NOT ALL RISKS ARE MADE EQUAL

Retirement funds manage risk on behalf of their stakeholders. The members and beneficiaries of these funds look to their trustees to prepare them for the uncertainties of the future. These trustees have a deep responsibility to execute on this task as carefully as possible. Not all risks are equal, however. Some should be avoided, others tolerated but managed. But some risks must be actively sought in the pursuit of the goals of the fund.

We are all different in our attitudes to risk. Some will spend a few rand on lottery tickets in the hope of a return, others a great deal more at the races or casinos. Cyclists take different approaches to hair-raising downhills and children to the thrills at the amusement park. Some invest in cyber-currency; others avoid it.

Our circumstances play a part in these differences. Willing to jump from an aircraft with a chute on my back when young, I changed my mind when the children arrived. As a youngster, I weaved through traffic to cross the road. When older I will wait my turn at the crossing.

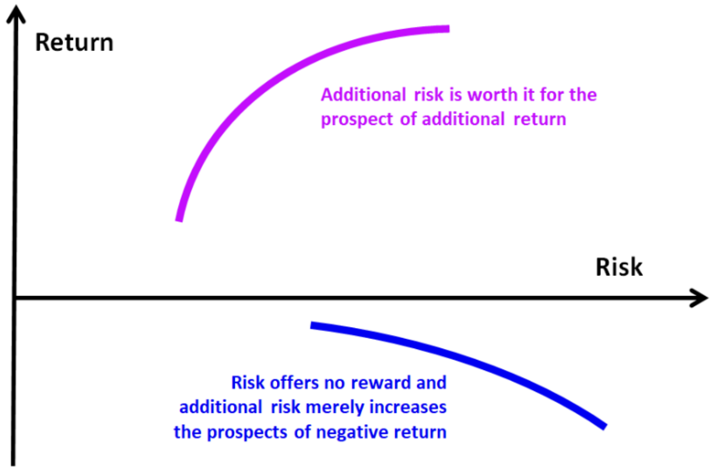
It is not just the situation that matters, though. The risks themselves may be intrinsically different. Short-term investment volatility is actively sought because it provides a better prospect of long-term gain. We tolerate physical discomfort when jogging for the potential of improved fitness or a better race position. These risks are worth taking for the reward offered.

Other risks do not offer such prospects. We avoid cold and hunger unless there is a benefit to be gained at the time. Most of us avoid trouble with the law no matter the potential gains. We are particularly wary of actions that might lead to reputational damage.

Risk characteristics

Our management of risks in retirement funds would benefit from a similarly careful approach. Understand the nature of these risks, classifying them into broad types in the process. Then determine the most appropriate way to respond to each of them.

Some risks may be depicted like the pink line on the chart alongside. Taking more of the risk is expected to deliver a return, even if only in the long-term. In other words, achieving the objectives of the fund is facilitated by taking more risk. Investment risk is a fine example of this: funds deliberately take short-term risk for long-term gain.



Others are more like the blue line. Any exposure to the risk is bad. There is no reason to add further to the risk. Reputation risk, for instance, is always to be avoided. There is no merit in adding to regulatory risk.

Others fall somewhere in the middle. Operational risk is almost impossible to avoid completely. The costs of doing so most likely exceed the corresponding benefits. So, it is better to acknowledge the existence of the risk and devote appropriate resources to identifying the sources of such risk and to managing the potential for the damage that it could cause.

Risk management strategy

We need to take a deliberate approach. Strategy is not just appropriate for the pursuit of our goals but for our defence of those goals as well. We have a better chance of achieving what we seek from our risk management practices if we identify their objectives.

And how do we do this? We establish first the priorities of the fund. We then identify the traps most likely to imperil these goals. This puts us in a strong position to itemise the types of risks that our fund is exposed to and describe an appropriate approach in response to each of them.

Success in risk management takes hard work. To determine the key risks to success, we must start by defining this success. And then we need to scrutinise those risks with care. Does further exposure to these risks promise the prospect of a better return, in other words success as we have defined it, or does it detract from it? This provides the foundation for a deliberate approach to each of these risks, ultimately **in pursuit of the objectives of the fund**.

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