IOPS TOOLKIT RISK-BASED SUPERVISION

INTRODUCTION TO RISK-BASED SUPERVISION

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IOPS Toolkit for Risk-based Pensions Supervision

- Major IOPS project, based on standard-setting and research/policy work conducted by the IOPS (e.g.: IOPS Principles on Private Pension Supervision, IOPS Working Papers, www.iopsweb.org)
- Draws also on the work accomplished by other international organisations: OECD, IAIS, BCBS, IOSCO, EIOPA, etc.
- Launched in December 2010
- Web-site based project available on www.iopstoolkit.org
IOPS Toolkit: structure

Toolkit Modules and country case studies

• **Module 0**: Introduction to RBS: definition and reasons for adopting, how to apply RBS, challenges and lessons learn;

• **Module 1**: Preparation for RBS: preparing the legislative background, checking supervisory readiness/industry skills;

• **Module 2**: Quantitative Risk Assessment: quantitative tools for measuring risks in DC and DB and their integration into risk-assessment process;

• **Module 3**: Identifying risks: main areas of focus, individual/systemic risks;

• **Module 4**: Risks mitigants and risk scoring: assessing risk on net basis, weighting in risk scoring models and checking the consistency of scores;

• **Module 5**: Supervisory response matrix, communication and escalation of supervisory response;
IOPS Toolkit Modules

- **Module 1:** Preparation for RBS
  - Legislative background
  - Supervisory readiness
  - Industry skills and readiness

- **Module 2:** Quantitative assessment risk
  - Quantitative regulatory requirement
  - Integrating quantitative tools

- **Module 3:** Identifying risk
  - Risk focus
  - Individual entity risk
  - Systemic risk
  - Consistency of scores

- **Module 4:** Risk mitigants + scoring
  - Risk mitigants
  - Weighting
  - Escalation of response

- **Module 5:** Supervisory readiness
  - Supervisory response matrix
  - Communicate assessments

- **Introduction to RBS**
  - What is RBS?
  - Why adopt RBS?
  - RBS process
  - Challenges + lessons learnt
Toolkit’s case studies

- Models examples are completed by the case studies, presenting the experience of countries that have already adopted and implemented RBS to the pension sector
- Examples of Australia, Canada, Chile, Germany, Hungary, Kenya, Netherlands, South Africa, United Kingdom are available
- Ongoing work to update and complete case studies
- Our objective is to enlarge the country studies section of the Toolkit with new country experiences.
What is Risk-based Supervision?

- A structured approach focusing on identifying potential risks faced by pension funds and assessing the financial and operational factors in place to mitigate those risks. This process then allows the supervisory authority to direct its resources towards the issues and institutions which pose the greatest threat.

- Can be applied in many different ways
  - Quantitative measures of risk vs. qualitative judgement of risk management
  - Risk-scores for each entity vs. analysis of risks systemic to the pension system
  - Identify weak areas within a supervised entity vs. which institutions amongst thousands may pose the greatest threat

- Elements common to all RBS systems
  - Determine objectives of supervisory authority + greatest risks to these
  - Assess hazard or adverse events + likelihood of these occurring
  - Assign scores and/or ranks to firms or activities based on assessments
  - Link supervisory response to the risk scores assigned
Combine ‘risk’ and ‘rules’ based approach
Risk-based supervision for pensions

**THE BASIC RISK MANAGEMENT ARCHITECTURE**

**FOR THE INSTITUTION**
- Risk management strategies
- Board committees
- Risk management functions in the managerial structure
- Internal controls
- Reporting responsibilities

**FOR THE SUPERVISOR**
- Regulations, including minimum risk management standards
- Risk-based solvency rule
- Risk scoring model guiding supervisory actions
- Internal organization of the agency, with specialist risk units

**MARKET DISCIPLINE**
The contributions of the actuary, auditor, fund members, rating companies, and market analysts to sound risk management
## Risk-based Supervision DB vs. DC

<table>
<thead>
<tr>
<th>RBS DB</th>
<th>RBS DC</th>
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<tbody>
<tr>
<td>Focus on sponsor</td>
<td>Focus on individual members</td>
</tr>
<tr>
<td>Solvency and funding key issues</td>
<td>Focus on risk-management systems</td>
</tr>
<tr>
<td>Use of quantitative measurement tools</td>
<td>Qualitative measurement more appropriate</td>
</tr>
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Why adopt Risk-based supervision?

- To improve supervisory effectiveness and efficiency
- To address internal organisational concerns
- To adapt to changes in the overseen industry
- To gain legitimacy following supervisory failure
- To meet requirements imposed by legislation
- To adapt to the changing nature of financial risks themselves, as these become more complex and - with the growth of DC pension systems - are increasingly transferred to individuals
Risk-based Supervision Process

Risk focus

Risk factors
- Individual
- Systemic

Risk indicators
- Quantitative
- Qualitative

Risk mitigants

Risk weightings

Probability

Impact
Challenges

- Combining simplicity with complexity
- Knowledge and data
- Ensuring that assessments of firms are forward looking
- Going beyond the individual firm in assessing risk
- Structure and operation of internal risk governance processes
- Changing the culture to embed the risk based approach across the whole organization
- Managing blame
- Making resources follow risks
Lessons Learnt

- **Adaptation of Models** - consult widely but build your own/ flexibility, upgrades, pilot test
- **Application of Models** – know weaknesses / consider ‘tail risk’/ use with judgment
- **Data Collection** – plan properly/ use existing where possible/ collect electronically
- **Reorganisation of the Supervisory Body** – allow plenty of time
- **Staff** – train all on philosophy as well as process
- **Industry** – explain new approach and what is expected of them
- **Powers** – make sure sufficient data collection + enforcement powers
- **Risk-based solvency** – apply flexibly in volatile conditions / counter-cyclical
- **Systemic risk** – build into analysis
- **Think in terms of achievability** – target resources for maximum impact
- **It is worth doing**
IOPS Toolkit for Risk-based Supervision