple Book 2015)



INTEGRATED FUNDING FRAMEWORK – ANTICIPATING THE GUIDANCE

Technical provisions

The Trustees and Employer agree how to work out the liabilities

Depends on:

- Employer **covenant**
- **Prudent** actuarial assumptions
- Investment strategy

Funding target = level of assets estimated to cover projected value of Scheme liabilities

Recovery plan

How the Trustees and Employer will get to their target

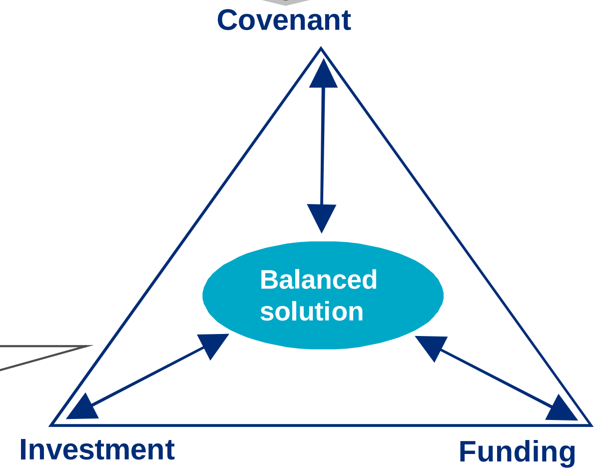
Depends on:

- Employer **affordability**
- **Appropriate** assumptions
- Investment strategy

Contributions required to cover projected shortfall of assets

Integrated approach

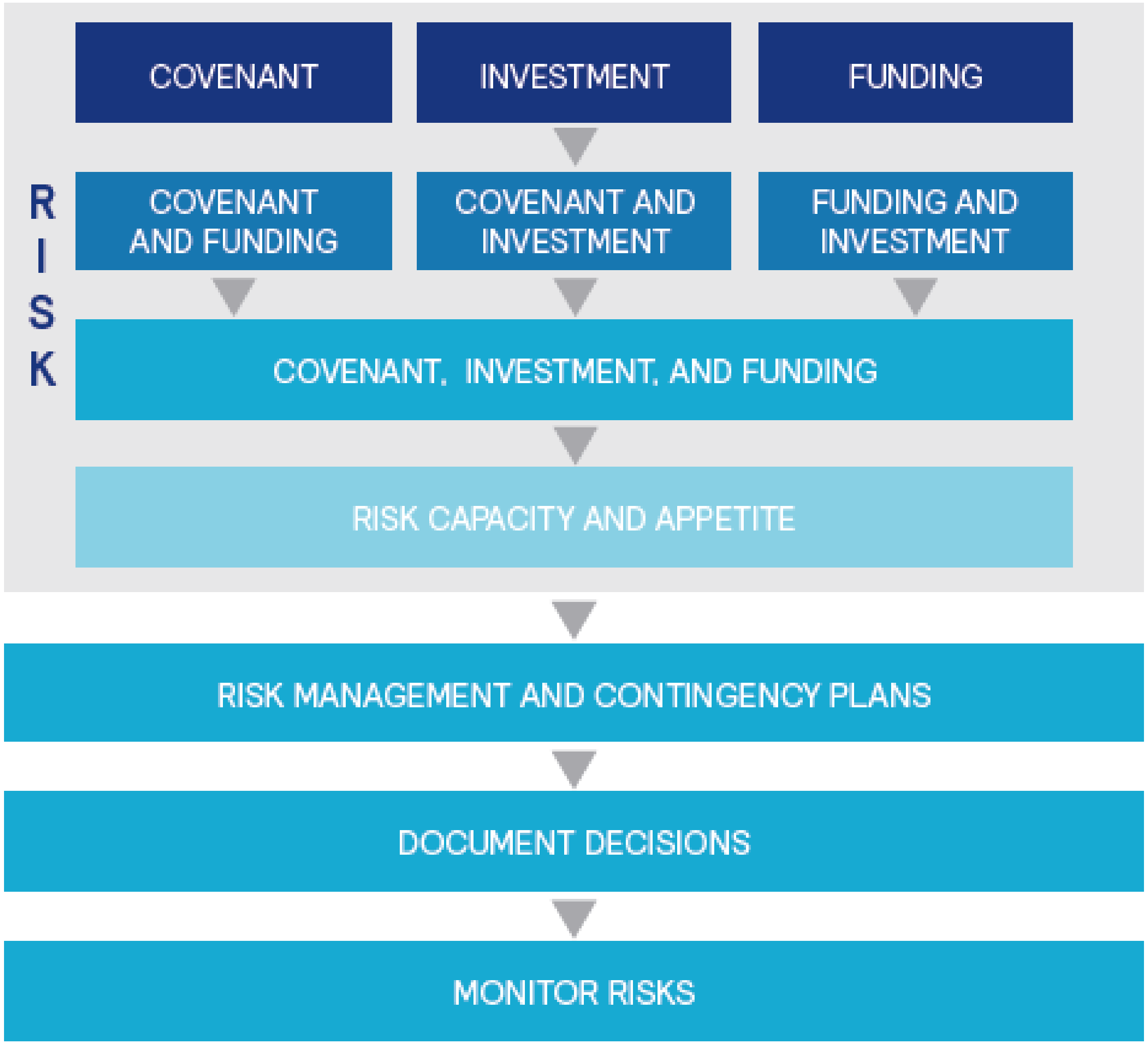
Investment strategy, funding and covenant



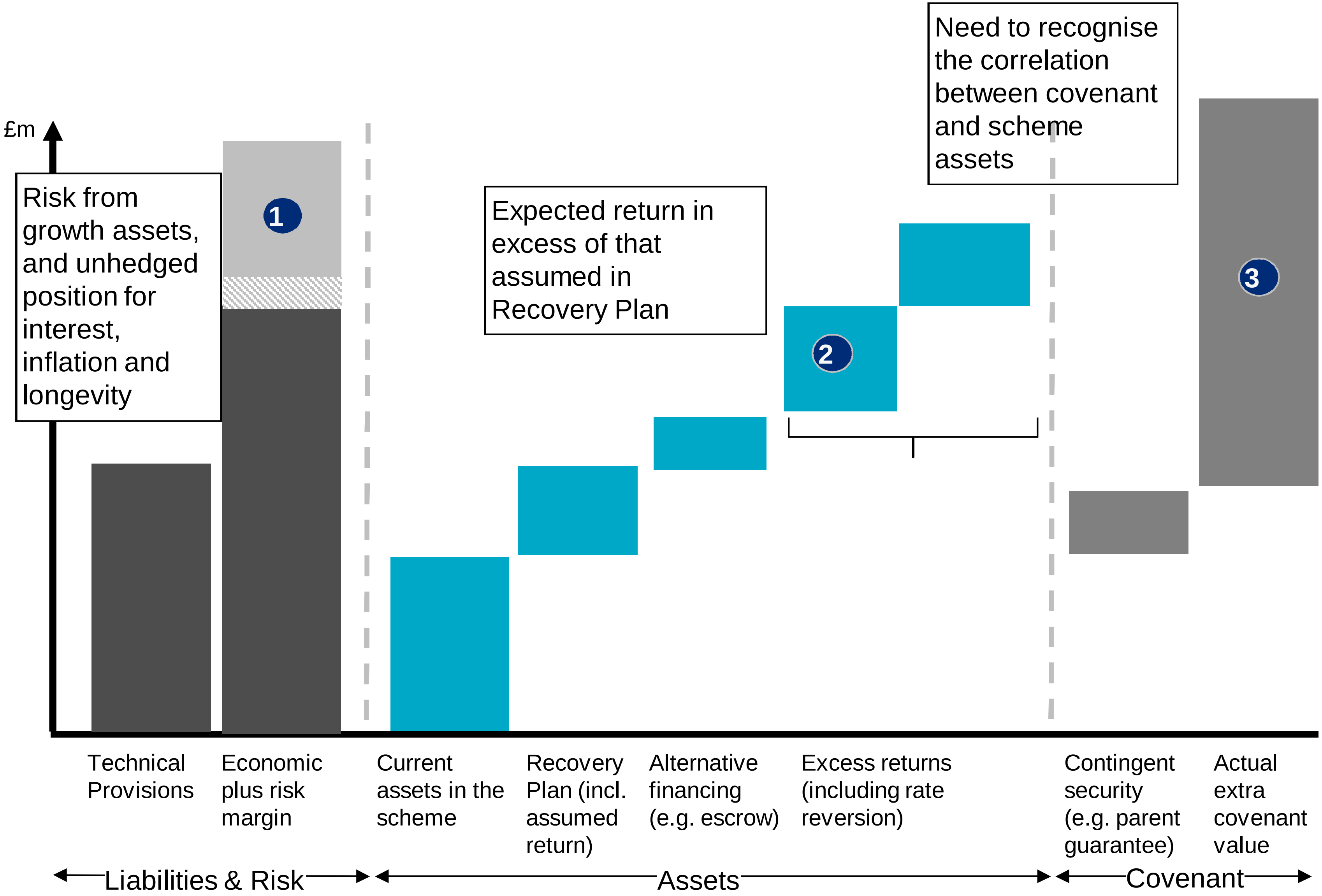
Viable contingency plans if assumptions are not borne out

INTEGRATED RISK MANAGEMENT FRAMEWORK

- An IRM framework should allow trustees to focus on the key risks for the scheme, monitor them and respond to changes if required.
- However it should be proportionate to the objectives and the circumstances of the scheme.
- TPR guidance advocates a five step approach to IRM, but is in no way prescriptive of the approach to be adopted.



QUANTITATIVE APPROACH TO IRM



Solution set is highly dependent upon circumstances, involving:

- Cash contributions
- Covenant fix, including contingent assets, ABCs
- Investment strategy changes and risk hedging
- Liability management

Immediate fix may not be possible, requiring management over time

INTEGRATED RISK MANAGEMENT FRAMEWORK

- An IRM framework should allow trustees to focus on and manage the key risks for the scheme
- Trustees should already have the basics in place – covenant assessment, actuarial funding reports and investment strategy.
- Challenges likely to be faced:
  - Understanding how the various risks are linked.
  - Collaborative engagement with the employer regarding risk appetite.
  - Development of scenario testing for the covenant support.

CHALLENGES OF COVENANT SCENARIO OR STRESS TESTING

- Chart below illustrates share price movements for 2 Plc sponsors of schemes from January 2008 to date.

- Covenant A is currently valued at quadruple the opening value, and more than 10 times the lowest value in the period
- Covenant B is currently valued at around 10% of the opening value, and down 92% from the peak value

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- Challenges likely to be faced:
  - Understanding how the various risks are linked.
  - Collaborative engagement with the employer regarding risk appetite.
  - Development of scenario testing for the covenant support.
  - Development of contingency plans to deal with material risks if they emerge.
    - Contingency plans might include triggers for provision of information and further discussion or <u>could</u> involve pre agreed actions.
  - Lack of trustee leverage
    - challenge of the “Sustainable growth objective”.
    - weakness in general trustee bargaining power.
  - Cost?

MY PERSONAL VIEW ON THE IRM GUIDANCE

WE HAVE ALL THE PARTS, BUT NOT ENTIRELY SURE HOW THEY FIT TOGETHER AND WHAT TOOLS WE SHOULD USE?

MAKE
TOMORROW,
TODAY

MERCER