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The Unique Alternative to the Big Four®

Governance, Risk and Compliance in Today's Public Pension Fund Environment

November 5, 2013

Association of Public Pension Fund Auditors

Audit | Tax | Advisory | Risk | Performance

Agenda

- Observations in Today's Environment
- Challenges and Disconnects
- Need for Coordination and Integration
- Promises of "GRC"
- Changing Role of Internal Audit

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Observations in Today's Environment

Participant Scrutiny

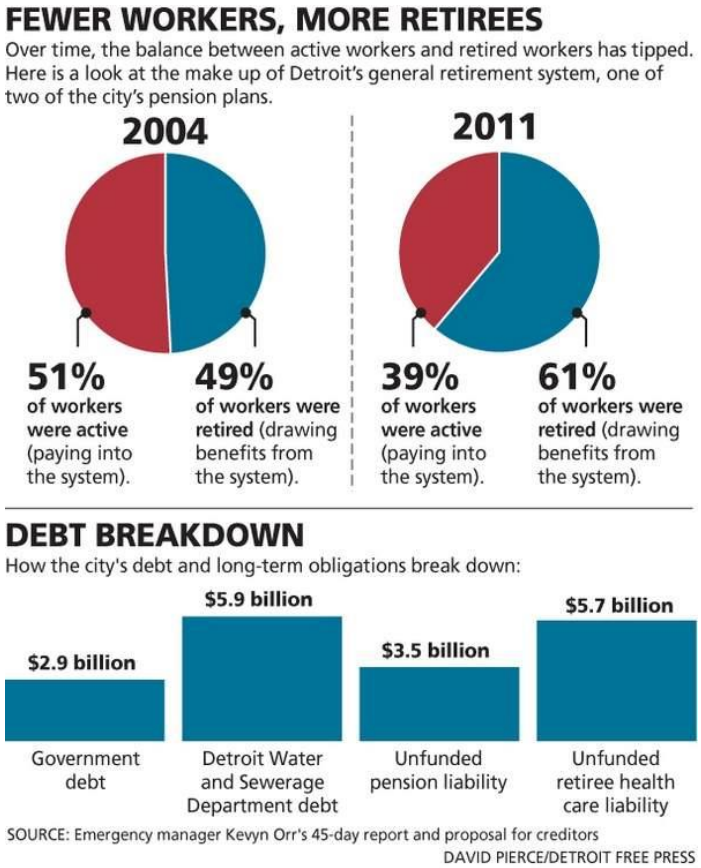
- Investment Performance
- Portfolio

Increased Disclosure requirements

- Statement No. 67, Financial Reporting for Pension Plans
- Statement No. 68, Accounting and Financial Reporting for Pensions.

Emergence of ESG Standards

- SASB
- GRI
- Bloomberg



http://www.washingtonpost.com/blogs/wonkblog/wp/2013/07/19/detroits-pension-problems-in-one-chart/

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Observations in Today's Environment

State Regulator Scrutiny

- Mr. Lawsky's office has been examining the state's largest pension fund—New York State Common Retirement Fund, with net assets of $153 billion—for about a year with a Focus on a range of issues including:
  - anti-fraud measures
  - technology systems and
  - the "structure" of the investment process.

http://online.wsj.com/article/SB10001424127887324354704578636374192838886.html

Rating Agencies Scrutiny

- Moody's Investors Service Inc. is implementing — starting this month — a new set of calculations that puts pension debt front and center in rating state and local governments.

http://www.pionline.com/article/20130401/PRINTSUB/304019998

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Observations in Today's Environment

Sophistication of Capital, Liquidity and Stress Testing Tools

- Model Risk Governance

Use of Third Parties

- Auditors
- Investors
- Administrators
- Information Systems
- Others

COSO Internal Control Framework

- Fraud
- Information Technology

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Challenges and Disconnects

- Performance, Compliance and Risk is managed in Silos
- Difficult to Measure Effectiveness
- Requirements are Ever Evolving
- Redundant or Inconsistent Processes

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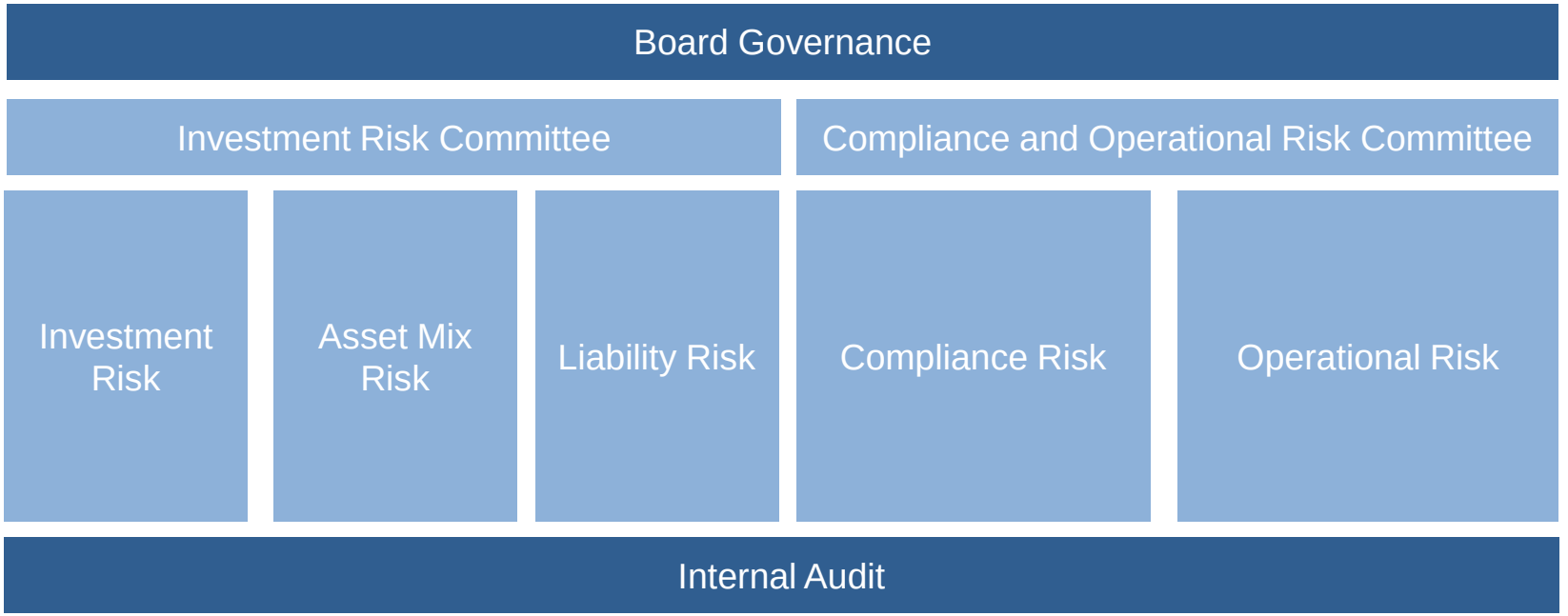
Governance, Risk Management and Audit



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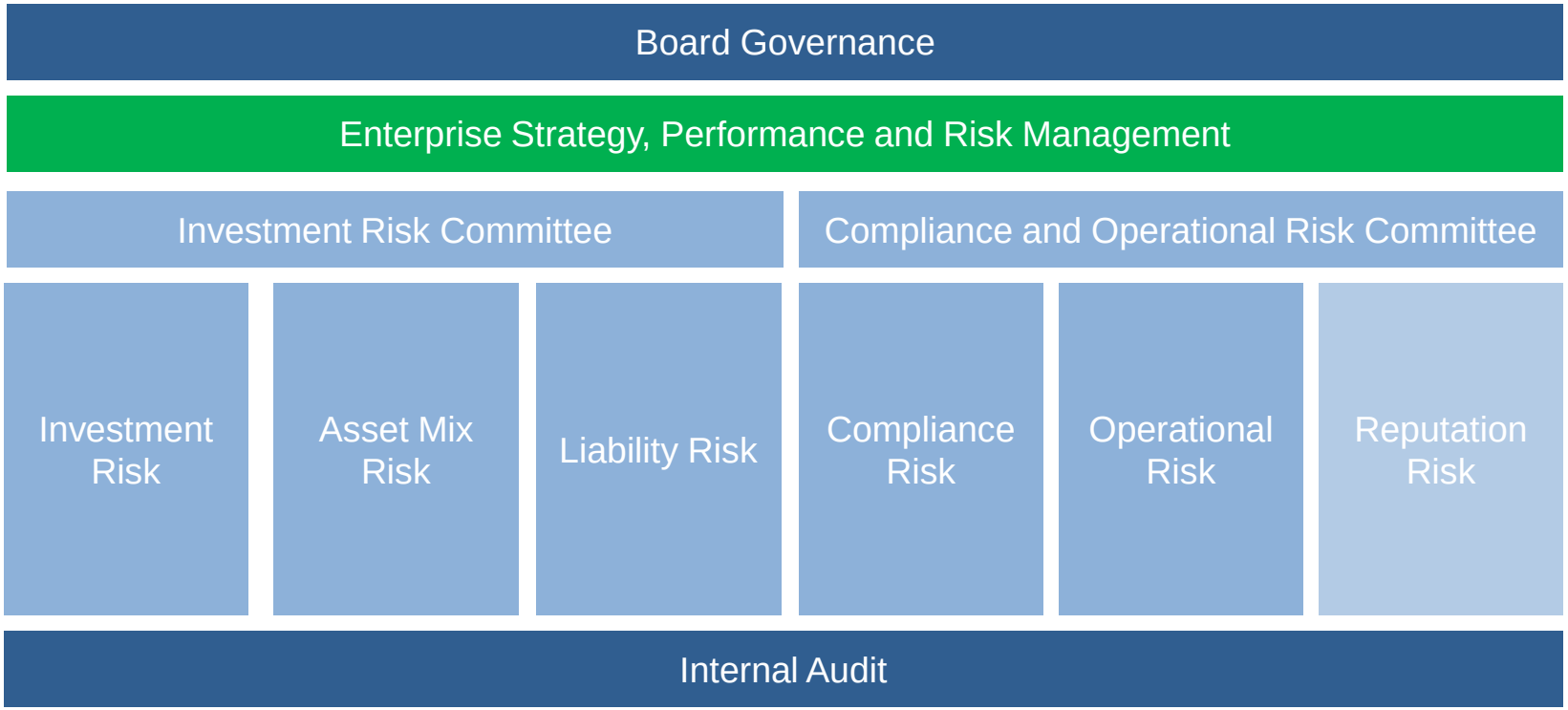
Governance, Risk Management, Compliance and Audit
Emergence of the Second Line of Defense



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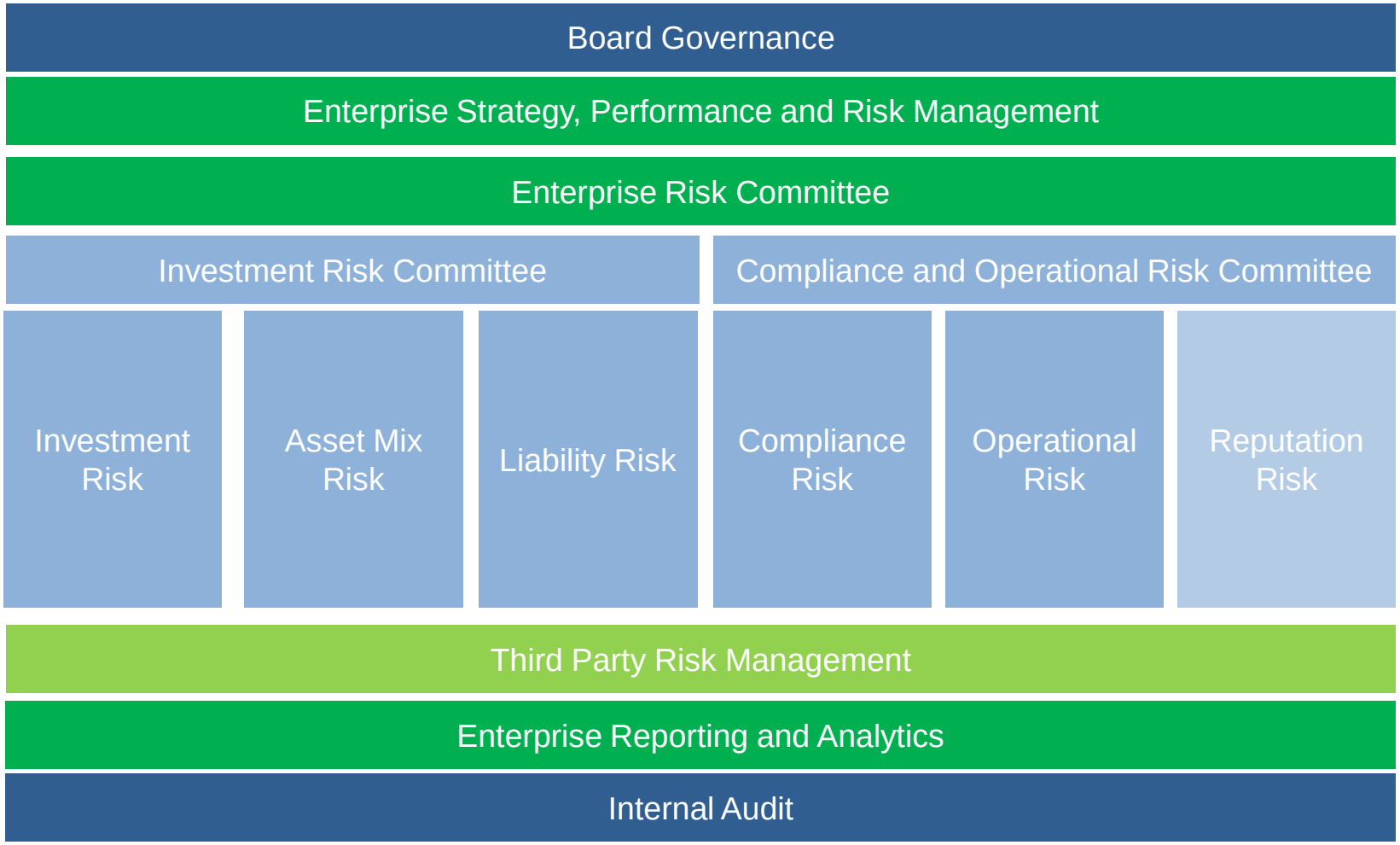
Governance, Risk Management, Compliance and Audit
Emergence of the Second Line of Defense



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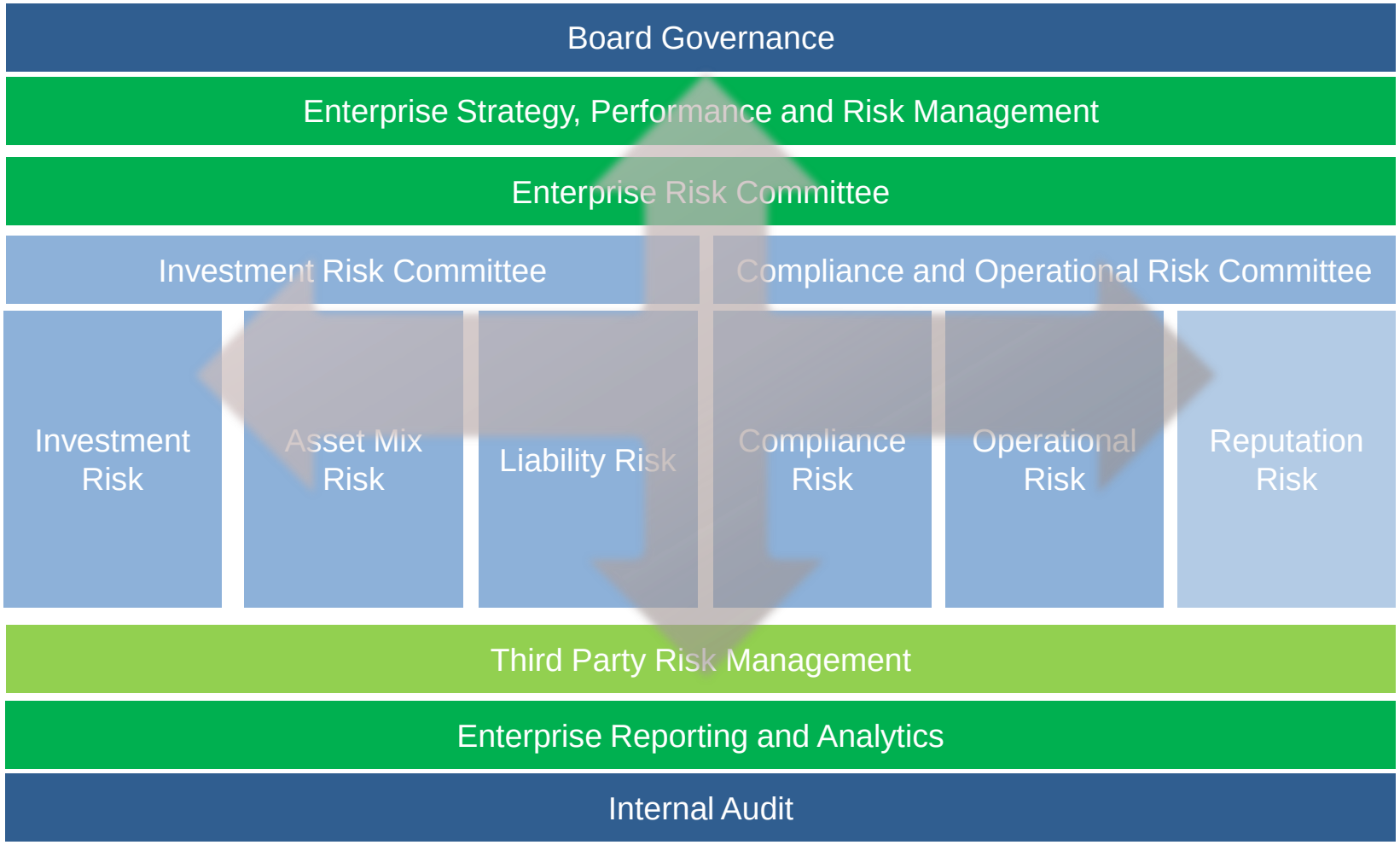
Complexity Drives Need for Greater Integration and Coordination



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"Promises of GRC"

- "Enterprise GRC helps organizations gain a greater understanding of their risk position and control environment, enhances the ability to respond to unforeseen events, and ultimately empowers an organization to take advantage of emerging opportunities."
- GRC solutions and incorporate risk management and compliance into your strategy, planning, and operational execution. Leverage GRC as a competitive differentiator and performance optimizer."
- "We challenge ourselves and our customers to adopt an approach to risk management that enables us to use enterprise risk management (ERM) in the broader context of GRC management: to mitigate risks and also revisit their business processes to capture value generating business opportunities."
- "Building an ethical and successful business starts with setting the standards for acceptable and unacceptable conduct in your company. You need to drive the behavior you want from your employees, and our enterprise GRC solutions can help."

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The Open Compliance and Ethics Group (OCEG) Definition of “GRC”

- GRC is an acronym describing an integrated approach to the governance, assurance, and management of performance, risk, and compliance.
- GRC enables an organization to reliably achieve objectives while addressing uncertainty and acting with integrity.
- The term "integration" means using the same or similar approaches across silos of interest in a way that allows for a unified view of the information. Some people refer to this as a “harmonized” or “consistent” approach.

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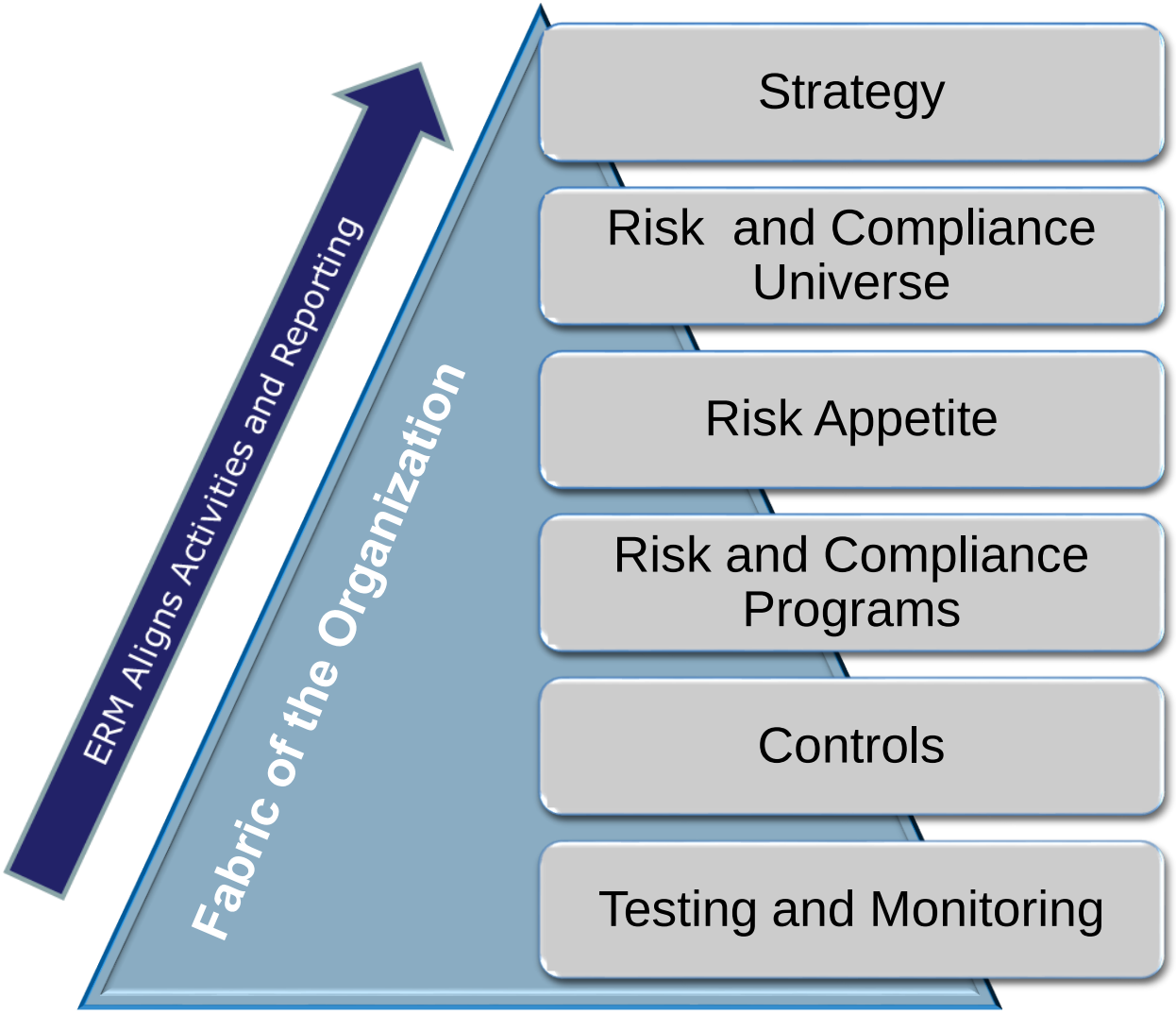
Integrated GRC Framework



The fabric of the organization includes:

- Values
- Culture
- Processes
- Compensation
- Rewards
- Communication
- Change management

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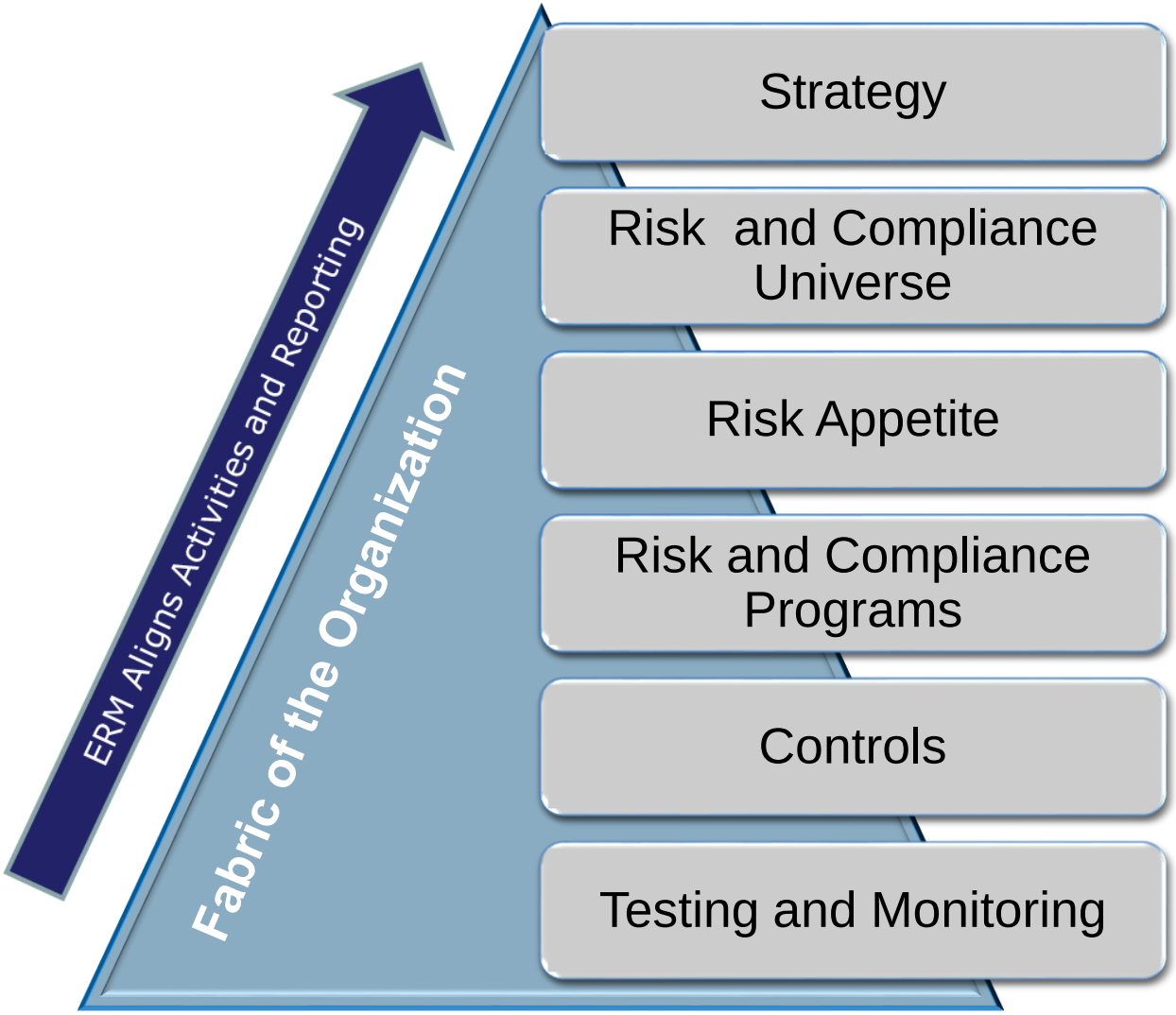
Integrated GRC Framework



Risk Appetite

The articulation in written form of the aggregate level and types of risk that a firm is willing to accept in order to achieve its business objectives.

- Financial Stability Board
- 2013

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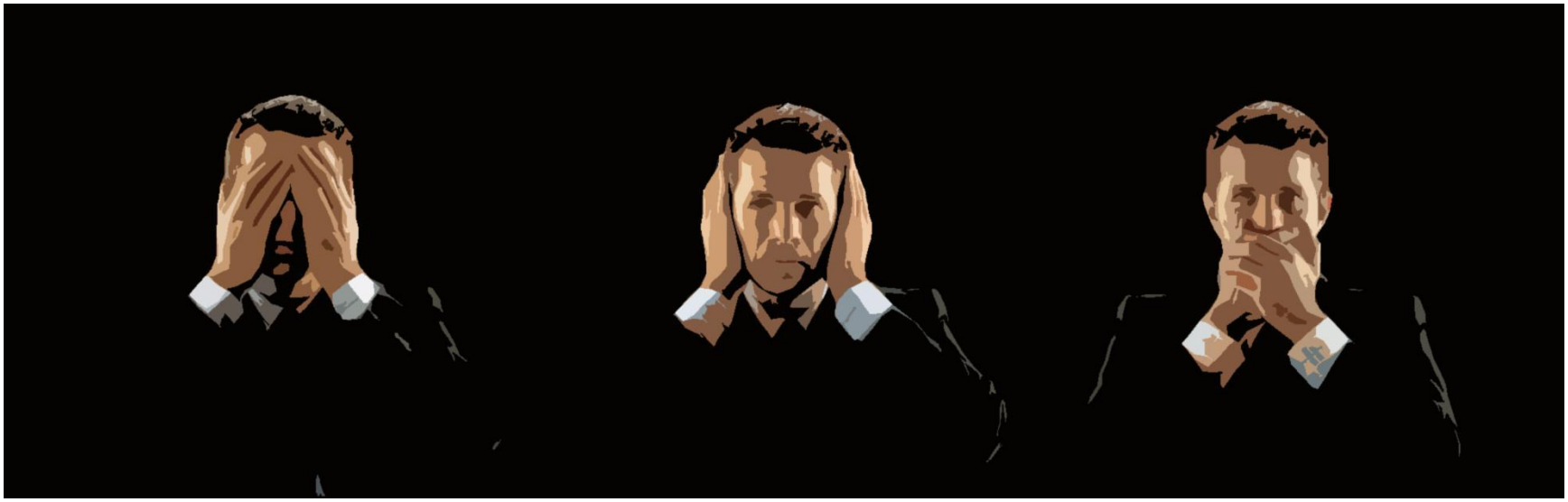
Common Blind Spots

- Responsibilities Between the 1st Line and 2nd Line
- Technology
- Third Parties



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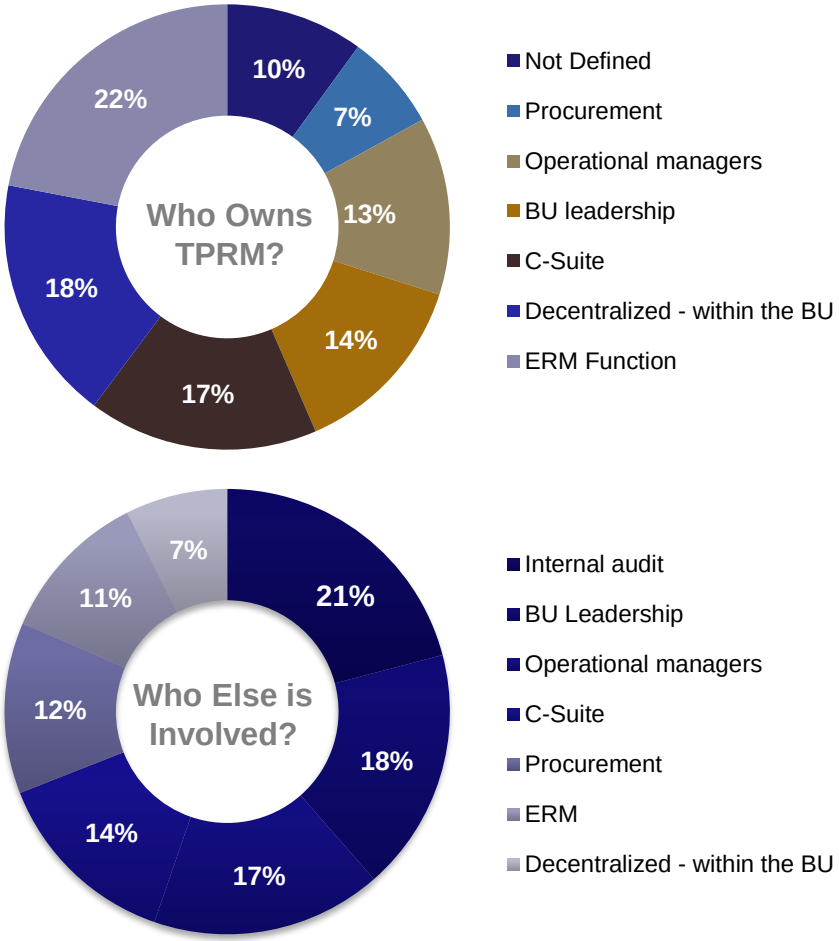
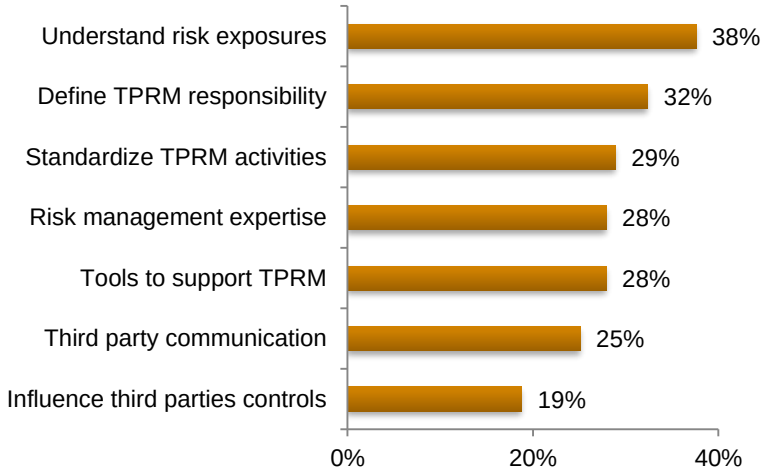
State of Third Party Risk Management



Where Executives Want to Improve TPRM:



Top Four Third Party Concerns

1. Monitoring third party practices
2. Obtaining assurance compliance with laws and regulations
3. Evaluating technology controls to protect company data
4. Determining how well intellectual property is protected

Source: Crowe/CFO Research Services Study 2011

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Challenges in Public Pension Fund Governance

- The board may not have the ability to hire and retain appropriate staff expertise.
- Control of budgets and headcount often remains with the Legislature or state budget-setting apparatus.
- There are still examples of legal lists for allowable investments that limit investment options.
- A fiduciary board is typically focused on achieving the best risk-adjusted return. However, if another board is responsible for fund actuarial assumptions, the fiduciary board might not be able to fully consider whether the portfolio risk profile is most appropriate for participants and fairly addresses intergenerational transfer of risk.
- In systems with separate investment and administrative boards, there can be a lack of coordination between assets and liabilities, as well as ambiguity about applicable time horizons and diffused responsibility for stakeholder relations.
- Most public pension funds have some areas of mismatch between fiduciary responsibilities and accountabilities, on the one hand, and powers and decision-making authorities, on the other.

http://www.pionline.com/article/20120801/REG/120809999/public-pension-fund-governance-alignment-of-responsibility-with-authority

- Funston Advisory Services LLC

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Changing Role of Internal Audit

- IIARF Research
  - 81% of Respondents believe an Internal Audit of ERM process would have a positive impact
  - % of Respondents who agreed or strongly agreed that internal audit adds value through the assessment of:
    - Controls 92%
    - Compliance 86%
    - Risk 82%
    - Governance 76%

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Changing Role of Internal Audit

Components of a Governance Audit

- Corporate Culture
- Tone at the Top
- Organizational Structure
- Human Resources – Policies and Practices
- Conflict of Interest Statement
- Communication Process
- Audit Committee Process
- Strategic Planning
- Executive Compensation and Benefits
- Corporate Policy
- The Annual Employee Survey

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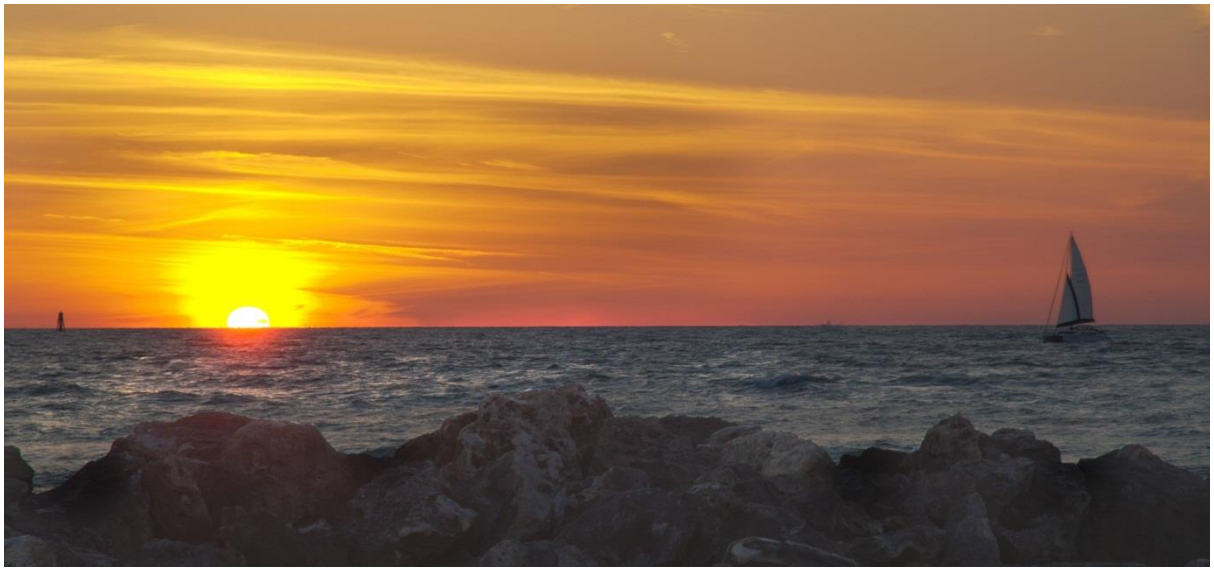
Guidance

- Financial Stability Board, Principles for an Effective Risk Appetite Framework
- COSO Internal Control and ERM Frameworks
  - Fraud
  - Information Technology
- OECD Guidance



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Discussion

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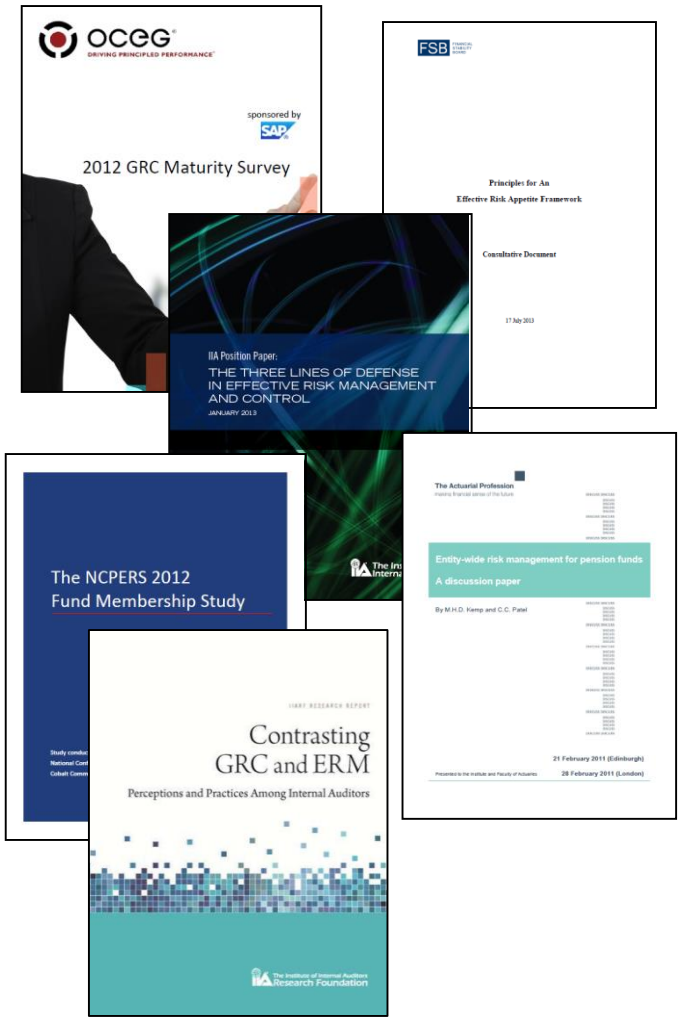
References



OCEG 2012 GRC Maturity Survey

IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control, January 2013

The NCPERS 2012 Fund Membership Study

IIARF Research Report: Contrasting GRC and ERM, 2013

FSB Principles for An Effective Risk Appetite Framework, Consultative Document, July 2013

Institute and Faculty of Actuaries: Entity-wide risk management for pension funds, February 2011

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