# Interesting times

**Maggie Williams looks at the variety of new and emerging risks for pension schemes**

**Summary**
- The range of new and emerging risks that DB and DC schemes face is becoming wider.
- Regulatory pressures are particularly challenging for trustees.
- Core risks such as investment remain but are changing.
- Emerging risks include cyber and AI, limited member knowledge and DC decumulation.

Geopolitical instability, climate change, cyber, artificial intelligence (AI), and even the changing nature of retirement itself are just some of the factors that are creating new and emerging risks for pension schemes.

Trustees now face the combined challenge of identifying new and emerging risks, then making sure they have the skills, policies, resources and governance in place to address them.

"The spectrum of risks that schemes face is widening," says Aon head of UK retirement policy, Matthew Arends. "Risk management is becoming scheme-specific and dependent on trustees' circumstances. Being able to prioritise and differentiate between important and urgent risks is vital."

### Changing DB investment risks

With the impact of the 2022 gilts and LDI crisis still fresh in DB schemes' memories, perhaps it's no surprise that recent research from Aon found that trustees' top risk priorities remain investment, interest rate and inflation.

However, as Cardano partner and co-head of clients, Patrick Cunningham, says, the nature of investment risk is changing: "While we might see a reduction in equity risk and management, there is now more focus instead on corporate bond risk and widening credit spreads."

Sustainable investment also continues to be a focus, with risks such as limited fund track records, 'greenwashing' and regulatory requirements all demanding trustees' attention. Arends argues that "small steps and positive intent are the most important". He cautions against "great becoming the enemy of good, with the result that schemes do nothing at all other than basic compliance".

Cunningham says the risks associated with LDI strategies exposed by last year's gilts crisis also remain high profile: "Lots of the issues from last year were in co-mingled LDI funds. Trustees can think about a 'fund of one' structure that creates a bespoke hedge as an alternative."

### Long-term goals

One of the positive outcomes of the crisis was a general improvement in schemes' funding positions, helping many to get closer to their long-term goal of buyout. But, says Arends, that is driving capacity risk with insurers, in terms of human expertise. "While there's no issue with capital capacity, people with the skills and knowledge to guide trustees through a buyout is an issue. As a result, processes are taking longer." Newer options, such as super funds and DB consolidation, could gain traction soon, perhaps helping to alleviate some of this pressure.

### High-quality governance

Scheme governance models are also shifting. "Standing down a traditional board in favour of a sole trustee and fiduciary manager opens up some new and different risks," says Cunningham. "We have been interested to see how professional trustee companies approach this – especially in terms of how well a sole trustee is supported by a wider team."

Sole trusteeship can simplify governance, but Vidett client director, Mark Cliff, argues that losing member-nominated trustee (MNT) perspectives presents different challenges. "You risk losing the insights of members and hearing messages directly from them. We need to find ways to bring member thinking into decision-making within new governance models."

The Pensions Regulator (TPR) CEO, Nausicaa Delfas, is committed to reducing the risk of poor trusteeship. Speaking at a recent PLSA conference, she said: "We want appropriately skilled and qualified trustees who can ask tough questions. We also want diversity of thought to drive good governance."

**Regulatory burden**

The July 2023 Mansion House reforms introduced a wealth of proposed legislation for both DB and DC schemes. But even before then, trustees were concerned about the volume of regulatory change, and scheme time and resources needed for compliance. Delays to key documents such as the DB Funding Code have added to that uncertainty. "Schemes are worried about the extent of regulatory change and uncertain pensions policy, all of which is an implementation burden," says Arends.

**DC risks**

DC schemes have not been exempted from regulatory change. "We have seen a lot of new regulation and focus on continually improving DC. That is mostly positive," says Aon partner and head of DC, Ben Roe. Scheme consolidation to improve governance, member outcomes, and providing scale and value are all key areas of focus. However, as with DB, Roe cautions that "we need to ask if pushing more compliance and governance onto trustees is adding value".

In particular, Roe questions whether current industry and regulatory scrutiny of charges should be the primary focus. "There are stark differences between the best and worst performing default funds. But at the moment, the emphasis is on differences in charges. Is this the biggest risk to member outcomes?"

Some of DC's current risk issues are the result of past processes says Roe. "Trust-based DC has suffered in comparison to DB schemes. It has not had enough time spent on it by trustees and needs to be much higher priority."

**Decumulation risks**

As savers become more dependent on DC pensions to fund their retirement, the flaws in decumulation products and processes are becoming apparent.

Columbia Threadneedle Investments head of pensions and investment education, Chris Wagstaff, says limited support for members approaching retirement is a major concern: "Savers' decision-making processes continue to be largely unsupported. They need accessible frames of reference, guidance and low-cost advice. Most people simply don't know what's feasible at and in retirement."

Wagstaff points to Pension Wise, the PLSA's Retirement Living Standards, and pensions dashboards as three initiatives that can help, but he says, "much more can be done". There is the inevitable risk that "most people will never truly engage with the complex decisions they need to make, nor have the confidence and capability to choose and manage the retirement solution that most closely meets their needs."

Decumulation-only collective defined contribution (CDC) is one potential solution, says Wagstaff, as well as "the legendary power of the default" in creating retirement paths that support savers that struggle to make decisions.

**Lost pots**

Members can't see the full value of their pensions savings if they can't find lost pots. Research carried out by Hargreaves Lansdown found that 23 per cent of scheme members believe they have lost track of a pension. "Knowing how to track these lost pensions down is vital to members' long-term financial security," says Hargreaves Lansdown head of retirement analysis, Helen Morrissey.

The government's consultation into how to manage legacy pots should help to provide a solution and pensions dashboards should be another obvious panacea. However, Arends warns that these could, in the short term, create their own issues. "The dashboards will provide a lot of information, but it may not give members the answers that they need. There's a member confusion risk that dashboards will generate a lot of questions that schemes will need to support."

**Digital risks**

As digital tools take an increasing role in pension provision, social media scams, cyber issues and AI will all become more significant sources of risk. Aon found that the number of DB schemes experiencing a cyber incident doubled in the two years between its 2021 and 2023 *Global Pensions Risk* reports. Although numbers are small (this year's report found that 14 per cent of schemes had experienced an incident), Arends says that cyber risks "cannot be ignored" by schemes.

The use of AI in pensions is still at an early stage, but as with almost every other area of life, the opportunities and risks that it presents are still emerging. "AI needs some core principles," says Delfas. "We can't simply turn round and say 'AI did this' if there is a problem. We want to harness innovation and engage further, but we need to be aware of the risks as well as the opportunities." Delfas also points to embedded bias in AI algorithms as a risk that could affect member-facing technologies.

"In a short period of time, we have seen some risks diminish and others rise quickly," concludes Cunningham. The outcome of that for trustees will be greater pressure to prioritise major risks, continually review risk registers and potentially rethink the entire governance structure of their schemes. While the volume and complexity of work for trustees might feel overwhelming, as ever the greatest risk of all is to do nothing.

**Written by Maggie Williams, a freelance journalist**

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