

Leadership in the Pension Sector

“The Power of Diversity in Risk Analysis”

Rajish Sagoenie, December 2017



This opinion article by Rajish Sagoenie (Milliman Pensions) discusses one of the lessons which those of us working in the pension sector learned from the financial crisis of 2008. Not only financial, but also non-financial risks should receive more attention/should be paid more attention to. Conduct and culture now play an increasingly more important role. What does diversity in that context mean and how can we provide better guidance on the cultural and behavioral aspects in the pension sector?

INTRODUCTION

The pension sector is rapidly changing and in order to better assess the aforementioned risks, both behavior (soft management elements) and culture (unwritten rules) need more attention from the Board of Directors of pension funds. Two years ago, the regulator, the Dutch Central Bank (DNB), already called for more attention to behavior and culture. Moreover, last summer an investigation was launched regarding the non-financial risks among pension funds. How can directors improve their understanding of behavior and culture? In this article, we will take a closer look at this.

THE PENSION SECTOR

The pension sector is currently not only in a major state of flux, but confidence in this sector has also decreased. While a lot has changed in recent years, it makes sense that there is still a lot of space for improvement in this fairly traditional sector. Directors of pension funds are almost daily engaged with risk assessments. The question that can be posed in this regard is how the quality of decision making in this framework can be improved, and whether there is adequate diversity among these Boards of Directors? Some questions (are), for example:

- To what extent has adequate attention been paid to having an accurate reflection of society or the stakeholders on the Board of Directors of pension funds to regain confidence?
- Are enough women represented on the Board of Directors?
- Are there enough young people on the Board of Directors?
- Are there enough 'people of color' (different ethnicities) on the Board of Directors?
- Are new board directors recruited from appropriate networks?

In this rapidly changing world, Board of directors are being asked to spend more time thinking 'out of the box' to gain more insight into the uncertainties that these pension funds are confronted with. Diversity can help to better meet this demand. . Of course this does not dispute that the 'competency requirements' set are being satisfied/fulfilled.

DIVERSITY

Diversity is all aspects in which people differ from one another. This does not only have to do with visible characteristics such as gender, sexual orientation, ethnicity, and age, but also with non-visible characteristics such as personality traits, competencies and behavior.

In this article cultural diversity concerns the diversity of people from different cultural backgrounds.

An important element, of course, is the way in which (cultural) diversity influences thinking about risk and the decision making involved, not only as individuals but also as a group.

VARIOUS STUDIES

There are various (scientific) studies which emphasize the importance of diversity. Below, I will provide some examples regarding thinking about risk:

- In 2015, DNB published the report "Supervision of Behavior and Culture, Foundations, Practice and Future Developments". This report draws the conclusion, among others, that unsatisfactory compliance with strategic or other objectives and 'herd mentality' leads to risky decisions which result in financial losses.
- According to research at the University of Groningen, decision making by like-minded people is often faster and more effective.

This seems logical, but the question arises: what does it say about the quality of the decision made that way? According to researcher Dennis Veltrop, diversity can lead to subgroups which put pressure on each other and have more difficulties reaching a compromise. So far, there has not been evidence for claims that organizations with a diverse Board of Directors deliver better performance. However, with a board of like-minded people there is the risk that the chairperson acts too much as a soloist, with a growing lack of confidence among a diverse constituency as result. The question is how to break through such a culture? How to change such a culture?

- In his book "Memento Futuri : Fundamental Uncertainty and Scenario Analysis," Theo Kocken discusses ways in which prejudices can be overcome. He concludes that group diversity in developing scenarios is crucial. As far as I am concerned, (cultural) diversity can also make a serious contribution here.
- It appears that those in the pension sector are insufficiently aware of the fact that diversity is a component of the concept Corporate Social Responsibility (CSR). One of the 17 objectives of the United Nations also makes reference to this. Here too, I see many possibilities for improvement.

THE PRICE OF DIVERSITY

One of the prerequisites for stimulating diversity and an open culture is the creation of a safe environment. Better decision making processes can only be realized in an environment where people feel comfortable and free to express themselves and are able to show different perspectives and opinions during discussions. This also prevents the risk of tunnel vision.

Diversity also reduces the likelihood of identification with the chairperson. On the other hand, the board will probably meet more often and for a longer time in order to get everyone on the same page. We can accept this inconvenience without a problem, because the reflection of the pluriformity in the society will be recognized and can help to restore the lost confidence.

In addition, an increasing diversity at the level of the Board of Directors can help the pension sector to create and identify role models, which can be seen as inspiring by the participants and others in society, who can really use the right role models, certainly these days. This is where the concept of CSR comes to mind again.

It's often said that there are very few alternatives available to put diversity into practice. The question,

of course, is whether that is really the case/true. Fishing in the right pond is essential. If you are fishing in a pond with carp, you are not going to catch sea bass, unless the sea bass got lost. In other words, searching for talent in the right environment and outside of the traditional networks would certainly help.

Diversity is about leadership and it is certainly not an instrument or a fill-in-the-blank exercise. Those who are currently in charge can, with an open culture and stimulating active conduct, contribute to an increase in diversity among the top talents we have in the Netherlands.

Another important element is how prejudice is dealt with. According to the aforementioned Theo Kocken scenario-analysis can support development of unilateral thinking within the Board of Directors of a pension fund. He describes methods to increase creativity and by considering extreme risks to get out of one's comfort zone. This allows unconscious and conscious prejudices to be reduced within a group, which in turn has a positive influence on decision making.

With regard to the individual, one can work on unconscious prejudices, for example, by creating an 'internal spy' using impactful conversations. This helps the individual to recognize specific situations and be able to anticipate on these. This latter may also apply to the ignorance of some of the involved leaders in the pension sector when it comes to diversity. Does this ignorance also apply to risk analysis done by the leaders involved in the pension sector?

IN CONCLUSION

For the pension sector, which in general is viewed as being rather traditional, it is now the perfect moment to change especially when it comes to culture and behavior. To counteract possible 'herd mentality,' and to really improve the quality of decision making in general, (in particular with regard to risks), there is plenty of room for improvement.

This does not only apply to the individual, but also to the group process in decision making. By revising issues from multiple perspectives together with scenario analysis, and by creating more diversity in the recruitment of top talent in the pension sector, the quality of decision making will increase.

What could also help is for individual directors to examine how they can better deal with prejudices. The creation of a safe and stimulating environment is also 'key.' This is how possible prejudices with regard to diversity can be reduced. These

instruments also apply to the possible ignorance of Boards of Directors about risk analysis and attitudes about risk.

The fact that diversity is more and more a component of CSR is an added advantage. By accounting for this in the annual report, directors of pension funds can only further accelerate awareness.

Diversity is not about what someone looks like, but more importantly who someone is and which specific extra quality someone adds to the team. That also applies to the pension sector. This is how you create a redefined future.

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