



# *Challenges to introducing risk-based supervision*

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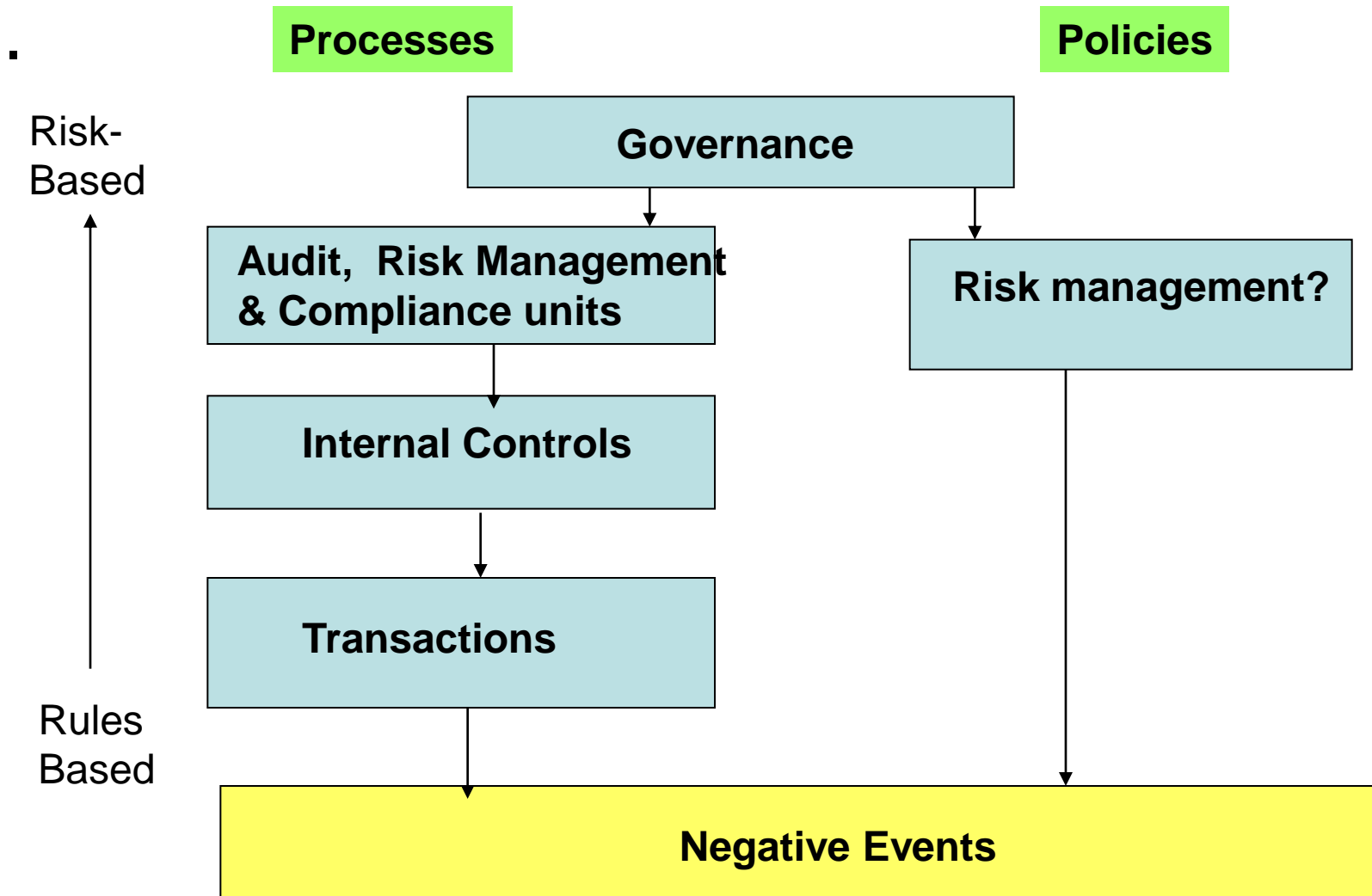
# Challenges to introducing risk-based supervision (RBS)

- Why try?
- The value chain for risk-based supervision
  - Obtaining information
  - Analysing risk
  - Strategies for responding to risk
  - Communicating the response
  - Verifying compliance
  - Enforcement
  - Organisation and resources
- A few concluding observations

# What is RBS trying to achieve

- Primary objective is to improve traction on the most serious risks, through intensive and focused supervision aimed at mitigating them
- To do this within constrained resources, the supervisor needs to free up resources currently applied to less serious risks,
- Especially by being able to place greater reliance on supervised entities to manage the risks themselves through taking structured assurance

# Moving up the levels



# Characteristics of serious risks

## Principal/agent mis-alignment

- Pension fund management represent interests other than members'
- Pension fund management indifferent to outcomes
- Interests of board and day-to-day managers differ

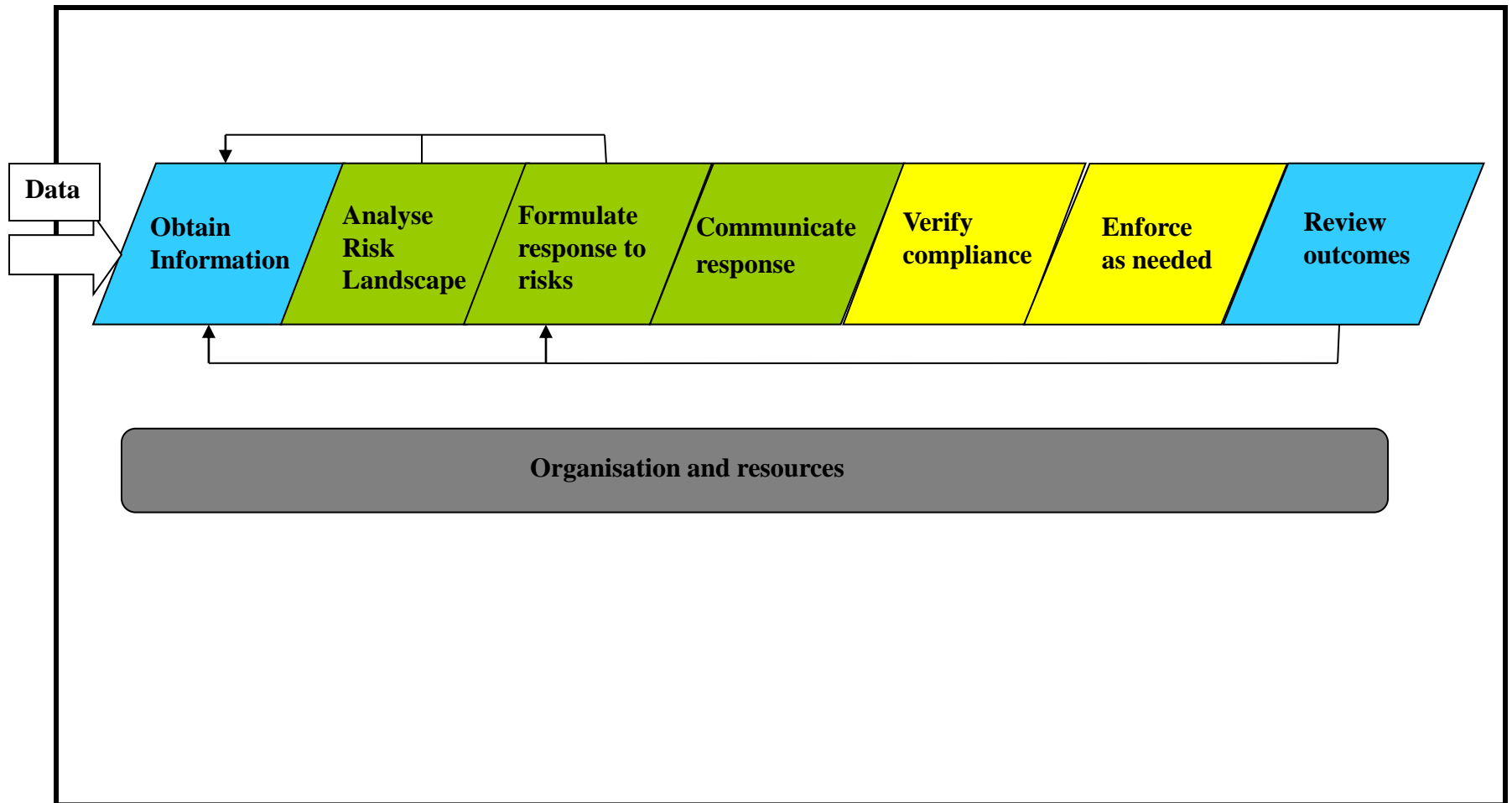
## Lack of transparency

- Performance or risks difficult to measure
- Long time horizons
- Informational asymmetry

# The supervisory authority therefore needs to

- Identify and focus on the biggest risks (not those easiest to supervise)
- re-orientate on-site supervision to seek assurance on governance, risk management and how assurance obtained that risks are being mitigated
- Implement a structured risk assessment methodology that drives prioritisation and response to problems
- Integrate off-site supervision with on-site, as the supplier of quantitative analysis
- Proportionately enforce regulatory principles so as to improve the assurance that can be taken

# Risk-based supervision Value Chain



# Obtain information

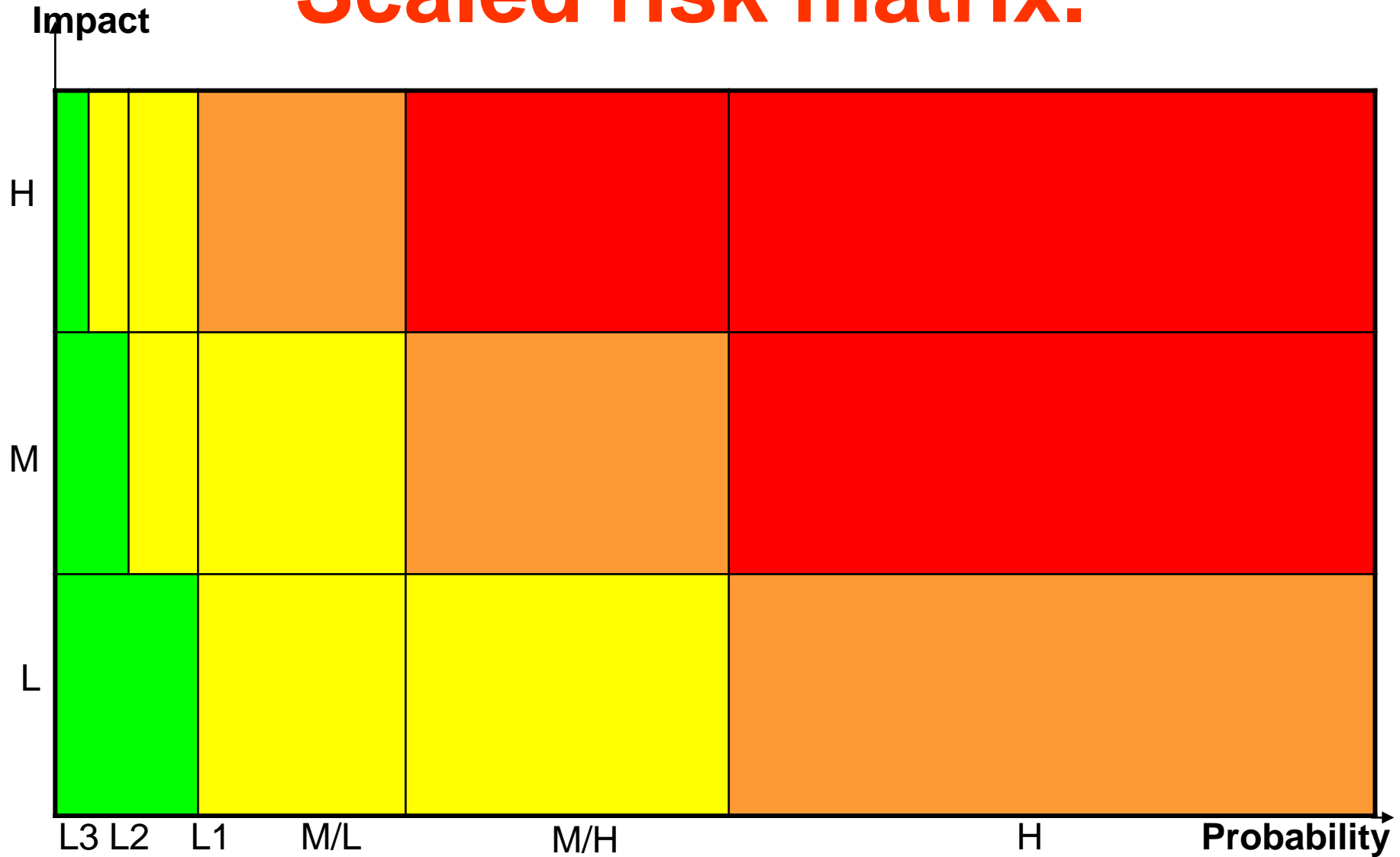
- Really the last step not the first - should be driven by what is needed for other steps
- May need to trade frequency for depth
- IT a challenge (but much can be achieved with Excel)



# Analyse risk

- Designing a jurisdiction-specific risk model is a challenge:
  - Information for assessing inherent risk may be missing or approximate (may not matter)
  - Transformation matrices can lead to disproportionate complexity
  - Residual risk has to be given meaning
- Co-ordinating risk analysis/ identification across an organisation is also a challenge
  - needs a central function or committee

# Scaled risk matrix.

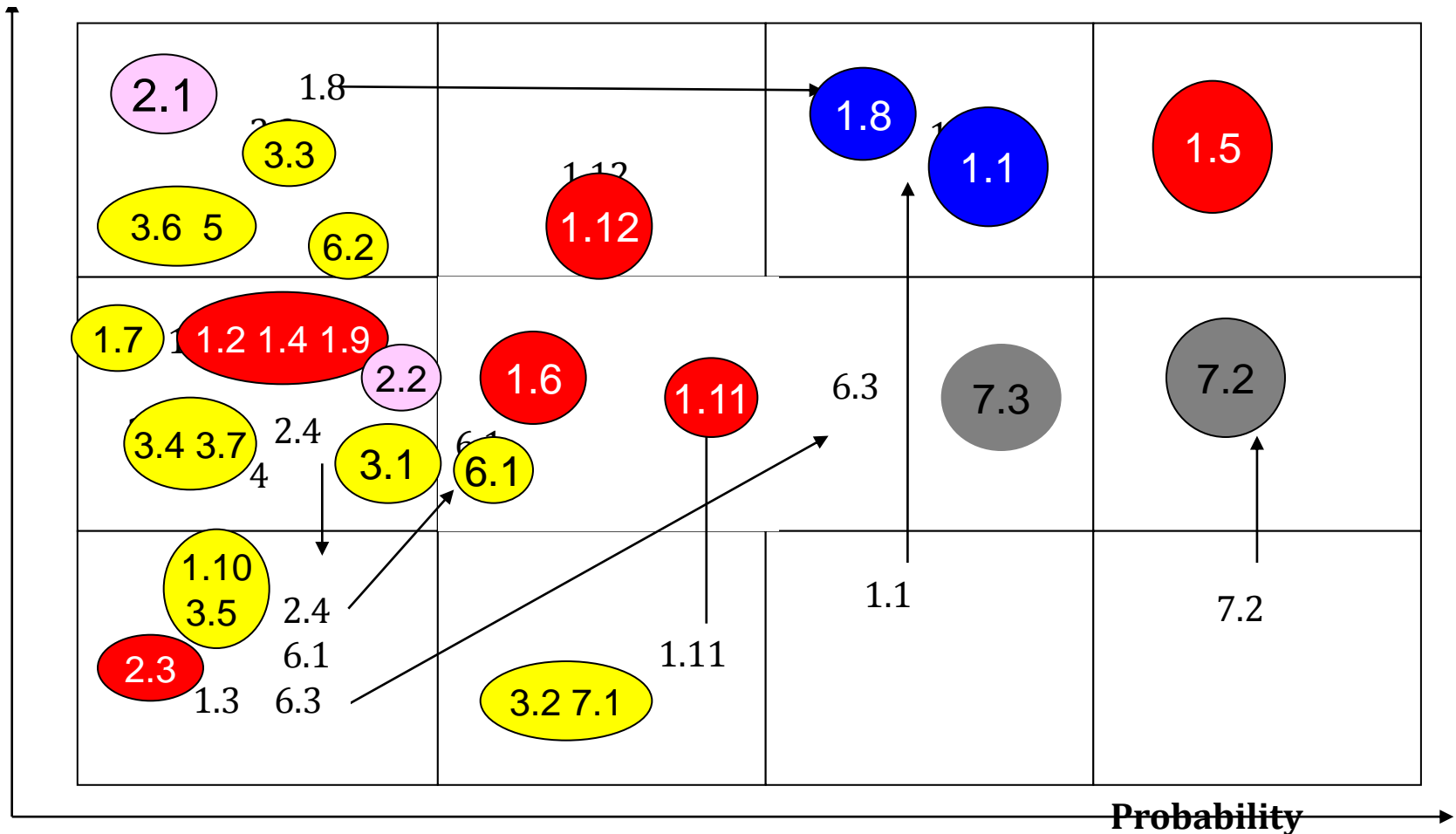


# Formulate response to risk (strategy)

- The core of RBS
- Focus depends on the problem:
  - Educate if due to ignorance
  - Re-orientate (enable) if due to laziness
  - Enforce/intervene if due to wilful acts or misalignment of interests
- Letting go or breaking the dependency culture may be a challenge
- Integration of different tools also a challenge
- DC investment is a huge supervisory challenge
- Entity risk management is an educational challenge

# Risk matrix – showing strategies mapped to risk

Impact



# Communicate response

- Supervision should be concerned with changing or reinforcing behaviours, so communication and persuasion is vital
- Lack of professional communications function a real challenge
- May also be cultural issues to overcome

# Verify compliance

- What most people think of as supervision
- Supervisory staff know how to inspect entities and analyse data
- But they:
  - Are not necessarily used to a structured and disciplined approach
  - Have little experience of inspecting governance, let alone risk management
  - May need to new skills for off-site analysis of what matters most

# Enforcement

- Perhaps biggest challenge, regardless of legal system
- Enforcing highest risks likely to touch sensitive issues for senior entity management
- Powers can be limited in practice
- To enforce principles the supervisor needs to win the argument, and establish agreement on what good practice looks like
- Macedonian fees regulation provides a good example

# Review performance

- Requires robust measurement of risk reduction
- Limited international experience



# Organisation and resources

- Moving to RBS requires culture change – takes time, effort and leadership. It needs:
  - a commitment to professionalism and expertise
  - champions
  - quick wins - early tangible outputs (such as manuals) are valuable in demonstrating RBS is here to stay
  - the involvement of the whole organisation working to shared goals
- Staff turnover/mobility is a challenge when building the core team

# Concluding observations

- (Nearly) all supervisors are risk-based to some extent – but not in all respects and not in a structured and defensible way
- RBS essential for effective supervision of the highest risks and tackling serious issues
- And for ‘moving the market’ to address the risks
- It is challenging in many respects...
- ...but can also be highly motivating