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**FSCA INTERVIEW**
'Everything you do is risk management'

**UNDERSTANDING RISK**
and the importance of managing it

**RISK MANAGEMENT**
process steps


# RETIREMENT FUNDS AND RISK MANAGEMENT

**VOL.8**

**ALSO IN THIS ISSUE:** GUIDELINES FOR RETIREMENT FUNDS AND RISK MANAGEMENT | OVERVIEW OF RISK MANAGEMENT PROCESS | RESOURCES FOR FURTHER INFORMATION

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# UNDERSTANDING RISK
## AND THE IMPORTANCE OF MANAGING IT

## overview

**Whether a mega-sized multinational or a small start-up, enterprises undertake risks to achieve rewards. And while not all risk is negative, it constitutes uncertainty, which is why the management of an organisation needs to engage in active, structured risk management to deal with unexpected events or opportunities. This article takes a broad look at what risk is and how it should be managed.**

"No risk, no reward" is the often paraphrased saying. While this might be an oversimplification of the concept of risk, what it does highlight is that there is an upside to risk as well. The very nature of its uncertainty means that risk can also offer opportunity. Explained in financial terms, for example, risk is encompassed in the volatility of returns; riskier assets should have higher expected returns to compensate investors for the higher volatility and increased risk.

But, of course, risk also represents the uncertainty of undesired outcomes – and whatever the nature of a business and the sector it operates in, understanding and proactively managing the chance of these undesired outcomes taking place forms an integral part of an organisation's daily operations. That is to say, risk management.

In its Guideline to Risk Management, the Institute of Risk Management South Africa (IRMSA) explains that: "Understanding the meaning of the term 'risk' is the most fundamental prerequisite to developing a risk management programme."

## The meaning of risk

**The IRMSA Guideline sets out common perceptions of risk as follows:**

- **The possibility of loss, danger or injury.**
- **The possibility that the future may be worse or better than what was expected.**
- **The possibility of a loss arising from an undesirable future event.**
- **An uncertain event or condition, which, if it occurs, will have a negative effect on the achievement of objectives.**





Focusing then on the achievement of an organisation's objectives, risk is the effect of uncertainty on these objectives. An effective risk management framework will enable an organisation to "manage the probability of any unforeseen events that may arise and to limit the effect of the consequences, along with responding proactively to opportunities". In other words, it will be better able to carry out its plans (achieve its objectives) despite the uncertainty of the events in the environment in which it operates.

**Contextualising an organisation's risk**
There are several types of risk, which will be explored in more detail in this publication – but to broadly contextualise risk in a more concrete, tangible manner, it serves to outline the two broader categories of risk: systemic and unsystemic risk.

**Risk**

- **Systemic** (external oprating environment, for example: macroeconomic factors)
- **Unsystemic** (internal to the organisation, also known as residual risk)

Systemic risks represent external factors that impact all (or many) companies in an industry or group, while unsystemic risks are unique to a specific company or industry.

» **Understanding the external context, as per the IRMSA Guideline:**
In identifying the external risks to an organisation, it is important to understand the market forces (e.g. political, technological, legal, economic, etc.) and the social environmental forces that will affect the organisation's operating and strategic capabilities. The external context can include, but is not limited to:

- The sociocultural, economic, political, legal and regulatory, natural and competitive environment, whether international, national, regional or local.
- Key drivers and trends that influence the objectives of the organisation.
- Relationships with, and the perceptions and values of external stakeholders.

» **Understanding the internal context, as per the IRMSA Guideline:**
The internal context is the internal environment in which the organisation seeks to achieve its objectives. These factors lie wholly or mostly within the organisation's decision-making capacity, and the organisation can thus influence it directly. Specifying the internal context is critical in understanding the internal drivers that shape the organisation's ability and capacity to reach its objectives. This can include, but is not limited to:

- Governance, organisational structure, roles and accountabilities.
- Executive mandate for risk function – sign-off on project contingencies, escalation on exposures beyond appetite.
- Risk calibration / quantification.
- Policies, objectives, and the strategies in place to achieve them.
- The inter-dependencies of the various management systems, functions and activities of the organisation.
- Capabilities, understood in terms of resources and knowledge (e.g., capital, time, people, processes, systems and technologies).
- The relationship with, and perceptions and values of internal stakeholders.
- The organisation's culture, including its risk management culture, attitudes and behaviours.
- Information systems, information flows and decision-making processes (both formal and informal).
- Standards, guidelines and models adopted by the organisation.
- The nature and extent of contractual relationships.

**Undertaking risk management**
Risk management refers to the different strategies and processes deployed by an organisation to help manage and minimise risks identified within the context outlined above in order for an organisation to maximise its ability to protect and create value. The process of risk management includes the identification, analysis, and response to these specific risks (see p.10 for a detailed outline of risk management process steps).
As emphasised by the IRMSA Guideline to Risk Management, failing to manage risks may prevent the organisation from achieving its objectives, and ultimately lead to the diminishing share value and loss of competitive advantage or even closure.

**Retirement fund governance and risk management**
As risk management relates to retirement funds, the primary objective of retirement funds is first and foremost to protect members and beneficiaries. The main resulting risk, then, is fund failure. As part of its fiduciary duty towards the fund and beneficiaries, a retirement fund's board of trustees must engage in, among other things, the oversight of risk management of the fund.

The remaining articles in this publication seek to highlight the key elements of risk management as it relates to retirement funds and trustees' role in the responsible risk management of a retirement fund.

## REFERENCES

IRMSA Guideline to Risk Management. Available at: https://www.irmsa.org.za/page/practise
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# RISK MANAGEMENT
## AS IT RELATES TO RETIREMENT FUNDS

## overview

**This article outlines the risk management responsibilities for retirement fund boards of trustees and the types of risks that the board of trustees may be exposed to.**

**Risk management in the context of retirement funds**

A key objective of a retirement fund is to ensure that the fund members reach their investment goals and are in a position to retire comfortably. It is therefore imperative that the board of trustees governs the fund in the most optimal, efficient and ethical way to ensure such objectives are met. A critical part of fund governance incorporates the process of risk management – boards of trustees should have processes in place to identify the risks that their retirement fund is exposed to and have a risk management framework in place to identify, assess, manage and minimise or mitigate all identified risks.

Retirement funds can be exposed to different types of risk, including those related to governance, compliance, strategy, investment, regulation and reputation. Against this backdrop, there are both regulation and codes of best practice in place that provide guidelines on how to identify, address and minimise the various risks pension funds may be exposed to. This would include the following:

- The Pension Funds Act, which regulates pension funds;
- PF130, a circular issued by the Financial Services Board (FSB), now the Financial Sector Conduct Authority (FSCA), which encourages good corporate governance of retirement funds. Although not legally enforceable, it is recommended best practice for retirement fund governance; and
- The King IV Report on Corporate Governance, which is a set of principles for the governance structures and operations for organisations, such as companies, non-profit organisations (NPOs) and other entities, such as retirement funds, and is seen as the benchmark for corporate governance in South Africa.

**What is the role of trustees when it comes to risk management?**

As a starting point, it is important to emphasise the roles and responsibilities of the board of trustees when it comes to managing the risks to which their funds are exposed.

- **The primary role of trustees**

As per Section 7C of the Pension Funds Act, the primary role of a trustee is to: "take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of the Pension Funds Act are protected at all times". Within this context, one of the duties of trustees should be to have a process of risk management in place to identify and minimise risks to the fund to avoid unnecessary financial losses.





**"Risk management and risk mitigation falls within the ambit of what a fund's members should require – and indeed demand – from their appointed board of trustees."**

- **The capability of trustees to ensure proper risk management**

As per Principle 7 of King IV (as it relates to retirement funds), the board should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively – this would include the process of risk management.

Further to this, PF130 states that "Board members should be educated on an ongoing basis about new matters relating to funds to ensure that they acquire and maintain an understanding of risk management, investment risks and strategies…".

- **Ownership and accountability**

The role of risk management for the retirement fund should not be outsourced to external parties, as regulation and best practice clearly state that the responsibility for risk management sits with the board of trustees.

**Different types of risk to which retirement funds are exposed**

Funds may be exposed to different types of risk. It is important that the board of trustees has a process in place to identify all risks so that such risks don't go unmanaged and result in value destruction. Examples of the types of risk that funds may be exposed to include:

- **Governance and compliance risk**

Good governance underpins the effective, optimal and ethical functioning of a board of trustees as stipulated in King IV. The duty of risk management falls within this ambit and is therefore closely aligned with the concept of good governance.

According to King IV, good governance is defined as: the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes:

- Ethical culture
- Good performance
- Effective control
- Legitimacy

A board of trustees is at risk of not meeting any of the above governance outcomes should there not be a good governance framework already in place – the absence of such a governance framework introduces the risk of the fund not complying with its regulatory requirements, not meeting its strategic objectives or not achieving good performance.

- **Strategic risk**

As per King IV Principle 4 (as it relates to retirement funds), "the board should appreciate that the fund's core purpose, its risk and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process". Strategic risk is the risk of failure by the fund in not achieving its strategic objectives over the short, medium and long term, therefore resulting in financial losses for the fund's members, who are the ultimate beneficiaries of the fund.

- **Investment risk**

This is the potential for financial losses relative to an expected return. There are a number of factors that can contribute to investment risk, depending on the nature of the investment, such as market risk, liquidity risk or credit risk.

According to PF130, the purpose of good governance in a fund is to ensure that: "the benefits are optimised and the associated investment risks are minimised with these opposing concepts being appropriately balanced against each other".

Regulation 28 of the Pension Funds Act stipulates how much may be invested in different asset classes. This ensures that investment portfolios are well diversified and limits exposure to risky assets, thereby ensuring there are no excessive risks taken with retirement fund investment portfolios.

- **Regulatory risk**

Boards of trustees are responsible for the ongoing monitoring of the regulatory environment as it relates to pension funds – and for responding appropriately. The risk of a change in legislation that may impact the fund is referred to as regulatory risk.

- **Reputational risk**

Reputational risk can threaten the fund's operational credibility, which could result in the destruction of value. An example of reputational risk can be lapses of governance or management processes in a fund or the fund receiving a qualified audit with respect to the fund's submission of its annual financial statements.

**In closing**

Risk management and risk mitigation falls within the ambit of what a fund's members should require – and indeed demand – from their appointed board of trustees. Failure to perform appropriate risk management functions can have significant detrimental impacts on the fund, including a loss of value (i.e., reduced pension benefits) for the fund's members.

If a fund is well governed – and meets both regulatory requirements and the guidelines and codes of best practice, such as King IV, PF130 etc. – the board of trustees should have sufficient capabilities and processes in place to ensure a thorough and robust risk management process is in place and implemented on a continuous basis.

## REFERENCES

**Today's Trustee: www.totrust.co.za**
**Financial Markets Journal: www.financialmarketsjournal.co.za**
**Sanlam: www.sanlam.co.za**
**King IV: www.iodsa.co.za**
**FSCA: www.fsca.co.za**

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# RISK MANAGEMENT:
## GOOD PRACTICE FOR RETIREMENT FUNDS

## overview

**This article highlights the main risk categories that impact retirement funds and considers recommended board and management responsibilities as they relate to effective risk management for retirements funds.**

The good practice guidelines developed by the Organisation for Economic Co-operation and Development and the International Organisation of Pension Supervisors (OECD/IOPS) in Good Practices for Pension Funds' Risk Management Systems outline the main features of risk management systems that retirement funds should employ.

These good practices build on the IOPS Principles of Private Pension Supervision and the OECD 'Guidelines for Pension Fund Governance.' For the purpose of this Atleha-edu article, we focus on highlighting the main risk categories and retirement fund board and management responsibilities as they relate to effective risk management.

**Categories of risk impacting on retirement funds**

The following may be considered as the broad categories of risks that retirement funds face. It should be noted that not all risks apply to each type of retirement fund, and any risk management system needs to identify which risks are material to the particular pension fund in question (according to whether it is a defined benefit or defined contribution fund, offers guarantees, is funded by a plan sponsor etc.).

- **Investment or market risk:** Risk of losses due to adverse movements in interest rates and other market prices. The risk may also arise due to investment in unregulated/unlisted products. 'Concentration' risk is also possible – i.e., risk that the retirement fund's portfolio is not adequately diversified and is too exposed to one asset or issuer.
- **Counterparty default risk / credit risk:** Risk of loss from the failures of a counterparty to meet its obligations.
- **Funding and solvency risk:** The risk that a retirement fund does not have sufficient assets to meet its liabilities, and the risk of insolvency in the plan sponsor affecting its ability to fund the plan.
- **Liquidity risk:** The risk that an entity will not be able to meet its financial obligations as they fall due for lack of fungibility.
- **Asset-liability mismatch risks:** Risk arising from insufficient assets to meet liabilities, which may arise from, for example, adverse market movements having a differential effect on assets and liabilities.
- **Actuarial risk:** Risk arising from inappropriate actuarial valuation methods and assumptions (e.g., mortality, longevity, disability, inflation, liquidity etc.).
- **Governance and agency risks:** Risks that could otherwise be described as 'competition risk' or 'competition failure'. Issues include excessive fees, conflicts of interest, biased funding decisions, fraud, misappropriation and misallocation, as well as inadequate objectives and strategies and other aspects of bad governance.
- **Operational and outsourcing risks:** The risk of losses resulting from inadequate or failed internal processes, people and systems, including IT systems, as well as the risks related to the outsourcing of business activities. Record keeping risks (such as errors in investment holdings, benefits not paid or late contributions etc.) would also be included. IT risk – a subset of operational risk – is the risk arising from inadequate information technology and processing in terms of manageability, exclusivity, integrity, infrastructure, controllability and continuity.
- **External and strategic risk:** These are the inherent risks with regard to the sensitivity of the fund to external factors (such as political risk, demographics, competition, technology, reinsurance, mergers, plan sponsor risk, political stability, natural disasters, etc.). The risk of non-payment of contributions should also be considered. Strategic risk is the risk resulting from strategic business decisions.
- **Legal and regulatory risk:** The likelihood of adverse consequences arising from the failure to comply with all relevant laws and regulations.
- **Contagion and related party / integrity risk:** Risks arising as a result of close association with another entity – the risks may be direct through financial exposure or indirect through reputation damage. Integrity or reputational risk may also arise from possible damage to an entity's reputation as a consequence of negative public perception (e.g., among clients, business partners, shareholders or the authorities).

**Board and management oversight of risk management**

Risk management systems need to be proportional. For example, retirement funds with more complex business models may need more resources to carry out their functions to help the governing trustee board with its tasks – such as a risk management, compensation, audit, or compliance committees. The governing trustee board of a large complex fund, for example, may, in addition, also rely on a centralised risk management function, such as a chief risk officer. Whatever the structure chosen, it should reflect the nature, complexity and size of the pension fund.

**OECD/IOPS recommended good practice for retirement fund boards:**

- The governing board of the retirement fund or plan should be responsible for defining, implementing and improving the pension fund or plan's risk management system, and for establishing a highly ethical standard throughout the organisation.
- The governing board of a retirement fund or plan should determine and regularly review its overall risk management strategy. This process involves understanding risks; setting acceptable levels of risk; and outlining how these risks will be measured, monitored and controlled.
- In order for risk assessment to remain effective, the governing trustee board needs to frequently evaluate and record the risks affecting the achievement of its goals and react to changing circumstances and conditions.
- As well as setting up the risk management system, the governing trustee board should check that it is working effectively on an ongoing basis and that there is a process in place for modifying or adapting the strategy as required.
- The risk management strategy needs to be documented, communicated to all relevant staff members and followed.
- There should be a clear division of responsibilities within the organisation. Decision-making, execution and checking functions should be assigned to different people and have suitable oversight. The division of responsibilities should reflect the nature and extent of the risks posed.
- It is the responsibility of the governing trustee board to develop a strong internal control culture within its organisation, a central feature of which is the establishment of systems for adequate communication of information between levels of management.
- A conflicts of interest policy (including disclosure and review procedures) and a code of conduct policy for all staff should also be in place.
- Policies and practices (including compensation) that may inadvertently provide incentives or temptations for inappropriate activities should be avoided.

## Risk management systems

**Risk management systems can be defined as the process designed to provide reasonable assurance regarding the achievement of objectives in terms of: effectiveness, efficiency and resilience of operations; reliability of financial reporting; and compliance with laws and regulations. The process does not involve just one policy or procedure performed at a certain point in time, but should be continually operating at all levels of the organisation, and involve all staff. Internal controls are one part of the overall risk system, which also incorporates a holistic philosophy of management oversight, risk awareness, separation of functions, communication, external controls, etc. – OECD/IOPS**

## Elements for a comprehensive risk management system:

- **The OECD/IOPS Good Practice Guidelines require retirement plans or funds to have a comprehensive risk management system in place.**
- **The risk management system needs to be well integrated into the organisational structure and in the decision-making process of the retirement fund.**
- **These systems should be commensurate with the nature, scale and complexity of the retirement fund, reflecting the scope and degree of sophistication of its activities.**


## REFERENCES

OECD/IOPS. Available at: https://www.oecd.org/daf/fin/private-pensions/46864889.pdf


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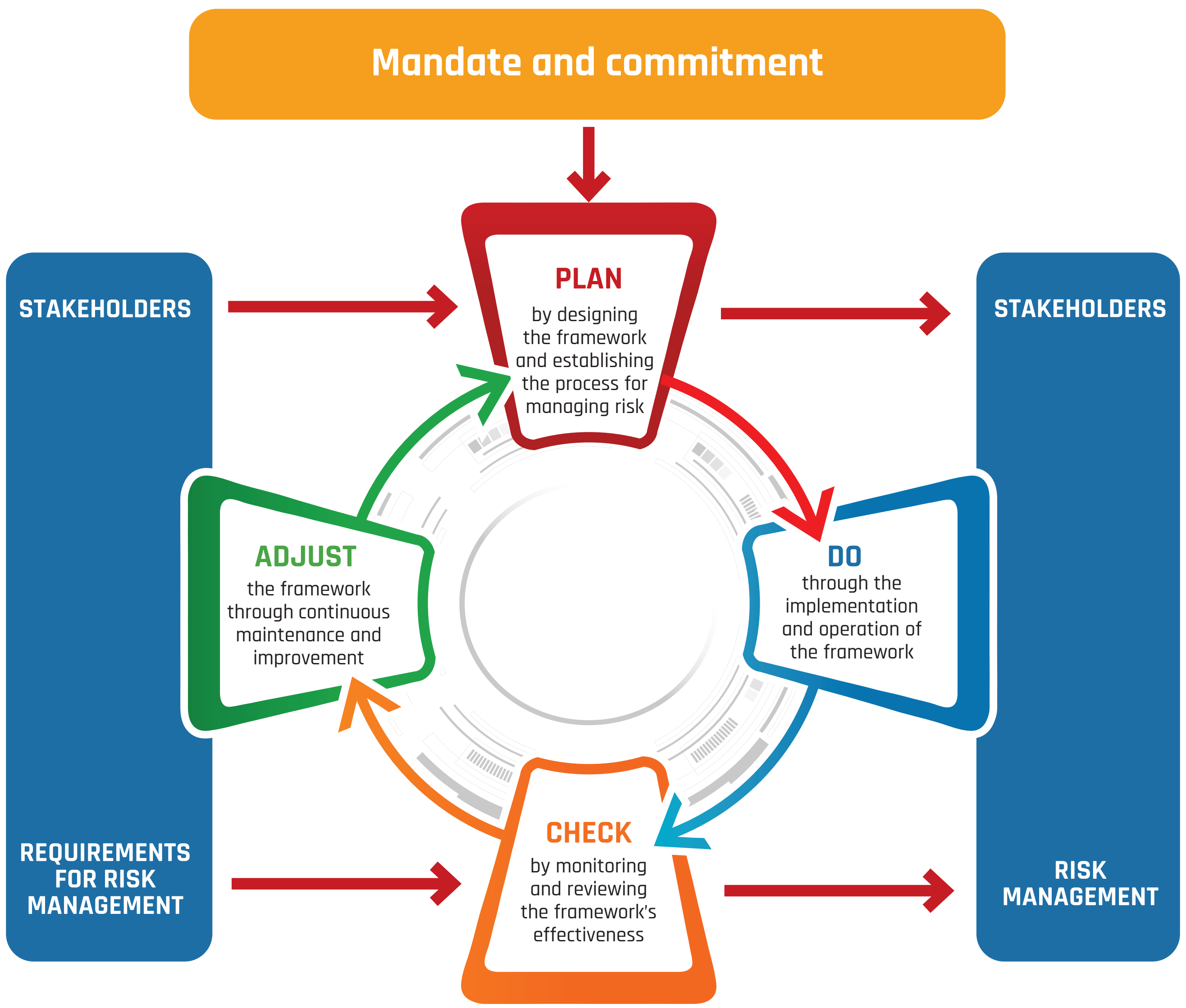
# An overview of the risk management framework and process

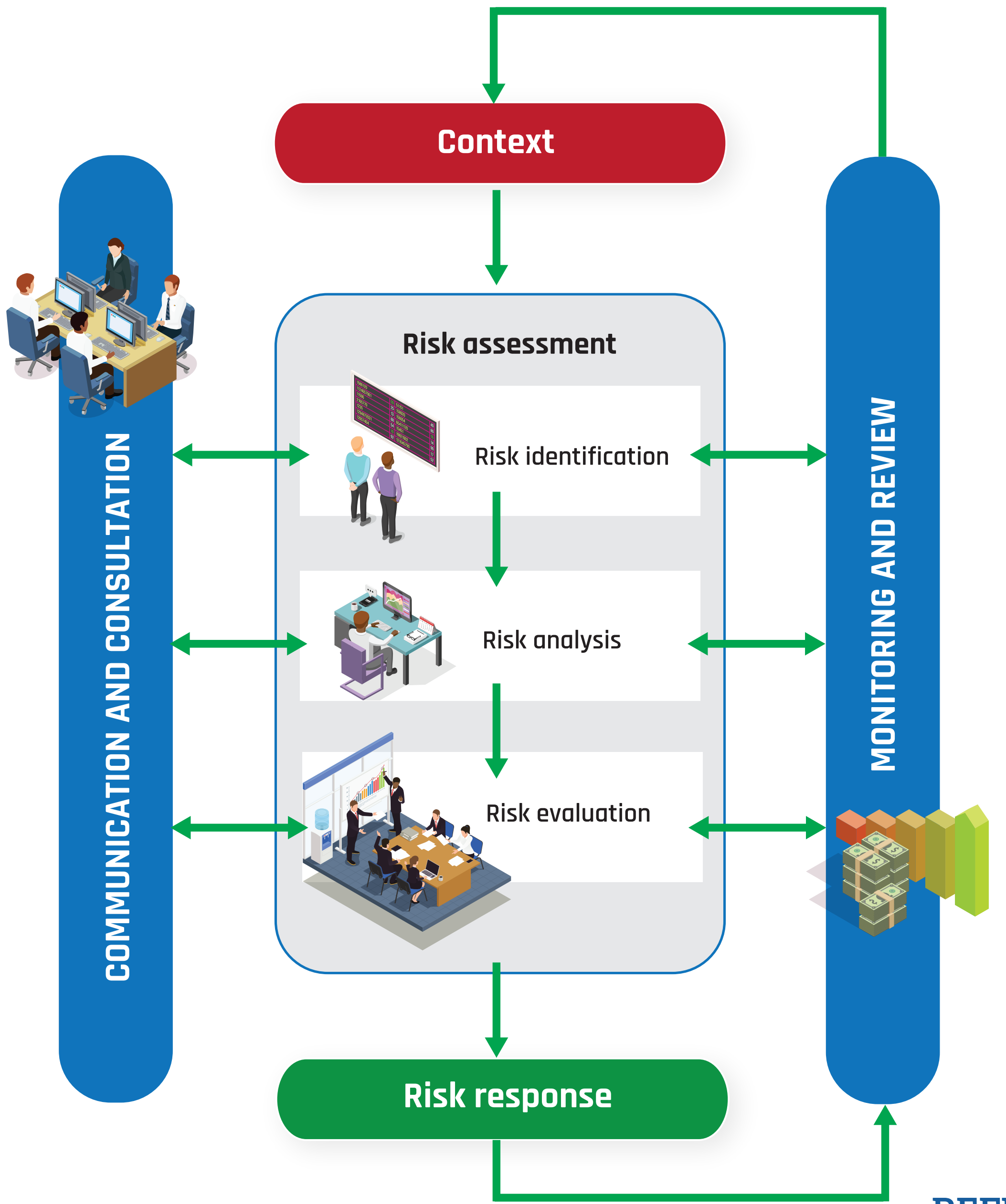
## RISK MANAGEMENT SHOULD BE ONGOING

Successful risk management requires that the foundation, components and arrangements within which risk management is undertaken, are institutionalised within the organisation and adhered to by the entire workforce, including non-managerial staff.
The infographics below provide a high-level overview of the design, implementation, review and improvement of the risk management framework, as well as the various steps of the risk management process, which need to be referred to on a continuous basis.

### CONTINUAL IMPROVEMENT OF RISK MANAGEMENT FRAMEWORK




### RISK MANAGEMENT PROCESS




**REFERENCE:**

The IRMSA Guideline to Risk Management
Available at: https://www.irmsa.org.za/page/practise


# RISK MANAGEMENT PROCESS STEPS

## overview

**This article provides an overview of some of the key steps that a retirement fund can take in determining its risk exposure in order to develop its risk management process as part of its risk management framework.**

"The final component of developing or enhancing the risk management framework is to apply the organisation's risk management process. This will identify the various risks that the organisation must address, and allows the executive leadership team to establish the appropriate internal risk parameters the organisation should follow." – IRMSA Guideline to Risk Management.

Not all risks carry the same rewards, while the negative outcomes of certain risks can outweigh others. Thus, an important component of risk management for a retirement fund is outlining a clear risk management process. This involves determining a fund's propensity for risk that, if not appropriately managed, could be detrimental to the fund and its beneficiaries.

**DEFINING YOUR RISK UNIVERSE AND YOUR RISK APPETITE**

- **Your risk universe**

In order to manage the risks your retirement fund is exposed to, you need to know what they are. A good place to start is to define your risk universe and risk appetite. Your risk universe is a list of risks that the fund could encounter either internally, or within its external operating environment, along with a description of their materiality and frequency.

Since each organisation is unique and comes with its own operating context, so too will be its risk universe. Understanding your retirement fund and its stakeholders will help you define your risk universe. The risk universe needs to be revised regularly as time and circumstances change for the fund.

- **Your risk appetite**

As outlined in the IRMSA Guideline, an organisation's risk appetite reflects the level of risk it is willing to accept in all spheres in order to achieve its stated objectives.

Defining your retirement fund 's risk appetite can be done in one of two ways. The first is to decide on an acceptable level of risk for each type of risk. The second approach is to have the same limit for how much exposure to have on any risk. While the latter method has the benefit of being simple, it also minimises the potential gains from taking on a risk. The former method is more flexible and specific to the likelihood and impact of the risk.

It remains the responsibility of the highest level of management to determine the various levels of risk appetite within the limits of legal and regulatory requirements. (Read the article "Everything you do is risk management" on p.12 to p.14 of this publication for more information on the regulatory environment for South African retirement funds.)

**Risk universe:** the list of risks the company faces or might face, coupled with a description of their severity and frequency, along with the decision as to what the company wants to do with such risk.

**Materiality:** a concept or convention within auditing and accounting relating to the importance/significance of an amount, transaction, or discrepancy.

## Common risk-related information contained in a risk register

| Item | Description |
|---|---|
| **Risk description** | Describes the risk, its causes and impacts. |
| **Risk owner** | Describes who takes responsibility for a particular risk. This person should be equipped and have the knowledge to deal with the risk event, should it happen. |
| **Triggers** | Indicate that a risk is about to occur or has already occurred. |
| **Category** | Assigning each risk to a category allows the user to group them which, in turn, allows the user to analyse and respond to each group in an effective manner. |
| **Probability risk rating** | Determines the likelihood of each risk occurring. The higher the rating, the more likely the risk is to occur. |
| **Impact risk rating** | Used to quantify the materiality of the risk, i.e., the damage that could be caused, should the risk occur. |
| **Risk score** | The probability risk rating multiplied by the impact risk rating. |
| **Risk response strategies** | Prompts on how to handle each risk, should it occur. Common responses include: accept the risk, avoid the risk, mitigate the risk and transfer the risk. |
| **Risk response plan** | Determined by the risk owner and describes the actions to be taken immediately once a trigger is hit. |

**BUILDING AND USING YOUR RISK REGISTER**

Once the risk universe and appetite are defined, you will need to keep track of all your risk exposure. A good tool for doing this is a risk register. A risk register is a tool that organisations use to determine the potential risks to which they are susceptible. It is a handy way of keeping track of risks and the actions that can be taken to mitigate them. (See table above.)

**RISK TAKING AND DECISION-MAKING**

Once a retirement fund has identified the risks it faces, it will need to manage them and make decisions that will achieve its objectives.

While many steps can be taken to quantify risk and its likelihood of occurring, there is no sure-fire way of predicting all the possible outcomes that could come from taking it on. It thus becomes imperative to strike a balance between the risk you are taking on and its potential outcome. A good rule of thumb is not to take on a risk if the financial implications of doing so cannot be absorbed, regardless of the likelihood of its occurrence.

Understanding your retirement fund's profile and risk appetite and knowing the roles that each individual or functionary plays can also make a big difference in helping manage risk. Having support from fund executives or service providers who are experts in their fields can help minimise risk, as they will also use their expertise to help minimise your fund's risk exposure.

## BUILDING RESILIENCE IN YOUR RETIREMENT FUND

Some risks are unavoidable and some simply cannot be predicted. This is when it becomes important to ensure that your retirement fund is resilient and can withstand the effects of unforeseen circumstances.

Building a resilient retirement fund is a constant process that can be summarised in three steps:

- **Anticipate.** Be constantly aware of what is happening in your fund's environment and be prepared to act when necessary.
- **Adapt.** Be able to make decisions that allow for change when new information is presented or when the unexpected occurs.
- **Assess.** Constantly review your fund's progress and take key learnings from decisions made in the past and revise if necessary.

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Takalani Lukhaimane is manager in the Retirement Funds Conduct Supervision Department at the Financial Sector Conduct Authority

# 'EVERYTHING YOU DO IS RISK MANAGEMENT'

## overview

**We spoke to Takalani Lukhaimane, manager in the Retirement Funds Conduct Supervision Department at the Financial Sector Conduct Authority, about the importance of pension fund risk management and what needs to be done to ensure trustees are equipped to fulfil their fiduciary duty in this regard.**

When speaking to the Financial Sector Conduct Authority's (FSCA's) Takalani Lukhaimane about her department and its role of supervising South African pension funds, one thing becomes abundantly clear: risk management is not simply a tick-box exercise. It's a continual process that needs to form part of a retirement fund's daily operations – and trustees need to have an understanding of risks that go beyond simply having a copy of their fund's risk management policy in their induction pack.

Lukhaimane has been a manager in the Pension Funds Department of the Financial Services Board (FSB), now the Financial Sector Conduct Authority (FSCA), since 2006. She is currently manager in the FSCA's Retirement Funds Conduct Supervision Department – formerly known as Pension Enforcement and Surveillance – which supervises retirement funds registered with the FSCA on an ongoing basis and, among other things, investigates complaints received about these funds.

In building a model for supervision, the FSCA has itself engaged in risk management for a long time throughout the organisation, according to Lukhaimane. She adds that this is also an international practice, followed by international regulators who the FSCA looks to for trends and processes.

"At the FSCA – as was the case with the FSB – we use risk-based supervision. We identify risks faced by the industry. We consider which funds we would perhaps deem high risk, based on whether there were early warning systems from their financial statements that came through; were issues identified in that regard? Or risks based on their size, using impact and probability models; if something were to happen to, say, the top ten retirement funds in the industry, what would the impact be on our financial sector?"

In its role of supervising retirement funds, the conduct supervision department is separated into a few teams, explains Lukhaimane. These are: a team that engages with the Top 200 retirement funds on a regular basis, conducting ongoing supervision of these funds; a recently established team that conducts dedicated supervision of distressed entities; and Lukhaimane's own team that focuses on high-risk funds.

In dealing with specific complaints that are filtered through to her team, Lukhaimane explains that "they will work by looking at what trends are coming through from the pension funds adjudicator's office regarding those complaints. We also liaise with other departments – such as the team that deals with the benefit administrator – to check whether they are experiencing specific issues."

"We try to identify the risk, isolate it and treat it. We look systematically at what is going on with a specific fund that complaints are being received about." She does point out that although this process can exasperate some funds – due to the back and forth – conducting this process in "smaller chunks" allows the team to expand on the level of detail for information requests and allows for more time to deal with that specific issue, so that the fund can ultimately ensure it has the right processes in place

**"[Your risk management] policy is not a document that you look at once a year when you are reviewing it. It's meant to be a living document you refer to all the time because that always links you back to your objectives..."**

### IDENTIFYING TRUSTEE-RELATED RISKS

When asked about some of the key themes identified via complaints that her team has dealt with, Lukhaimane explains that some of these complaints have indicated that trustees don't have enough training.

"That's why we issued the minimum requirements training standard in 2020. The six months in terms of implementation of that training has lapsed, so we are going to follow up on that training. As much as trustees have a right to get expert advice, it helps to know what questions to ask. This helps a lot because what we have always found distressing is this feeling that the industry runs the trustees, instead of the other way around. If we are ever going to change that in some form or fashion, then the trustees need to be able to manage better. There is no point in saying 'here are policies and service providers'. If you don't know which questions to ask, you really are on the backfoot."

**"I think that the industry needs to really focus on and do more risk management training. Incorporating that into trustees' work will then better equip them to understand why they are doing what they are doing."**

This lack of training can also lead to a deviation from a fund's policy. She points out that some trustees are unaware of the FSCA. In some cases, administrator staff are not even aware of the regulator. The effect of this is that when a new administrator staff member arrives, they aren't aware, for example, that there is a standard from the regulator stipulating what needs to be issued to a member in their benefits statement. The result is that the practice they have inherited on arrival is simply adopted – instead of them being informed at base level of why and how things need to be done.

"Unlike in the advisory and intermediary sectors, administrators do not have a minimum qualification requirement. So they do not have to pass any form of examination, for example. So when it comes to, say, calculating a late benefits payment and they are asked how they calculated it, the response is that they used the formula they received when they arrived. They don't know ***why*** the calculation is done in a particular way and they don't know which section of the [Pension Funds] Act to refer to in this regard."

"If [this understanding] is not even there at administration level, it's not going to exist at the top."

Her advice for trustees is to always ask why. "Someone will have to explain, for example, the section of the [Pension Funds] Act that answers the why and will provide you with understanding."

Lukhaimane also points to the issue of many trustees being conflicted in making decisions. Generally, she says, when conducting onsite visits, there will be a group of trustees that are aware of what is happening, but some trustees are simply "there".

"So, after an onsite visit, you would get one or two trustees emailing you saying that they were a bit uncomfortable with a particular decision, but didn't know what to say when the issue was being raised at a board meeting; they know something is wrong, but they don't know how to address it."

Again, that is why training is important, she emphasises. However, the FSCA has seen an uptake in protected disclosures, "which is fantastic," she says, because it points to the fact that trustees are proactively coming forward to disclose information about pending decisions that they are uncomfortable with.

"[As the regulator], you don't want to find out after the fact." She does note that should they look into the disclosure and find that there was no contravention of the Pension Funds Act, "then we will let it go. But it gives us the opportunity to ask all the relevant questions to ensure things are above board."

» Continues on p.14

> **“Look at your fund and ask: What could go wrong? And then what is required from you to prevent this from happening?”**

### TOOLS AND FRAMEWORKS TRUSTEES CAN ALIGN WITH TO IMPLEMENT RISK MANAGEMENT

In terms of setting up a risk management framework, we ask Lukhaimane if there are any resources that trustees can refer to to assist with identifying and establishing the risk management process.

A good place to start, she says, is the requirement from the FSCA that funds disclose and define financial risks in their financial statements. But, she adds, risk is not just limited to financial risk, it’s about governance risk as well.

“If the governance is not right, you are not going to get anything else right in terms of achieving what you are setting out to achieve.”

“As a trustee, start by looking at what you are doing. We can define risks by categories, such as market, strategic or operational risk. But, for instance, a trustee needs to break it down in relation to what they do. They know, for example, that certain things are delegated to the administrator. So go through the service level agreement [to get a better understanding]. For example: If contributions aren’t received on time, what is the risk that poses?”

> **“If the governance is not right, you are not going to get anything else right in terms of achieving what you are setting out to achieve.”**

“Look at your fund and ask: What could go wrong? And then what is required from you to prevent this from happening?”

Lukhaimane says that she would like to see more risk management training within the industry and have it be put at the forefront. From an FSCA perspective, legislation and tools are being issued due to the fact that the trustee conduct and governance department is working on a governance conduct standard.

“So they are also looking at the governance issues that they want funds to look at.”

### UNDERSTANDING RESPONSIBLE RISK MANAGEMENT

So, given some of the core issues around lack of trustee training, what can a brand new trustee, for example, do to equip themselves to understand responsible risk management?

Lukhaimane suggests PF Circular 130, which has a framework on risk management policy. The King Code [IV] Risk Governance: Principle 11 also sets out how risk management must form an integral part of a fund’s daily operations.

“[Your risk management] policy is not a document that you look at once a year when you are reviewing it. It’s meant to be a living document you refer to all the time because that always links you back to your objectives; why you are doing what you are doing; and what you are doing to make sure you can arrive there. So if you are saying you are implementing the rules, understand and set out what the risks are if you do not implement those rules.”

Importantly, she says, one shouldn’t look at risk management as a tick-box approach. Some funds that have never been visited by the FSCA, for example, will have a generic risk management document in place, which has been set up by the administrator for any type of fund, which is problematic. Upon interrogation of these risk management documents, the FSCA is finding that the risk allocation is not proportionate to what the matter actually is, explains Lukhaimane. These documents also make it clear that the risk management process is not understood either. In establishing a risk management framework, “you need to identify, assess, evaluate, and you need to then mitigate and make sure that controls are actually appropriate, and then determine what financial resources you are going to attach to manage those risks.”

“There really is a need to put trustees in a position where they look at everything that is happening in the fund in terms of risk management on a daily basis. Everything that you do is risk management,” reiterates Lukhaimane.

The FSCA has also conducted risk management training to determine what its objectives are as an organisation, she says. This has focused on assessing where they are in achieving those objectives; risks they have identified and how they will mitigate them.

“And, I think that the industry needs to really focus on and do more risk management training. Incorporating that into trustees’ work will then better equip them to understand why they are doing what they are doing.” ■

## Resources for trustees

- PF Circular 130 (PF130), which provides information on the good governance of retirement funds. PF130 can be accessed via this link: **https://bit.ly/3dZGtMi**
- King IV Principle 11 on risk governance, which states that the governing body should govern risk in a way that supports the organisation in setting and achieving its strategic objectives. The King IV Report on Corporate Governance for South Africa 2016 can be accessed here: **https://bit.ly/2QlgLtl**



# RESOURCES
# FOR FURTHER INFORMATION

**The primary objective of retirement funds is first and foremost to protect members and beneficiaries; and a fund’s board of trustees has a fiduciary duty to act diligently in the interest of the fund, with loyalty and duty of care. Risk management forms an integral part of the oversight and governance of a retirement fund. Below we share some resources that relate to overall risk management best practice, as well as specific regulatory requirements that a board of trustees should be cognisant.**

### REGULATION 28 OF THE PENSION FUNDS ACT

The South African retirement industry has regulatory standards, in the form of Regulation 28 of the Pension Funds Act, that aim to ensure a high level of governance on retirement fund boards. “[The] aim of retirement fund investment regulation is to ensure that the savings South Africans contribute towards their retirement is invested in a prudent manner that not only protects the retirement fund member, but is channelled in ways that achieve economic development and growth”.

Some of the principles in Regulation 28 include:

- Promoting relevant trustee education;
- Monitoring compliance by the fund and its agents;
- Ensuring asset/liability matching by the fund;
- Performing appropriate due diligence on investments, making sure not to rely wholly on credit rating agencies for assessing credit risk;
- Taking into account the long-term sustainability of investments, in particular considering the impact of environmental, social and governance (ESG) factors.

These principles were included in Regulation 28 to strengthen the investment decision-making processes, and improve the transparency and accountability to a fund’s members and the Registrar to ensure that a board is equipped to perform its fiduciary duty.


### THE IRMSA GUIDELINE TO RISK MANAGEMENT

Risk management is integral to any entity. The Institute of Risk Management South Africa (IRMSA)’s Guideline to Risk Management provides the governing bodies of organisations – such as a retirement fund’s board of trustees – with insight into the various activities of risk management, in particular the development of a risk management framework and the process of risk management.

“This guideline recognises the importance of the proper management of risk in any organisation, and clearly specifies the recommended roles and responsibilities for risk management of the leadership function in an organisation.”

The cost of access to this guideline for non-IRMSA members is R250. Contact IRMSA directly for more information.

Visit: https://www.irmsa.org.za/

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**Please select the correct answer by marking the correct box below each question.**
**True or false? Retirement funds are only exposed to investment risks.**

☐ True
☒ False

**1. True or false?** Unsystemic risk represents external factors that impact all (or many) companies in an industry or group.

☐ True
☐ False

**2.Which of the below examples is NOT an example of systemic risk?**

☐ COVID-19
☐ The fund's investment policy statement (IPS)
☐ South Africa's gross domestic product (GDP)
☐ Inflation

**3.Fill in the missing word.** According to King IV, there are four governance outcomes that need to be achieved through ethical and effective leadership of an organisation's governing body, namely: ethical culture, good performance, effective control and _________.

**4.True or false?** Risk management need not be adhered to by non-managerial staff of an organisation.

☐ True
☐ False

**5.Name the section of the Pension Funds Act that states the following with regard to the primary role of a retirement fund trustee:** "[To] take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of the Pension Funds Act are protected at all times".

**6.True or false?** A successful risk management process is an ongoing process of continual review and improvement over time.

☐ True
☐ False

**7.Choose the correct answer.** IRMSA refers to the following organisation:

☐ Independent Retirement Managers of South Africa
☐ Institute of Risk Management South Africa
☐ Institute of Retirement Funds Mauritius

**8. A risk owner is someone best described as:**

☐ Someone like the fund's principal officer employed by the fund
☐ Someone who takes responsibility for a particular risk
☐ A service provider appointed by the fund

**9.Which risk tool is used to determine the potential risks to which an organisation is susceptible, and can be useful for keeping track of risks and the actions taken to mitigate them?**

☐ Risk index
☐ Risk management plan
☐ Risk register
☐ Risk toolkit

**10.Choose the correct answer.** Which King IV Principle provides risk governance guidelines for governing boards of organisations?

☐ Principle 8
☐ Principle 9
☐ Principle 10
☐ Principle 11