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RETHINKING PENSION REGULATION AND SUPERVISION: TOWARDS A RISK-BASED APPROACH

“...this involves a transition from checking detailed compliance requirements to reviewing the internal decision-making processes and bodies of funds.”

Pension Funds’ Risk Management Framework:
Regulation and Supervisory Oversight
OECD, July 2009

Paris in Summertime

There was envy when we told people that we would be flying to Paris in early July. Indeed, we did have a brief chance to become a boulevardier sipping a glass of wine near La Tour Eiffel on a brilliant sunny day. However, the main mission of the trip was somewhat less glamorous. It was to participate in a Workshop on risk management organized jointly by The Organization for Economic Co-operation and Development (OECD) Working Party on Private Pensions, the International Organization of Pension Supervisors (IOPS), and the Rotman International Centre for Pension Management (ICPM).

The pre-work for the Workshop was to read a new OECD paper on pension fund risk management authored by Fiona Stewart especially for the occasion (see a quote from the paper above). The purpose of the paper was to propose a risk management framework “which pension funds should employ, and provide guidance for pension fund supervisors on how to check that such systems are not only in place, but are operating effectively.” The purpose of the Workshop was to explore the implications of the paper for pension fund managers and supervisors alike. The purpose of this *Letter* is to report on these deliberations and summarize the conclusions (at least, our view of them) that resulted.

The Four Elements of an Effective Risk-Management Framework

As the above quote suggests, the essence of any risk-based supervision approach is to place the responsibility for risk management clearly on the shoulders of the pension fund supervisory board and management. The role of the supervisor is not to create such a system, but to ensure it exists and that it is being used effectively. In its preamble, the OECD paper pointed out that this regulatory philosophy is already in place in the banking and insurance sectors, and that the pensions sector has been moving in this direction for some time now. (As an aside, we would observe that an important contributor to the global financial crisis were widespread problems with risk management systems in the global financial sector, both on the institutional and supervision sides).

The OECD paper suggests an effective risk management system has four key elements:

1. **Management Oversight and Culture:** requires a clearly-articulated set of Supervisory Board responsibilities, which includes ensuring the existence of a risk management strategy and systems. Not only must these things exist, but they must be operating effectively as part of a strong risk management culture. An organization chart should indicate the allocation of