

PLSA conference

Practical integrated risk management

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*Strictly private
and confidential*

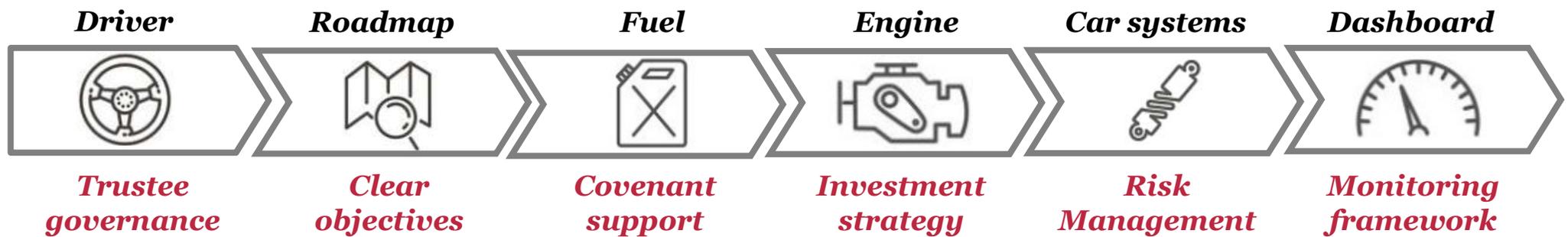
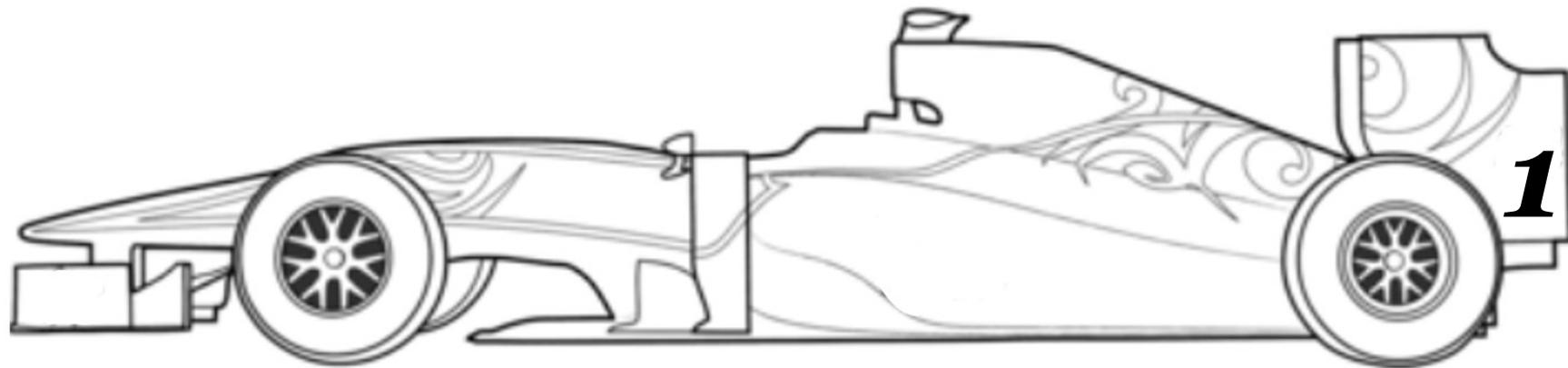
June 2018

**PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION**



Integrated risk management

A real world illustration



We believe the key to success is the combination of expertise, market leading technology and a partnership approach focussed on achieving your strategic objectives.



Integrated risk management

Driving effective governance

Guidance was released nearly 3 years and references to IRM and its key themes are consistently highlighted in the annual funding statements and recent white paper:

*“Trustees should **prioritise risks according** to how much they affect the scheme’s **long term funding target** and employers capacity to support them”*

TPR, 2018 annual funding statement

*“Integrated **risk analysis should recognise that certain risks affecting the scheme** could **also affect the employer’s** ability to support the scheme,”*

TPR, 2018 annual funding statement

*“For **small schemes**, we would **expect to see scenario planning** exercises to illustrate the impact of risks”*

TPR, 2018 annual funding statement

We see the strategy promoted by IRM as the future, advice from advisers in silo’s is no longer fit for purpose. An integrated approach is needed.



A practical approach to IRM

Start in the right place, ask the right questions and have a clear output

1 Start in the right place:

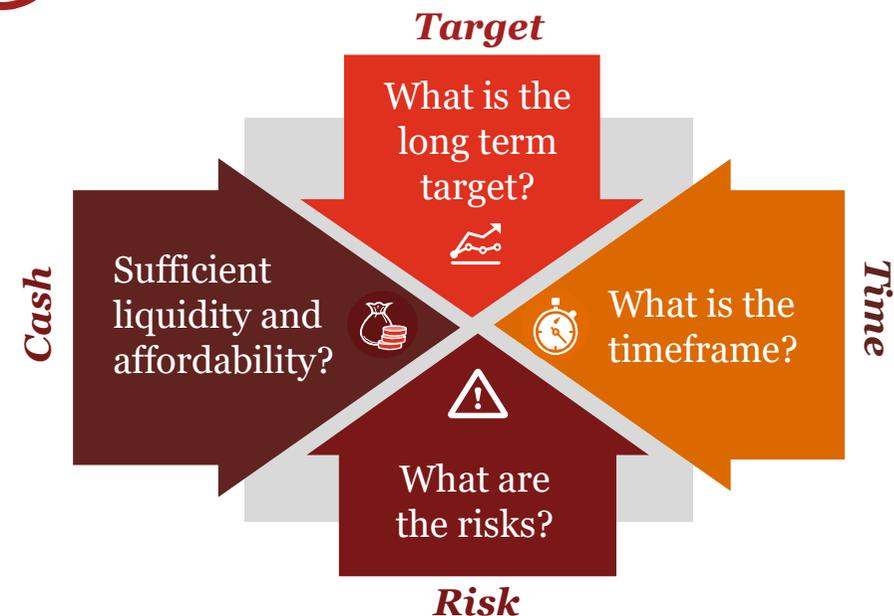
Evaluate employer covenant strength

Assess the ability of covenant to support investment risk

Agree a funding target that matches the level of investment risk

Test underlying assumptions under stressed scenarios

2 Ask the right questions:



3

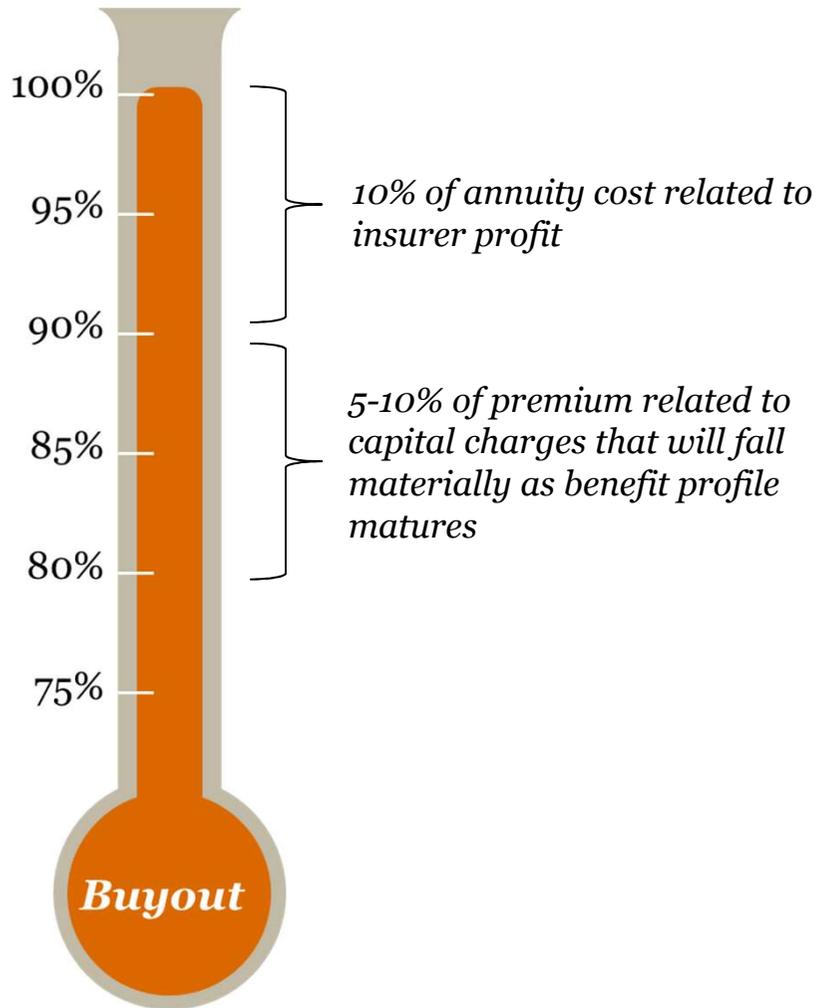
Have a clear output:

1. A clear target and way to reach it.
2. An understanding of how to deal with the risks involved:
 - Mitigate
 - Manage
 - Monitor

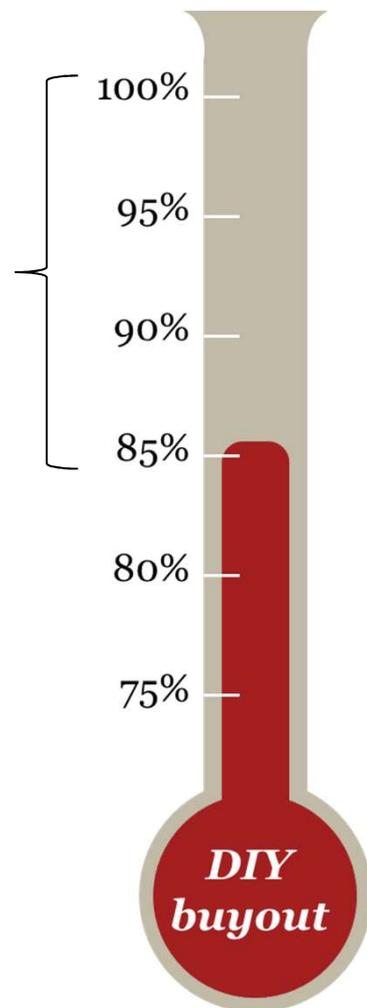


Setting clear objectives and long term target

Preparing for the road ahead



For schemes with the right governance structure it is possible to secure member benefits far sooner than implied by traditional de-risking targets





Covenant support

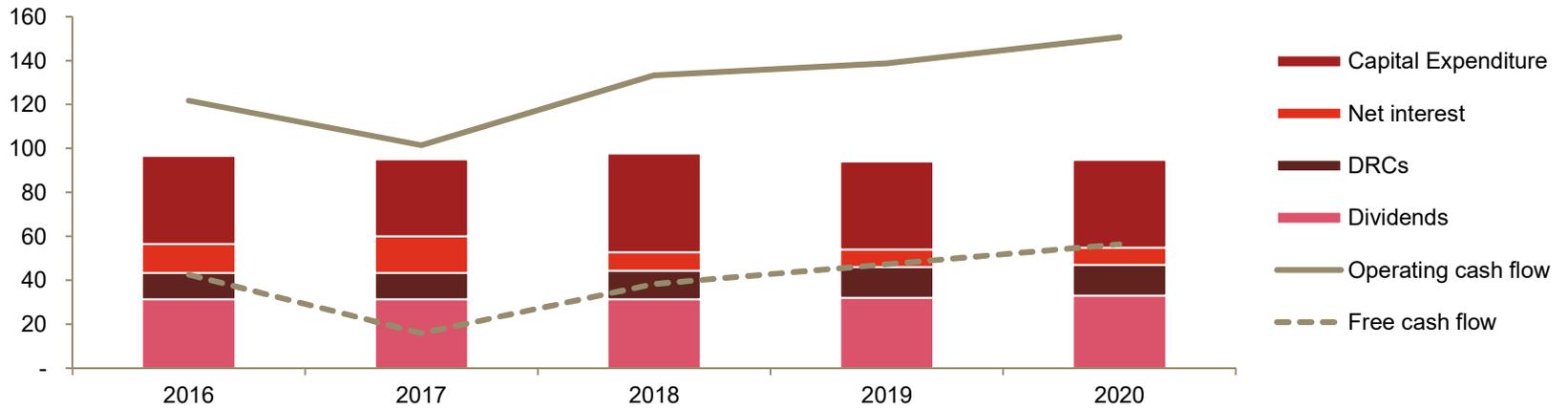
Understanding what covenant support is available to underpin your strategy

Cash
What is affordable?

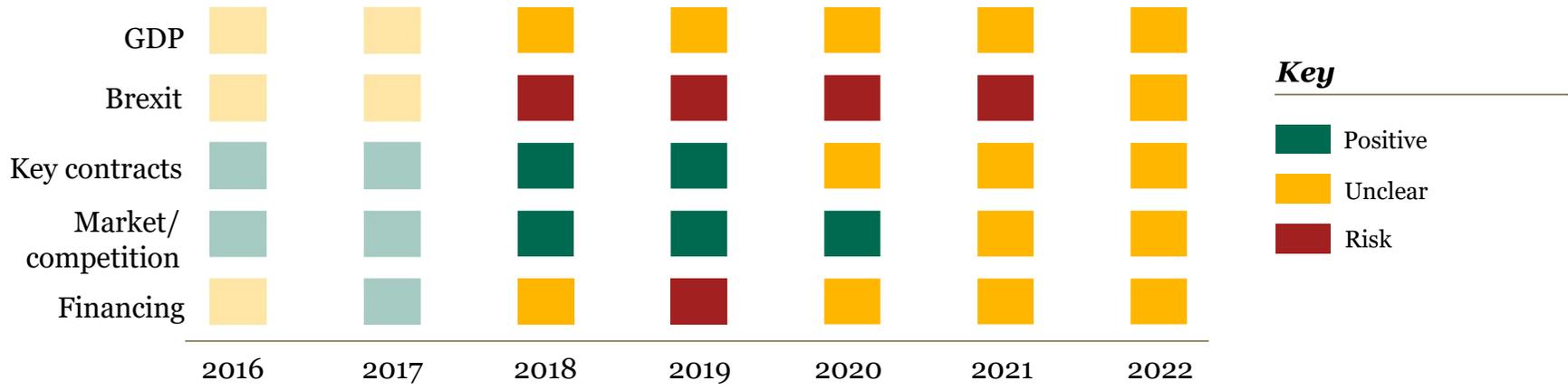
Time
For how long?

Risk
At what risk?

Example PLC cash position: what is affordable and when?*

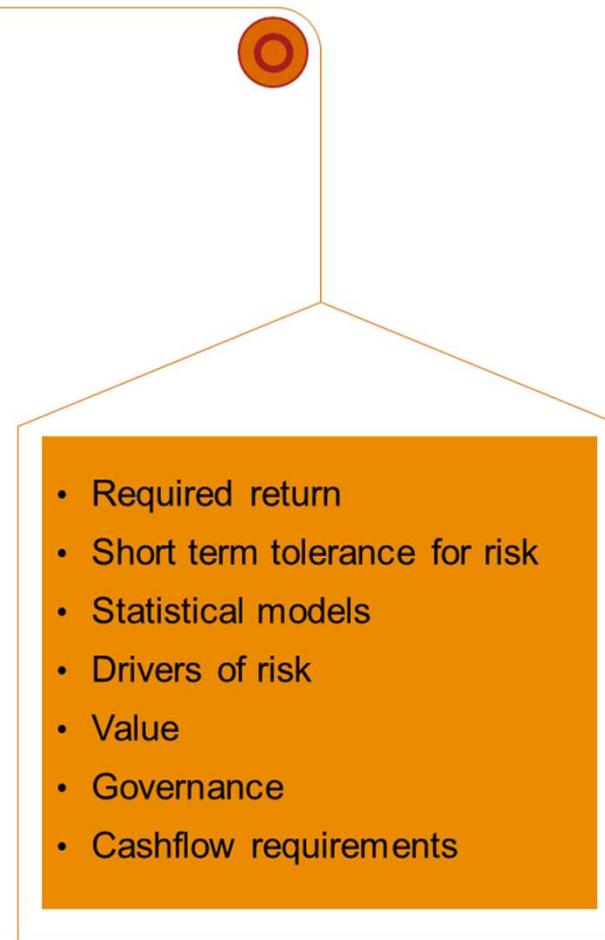


Illustrative risk position: what are the risks and when does it become unclear?





Investment strategy Finding the right balance





Funding strategy slide

Pit stops along the journey

- *Funding is a budgeting exercise - it is not really a valuation*
- *Liabilities are a series of cashflows that could be met by matching asset cashflows*
- *So does the discount rate chosen matter?*
 - *It impacts “Value at Risk” modelling*
 - *It could drive investment approach*

Important that funding strategy and investment strategy talk to each other

March 2018 (DWP White paper)

- Proposes a new funding Code of Practice, which focuses on:
 - **Ensuring schemes set a ‘long-term’ strategy, with valuations becoming ‘staging posts’ along that journey.**
 - How prudence is demonstrated in Technical Provisions.
 - How appropriate is defined in a recovery plan.

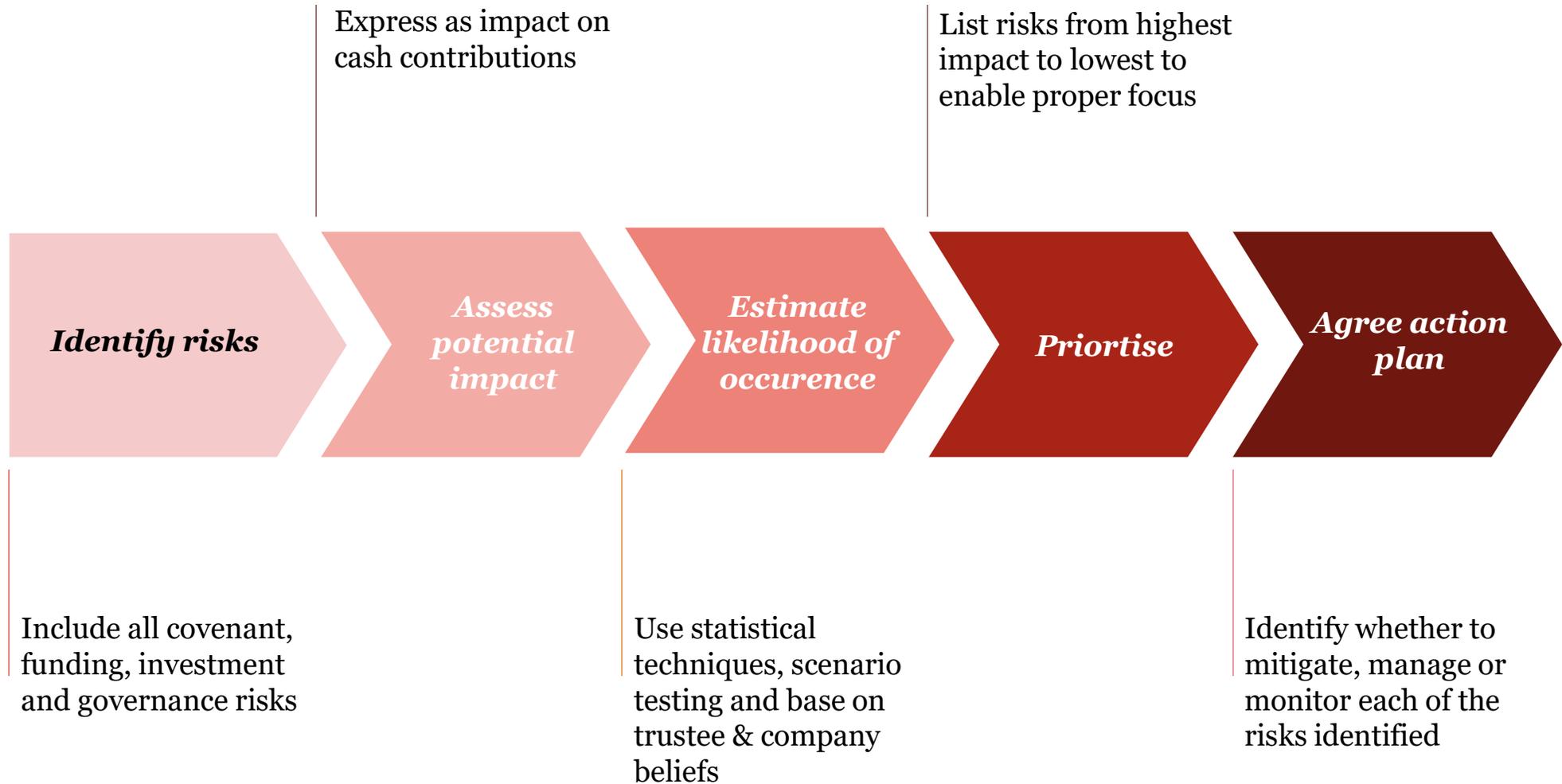
April 2018 (TPR 2018 Annual Funding Statement)

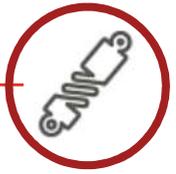
- ‘*Integrated*’ approach to risk, taking into account employer covenant, investment risk and funding.
- Understand ‘*what the proposed discount rate assumes*’ about future financial conditions.
- ‘*Trustees should negotiate robustly with the sponsoring employer to secure a fair deal for the pension scheme*’, in particular where dividend or other distributions appear ‘*unreasonable relative to contributions*’



Risk management systems

Developing an efficient process

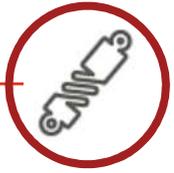




Proportionate risk analysis and contingency planning

At one end of the spectrum: Scenario planning without detailed quantitative analysis

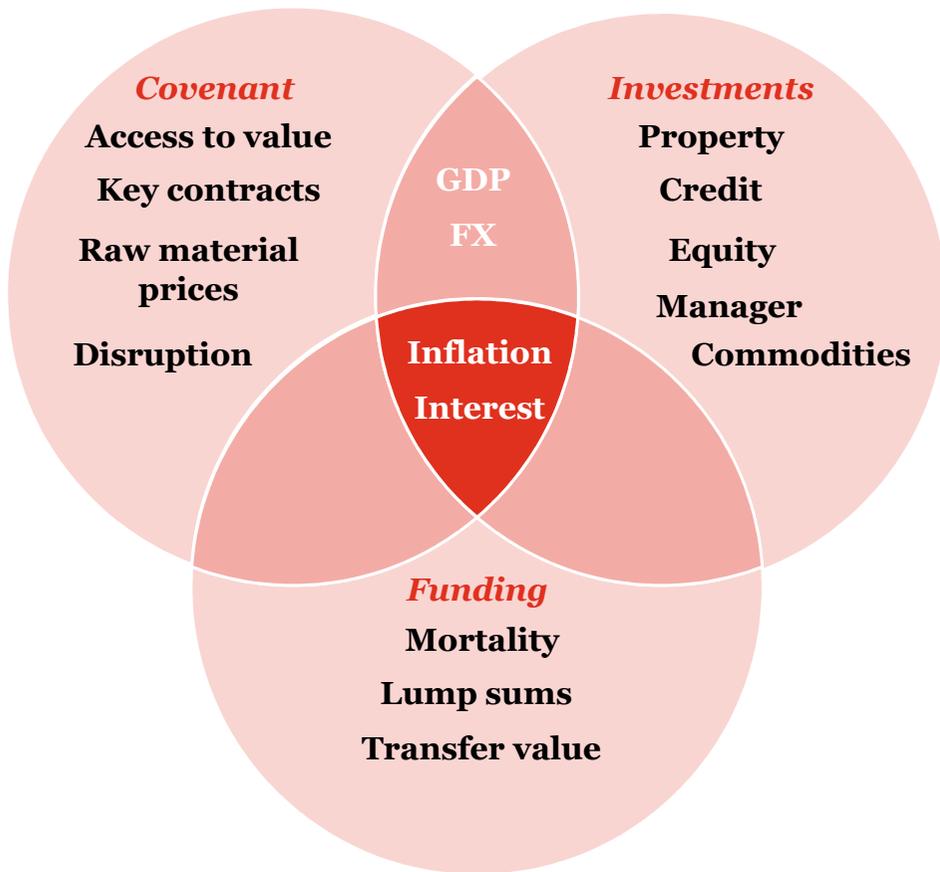
Area	Covenant	Investment	Funding
Question	<ul style="list-style-type: none">• Threat or opportunity to the firm?• What are the Brexit impacts on markets and regulation?• At what point should the Trustees start to worry?	<ul style="list-style-type: none">• Would the scenario be positive or negative for investment returns?• Could/should we do anything to hedge this scenario?	<ul style="list-style-type: none">• What impact will this have on funding?• Should the balance between cash and reservoir trust change?
Impact?			
Actions	Mitigate	Monitor	



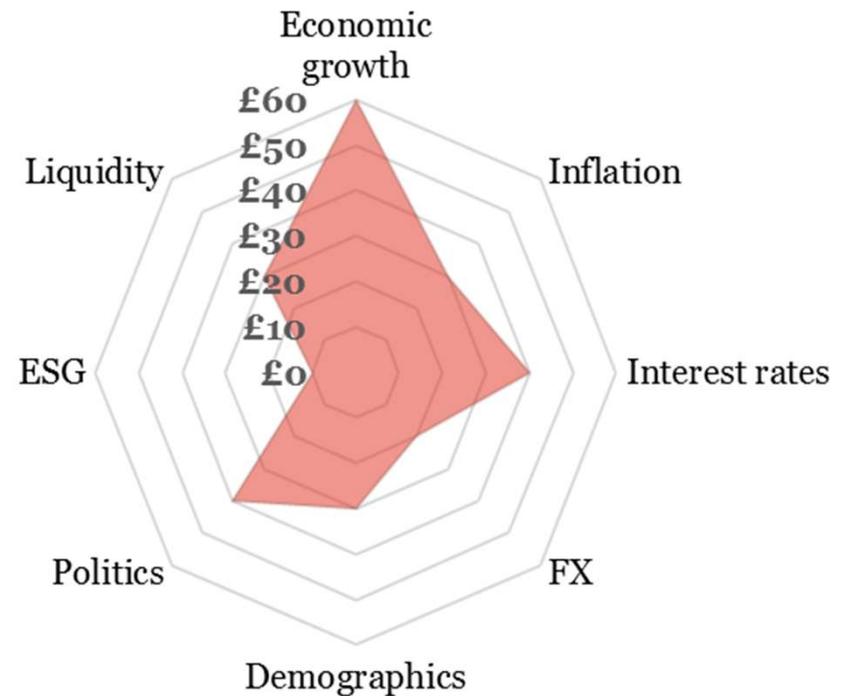
Proportionate risk analysis and contingency planning

At the other end of the spectrum: detailed quantitative analysis

1 Understand drivers of risk



2 Understand impact of common risk drivers



Case studies of an integrated approach

Case study 1

Case study brief

Situation

Large scheme relative to size of employer. Potential for volatile trading results with uncertainties over Brexit and economy.

Work performed

- **Correlation of risks between employer and scheme** Understanding where risks ‘double up’ and how investment strategy/monitoring could better deal with these risks.
- **Long term scenario analysis** Carrying out long term employer and scheme forecasts to understand integrated position and its downside risks.

Impact

- Greater understanding of affordability (leading to performance linked contributions).
- Greater understanding of risks (leading to downside mitigations).
- Clear understanding of the risks that matter and articulation of current response.
- Clear, forward looking monitoring.

Case studies of an integrated approach

Case study 2

Case study brief

Situation

Large schemes material in size to a multinational company. Desire to maintain as open schemes and take a long term view consistent across all schemes.

Work performed

- **Understanding the long term nature of covenant**
Economic scenario test the viability and security of the business.
- **Investigate asset investment approach**
Review current approach and define a lower risk long term approach.

Impact

- Future investment strategy driven by scheme liability profile.
- De-risking to occur at an agreed point of scheme maturity
- Funding approach reflects prudent expected asset returns.
- A consistent principles based approach that could be applied to all schemes.

Case studies of an integrated approach

Case study 3

Case study brief

Situation

Overseas parent with UK businesses with 2 schemes. Previous funding agreement included no dividends to be paid to parent company as a mechanism to enhance covenant.

Work performed

- **Understanding lack of security.**
- **Determining a long term investment strategy** which was contingent of covenant being improved via additional security.
- **Improving security** via a package of overseas guarantees and an asset-backed contribution structure which enable the parent company to receive dividends from UK business.

Impact

- Long term security package agreed.
- Long term investment strategy with lower risk profile agreed.
- Long term funding plan consistent with investment strategy.
- Funding approach reflects prudent expected asset returns.

Key takeaways

1 *Start in the right place:*

- Covenant
- Investment
- Funding

2 *Ask the right questions:*

- What is the target?
- How much time do we have?
- When cash is available and when is it needed?
- Is the strategy optimised to deal with the risks the scheme may face?

3 *Have a clear output:*

- An agreed target
- A plan to mitigate and manage risks
- Focused monitoring on the risks that matter

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