

5TH ANNUAL PENSION GOVERNANCE CONFERENCE

# Risk Management Practices and Internal Controls: Safeguard Pension Assets

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 Pride Inn Paradise, Mombasa

# RISK MANAGEMENT

## Understanding the Lifecycle of Protection

Pension schemes operate in a dynamic and highly volatile ecosystem. Implementing strict risk methodologies guarantees that retiree funds remains intact over decades of economic changes.

*Effective practices ensure known risks are mitigated while flexible frameworks guard against emergent, unknown threats to the scheme's capital.*

- **Identifying, Assessing & Controlling:** Actively neutralizing threats to Pension Scheme existence, assets and earnings.
- **Managing Vulnerabilities:** Monitoring operational weaknesses and executing corrective actions on a strict, timely basis.
- **Protecting Scheme Resources:** Ringfencing the overall scheme name, brand reputation, market image and underlying asset value from known and unknown risks.

# UNDERSTANDING RISK

## DEFINITION & IMPACT

**Dangerous exposure to lives of persons - natural or legal, leading to loss of lives, assets, earnings, brand, name, image or proprietary rights.**

Risk is not a single element but an overlapping structure of negative exposures. Identifying these coordinates is key to designing corporate barriers and controls.



### Loss

Threat of absolute financial or asset loss



### Danger

Direct exposure to operational danger



### Vulnerability

Inherent security or system vulnerability



### Hazard

Unmanaged hazardous opportunity

# UNIVERSAL RISKS

THE ENTIRE SPECTRUM OF OPERATIONAL AND EXTERNAL THREATS TO CORPORATE ENTITIES:

- Financial risks
- Strategic risks
- Credit Risks
- Market risks
- Climatic risks

- Liquidity risks
- Credibility risks
- Operational risks
- Reputational risks
- Technological risks

- Legal/Compliance
- Health & safety
- Environmental
- Social-cultural
- Competition risks

- Economic risks
- Political risks
- Security risks
- Fraud risks
- People risks

# RISKS IN PENSION SCHEMES

## Investment Risk

Risk of invested Scheme assets declining in value during market downturns.

## Inflation Risk

Growth rate failing behind inflation rate - reduced future purchasing power.

## Governance Risk

Exposure of the pension fund and operations to fraudulent activities.

## Longevity Risk

Defined Benefit (DB) risk of retirees living much longer than actuarially forecasted.

## Contribution Risk

Risk of employers defaulting on contributions, leading to funding deficits.

## Sequencing Risk

Negative investment returns right before or early in retirement depleting funds.

# RISK MANAGEMENT COMPONENTS

## Five Crucial Dimensions of the Corporate Risk Cycle:

**1. Risk Identification:** finding vulnerabilities, applying tools and control processes

**2. Risk Analysis:** determining the likelihood of a risk occurrence, its severity and possible impact

**3. Response Planning:** addressing risks appropriately and effectively in a timely manner

**4. Risk Mitigation:** taking prompt corrective action before the likelihood, severity or potential impact exceeds acceptable levels

**5. Risk Monitoring:** tracking effectiveness of mitigation measures while identifying and managing new risks

# RISK IDENTIFICATION PRACTICES

**01**

**Understand**

Risks components and structures

**02**

**Identify**

Various types of threats and risks

**03**

**Find Out**

& document risk prone areas

**04**

**Define**

Universal risk boundaries

**05**

**Scan**

Holistically scan the risk universe

**06**

**Analyze**

& categorize noted risk elements

**07**

**Create**

Detailed system risk registers

**08**

**Monitor**

Keep in constant view emerging risks

# RISK MANAGEMENT STRATEGIC OPTIONS

## AVOID

High Probability, Large

Don't Own  
Don't Do  
Don't Say  
Don't Expose

## REDUCE

All Possible Operational Risks

Safety Procedures  
Pooling  
Segregation  
Diversification

## TRANSFER/SHARE

Low Probability, Large

Rent  
Insure  
Government Credit  
Hold Harmless Agreements

## RETAIN

Small Consequence Elements

Absorb  
Deductibles  
Co-Insurance  
Self-Insurance  
Ignore

# WHAT IS A RISK

## Core Definition:

*"Risk is an uncertain event or condition that if occurs, has a positive or negative effect on one or more project objectives, such as scope, cost and quality."*

Keep risk response appropriate based on the importance and significance of the risk.

### – Minimize Negative Risks

- **Avoid:** Terminate exposure completely
- **Transfer:** Shift liability to third parties
- **Mitigate:** Minimize probability/consequence
- **Accept:** Acknowledge and retain
- **Escalate:** Inform higher authority

### + Enhance Positive Risks

- **Exploit:** Secure 100% of the benefit
- **Enhance:** Increase probability/impact
- **Share:** Distribute benefits to allies
- **Accept:** Realize benefit if it occurs
- **Escalate:** Report opportunity upwards

# ALIGN RISK MANAGEMENT TO CONTROLS

## RISK MANAGEMENT COMPONENTS

## ALIGN

## CONTROL COMPONENTS

- ➔ **Risk Identification:** Discovering vulnerabilities
- ➔ **Risk Analysis:** Testing likelihood & severity
- ➔ **Risk Planning:** Crafting corporate defense
- ➔ **Risk Mitigation:** Initiating containment measures
- ➔ **Risk Monitoring:** Tracking overall indicators

- ✓ Strategic Plan
- ✓ Annual Budgets & Workplans
- ✓ Processes & Procedures
- ✓ Policy Frameworks
- ✓ Internal Controls
- ✓ Corporate Audits

# RISK ALIGNMENT STRATEGY

## Categorize: Strategic Issue

Investment of Funds in Non-Performing Portfolios

## Treat: Compliance Issue

Failure to investment in RBA approved markets

## Appreciate: Internal Control

Delayed auditing of financial statements

## Treat: Governance Concern

Growing Debt - Unfunded Programs and Liabilities

# PENSION RISK MITIGATION STRATEGIES

## Essential Asset and Liability Protection Actions:

- ✓ **De-risking:** Gradual transfer of a pension portfolio from growth-oriented, volatile assets (equities) into safer, income-generating assets (bonds) to secure retirement safety for members.
- ✓ **Diversification:** Splitting investments across various asset classes to prevent over-reliance on a single market or sector.
- ✓ **Cash Buffering:** Holding sufficient liquid cash reserves to avoid forced sale of assets during market dips.
- ➔ **Liability-Driven Investing (LDI):** Aligning scheme's assets closely with its liabilities to protect against interest rate and inflation volatility.
- ➔ **Hedging Strategies:** Utilizing derivatives to hedge against extreme market events, currency fluctuations and declining interest rates.

# PENSION RISK MITIGATION STRATEGIES

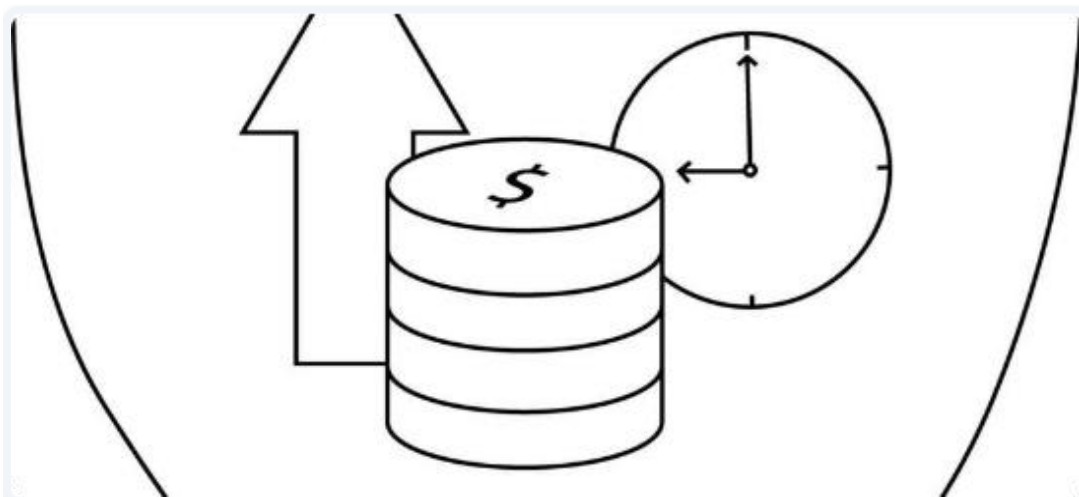
## Socio-Technical and Administrative Control Measures:

- ✓ **Policy Formulation:** Continuously aligning internal policies with legal & regulatory frameworks to avoid penalties.
- ✓ **Tax Optimization:** Consulting with tax professionals to navigate changing tax laws and avoid double taxation on international investments.
- ✓ **Robust Governance Frameworks:** Having active Trustees with clear oversight, documented investment policies and regular performance tracking.
- ➔ **Cybersecurity & IT Resilience:** Securing member data and systems against technological failures, data breaches and fraud.
- ➔ **Internal Audits:** Conducting independent audits of internal processes for early detection & deterrence of errors, outsourcing risks and mismanagement.
- ➔ **Regular Actuarial Valuations:** Undertaking comprehensive audits to assess the Scheme's funded status, contribution policies and mortality/longevity risks.

# PENSION ASSETS

## DEFINITION

The sum-total of pooled financial reserves and investments held by retirement benefits schemes in various classes.



### PERMISSIBLE ASSET CATEGORIES:

- ✓ Government securities
- ✓ Guaranteed funds
- ✓ Quoted equities
- ✓ Immovable properties
- ✓ Collective investments
- ➔ Private equity
- ➔ Infrastructure & Housing
- ➔ REITs
- ➔ Offshore investments
- ➔ Derivatives

# INTERNAL CONTROLS: PENSION SCHEMES

## Systemic Defense & Governance

Internal controls constitute the daily operational rules designed by management to ensure that standard protocols are strictly respected across every level of the trust.

*"Pension Schemes' Internal processes and mechanisms of control are the lifeblood of security."*

- ✓ **Secure Integrity:** Protect and secure the quality and integrity of financial and non-financial resources.
- ✓ **Protect Data:** Ringfence and protect critical Scheme data and confidential member information.
- ✓ **Promote Accountability:** Promote complete accountability and absolute transparency in actions.
- ✓ **Prevent Fraud:** Establish proactive measures to detect and prevent fraudulent activities.

# TYPES OF INTERNAL CONTROLS

## Code of Practice

Build functional consensus, promote clarity of work, galvanize operations, and Maintain law & order.

## Procedures & Processes

Guide operations, promote accountability, uphold uniformity: Ringfence integrity of data, prevent fraud & loss of information.

## Standards of Work

Allow measurement of results, monitoring, reporting, mitigation of losses & unexpected outcomes: Benchmarks, Best practices.

# TYPES OF INTERNAL CONTROLS

- ✓ **Checks & Balances:** Systems to guide acceptable behavior, limit discretion and set strict performance standards.
- ✓ **Separation of Power:** Allocating processing, verification, and approval tasks to distinct, independent individuals.
- ✓ **Periodic Management Reports:** Tracking performance and providing actionable feedback on resource utilization to support Communication & Accountability.
- ➔ **Organizational Chart:** Instituting formal reporting lines, defining clear chain of command & indicating span of control.
- ➔ **Physical Barriers:** Monitoring accessibility, protecting physical assets, and strictly controlling mobility.

# TYPES OF INTERNAL CONTROLS

## Structures

Direct and manage complex work flows & actively mitigate operational risk vectors.

## Quality Measures

Assure value of services, success of set goals and objectives, compliance with laws, protection of public confidence & trust, and create brand visibility.

## Jurisdictions

Set operational boundaries, limitation of scope, responsibility lines & reporting timelines: Give power & authority.

# SAFEGUARDING PENSION ASSETS

## Control Environment

Influence control & performance, set the Scheme value tone.

## Risk Assessment

Define risk clusters & target specific mitigation actions.

## Control Activities

Barriers, brakes, guidelines, corrective actions, direction signs.

## Info & Comm

Informed decision making & knowledge management.

## Monitoring & Eval

Remain on course, within plans, and strictly limit deviations.

## Financial Analysis

Trend analysis, variance analysis, cost-benefit analysis.

# INTERNAL SAFEGUARDS: PENSION ASSETS

- **Control Environment:** Setting the ethical tone, establishing correct Scheme structure, and demonstrating integrity set by leadership.
- **Risk Assessment:** Proactive identification and ongoing analysis of potential risks to achieving Scheme objectives.
- **Control Activities:** Executing specific policies and guidelines used to directly mitigate identified risks.
- **Information & Communication:** Ensuring accurate data is effectively shared across the Scheme to support daily control functions.
- **Monitoring Activities:** Continuous tracking of Scheme operations to ensure the internal control systems are functioning properly.

# PENSION RISK GOVERNANCE

## STRATEGIC PREPAREDNESS

### Designing Risk Management Beyond the Standard Landscape

Traditional models fail when Black Swan events arrive. Board governance is tasked with maintaining fluid channels of communication and swift decision frameworks.

**Governance requires balancing risk management investment costs with target investment yields.**

- ✓ In-depth understanding of pension industry risk universe
- ✓ Thinking risk management strategies beyond known risk universe
- ✓ Continuous preparedness for Black swans & evolving risks
- ✓ Being clear on the dos and don'ts in risk management & governance
- ✓ Balancing between investment costs & returns on risk management strategies
- ✓ Removing barriers to timely risk responses

# PILLARS: STRONG INTERNAL CONTROLS

The Five Core Structural Pillars of Internal Governance:



Integrity and ethical  
values



Commitment to  
competence



Tested policies and  
procedures



Leadership and  
operating style



Delegation and  
development

# BENEFITS: STRONG INTERNAL CONTROLS

- ✓ Entrenches transparency and accountability
  - ✓ Fosters risk mitigation and fraud prevention
  - ✓ Promotes ethical behaviors across team members
  - ✓ Improves corporate operational efficiency
  - ✓ Assures consistent actions and business results
- Enables the Scheme meet its set goals
  - Enhances overall financial integrity and accuracy
  - Strengthens legal and regulatory compliance
  - Empowers decision-making and strategic planning
  - Improves employee productivity and quality of service

## CONCLUSION

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*"A major lesson in risk management is that a 'receding sea' is not a lucky offer of an extra piece of free beach, but the warning sign of an upcoming tsunami."*

”

— Jos Berkemeijer





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