Could this become a risk management policy for schemes?

ENWEALTH FINANCIAL SERVICES LIMITED

Navigating Uncertainty: Building Resilience in the Face of Evolving Risks

Enwealth
For a better tomorrow

PRESENTATION BY RCL

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About us

ABOUT US

- RCL is an East African-based consultancy providing actuarial, financial modelling and risk management advice.
- Registered by both RBA and IRA.
- 2017, awarded the Fund Actuary of the Year by the Institute of Pension Management in Kenya.
- 2018, accepted into the International Benefits Network.
- 2020, winners of the Employee Benefits Consultancy Firm of the Year category in the 2020 Global Advisory Experts Annual Awards.

FOOTPRINT

VALUES

- Client Focus
- Reliable
- Agile
- Clear
- Informative
- Integrity

Speaker Profile

Darshan Ruparelia FIA FeASK FAST – Director at RCL

Darshan Ruparelia is a Fellow of the Institute & Faculty of Actuaries (UK) with over 15 years of experience in advising public and private sector employee benefits' schemes.

Darshan relocated to Kenya from the UK in 2013 to set up a new actuarial consultancy, RCL.

Darshan advises both trustees and sponsors of employee benefits' schemes in the areas of scheme funding, scheme design, investment strategy, accounting valuation, risk benefits, cashflow modelling and projections, actuarial factors and member communications.

He also advises both life and general (re)insurance companies in the areas of pricing, reserving, quarterly and annual liability valuations, reinsurance arrangements, asset-liability modelling and preparation of Financial Condition Reports.

Darshan is a Fellow of The Actuarial Society of Kenya (TASK).

Darshan has been appointed to the Committee of Actuaries of the United Nations Joint Staff Pension Fund.

What is Uncertainty?

Uncertainty refers to epistemic situations involving imperfect or unknown information. It applies to predictions of future events, to physical measurements that are already made, or to the unknown. [Wikipedia]

What is Uncertainty?

No one can predict the future with certainty!

Who predicted:

- The global credit crunch (global recession in the late 2000s)
- The pandemic (Covid-19) – macro-economic impact, investment, inflation and longevity?
- Climate change – effects unknown but can’t be good!
- Kenyan tight fiscal and budget conditions
- Ukraine-Russia war, Palestine-Israel conflict, etc

Define Risk

- Risk is the potential of gaining or losing something of value. Values can be gained or lost when taking risk resulting from a given action or **inaction**, foreseen or unforeseen (planned or not planned). [Wikipedia]

Types of risks

Investment risks

Risk Type	Possible types of control (where appropriate)
➢ Inflation risk ➢ Risk of volatile returns ➢ Under-performance risk ➢ Concentration risk ➢ Capital erosion ➢ Default risk ➢ Liquidity risk ➢ Currency risk ➢ Legal and regulatory risk ➢ ESG risk	➢ Setting appropriate investment strategy that suits the liability profile of the scheme. (i.e. maximising returns at acceptable risks levels) ➢ Proper diversification both geographically and considering different asset classes ➢ Regularly monitoring the performance of the investments in relation to the benchmarks i.e., i. Assess the performance of each asset class. ii. Compare the performance of the whole scheme with peer group schemes (schemes with similar size and investment strategy). iii. Compare the performance of the whole scheme with the market (PIMS report). iv. Always consider medium to long term horizon ➢ Considering alternative investments eg offshore, private equity/debt, reits, infrastructure bonds etc ➢ Considering ESG compliant investments

Embracing Asset-Liability Matching as a tool of managing investment risk

What is ALM?

- This is a powerful tool that aligns investments with future obligations, safeguarding the financial well-being of pension funds.

- It involves investing in assets that generate cashflows in line with the timing and amount of the pension payments that need to be made.

Embracing Asset-Liability Matching as a tool of managing investment risk

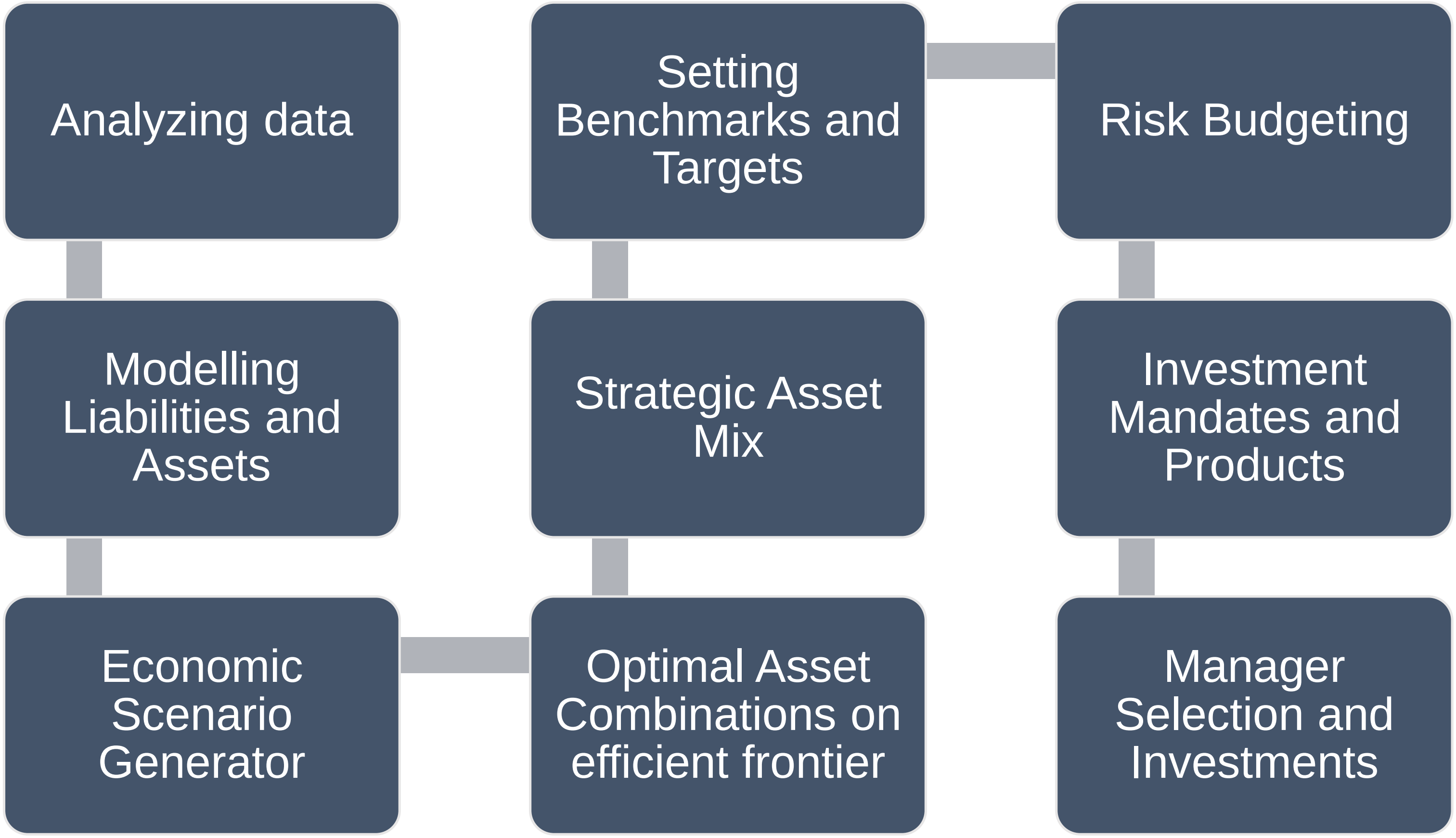
Why does ALM matter?

It is crucial in pension schemes for several reasons:

- Certainty of future payments: Ensures that pension promises are met through liability profiling and as a result cashflow planning.
- Volatility mitigation: By investing in assets with cashflows that align with the timing and amount of future liabilities, pension funds can reduce the risk of sudden fluctuations in the value of their investment portfolio and focus on diversification.
- Long-term sustainability: By adopting an ALM approach, pension schemes can better manage their cashflow requirements and maintain the financial health of the fund over the long term.
- Maximizing investment performance and/or minimizing risk
- Regulatory compliance: ALM helps in making prudent investment decisions to ensure maintenance of sufficient assets to cover future liabilities.
- Member confidence and clarity on their savings – NRRs
- Life-staging and unitization – giving investment choice

Embracing Asset-Liability Matching as a tool of managing investment risk

The ALM Process



Embracing Asset-Liability Matching as a tool of managing investment risk

Implementing ALM: A Tactical Approach

Investment Policy Statement (IPS):

- IPS serves as a long-term guide post, outlining goals and systematic review processes.
- It clarifies responsibilities and provides a baseline for monitoring performance.

Development of Asset Class Structures:

- Implement the asset allocation resulting from the ALM process.
- Establish asset allocation ranges to manage deviations from the long-term strategic allocation.

Review of Investment Mandates:

- Assess the suitability of investment mandates and manager architecture based on the Investment Policy Document.

Liquidity Considerations:

- Address liquidity constraints when implementing mandates in each asset class.

Closed vs. Open-Ended Portfolios:

- Consider the advantages and complexities associated with closed-ended and open-ended portfolios.

Time Horizon:

- Tailor investment strategies to align with varying pools of liabilities and their respective time horizons.

Tax Considerations:

- Monitor and adapt the investment strategy in response to changes in tax policy.

Types of risks

Administrative risks

Risk Type	Possible types of control (where appropriate)
➢ Miscalculation of benefits ➢ Poor record keeping ➢ Lack of good stable IT system ➢ Outdated or unclear TDRs ➢ Service providers’ risk ➢ Inappropriate interest rate distribution (i.e. MTM vs HTM)	➢ Peer review of key controls by administration team ➢ Periodic meetings between trustees and service provider (when required) ➢ Service level agreement reviews; performance appraisal of providers ➢ Internal quality review procedures by third party administrators (i.e. independent control reviews – “Assurance Reports”)

Types of risks

Longevity risk

Risk Type	Possible types of control (where appropriate)
➢ Members living longer than expected	➢ Monitoring Net Replacement Ratios (NRR) and improving through optimizing investment strategy or increasing contribution or both. ➢ Need for expected longevity improvements to be built into the model.

Types of risks

Governance risks

Risk Type	Possible types of control (where appropriate)
➢ Poor scheme management (ineffective stewardship by those with delegated responsibility)	➢ Trustees’ knowledge and training ➢ Managing of conflicts of interest? ➢ Clear procedures and protocols in place (including for procurement of services) ➢ Transparency and full disclosure – act impartially ➢ Annual AGMs ➢ Good governance policies

Types of risks

Fraud

Risk Type	Possible types of control (where appropriate)
➢ Misappropriation of assets ➢ Fraudulent financial reporting	Segregation of duties; frequent reconciliation procedures for cash and investment balances Need for a custodian How do Guaranteed funds operate?

Types of risks

System failure risks

Risk Type	Possible types of control (where appropriate)
➢ Computer system ➢ Database failures	➢ System recovery plans ➢ Data back-up procedures ➢ Password controls

Assessment of uncertainty and risks

What are internal controls?

- Arrangements and procedures to be followed in the administration and management of the scheme.

Why do you need internal controls?

- Internal controls assist the Trustees in monitoring the management and administration of their scheme.
- Improve the safe custody of assets and help protect the scheme from adverse risks which could be detrimental to the scheme.
- Assist with maximizing member benefits.

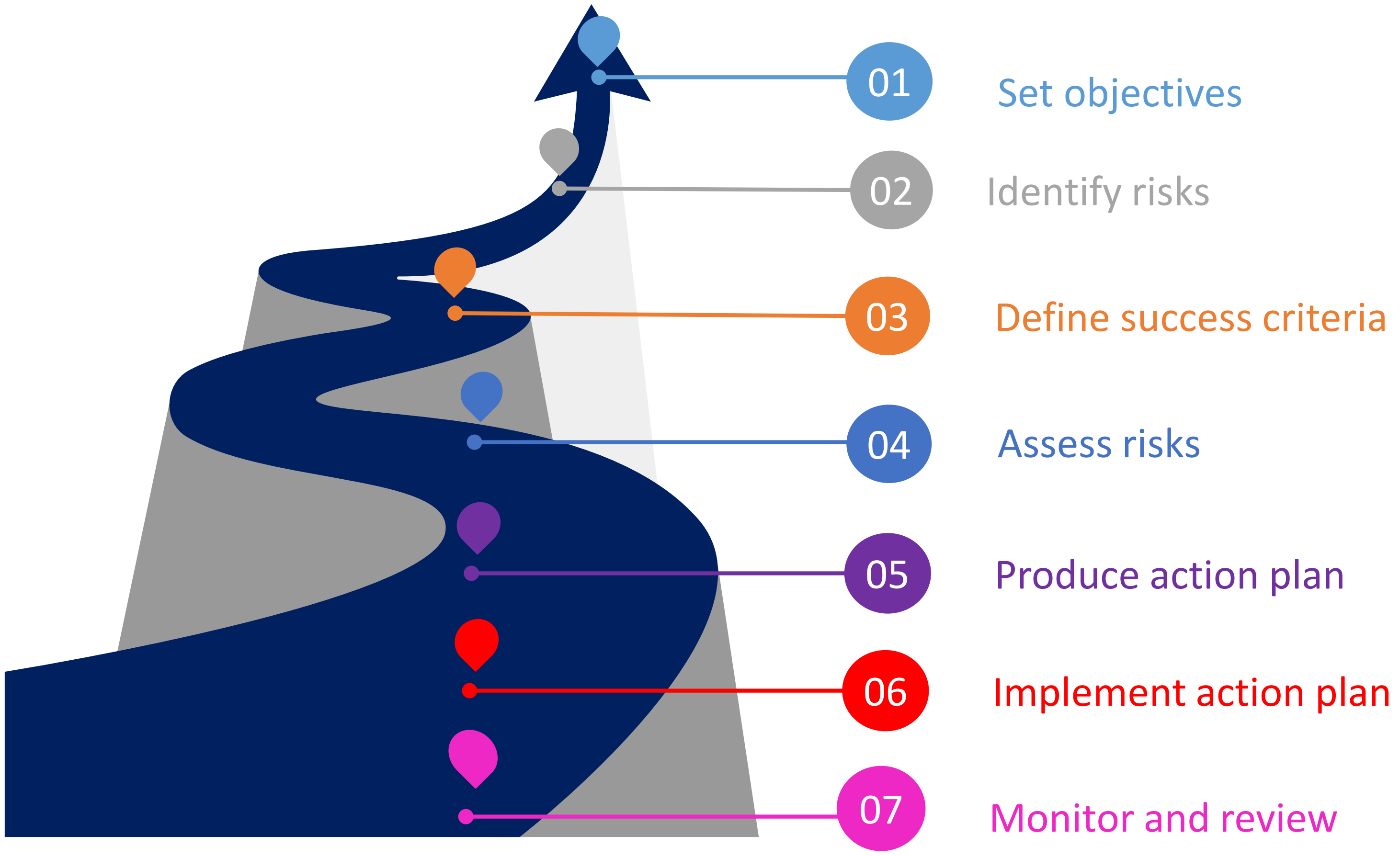
Assessment of uncertainty and risks

Trustees need to:

- 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/or impact.
- 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 identified and adequately controlled and monitored.
- Identify the key risks associated with the functions and activities carried out in the running of the scheme.
- Need to undertake a risk review. **Identify, mitigate, manage, monitor.**
- Undertake a risk-based approach which involves tailoring the supervisory response to fit the assessed risks.
- Exercise of judgement - decide what internal controls are appropriate to mitigate the key risks that are identified and how best to monitor them.
- Seek professional advice where trustees feel that they have insufficient knowledge to complete a risk review.(e.g. have investment consultant that can evaluate scheme performance regularly)
- Continuous review. This is a never-ending process!
- Appoint a risk manager and include as an Agenda item in quarterly Board meeting.

Assessment of uncertainty and risks

Scheme risk management cycle:



Source: based on Watson Wyatt business management cycle)

Current issues

- Lack of diversification in investments
- Lack of investment opportunities
- Upskilling trustees
- Short tenor of trustee term
- Government bond yields
- NSE volatility
- Property illiquidity
- HTM vs MTM confusion

Q & A

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