



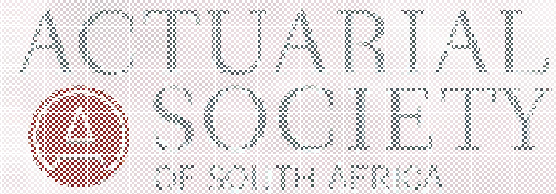
Managing Agency Risk in Defined Contribution Retirement Funds

Mickey Lowther

and

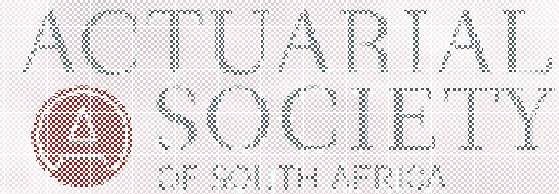
Jonathan Mort

What value can an actuary add in the risk management of a DC fund?



- How could an actuary help a board in the risk management of a typical DC fund?
- Is it not the administrator, the benefit consultant, auditor or legal adviser who are more appropriate to advise on most of this?
- So first need to try to understand the 'why' and the 'what' of risk management for this type of fund.

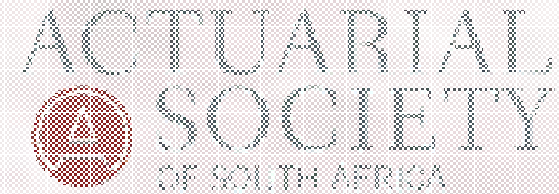
Where does the requirement for risk management come from?



- Pension Funds Act - s.7C(2)(a) protect members interests
- s.7D(b) ensure proper control systems
- Annual Financial Statements - schedule HA – board must set out risk management policy
- PF130 - risk management is one of the purposes of good governance (para 4.2)
- fund must have a risk management policy (principle 7, para 44) which includes non financial risks

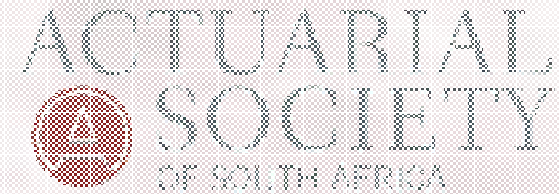
King 3

How do some boards do risk management?



- Ask the administrator to prepare something
- Perhaps ask subcommittees to give input
- Result - standard template of risk universe
 - tick the PF 130 compliance list
 - look at it again in a year's time

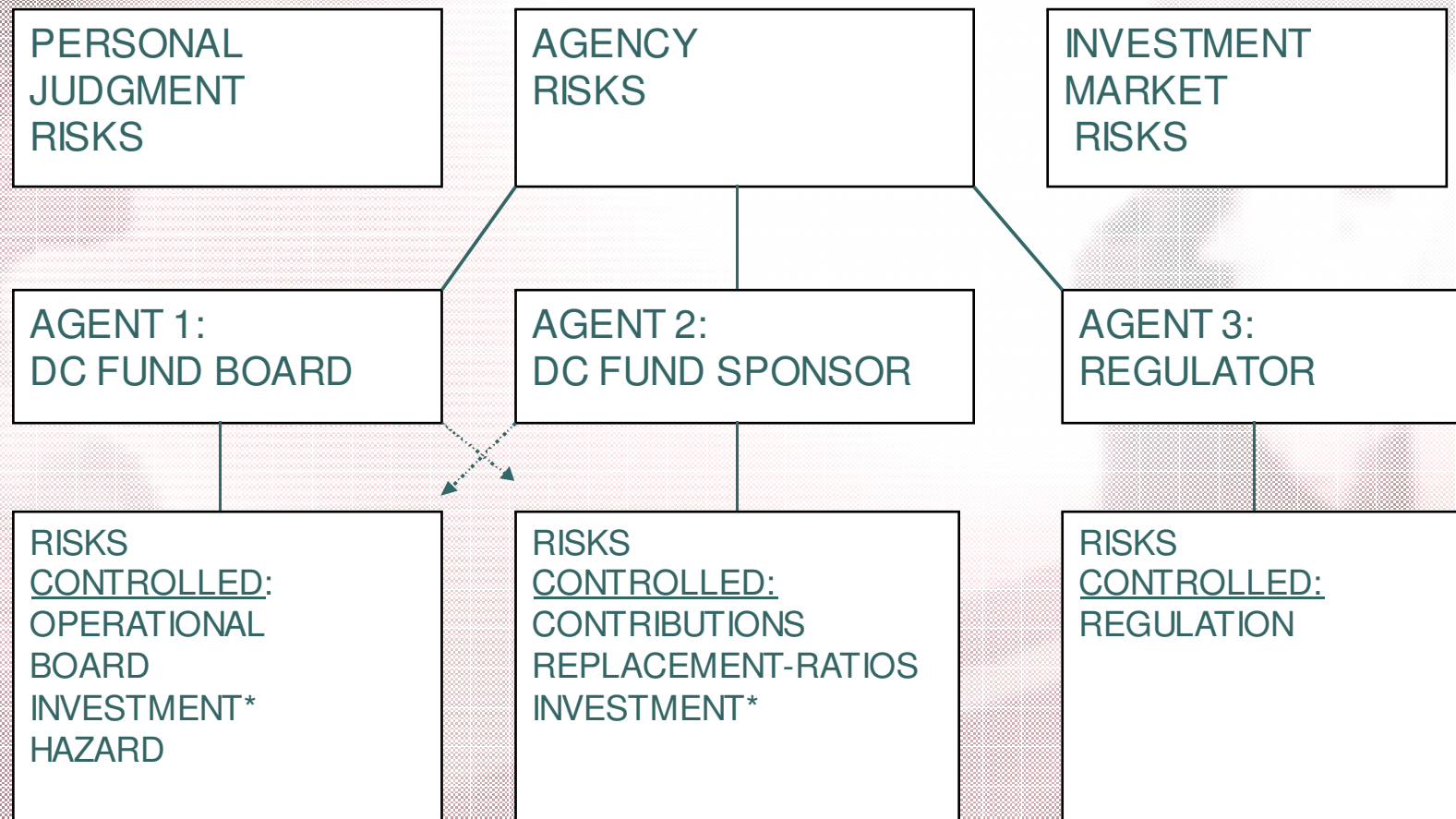
How should the board approach risk management?



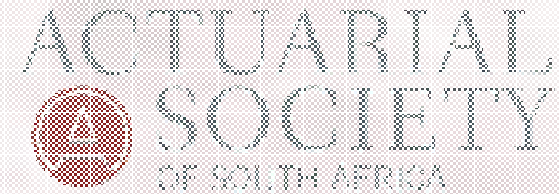
- Confusion!
- Clearly to do with the purposes of governance, especially 'ensuring benefits received'
- Per UK Regulator – risk management is the review of internal controls

Agency Risk

- Economists view of retirement fund as the agent of the member
- Managing agency risk means you can only be accountable for risks which you can control



Management of agency risks by the board



- Now we have a theoretical framework for the algorithm of 'identify, assess likelihood & impact, mitigate' risk categories such as
 - operational
 - investment
 - board
 - hazard

Not just 'risks' but also 'controls'

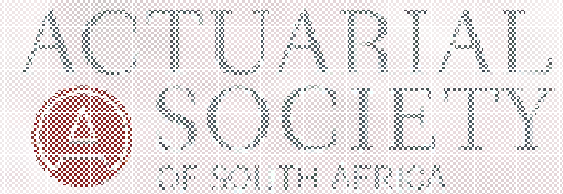
The Administrator...



- Where it delegates responsibility, the board must
 - oversee delegated responsibility
 - manage counterparty risk

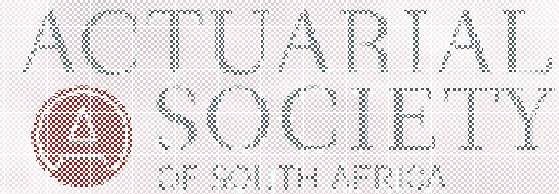
- Importance of internal controls, including vigorous admin sub-committee, reporting, verification, etc

The Auditor



- Can the board rely on the annual audit to manage risk?

Risk management and scenario planning

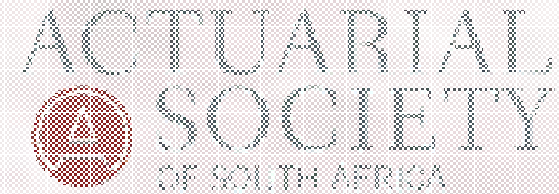


A disaster happens which was not identified in the risk management process:

Asset manager goes under which has a third of fund assets at the same time that the custodian discovers a system problem which shows that its data is corrupted. Employer is undergoing contentious retrenchment exercise and highly agitated that fund cannot pay out withdrawal benefits.

How does the board respond?

The Fire Drill

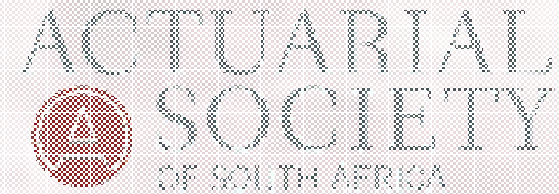


- Basil is the board
- Sybil is the FSB
- The guests are the members
- Manuel and Polly are service providers
- You are the media

The Fire Drill (cont)

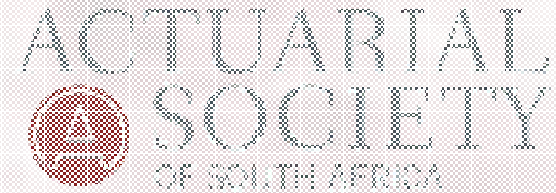
- Which service provider is the actuary?
Manuel or Polly?
- Who understands best the architecture of the environment to manage the crisis at its epicentre? - the administrator
 - the benefit consultant
 - the accountant
 - the lawyer
 - the actuary ?

Who is the most appropriate Fireman?



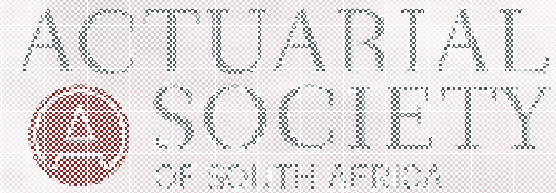
- In King III governance stated clearly to be a legal matter because of liability issues
- No actuaries involved in King III
- Liability issues are important, but risk must be managed not just to avoid liability, but to ensure delivery of benefits
- Those with the appropriate knowledge, expertise and involvement should be involved in both the risk management strategy and as firemen

The actuary as a risk management professional



- Vision of the Actuarial Society is to be an authority on managing financial risk
- But ERM also includes operational, board, and hazard risks
- Do Actuarial Society members have the expertise to compete with lawyers, accountants and management consultants to provide a quality service in this field?

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