

Financial Reporting
Managing Risk in Pensions Schemes

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What is Risk?

- Risk is the potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). The notion implies that a choice - having an influence on the outcome - exists (*Wikipedia*)
 - Any situation that may significantly reduce or prevent payment of the benefits due to members will be considered a risk (*Regulator*).
 - A risk is the possibility that an event may happen ... that adversely affects a scheme and may prevent the trustees from achieving their aim of delivering the promised benefits ... (*Group Pensions*)
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Risk Tolerance

- “Necessity is the mother of "taking chances."”
 - “Nothing will ever be attempted, if all possible objections must be first overcome.”
 - ”The policy of being too cautious is the greatest risk of all.”
 - “To be alive at all involves some risk.”
 - “The person who risks nothing, does nothing, has nothing, is nothing, and becomes nothing. He may avoid suffering and sorrow, but he simply cannot learn and feel and change and grow and love and live.”
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Risk Tolerance

- “It’s better to risk starving to death than to surrender. If you give up on your dreams, what’s left.”
 - “Only those who will risk going too far can possibly find out how far one can go.”
 - “Only those who dare to fail greatly can ever achieve greatly .“
 - “There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction. “
 - “Lets make a dent in the universe “
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Risk Tolerance



- “Take calculated risks. That is quite different from being rash.”
- “Never try to walk across a river just because it has an average depth of four feet.”
- “The most important questions of life are indeed, for the most part, really only problems of probability.”
- “The path is smooth that leadeth on to danger.”
- “Risk comes from not knowing what you are doing.”



Perspectives on Risk – A Difficult Concept

- “That which a man would prefer to be true he more readily believes.” (quod enim mavult homo verum esse, id potius credit, in Novum Organum)
 - “Faced with the choice between changing one's mind and proving that there is no need to do so, almost everyone gets busy on the proof.”
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- Man can believe the impossible, but man can never believe the improbable.“
 - “It's impossible that the improbable will never happen.” (*Il est impossible que l'improbable n'arrive jamais*)
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In a Class of Their Own!

- Today, basically, on Wall Street, the big money is made by taking risks.
Bernard Madoff

 - “If we don't succeed we run the risk of failure”
Dan Quayle 44th US Vice President under George Bush (1989-93).
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Internal Controls

Influencers

- **Trustee's Report:**

The Trustee has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to it, **including the maintenance of an appropriate system of internal control**, to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities.”

- **Legal requirement under the 2004 Pensions Act**



What are Internal Controls and Why Have them?

Internal Controls are:

- (a) arrangements and procedures to be followed in the administration and management of the scheme;
- (b) systems and arrangements for monitoring that administration and management, and
- (c) arrangements and procedures to be followed for the safe custody and security of the assets of the scheme.

The implementation and application of internal controls will therefore help trustees monitor the management and administration of their schemes. Internal controls will also improve the safe custody of assets and help protect the scheme from adverse risks which could be detrimental to the scheme had those risks not been mitigated.

Proportionate Approach

Not all risks will have the same potential impact or the same likelihood of materialising. Trustees will need to look at both these areas and assess which risks the scheme can absorb without the need to take further action, and which risks require adequate internal controls to reduce their incidence and impact.

When considering risk, trustees should be mindful of the nature of their scheme and the risks which are inherent in a particular structure. Smaller schemes may require less formalised controls than more complex larger schemes, but regardless of size, key risk areas will still need to be adequately controlled.

The Need to Review Risks and Internal Controls

Trustees should be prepared to monitor, challenge and review their risk assessment process and outputs. As referred to above, trustees should also ensure that they can recognise when professional advice is required.

Risk assessment is a continuous process and must take account of a changing environment. It is not simply concluded when an internal control is implemented. Internal controls should be reviewed periodically, at least on an annual basis, or sooner if substantial changes take place, such as a deterioration in funding, change in investment manager, or where a control has been found to be inadequate.

Our Approach

Risk Management Cycle 2011

