Getting ready for the Code: Understanding your risks

Aren't we all facing the same risks?

Welcome to the Muse series Getting ready for the Code, where we are sharing tips and tools to help you navigate the Code and ORA requirements. Get in touch to find out more at governanceservices@museadvisory.com.

This second article is a practical look at how to identify and understand your risks.

So, how do we identify our risks?

Having an idea of why you're running your scheme the way you are and if you're taking it in a particular direction, is a good start.

Once you have an idea where you're going, you can determine the activities, resource and advice that will get you there and, importantly, what might prevent you getting there, hinder progress, or get you there quicker.

But what if you don't have objectives and a strategy; what if you're focused on running your scheme as well as you can? You'll still have risks that are specific to your scheme's circumstances e.g. relating to the strength of the employer covenant, the accuracy of your scheme data, the security of the IT system used to operate the scheme.

How will we know if we have identified, and are focusing on, the right risks for our scheme?

- ✓ *We have identified our objectives*
- ✓ *Our risks are aligned with our objectives*
- ✓ *We have a risk register in place, which is proactively managed*
- ✓ *Risk reporting is focused on key risks, linked to strategy, project work and decisions*
- ✓ *The Trustee Board and Committees consider risk in their decision making*
- ✓ *We consider current risks, emerging risks and control effectiveness regularly, as work progresses and circumstances change*

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Same but different – aren't we all facing the same/similar risks?

To an extent, yes, however there is a big BUT. Whilst the risk of 'not achieving your long-term funding objective' might apply now to all DB schemes, with the new Pensions Act 2021 requirements, how it is managed in practice will be different for each scheme.

The investment strategy which supports the long-term funding objective, the covenant which underpins it, the advice and support you have in place to keep you on track to achieve it, will be factors specific only to your scheme.

In a DC context, the risk of 'members making poor decisions' is likely to be on many risk registers. How material that risk is to a particular scheme will depend on how the trustees have articulated member outcomes, experience and value.

How you assess your risks – the impact they'd have if they crystallised, how likely they are to occur – shows how important they are to you.

Thinking about how much risk you're willing to accept – your risk appetite - helps determine how strong your controls need to be. The lower the appetite, the stronger the controls needed although you'll need to balance that with the costs e.g. admin errors are unwanted but costly to eradicate.

The type and strength of controls you have in place internally and with your providers will then be more specific to you based on how you rate your own risks.

How do we know we've identified all our risks?

The question should be "do we need to identify every single risk?" Doing so could lead to a very long risk register which adds little value in practice.

The ORA is designed to help trustees identify and monitor material scheme risks, in a proportionate and regular way. This might typically be, say, your top 10 risks.

For DB schemes, that's likely to include funding, covenant, investment related risks and/or certain operational (including IT/cyber) and governance risks. For DC schemes you might focus on operational, communication and investment risks.

The point is, as decision makers and stewards of your schemes, you can't be expected to be risk management experts and spend all your time reviewing your risk register. What you do need to know is that you're managing the things that need to stay on track or which could keep you awake at night.

Identify the risks, determine who owns those risks, understand what's happening with the risks through good reporting, take action if necessary and keep an eye on emerging risks.

What do we do with the risks?

It's often the case that the 'risk register' appears towards the end of a busy agenda. But it shouldn't be an after-thought. Thinking about risk when setting the agenda and planning the meeting cycle provides an opportunity to ask the right questions:

- How does what's on our agenda help us maintain progress with our strategy, mitigating risks to this?
- Are we allowing enough time for decision making?
- Have we got the right information from our advisers and/or providers, linked to our key risks?
- Are we planning our workload in the right way, so that decisions taken now support important work we want to undertake further down the line?

Seeing how key risks and any opportunities can be worked on through the agenda helps create clarity.

Framing your risks in the context of project work you'll be discussing and decisions you'll be taking helps focus your mind on asking the right questions in meetings, of each other and of your advisers/providers.

You want your advisers to be assessing your risks in their proposals and updates, bringing to the Trustee's attention any emerging risks. They can do some of the heavier lifting on risk for you. You also want your providers to be flagging resourcing and capacity issues at the earliest opportunity to help you better manage your risks, and to be ready for projects that need to be tackled, like GMP equalisation.

Can we delegate? As trustees you're responsible for your risks, but you're not expected to be involved in their day-to-day management. Assigning risk owners means you delegate how risks are managed and monitored to the people who best understand them. That might be to committees of the board if you're a big enough scheme. Or it may be to your pensions team or advisers if you have limited resource or are a sole trustee. Your role will be to ensure you delegate clearly and that you seek assurance on these risks.

The governance benefits

You want to have a **good understanding of your situation** – where you are now, where you might want to get to, what might impact that journey and/or impede you from running your scheme well, so that you can have **focused and effective oversight**.

Understanding **your specific risks**, based on **your circumstances** is what is required by the ORA as part of assessing the effectiveness of your system of governance.

The Getting Ready for the Code series

Contact us for practical help and independent advice at **governanceservices@museadvisory.com**

This article builds on our first article **'Where to start'**, on Trustee policies, scheme documents and processes.

Future articles build out a high-level **Risk Management Framework**. These will help you:

- know what your specific risks are;
- test how well your controls are working to manage your risks;
- know where you get your assurance from to answer the 'how do you know?' question; and
- use the information you receive to take relevant action.

Knowing how you manage risk is a key part of the ORA and Code requirements. Throughout our articles we will reference the ORA, with the Risk Management Framework being another tool in your ORA toolkit.

Our next article will look at why controls are so important to the effective management of risk, to help you understand how you manage your specific risks.

Case study: Risk considerations on the road to end-destination

Current long-term funding target is self-sufficiency by 2030 using a proxy basis of gilts +0.5%, but given experience over last 3 years, investment strategy will get the scheme there by 2023. Scheme is considering buy-out as the end-destination and could potentially get there by 2026.

- **Do we need to run the current level of risk if our investment strategy gets us where we want to be quicker than expected?**
- **Should we take less risk if we're not ready to get there that quickly?**
- **Do we have confidence in the strength of the covenant to support a longer timeframe?**
- **If we target buy-out, what do we need to do to be ready to transact?**
- **Can we do everything we need to be to be ready in the shorter timeframe, with the resource and capacity we currently have?**
- **What is the impact on funding position/self-sufficiency deficit/ buy-out deficit if there are positive or negative movements in markets, interest/inflation rates, mortality? Is the sponsor covenant sufficient to underpin the risks being taken?**