

How to survive “Integrated Risk Management”: a quick guide for Trustees

... or how to deal with 45 pages of guidance, multiple proposals from consultants, extra costs

Survival principles

1. Own the process
2. Keep it focused on a new **Statement of Integrated Risk Principles**
3. Get your existing advisers to jointly agree and propose to you what this should include
4. Pay for third party work that can genuinely improve trustee decisions
5. Build it in to the pre-valuation timeline
6. Start it before the next scheme valuation, update it during the valuation process and then review it annually as a trustee board agenda item

Don't

1. Delegate the whole process to advisers - with resulting agency problems
2. Cop-out by appointing a single integrated risk adviser - who will tend to focus on their specialist area
3. Lose the valuable knowledge that only your existing advisers have had the time to build up about your scheme
4. Pay for what you already know to be taken away and repackaged

Top Tip

GIVE covenant at least equal status with funding and investment when integrating risks

*The real challenge is to integrate **Covenant** because consultancy ALM modelling already integrates funding and investment policy. tPR's Integrated Risk Management regulatory guidance reflects the growing centrality of covenant support to maturing defined benefit schemes with de-risking agendas and looks to trustees to raise their game*

Ask advisers to jointly report on 3 key integrated risk focus areas which will improve Trustee decisions

1. **Overall security of member benefits** reflecting covenant, funding and investment policy, and the advisers perspective on, or measure of, how this may change over the scheme's life – this goes deeper than simple investment and funding strategy
2. **Consistency** between covenant support and the scheme's investment policy and contributions strategy, and whether adjustments are required – justifying the methodology used
3. **Correlation** of a sponsor's ability to support the scheme with investment and credit risk, and with interest rates – this is a fundamental risk which needs to be taken fully into consideration

Outline approach recommended by Gazelle for trustees to manage the process of developing a [Statement of Integrated Risk Principles](#) for a Scheme.

Assembly of relevant data

- Initial covenant assessment
- Existing investment strategy
- Latest actuarial valuation and funding objectives
- Trustee overall intentions (such as aiming for self-sufficiency in 20 years)
- Corporate attitude (such as to accept pension risk or to seek to eliminate it)
- Corporate Viability Statement

Project Management

- Role and coordination of advisers
- Trustee governance, oversight subcommittee

Initial assessment of risks

- Evolution of overall security of member benefits over time (could be improving or worsening)
- Compatibility of investment and contribution strategy with current and potential covenant support
- Realistic achievability of trustee and corporate aims
- Upside and downside risks
- Proportionality of approach to risk
- Correlations of risks

Identification of areas for further investigation, such as

- Extent of hedging of investment and economic risk, timescale for de-risking or re-risking and triggers
- Alternative contribution strategies
- Relevance of PPF solvency level
- Relevance of covenant enhancement options

Scenario Planning and Stress Testing

Formulation of an integrated risk monitoring framework for the scheme – bringing this all together

Discussions with the employer (likely to involve iterations of previous steps)

Summary Statement of Integrated Risk Principles (“SIRP”) (*analogous to Statement of Investment Principles, Statement of Funding Principles*) – agreed with the employer and available to members and interested parties

Example Statement of Integrated Risk Principles (“SIRP”)

This is a written statement of the Trustee’s policy for ensuring that an integrated approach is adopted to the management of investment, funding and covenant risk. The statement records the decisions taken by the trustees as to the methods and assumptions to be used, and the steps taken to ensure that the investment and funding of the scheme is compatible with the risks inherent in the sponsor covenant

The SIRP should cover at least the following:

Identification of key risks

Covenant	Corporate structure Business risks, as identified in company reports Long term industry outlook
Investment	Inflation Interest rates Equity market risk Credit risk generally
Liabilities	Longevity Other demographics
Funding	Achievability of actuarial return assumptions relative to investment strategy

Capacity of the sponsor to take investment risk inherent in the adopted investment strategy

Short term
Medium term
Long term

Techniques used to assess risks and establish proportionality

Measurement of the future evolution of covenant risk
Stress tests
Scenario planning
Contingency planning

Advisers used

Covenant assessment
Investment advice
Actuarial
Legal

Consultations undertaken with the sponsor

Key decisions taken to ensure that investment strategy and funding objectives are compatible with the risks inherent in the sponsor covenant

Conclusions as to the overall security of members’ benefits

Purpose of this “Quick Guide”:

This Guide is designed to help trustee boards to design a process and set objectives for incorporating integrated risk management in scheme decision-making and to provide a practical process outline aimed at achieving a tangible output namely a Statement of Integrated Risk Principles to be adopted for the particular scheme context.

The Guide sets out Gazelle’s suggestions as to how Trustees could choose to respond to tPR’s regulatory guidance on integrated risk management.

About Gazelle:

Gazelle is a leading independent covenant adviser to larger and medium-sized UK defined benefit schemes.

Gazelle has developed the first commercially available integrated pension risk model Mousetrap © which quantifies the overall security of member benefits for defined benefit schemes and incorporates correlation of risks.

With acknowledged integrated risks expertise, Gazelle has contributed to a number of professional bodies investigating integrated pension risks.