



**GUIDELINE:**

**RISK MANAGEMENT FOR PENSION PLANS**

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## GUIDELINE - RISK MANAGEMENT FOR PENSION PLANS

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### 1. INTRODUCTION

- 1.1 Risk management is the process of identifying, analyzing and managing the risks faced by an entity. The use of a risk management framework enables a registrant to employ a forward-looking approach which supports sound decision-making.
- 1.2 The Pensions (Superannuation Funds and Retirement Schemes) (Governance) Regulations, 2006 ("Governance Regulations") addresses the responsibilities and duties of trustees as it relates to the operation of approved superannuation funds ("funds") and approved retirement schemes ("schemes"). One such duty stipulated in Regulation 7(1)(v) of the Governance Regulations is that trustees are to ensure that written policies and procedures exist for the proper governance and management of a fund or scheme.
- 1.3 The Financial Services Commission ("FSC") posits that risk management is an important aspect of governance and specifies, within these guidelines, criteria that should be met in order to establish sound risk management practices. Further, the OECD Core Principles of Occupational Pension Regulation, 2016 provides that pension entities should have adequate control mechanisms in place to address investment, operational and governance risk, as well as internal reporting and auditing mechanism.
- 1.4 These guidelines are intended to provide best practice suggestions to trustees of funds and schemes regarding the:
  - a) Risk assessment cycle;
  - b) Minimum requirements of an effective risk management framework.

### 2. MINIMUM REQUIREMENTS OF A RISK MANAGEMENT FRAMEWORK

- 2.1 According to the Committee of Sponsoring Organizations of the Treadway Commission a risk management framework can be defined as the process designed to provide reasonable assurance regarding the achievement of objectives in terms of:
  - Effectiveness and efficiency of operations;
  - Reliability of financial reporting; and
  - Compliance with laws and regulations (as cited in Stewart, 2010, p. 2)<sup>1</sup>.
- 2.2 The risk management framework ("RMF") should be documented in a risk management policy and approved by the Board of Trustees ("BOT"). It should outline the context within which a fund's or scheme's exposure to risks are identified, measured, controlled, monitored and reviewed.
- 2.3 Stewart posits that a RMF for pension plans broadly consist of four main elements, namely (a) trustee oversight and culture (b) strategy and risk assessment (c) control systems and (d) information, reporting and communication as outlined below.

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<sup>1</sup> Stewart, F. (2010), "Pension Funds' Risk-Management Framework: Regulation and Supervisory Oversight", OECD Working Papers on Insurance and Private Pensions, No. 40, OECD publishing, © OECD. doi:10.1787/5kmlcz7qq3zx-en  
*Guideline for Risk Management for Pension Plans*

- **Trustee Oversight and Culture**

- (a) A BOT is responsible for establishing the RMF for a fund or scheme, inclusive of the risk management strategy and systems that will be utilized.
- (b) Trustees should ensure that a strong risk culture is established within the BOT and its agents and advisors. The development of a strong risk culture is accomplished through committed leadership, clear identification of responsibilities, and a continuous and comprehensive evaluation process.
- (c) The discussions, rationale and decisions made by a BOT regarding investments and risk management, as well as other governance issues, should be documented and maintained. This should include documentation of professional advice received from appointed agents such as the investment manager, legal counsel, actuary, auditor and administrator.
- (d) The RMF should be reviewed for effectiveness and adequacy at least annually and a record of the date of the reviews should be maintained.

- **Strategy and Risk Assessment**

- (a) A process should be implemented for identifying all material risks (includes operational<sup>2</sup> and investment<sup>3</sup> and governance risks) and assessing the likelihood and impact of each of those risks. The strategy should also outline the control mechanisms related to each risk and how they will be monitored.
- (b) The RMF should be proportionate to the size and complexity of the pension plan taking into consideration factors such as a plan's demography, solvency and design.

- **Control Systems**

- (a) Arrangements for ensuring that a fund or scheme is being managed in accordance with the Constitutive Documents, pensions legislation and best practice, as well as securing its assets, constitute its control system.
- (b) It is recommended that the BOT first establish their goals and objectives then undertake a risk assessment to identify the key risks associated with those functions and activities. Account should also be taken of the risk appetite and tolerance level, as well as the likelihood of a key risk materializing and the potential impact.
- (c) Appendix A provides examples of control procedures related to some key risks which may be identified by a BOT.

- **Information, Reporting and Communication**

- (a) A fund's or scheme's overall risk management strategy should address the provision of adequate, consistent, timely and reliable information regarding operational, financial, external market, and

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<sup>2</sup> Operational risks are those risks deriving from inadequate or failed internal processes, people, and systems or from external sources; for example, administrative errors, or loss of data due to computer failures/damage.

<sup>3</sup> Investment risks includes risk such as interest rate, credit, liquidity, and governance risks and typically may be outlined in the Statement of Investment Policy and Principles of a fund or scheme.

compliance data to the BOT on a regular basis. Information flow should also address reporting of a fund's or scheme's risks.

- (b) In relation to functions delegated by a BOT to an administrator or investment managers, the trustees should be provided, at a minimum, with information regarding the risk register, as well as emerging and realized risk events.
- (c) Before engaging an administrator and or investment manager, the trustees should make appropriate enquiries of these entities to ensure that the entity has appropriate control systems in place.
- (d) The trustees should also provide reports to the FSC as and when requested.

### **3. RISK ASSESSMENT CYCLE**

The below graphical presentation provides one approach to the risk assessment process with related details below.



#### **3.1 Identification and Classification of Risk**

- Identification of a fund's or scheme's risk should be based on an evaluation of its key goals or objectives and take into consideration any factor which may result in the plan's inability to adequately meet those targets.
- A risk register with all material risks including the risk description should be established and maintained by the trustees (See Appendix A for an example of a risk register).
- Trustees may adopt an appropriate classification of each risk identified.

#### **3.2 Risk Evaluation**

- Evaluation of risk involves an assessment of the probability and impact of a risk event occurring.

- In assessing probability, trustees should give consideration to the likelihood and frequency of the risk materializing, as well as when the event may occur. This will guide the level of urgency required in mitigating the risk event.
- Impact is the effect of a particular risk event occurring and where practical, the impact of different risks to which a fund or scheme is exposed may be quantified. It should be noted, however that the impact of some risks, such as those that are non-financial, may only be evaluated in qualitative terms.
- Trustees should consider developing a risk matrix to identify the materiality of risks illustrating the probability and impact of the risk event.

### **3.3 Risk Mitigation and Control**

- Once the risks have been identified and evaluated, it is necessary for the trustees to consider one of the following broad mitigation responses:
  - *Avoidance* – this involves the prevention of the risk or implementing countermeasures which eliminate the impact on the fund or scheme.
  - *Reduction* - this involves the implementation of measures designed to reduce the impact on the fund or scheme or reducing the likelihood of occurrence.
  - *Transference* - involves passing on part or all of a risk, to which a fund or scheme is exposed, to a third party via, for instance, an insurance policy or penalty clause for a service provider.
  - *Acceptance* –This method is typically used where the cost of prevention, limitation or transfer may outweigh the risk itself. Periodic reviews should be carried out to make certain that the risk does not escalate to unacceptable levels.
- In general, trustees should conduct the necessary due diligence to determine whether it can rely on the risk control measures in place by their service providers. (See Appendix A for additional examples of risk controls a pension plan may employ).
- Implementation of Responses: Trustees should ensure that a fund or scheme has the necessary financial, human and technical resources to satisfactorily implement the appropriate mitigation activities. The risk mitigation method should be clearly outlined, stating precise deliverables in the risk register, including the owner<sup>4</sup> and timelines or frequency, where applicable.

### **3.4 Monitoring and Reporting**

- (a) Risk monitoring involves tracking the implementation and effectiveness of controls and the RMF as a whole. This includes detecting residual and new risks.
- (b) Trustees should ensure they receive adequate and timely reports on risk incidents. This should include information on the cause with the aim of identifying the drivers of risk, so that decisions can be taken to enhance mitigation, where possible.

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<sup>4</sup> Individuals who will be assigned the responsibilities of monitoring each risk and is accountable for executing the controls agreed upon.

- (c) A mechanism should be established by a BOT to regularly review and assess the reports provided by their service providers such as the plan's actuary, auditor, consultants, administrator and investment manager.
- (d) In instructing the actuary to prepare the actuarial valuation report consideration should be given to requesting information that will be key in understanding and evaluating the fund or scheme; such as, stochastic and stress-testing to assess the pension plan's resilience to shocks. Consideration should also be given to requesting information on the maturity profile of the members' liability, as well as the appropriateness of asset liability matching profile of the fund.
- (e) A BOT should utilize reports received from its regulators to inform the development and monitoring of its RMF.

**Questions regarding this Guideline may be directed to:**

**Senior Director, Pensions  
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39-43 Barbados Avenue  
Kingston 5  
Telephone (876) 906-3010  
Facsimile (876) 906-3018  
Email: [pensions@fscjamaica.org](mailto:pensions@fscjamaica.org)**

**Appendix A**

**Illustrative Risk Register**

Goals	Risk Description	Risk Level	Control	Frequency or timeline	Owner	Review Status
Ensuring compliance with pension legislation and the Constitutive Documents	Failure to comply with pension legislation and the Constitutive Documents	High	Establish a mechanism where all trustees are alerted whenever there are any changes to pension law and other legal issues that might impact the fund or scheme.  Undertake Trustee training on compliance requirements for pension funds.	On-going  Semi Annually	BOT  BOT	
	Reports from agents are not adequate or received with sufficient lead time for timely submission of statutory filings	High	Compliance reports from service providers.	Quarterly	BOT	
	Ineffective performance by designated agents	High	Ensure contracts, including service level standards, are in place for all BOT agents.  Conduct periodic performance reviews which should be documented.	December 31, 2019 and thereafter, on appointment  Annually	BOT  BOT	
Ensuring investment performance is in line with established targets	Investments are not adequately researched	High	Document in the SIPP the establish standards for research provided to the BOT  Conduct follow- up research on large investment exposures.	December 31, 2019  Annually	Investment Manager  Investment Manager	
	Reasonable targets are not established and tracked.	Moderate	Routine review of investment strategies and updating of the SIPP  Reports are submitted to the BOT on actual performance against established benchmarks and targets.	Annually  Quarterly	BOT  Investment Manager	

	Sponsor contributions are not paid into the fund accurately or in a timely manner	Moderate	Receive reports from the administrator on contribution reconciliation and compliance with payment timelines.  Sponsor is requested to provide payment plan, inclusive of interest accrued, where there are outstanding contributions	Quarterly  As required	Administrator  Sponsor	
	Trustees fail to approve investment recommendations in a timely manner	Moderate	An investment committee is established with clearly defined method for review of proposals and communication of decisions.  Trustees provide responses to investment proposals within 3 working days or otherwise as agreed	December 31, 2019  On-going	BOT  BOT	
Maintaining effective communication with stakeholders	Member complaints are not addressed adequately or in a timely manner.	High	Agents of trustees are required to present the complaints' register to the BOT.  Ensure members are apprised of the complaints' resolution policy.	Quarterly  Annually	Agents of Trustees  BOT	
	The sponsor is not adequately appraised of initiatives which would impact members	Low	Written update provided to sponsor on matters affecting the pension plan, members and the sponsor.	Quarterly	BOT	
	Members are not adequately appraised of the activities of the fund	Low	Automatically dispatch annual report to all active members of the fund, pensioners and deferred pensioners with email contact on record.  Hold a members' meeting or provide a members' newsletter on pertinent matters	Annually  Annually	BOT  BOT	
Securing and maintaining accurate records	Trustee decisions and minutes of meetings are not recorded and maintained	Moderate	Minutes of each meeting are recorded, circulated to the BOT within three (3) weeks of the date of the meeting and confirmed by the BOT.  Minutes are stored in hard copy and scanned copies are maintained including back-up copies at a remote location.	On-going  On-going	BOT  BOT	
	Incorrect data is submitted to	Moderate	Establish list of assigned personnel who may	On-going	Sponsor/HRD	



	the administrator to update member accounts		provide instructions to update member records.  Provide training assigned personnel of the sponsor who interface with members on pension related issues.  Reports are submitted to the BOT on the total number of members in each category of membership as well as changes recorded and members due to retire or receive unclaimed benefits	Annually  Quarterly	Administrator  Administrator	
Providing for accurate and timely benefit payments	Miscommunication or misunderstanding of processes leads to delays in benefit payments	Moderate	The Human Resource team and members are appraised of the requirements and processes of benefit payments	Annually	Administrator and HRD	
	Assets are illiquid resulting in delay in benefit payments	Low	The investment manager provides an asset liability matching report and liquidity statement to the BOT.	Annually	Investment Manager	

Risk Level Matrix

		Impact		
		Negligible	Moderate	Significant
Likelihood	Certain	Medium	High	High
	Likely	Low	Medium	High
	Unlikely	Low	Low	Medium