Defined benefit pension risk: What's important – and what's urgent?

Aon's Global Pension Risk Survey 2023/24 found that trustees face more complex risks than ever before. Prioritisation and planning are essential, says Matthew Arends, Head of UK Retirement Policy, Aon and Alastair McIntosh, Partner, Aon

Defined benefit (DB) trustees and scheme sponsors must navigate a wide, diverse risk landscape, from long-standing risks such as investment and longevity, to fast-emerging issues such as cyber, ESG and political uncertainty.

But regardless of the size of their scheme, most trustees will not have the resources they need to address all of these risks simultaneously. As part of their planning processes, schemes must identify which risks are the most significant to their scheme and plan to address those as a priority.

About the research

Aon's biennial Global Pension Risk Survey has now been running for well over a decade and is a barometer of the actions, plans and concerns facing UK DB schemes.

Our 2023/24 research surveyed 204 respondents from UK private and public sector DB pension schemes. The smallest schemes had less than £100 million in asset value, and the largest over £10 billion. We included many different industry sectors including utility companies, financial services, manufacturing, and retail. In total, 87 per cent of respondents were from private sector schemes and 13 per cent from the public sector.

Sixty per cent of schemes were closed to new entrants and to future accrual. Those that remained open to future accrual were typically larger schemes, with 61 per cent having over £1 billion in assets under management. Schemes' solvency levels ranged from less than 80 per cent funded, to over 100 per cent funded on a solvency basis.

The majority of respondents (62 per cent) were trustees, including professional trustees. A quarter (25 per cent) of responses came from pension managers and just over one in ten (11 per cent) from scheme sponsors.

The range of risks is widening

The research explored different areas of risk and their impact on UK pension schemes, including liability risks, investment risks as well as governance and operational risks.

Since our 2021/22 survey, the range of risks faced by DB schemes has broadened. Trustees have always had to prioritise their workload and scheme projects in order to address the risks facing their scheme – but this time we found that the process is becoming increasingly challenging and scheme-specific.

Risk priorities vary with role

In this year's survey, and for the first time, we asked respondents to rank seven key risks to their scheme in order of importance. The results reveal some interesting differences between trustees' and scheme sponsors' perceptions of risk.

Investment returns were the highest priority for both trustees and sponsors. This was surprising, as schemes' funding positions have generally improved over the past two years and more schemes have started to de-risk their investments as they prepare for buyout.

Our risk ranking exercise also showed some key differences between trustees' and employers' priorities. Sponsors ranked longevity risk and regulatory risk as their second and third highest options, whereas trustees ranked interest rate and inflation risk in second place, with the other two risks moving down a place. The key takeaway is that perceptions of risk priorities are not always shared among stakeholders.

Covenant risk was a surprisingly low priority for both trustees, who ranked it sixth out of seven risks, and for sponsors who put it at the bottom of the list. This may reflect improved funding positions, but The Pensions Regulator's (TPR) forthcoming DB Funding Code could encourage trustees to take a more cautious view of covenant strength.

Regulatory burden and political uncertainty hits schemes

We asked all respondents a 'freeform' question about additional risks that their scheme is facing – 44 per cent replied that regulatory burden and political uncertainty are a key area of concern.

Our research answers pre-date the July 2023 Mansion House reforms, which launched new consultations on potential investment strategy and governance changes that could affect DB schemes. Even before those announcements, trustees' and sponsors' responses show that they are concerned about the impact of increased regulation and compliance on their scheme.

Some respondents said that regulation delivered little benefit for the time involved to become compliant. "Regulatory updates can be a drag on time resources… it sometimes feels that initiatives are being forced with no real benefit," said one.

With a general election due in 2024 or very early 2025, proposed legislation in this or other areas affecting pension schemes could stall or even be reversed depending on the election outcome. That is also likely to be fuelling concern and adding additional risk for trustees.

At the time of the survey (and at the time of writing this article) the final versions of TPR's delayed General Code and DB Funding Code were still to be released. This may be causing uncertainty for schemes who want to make sure they will be compliant with the new regulations.

The pensions risk prioritisation challenge

The volume and complexity of risks faced by pension schemes of all sizes is growing fast. This year's survey shows traditional risks such as investment, inflation and interest rates continue to dominate, especially for trustees. Newer risks such as cyber are becoming more entrenched, while regulatory burdens and political instability can make decision-making difficult.

Trustees have a real challenge in deciding which actions to prioritise, when to execute them, and how the costs will affect them. All schemes have limits on their resources and expertise, but all will be aware of the risk of non-compliance with regulatory requirements. Being able to differentiate between risks that are urgent and those that are important is vital for all schemes. Our checklist includes some of the factors that trustees can use to assess the urgency risks facing them.

As part of this complicated landscape, trustees and their advisers cannot lose sight of their core objective: acting in the best interests of scheme members. Keeping the right balance between regulatory demands, other forms of risk and members' needs will continue to be a focus for everyone responsible for pension schemes in the foreseeable future. Every scheme will have different risk priorities, depending on their funding position, long-term goals, member needs and trustee resources. Is your scheme ready for the pensions risk prioritisation challenge?

You can download a copy of the survey at www.aon.com/GPRS2023

How to decide what's important and what's urgent

Prioritise with budget, time and resources in mind - Work with advisers and others to prioritise risks and related projects according to budgets, skills, human resources and time. That means balancing important ongoing projects such as GMP equalisation and end game planning with urgent risks that the scheme is facing.

Talk to the sponsor – trustees and sponsors may have different risk priorities, or perceive the urgency of risks differently. Involving the sponsor in planning and decision-making helps to make sure that everyone is agreed on the scheme's top priorities and supportive of trustees' actions.

Regularly review the risk register – the risk landscape for DB schemes is changing. Risk registers need to reflect the real-life range and complexity of risks facing the scheme and their potential impact on the scheme.

Look at the wider environment – We have seen significant changes to market conditions over the past 12 months. These present both investment opportunities and risks, which are scheme-specific. Deciding whether to act urgently to take advantage of market opportunities will depend on factors such as a scheme's end goal, funding position and preparedness for buyout.

Think about how compliance-related work can benefit the scheme more widely – Preparing for regulatory compliance can often help schemes in other ways. For example, although the pensions dashboards programme has been delayed, many schemes have used GMP equalisation as a platform to do broader data cleansing of member records as well as other preparatory work on scheme data. This will have wider benefits and act as prelude to the introduction of dashboards.

Keep training up to date – An effective training plan helps all trustees build up their skills and knowledge and remain aware of current and emerging risks. Training needs are often scheme-specific and time-sensitive especially for urgent work. The Pensions Regulator also regularly updates its Trustee Knowledge and Understanding syllabus to cover new topics, such as cyber risks.

Written by Aon head of UK Retirement Policy, Matthew Arends, and partner, Alastair McIntosh