PenCom

GUIDELINES FOR RISK MANAGEMENT FRAMEWORK FOR LICENSED PENSION OPERATORS

RR/P&R/09/01

www.pencom.gov.ng

National Pension Commission

About this Guidelines

The Guidelines for Risk Management Framework for Licensed Pension Operators is divided into five (5) sections.

Section one is the introduction while Section two explains the risk management process.

The minimum requirements needed for a risk management framework are spelt out in Section three.

Section four outlines the reporting requirement, while section five spells out the roles and responsibilities of the Board and Senior Management.

The requirements of these Guidelines are consistent with the provisions of the Pension Reform Act, 2004.

RR/P&R/09/01

GUIDELINES FOR RISK MANAGEMENT FRAMEWORK FOR LICENSED PENSION OPERATORS

1.0 INTRODUCTION

1.1 A continuous process of effective risk management is critical to the safety and soundness of the operations of Pension Fund Administrators and Custodians. Furthermore, Section 66 of the PRA 2004 requires every Pension Fund Administrator to establish Risk Management Committee for the purpose of determining the risk profile of the investment under management with a view to providing advice on the management of associated risks. Consequently, licensed pension fund operators must develop, implement and maintain a sound and prudent risk management framework that comprises policies, procedures, and processes, appropriate to the nature, scale and complexity of their operations.

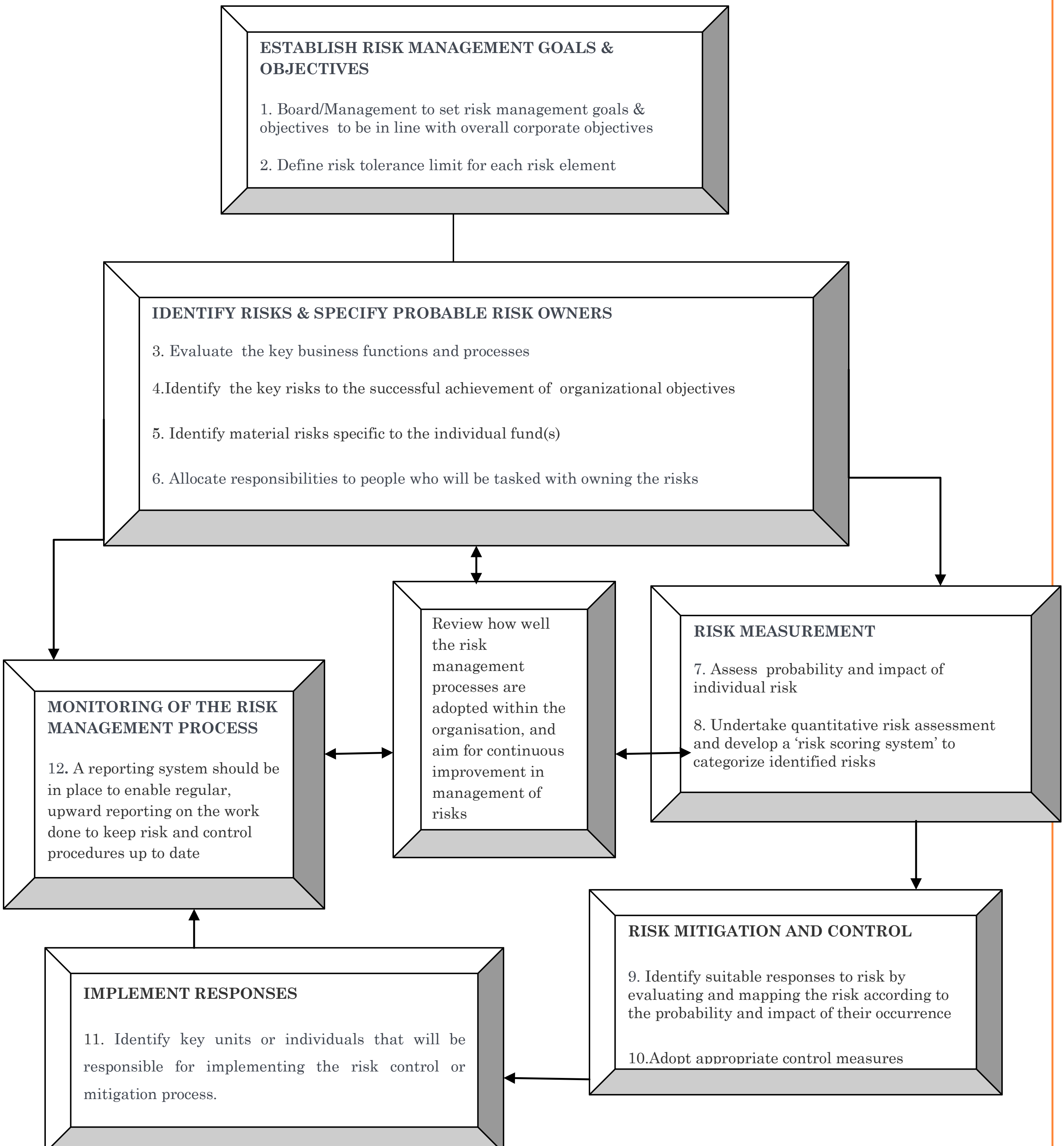
1.2 These guidelines are therefore intended to serve as a guide to operators for developing an effective risk management framework for their operations.

2.0 RISK MANAGEMENT PROCESS

2.1 Risk Management process involves the identification, measurement, monitoring and control of risks, to an acceptable level that would be proportionate to the company's risk appetite.

2.1.1 A typical Risk Management process is shown in the diagram below:

RISK MANAGEMENT PROCESS



2.1.1 **Risk Identification**: At this stage, all the potential categories of risk must be identified so as to come up with a comprehensive risk list or risk register which contains details of all types of risks, their assessment, owners and status of the risks

2.1.2 **Risk Measurement**: Each organisation should evolve a system of measuring its identified risks. The measurement should graduate risk levels, based on the scale or significance of the activities in relation to the organisation's risk management goals and objectives. Risk measurement should include a scoring system for all identified risks within the PFA/PFC.

2.1.3 **Risk Monitoring**: Assess the effectiveness of the risk management process and compare with set risk management goals and objectives. In monitoring its risks, each PFA/PFC should review the standards set on a continuous basis, to ensure that they are appropriate to meet the set objectives.

2.1.4 **Risk Mitigation and Control**: The risk control process involves the establishment of risk management standards. The standards to be set shall be a deliberate policy of the PFA/PFC to achieve its business objectives. The objective shall be to minimize the occurrence of identified risks and contain the effects of the risks when they occur.

3.0 MINIMUM REQUIREMENTS FOR A RISK MANAGEMENT FRAMEWORK

3.1 A framework for management of risk shall set the context in which risks will be identified, analysed, controlled, monitored and reviewed. It must be consistent with processes that are embedded in everyday management and operational practices. It shall address:

- how risks are identified
- how information about their probability and potential impact is obtained
- how risks are quantified
- how options to deal with them are identified
- how decisions on risk management are made, such as further risk reduction
- how these decisions are implemented
- how risks are subsequently tracked and managed

- how actions are evaluated for their effectiveness
- how appropriate communication mechanisms are set up and supported
- how stakeholders are engaged throughout the process.

3.2 The sophistication of a Risk Management Framework will depend on the nature, size and complexity of the PFA/PFC.

3.3 Existence of the Organisation's Risk Management Policy

3.3.1 To support corporate governance, there is need for a PFA/PFC to have a risk management policy in place. This policy shall:

- be appropriate for the size of the PFA/PFC and its operating environment
- be clear about the roles(and, if possible, individuals)that are responsible for the risk
- be clear about escalation criteria in relation to risk management (i.e. when to refer decision making upwards)
- be clear about the risk appetite of the PFA/PFC
- ensure that processes and culture/infrastructure to identify and manage risk are put in place
- set up the mechanism for monitoring the success of the application of the policy (including reports to management , at least annually)
- ensure that internal control mechanisms are in place for independent assessment that the policy is implemented.

3.4 Risk Identification

3.4.1 Identify the Risk

3.4.1.1 A PFA/PFC should be able to identify the key risks to the successful achievement of its organisational objectives. These are the risks that are likely to affect performance and delivery of business services.

3.4.1.2 The PFA shall take into consideration material risks specific to the individual fund(s) it administers.

3.4.1.3 This shall be done by evaluating the key business functions and processes, environment and the impact of changes in the environment; and their potential risks to the organisation. For example:

- Liquidity risks
- Economic /financial/market risks
- Legal, contractual and regulatory risks

- Technical/operational/infrastructure risks

3.4.1.4 The process of identifying the risk should be documented.

3.4.1.5 All identified risks and details thereon shall be recorded in a risk register maintained by the Risk Management Department of the PFA/PFC.

3.4.2 Specify Probable Risk Owners

3.4.2.1 Having identified the risks, it is necessary to allocate responsibility to people who shall be tasked with owning the risks. Ownership itself should only be assigned after the extent of the risk is understood.

3.4.2.2 When assigning risk ownership, the following shall be taken into consideration:

- Key risks shall be managed at senior levels
- Ensure anyone allocated ownership has the authority to take on the responsibility and that they are aware that they are the designated owner
- Adopt a mechanism for reporting issues – ultimately to the individual who has to retain overall responsibility

3.5 Risk Measurement

3.5.1 Risk Evaluation

3.5.1.1 Risk evaluation is concerned with assessing probability and impact of individual risk, taking into account any interdependencies or other factors outside the immediate scope under investigation.

3.5.1.2 Probability is the evaluated likelihood of a particular threat or event actually happening, including a consideration of the frequency with which this may arise. An example of risk probability categorised is shown below:

Probability	Criteria
Very low	0-5% (extremely unlikely, or virtually impossible)
Low	6-20% (low but not impossible)
Medium	21- 50% (fairly likely to occur)
High	51-80% (more likely to occur than not)
Very High	>80% (almost certainly will occur)

3.5.1.3 Impact is the evaluated effect or result of a particular risk actually happening, and it is usually measured in quantitative terms (or monetary losses). However, since not all risks can easily be translated into quantitative terms, there are qualitative means against which to measure impact etc. An impact score can then be allocated to the potential effect of an identified risk, if and when it does materialize.

3.5.1.4 The PFAs/PFCs shall undertake quantitative risk assessment and develop a 'risk scoring system' to categorize identified risks. The Risk score is the Probability Score multiplied by the impact score. The risk score shall be mapped onto a Risk Matrix as a graphical representation of the PFA/PFC's risk profile. A typical risk matrix is shown below:

Impact

High Impact Low Probability	High Impact High Probability
Low Impact Low Probability	Low Impact High Probability

Probability

3.5.1.5 The risk control process will govern the treatment or action required to improve the risk profile of the PFA/PFC.

3.5.2 Set Acceptable Levels of Risk Tolerance

3.5.2.1 The PFAs/PFCs shall set acceptable levels of risk tolerance. The risk tolerance level is the maximum overall exposure to risk that should be accepted, based on the benefits and costs involved. The amount of risk a PFA/PFC is prepared to tolerate, or its "risk appetite", will vary according to the perceived importance of particular risks and timing. An organisation may be prepared to take comparatively large risk in some areas and none at all in others.

3.6 Risk Mitigation and Control

3.6.1 Identify Suitable Reponses to Risk

3.6.1.1 When identified, risks are evaluated and mapped according to the probability and impact of their occurrence, before appropriate control measures are designed and implemented. One of the following broad actions may be considered:

- Avoidance: Urgent intervention/action is required to prevent the occurrence of the risk – this is usually for "High Impact, High Probability Risks".

- Controlling: Intervention is required in the form of controlling the frequency of occurrence through enforcement of internal corporate policies – this is usually for "Low Impact, High Probability Risks".
- Retention: Acceptance of the risk and its consequences, with periodic review to ensure that it does not escalate beyond the acceptable threshold – usually for Low Impact, Low Probability Risks".
- Transfer: This involves passing on the consequences of the risk externally through insurance and/or any other arrangement(s) – usually for "High Impact, Low Probability Risks".

3.6.2 Implement Responses

3.6.2.1 Once selected, responses to risk must have appropriate plans agreed for implementation.

- Identify key units or individuals that shall be responsible for implementing the risk control or mitigation process.
- Give such unit the necessary tools, resources and authority to discharge their responsibilities.
- Individuals responsible for the review function (i.e. risk review, internal audit, compliance, etc) should be independent from risk taking units.

3.7 Monitoring

3.7.1 Gain Assurances about Effectiveness

3.7.1.1 Mechanisms must be put in place for monitoring and reporting effectiveness in managing risk. A reporting system should be in place to enable regular, upward reporting on the work done to keep risk and control procedures up to date and in line with business needs.

3.7.1.2 There should be continuous monitoring of the situation in relation to those risks identified and actions planned.

- Check whether new risks are emerging
- Revisit plans, plot progress, look for trigger events that are reoccurring
- Watch for changes in circumstance, when changes

occur, initiate additional identification and assessment so that re planning can be undertaken where appropriate.

3.7.2 Embed and Review

3.7.2.1 Review how well the risk management processes are adopted within the organisation, and aim for continuous improvement in its management of risks. The review should be done annually as part of the support for corporate governance, and a report produced for the Board.

4.0 REPORTING REQUIREMENTS

4.1 Each PFA/PFC shall forward its developed Risk Management Policy to the Commission for review and approval. Also, the PFA/PFC shall duly advise the Commission of any major amendments/revision of the policy.

4.2 PFAs/PFCs shall forward to the Commission, monthly reports on any risk evaluated or rated as high and very high. Such reports shall be submitted not later than seven days after every end of month.

5.0 ROLES AND RESPONSIBILITY OF THE BOARD AND SENIOR MANAGEMENT

5.1 Board

5.1.1 The Board shall be responsible for the overall supervision of its Risk Management Process.

5.1.2 The Board at the minimum should be responsible for the following:

5.1.2.1 The establishment of a formal written policy on the overall Risk Management System.

5.1.2.2 Ensure the constitution of a Risk Management Committee at the Board level. The duties of the Committee shall include:

- Determination of the acceptable risk profile of the PFA/PFC
- Drawing up risk assessment and measurement systems
- Monitoring investment portfolio against risk tolerance limits
- Furnishing the Commission with reports on the investment performance analysis, quarterly

- Other functions relating to risk management as may be determined by the Board and the Commission, from time to time.

5.1.2.3 Ensure compliance with established policy through periodic review of reports provided by management.

5.1.2.4 Ensuring the establishment of a Risk Management Department/Office/Unit

5.1.2.5 Re-evaluate the risk management process of the PFA/PFC on a periodic basis to accommodate major changes in internal or external factors.

5.2 Senior Management

5.2.1 It is the duty of senior management to transform strategic direction and policies set by the Board into procedures and processes so as to implement those policies.

5.2.2 Senior management has the responsibility to ensure that these policies are embedded in the culture of the PFA/PFC.

6.0 **Review and Enquiries**

6.1 These guidelines shall be subject to review by the Commission from time to time as the need arises.

6.2 All enquiries regarding these guidelines shall be directed to the Director General, National Pension Commission.