

Governance Survey

Insights into the governance of Irish defined benefit pension schemes

November 2015

Errors in the sinking of the Titanic

1. Conflicts of interest
2. Confirmation bias
3. Poor documentation
4. Lack of training
5. Untested procedure
6. Outdated regulations
7. Overconfidence
8. No contingency planning

Purpose of the survey

1. Provide insight into pension scheme governance
2. Share best practice and areas for improvement
3. Understand industry attitudes and concerns

What did we want to find out?

- Who is driving key strategic decisions?
- Do scheme's have a robust long-term plan?
- Do schemes have the right controls in place?
- What analysis supports in assessment of risks?
- If we had more time, how would we use it?

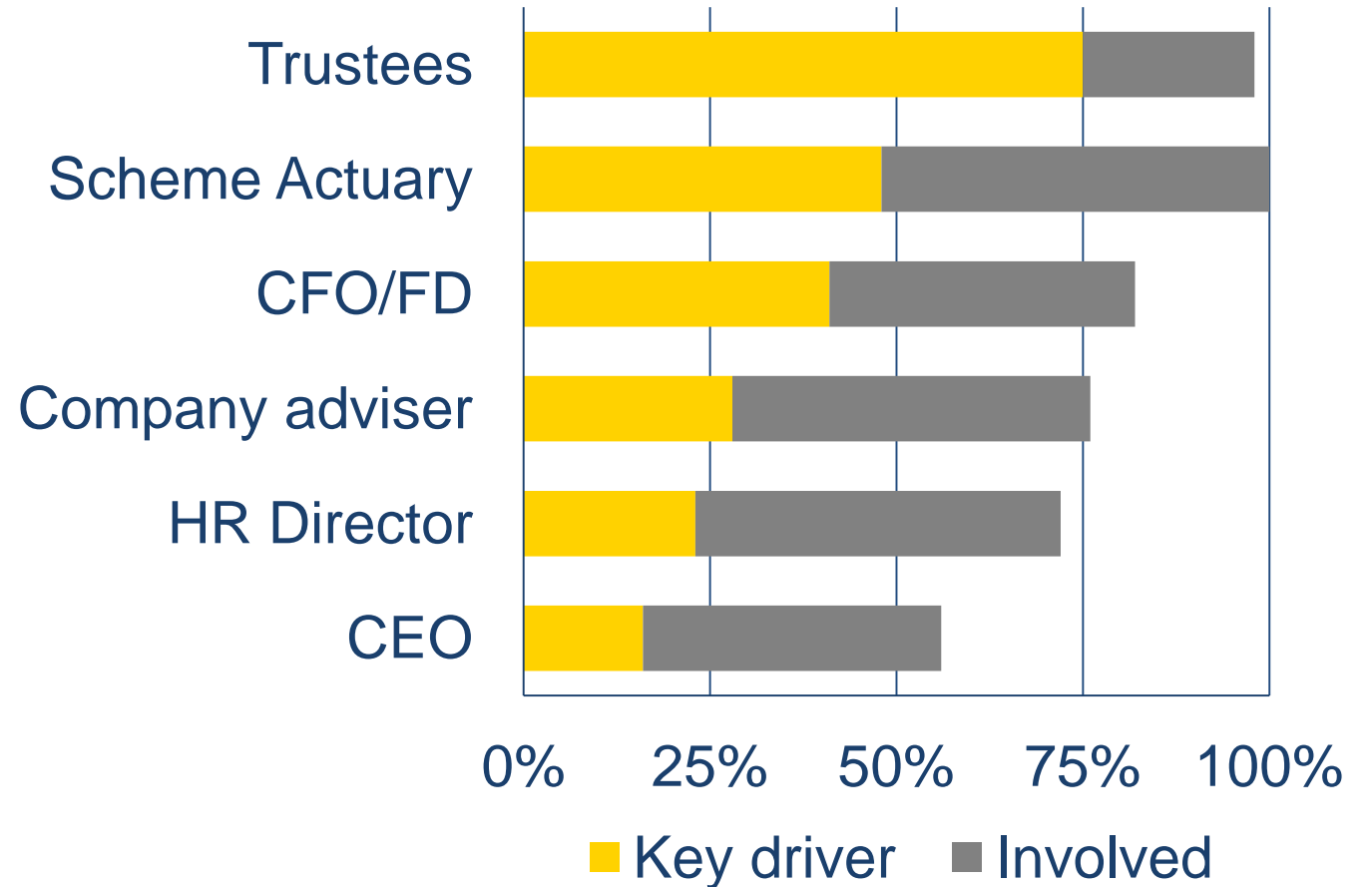


Strategic risk

The strategy setting process

- ▶ Trustees seen as the key driver for 75% of schemes
- ▶ Company representatives exert a strong influence (41% CFO and 23% HRD)
- ▶ The influence of company advisers is also apparent (from 28% of schemes)

In setting overall objectives, how involved are the following parties?



Delivering on scheme objectives

- ▶ Around 90% of schemes agreed on first two points
- ▶ Only 75% felt their goals were fully aligned with the wider business objectives
- ▶ Few schemes (only 25%) said goals enter into performance objectives

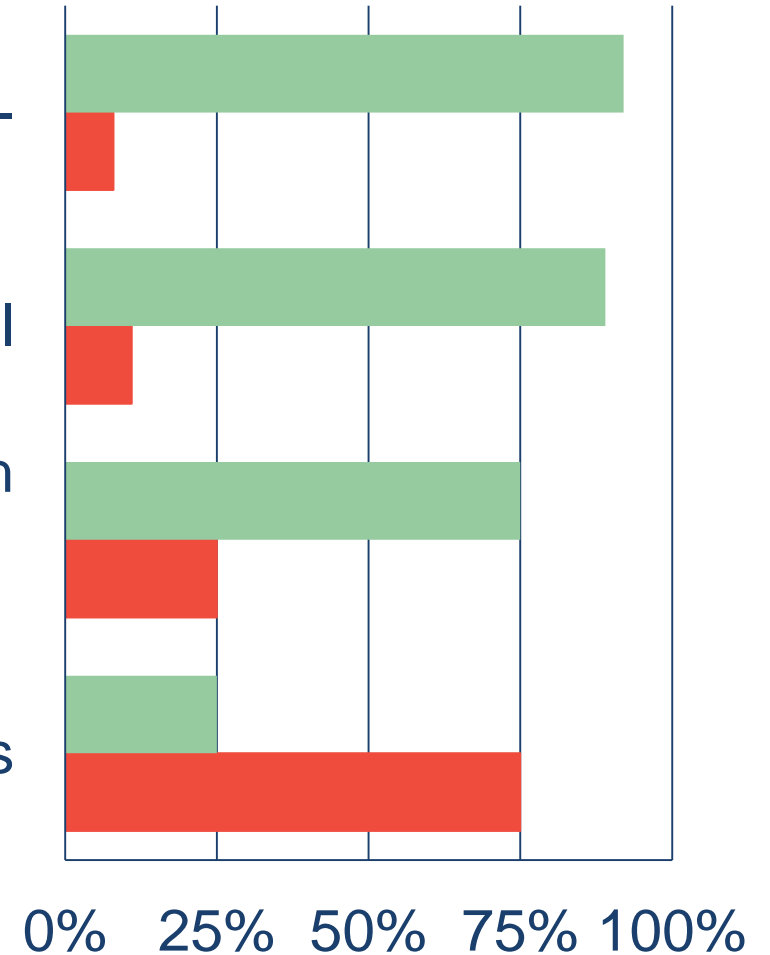
Our objectives for the scheme...

Contain a clear articulation of our long-term vision

Are effectively communicated to all relevant parties

Are fully aligned with wider business objectives

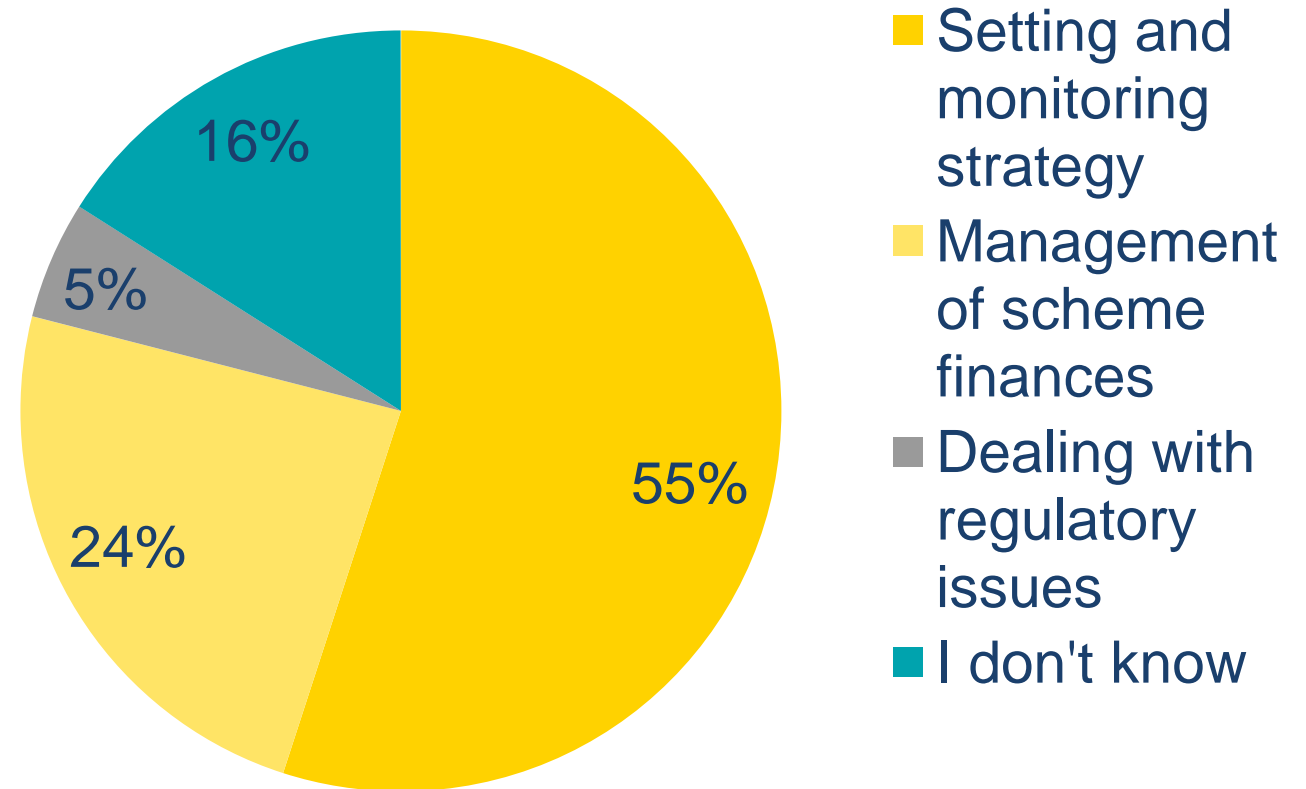
Enter into management's objectives



Time spent on risk management

- ▶ Currently, there is a broadly even split of time between areas set out
- ▶ If more time available, 55% would spend on strategy, and 24% would spend on scheme finances

If you had more time available, where could this best be spent?



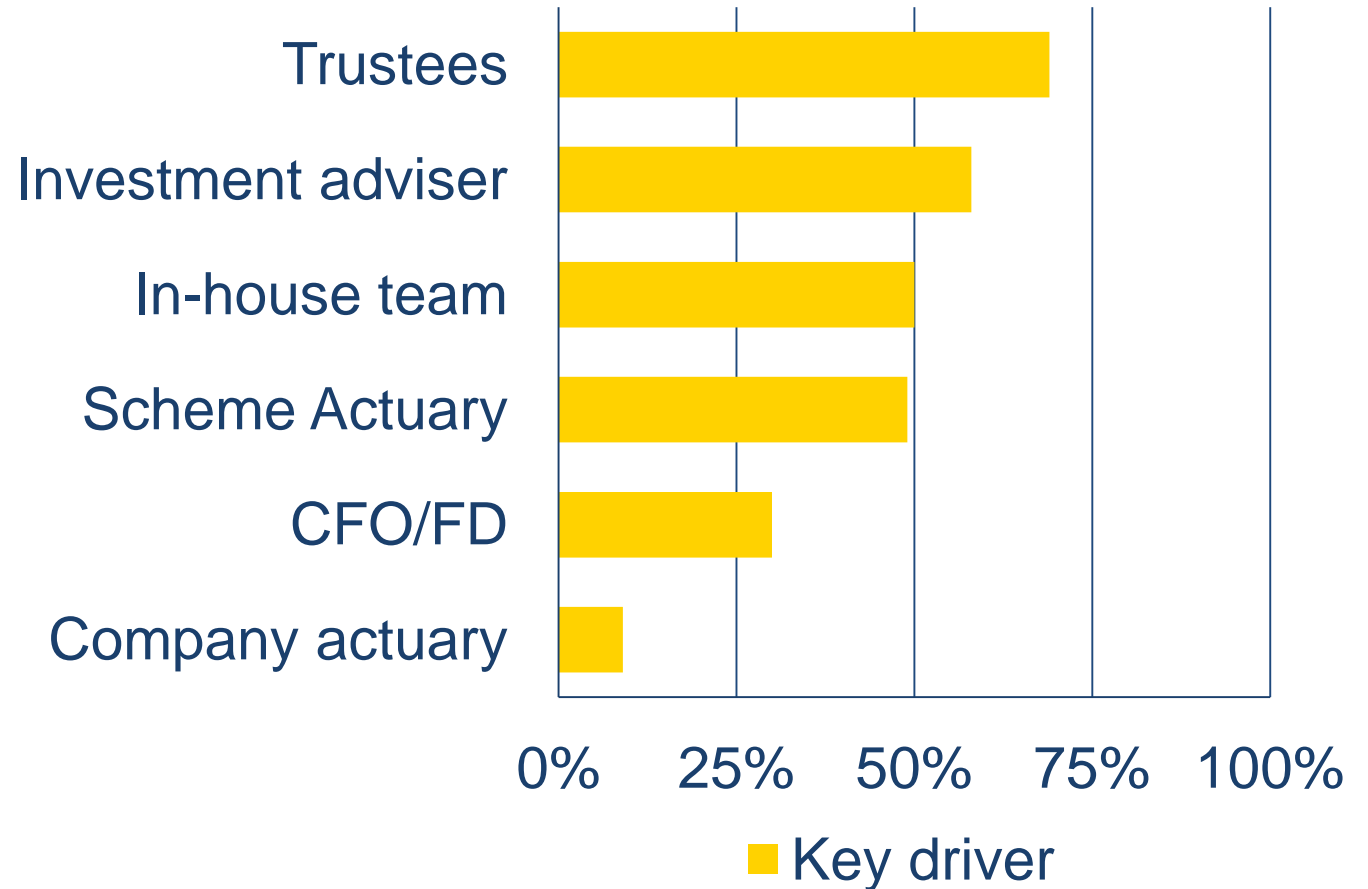


Financial risk

Setting investment strategy

- ▶ Trustees and investment adviser seen as a key drivers of investment strategy (69% and 58%)
- ▶ 30% listed the CFO as a key driver and 9% listed a company actuary

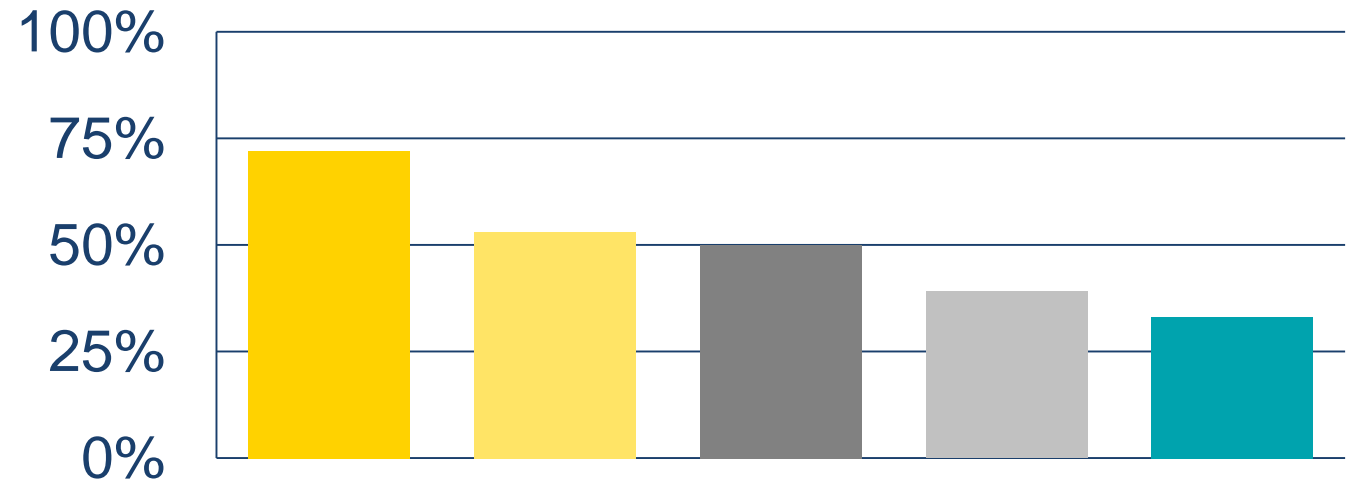
Which of the following parties are key drivers in setting investment strategy?



Modelling of investment risk

- ▶ Good progress made in understanding and analysing investment risk
- ▶ 72% of schemes now carry out stochastic modelling
- ▶ Both risk reserve and liability profile considered (over 50% of schemes)
- ▶ Fewer peer comparisons

What data and analysis underpin the scheme's asset allocation?

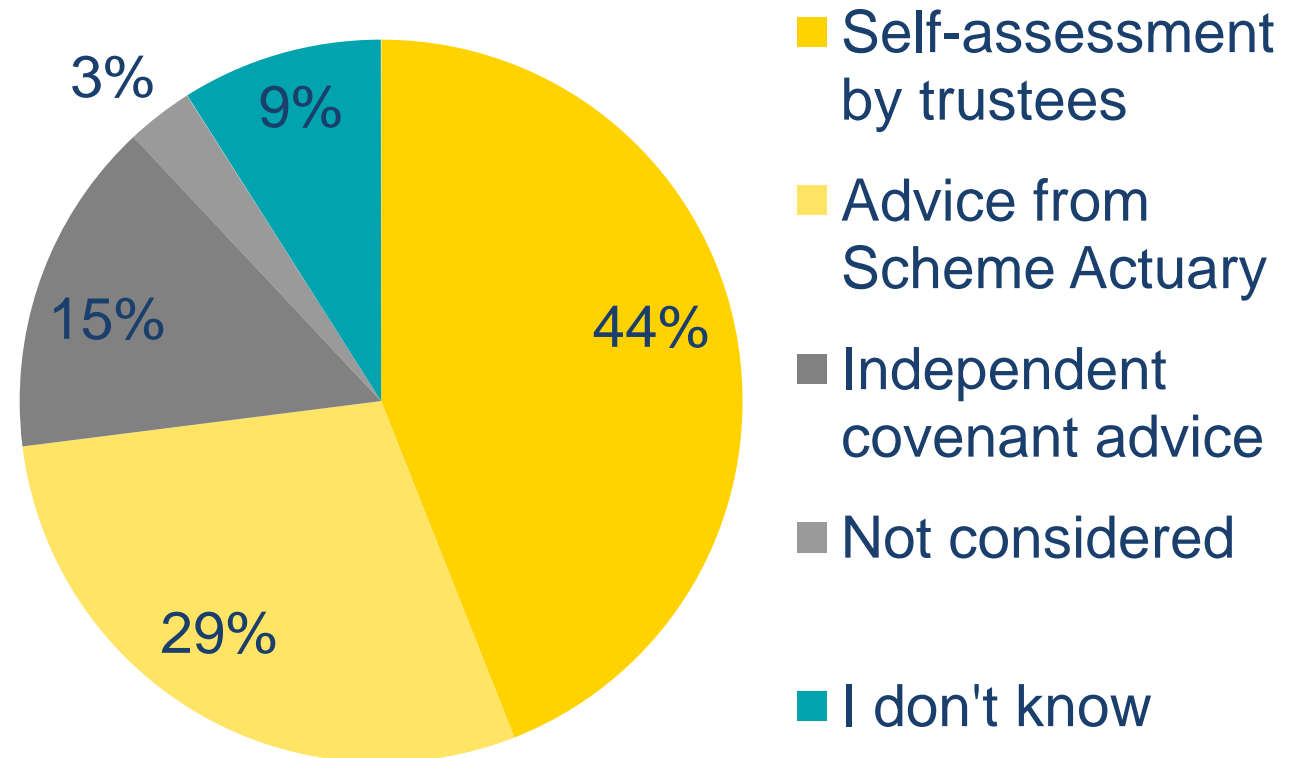


- Stochastic Asset Liability Modelling
- Analysis of impact on Risk Reserve
- Simple analysis of liability profile
- Deterministic analysis
- Peer group comparison

Forming a view on sponsor covenant

- ▶ Not a lot of independent covenant advice taken (only 15% of schemes)
- ▶ 44% said they use self-assessment by trustees
- ▶ 29% based view on advice from their Scheme Actuary

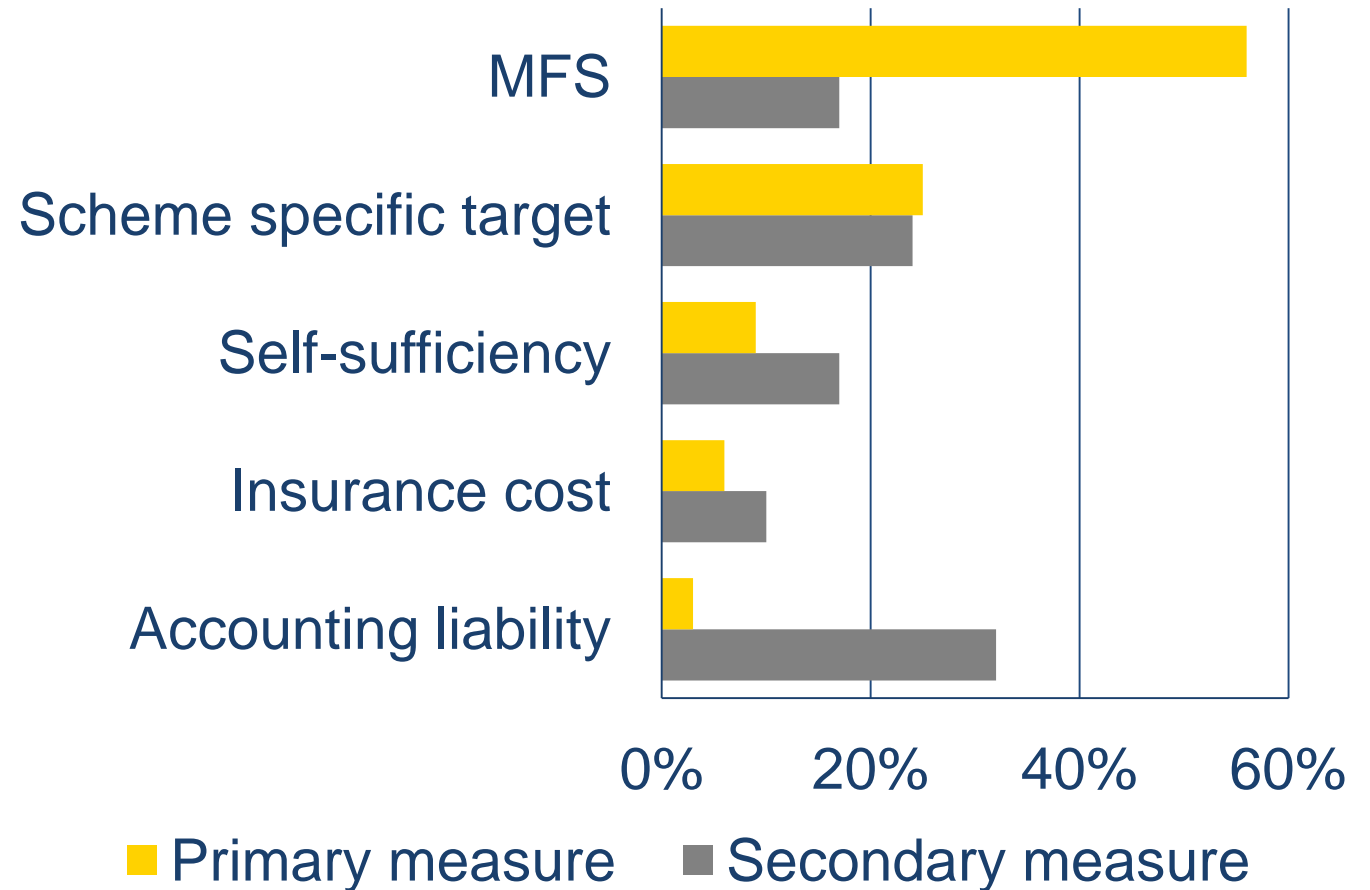
How do you form a view on sponsor covenant?



Making decisions on scheme funding

- ▶ Majority of schemes still focussed on MFS position
- ▶ 56% listed MFS as their primary funding measure
- ▶ Only 25% listed scheme target as primary measure
- ▶ Accounting liability seen as important secondary measure (32% schemes)

Which liability measure is the most relevant in scheme funding?



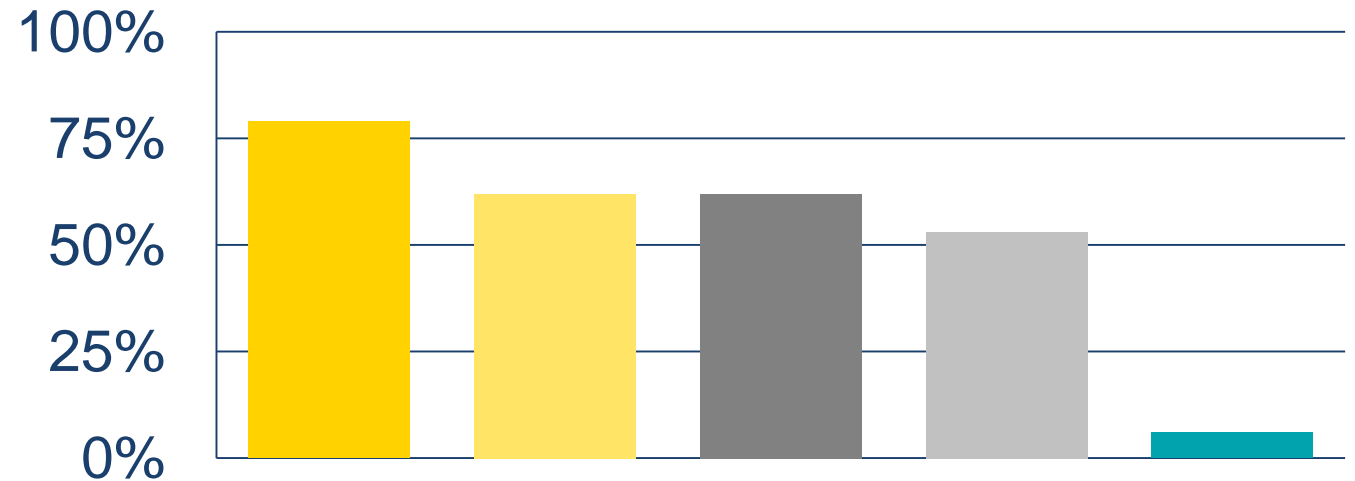


Operational risk

Quality of scheme membership data

- ▶ Majority of schemes feel their data quality is good
- ▶ Lack of clarity on all the data checks carried out
- ▶ Regular ongoing checks are happening but few schemes going beyond this

What checks were performed on the membership data in the last three years?

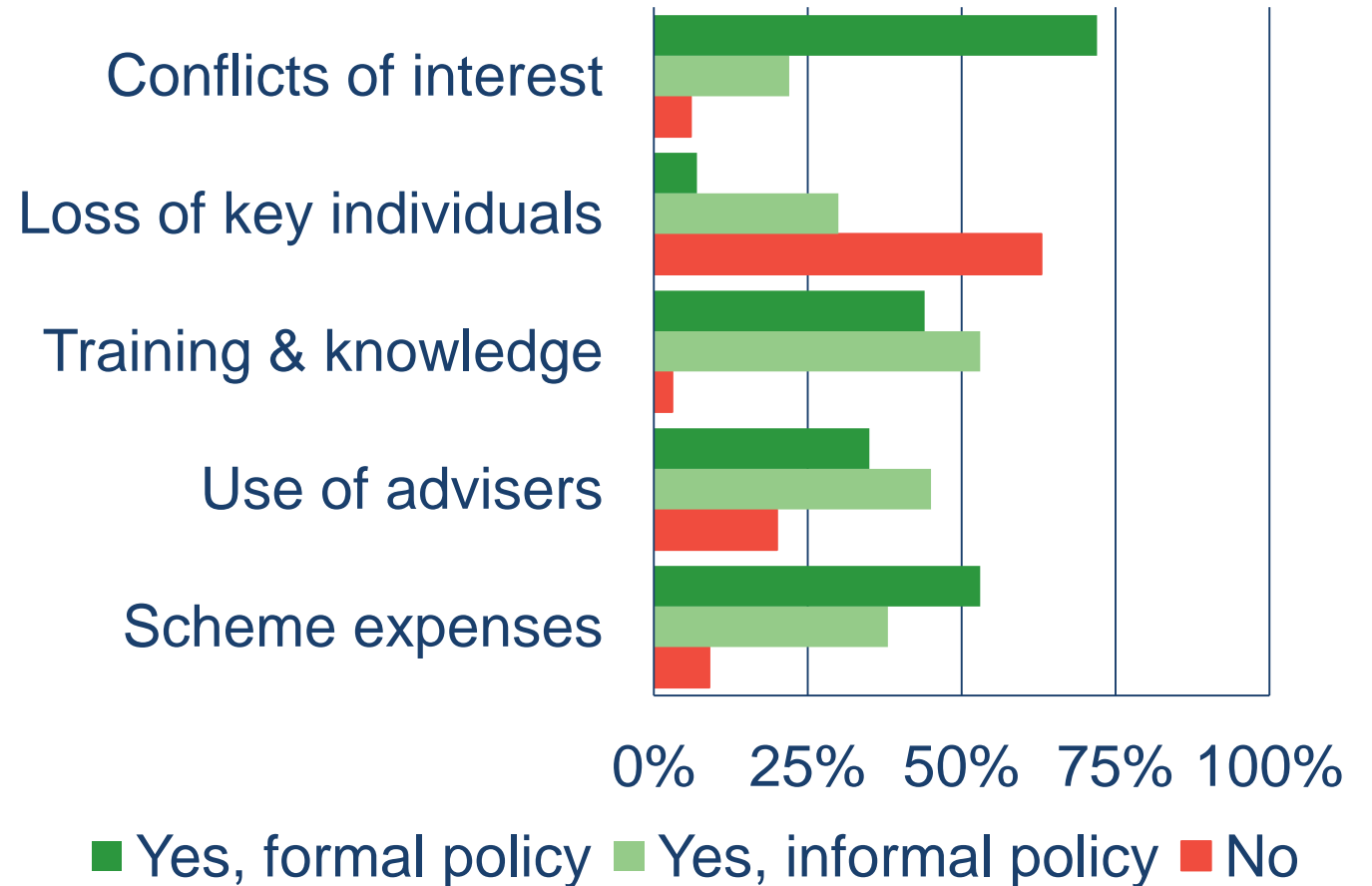


- Check against employer payroll data
- Checks by Scheme Actuary (valuation)
- Checks by scheme auditor (accounts)
- Checks against company annual report
- Independent review by third party

Review of scheme policies

- ▶ Most (72%) have a formal conflicts policy in place
- ▶ Majority (63%) no policy for loss of key individuals
- ▶ Majority (53%) organise training on informal basis
- ▶ More of these policies could be formalised

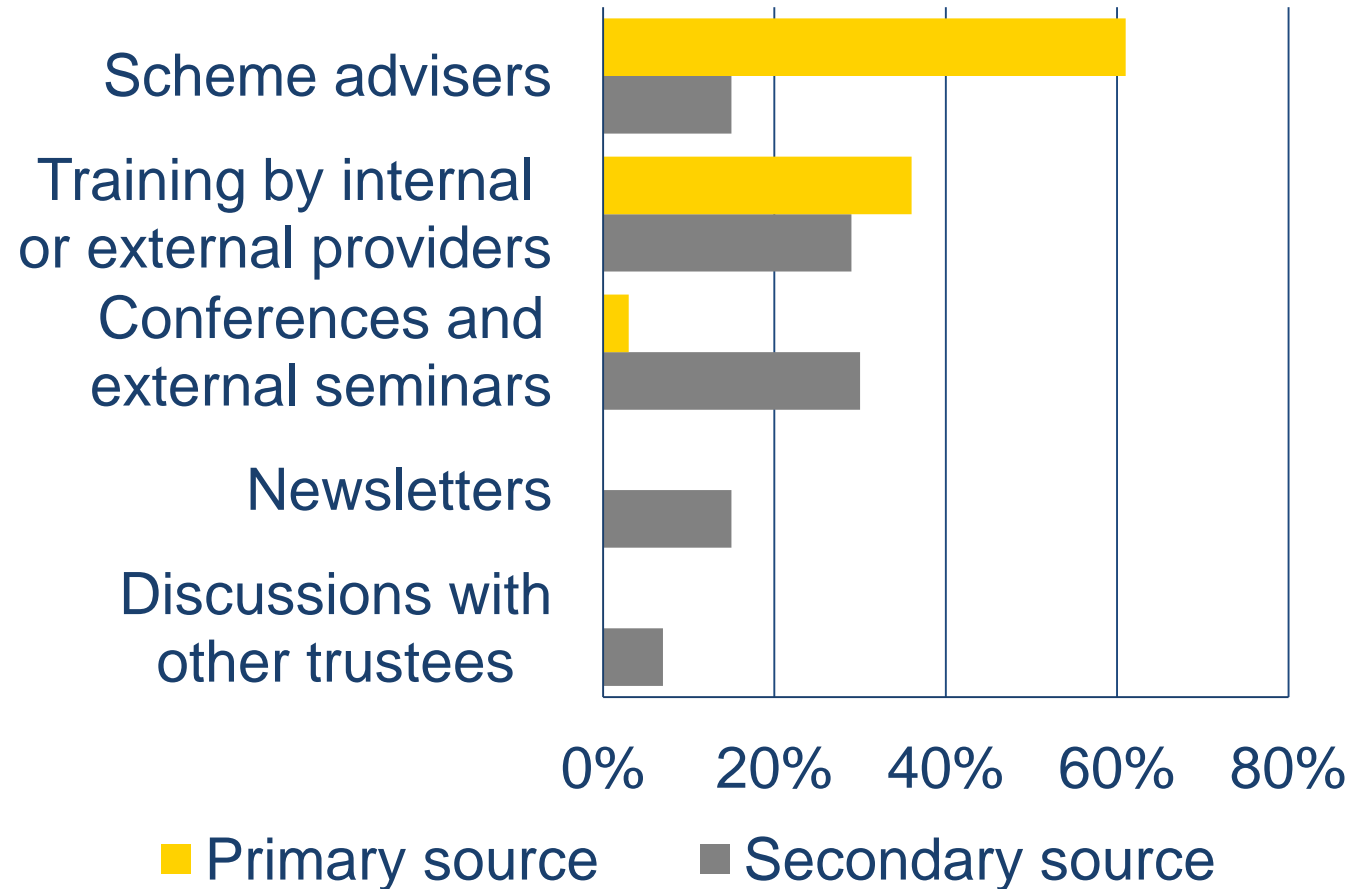
Does the scheme have a policy in place to deal with the following?



Trustee training sources

- ▶ Majority (61%) listed advisers as primary source
- ▶ Other main primary source was training by providers
- ▶ Top secondary source (30%) was conferences and external seminars

What are the top sources for keeping skills and knowledge up-to-date?





Final thoughts

Bringing it all together

1. Developing a strategy

- ▶ Consult all stakeholders
- ▶ Avoid a narrow frame

2. Controls framework

- ▶ Committees and structures
- ▶ Policies
- ▶ Documentation

3. Coping with uncertainty

- ▶ Plan for contingencies
- ▶ Use modelling effectively
- ▶ Reality-test assumptions

The strategy setting process

For many companies, defined benefit schemes represent a major risk for the business, and it is important that these risks are driving the management of these risks. Survey results show that the majority of pension schemes (63% of respondents) see the company and trustees as taking the lead on risk management. For 26% of schemes, it is trustees alone who take the lead, and for 11% of schemes, the company who takes the lead, either through the trustee or at the board level. When it comes to setting aims and objectives for the pension scheme, the trustees are still seen as the key driver in around 63%. For many schemes, company representatives also have a strong influence on these aims and objectives, with 23% of CFOs/Finance Directors, 23% of HR Directors and 16% of CEOs being seen as key drivers in setting overall aims and objectives for the scheme. The use of separate company advisers is also apparent, with 28% of schemes listing a separate company adviser as a key driver in objective setting, providing balance to the advice often received on the trustee side.

Figure 1: Who takes the lead on the management of pension scheme risks?

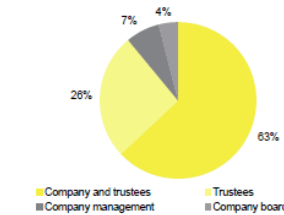
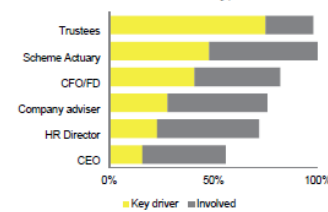


Figure 2: In setting overall objectives for the pension scheme, how involved are the following parties?



Modelling investment risk

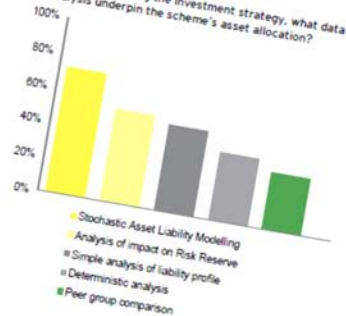
We were keen to find out what type of analysis was carried out by most schemes to understand and inform decisions on investment strategy. We asked respondents to tell us what data and analysis they relied on when setting the scheme's strategic asset allocation.

The chart opposite shows that most schemes in our study (72% of schemes) carried out a stochastic asset liability modelling exercise as part of their analysis, and this was supplemented by a range of additional analysis, and this included the impact of the Risk Reserve, and 50% looking at the scheme's liability profile and its expected evolution over time. A smaller number of schemes, around one third of schemes, said they also made comparisons with peer groups when setting the investment strategy.

We would expect a range of different approaches to be taken depending on the different risk profiles of the schemes supporting businesses. These results represent a good distribution, and show a good blend of approaches taken to understand and analyse investment risk.

Key insight: As schemes move towards understanding investment risk, and the relationship between asset and liability risks, and the impact of the Risk Reserve, the study is the gold-standard, an asset liability modelling exercise is the gold-standard. Most schemes in our study already engage in this kind of analysis, and stochastic approaches are fast becoming the norm - even at the smaller end of the market now carry out this analysis on a regular basis. We expect this upward trend towards stochastic approaches to continue, supported, where reasonable, by the use of some deterministic analysis. At the same time, we expect comparisons with industry peers to decline.



Figure 8: When setting the investment strategy, what data and analysis underpin the scheme's asset allocation?



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