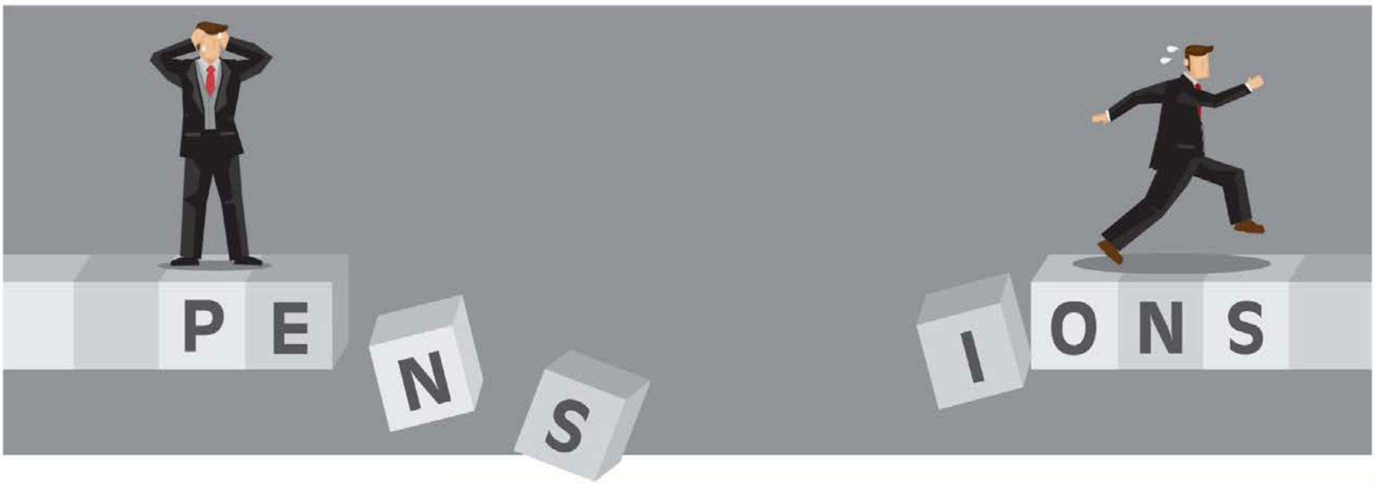
Remembering risks

Compared to DB, DC passes the bulk of risk onto the member. But there are still a number of risks that the sponsor and trustees hold onto with DC. So what are these 'left behind' risks?



Reputational risk

As an employer, it may seem a straightforward choice to choose a GPP and remove all responsibility and risk from your retirement solution. But if your employees' funds were to significantly underperform, there is no doubt responsibility for the choice will come back to you, the employer. A corporate brand can suffer through perceived simple choices.
Ensign Retirement Plan pensions director Ivan Laws

In recent years, pension scandals have increasingly been reported in the press, bearing the risk of damaging the reputation of both the sponsor and the trustee. Whilst most of these cases have been DB pension schemes, as the DC market gains in prominence, DC schemes' exposure to reputational risk will also augment.
JLT Employee Benefits head of DC investment consulting Maria Nazarova-Doyle

Adequacy risk

The evidence is clear that without decent contribution levels throughout an employee's working life, there will be a shortfall when it comes to retirement. With auto-enrolment levels at a bare minimum, there is a genuine risk that 20 years from now, there simply will not be enough money for people to retire on. Auto-enrolment currently puts the primary focus on the employee. However, it is worth bearing in mind that in the event of a financial shortfall in generations to come, it makes more sense politically for the government to turn to employers rather than employees, to help fill this gap. This poses a significant financial risk to employers down the line.
Ensign Retirement Plan pensions director Ivan Laws

Employers may find that 'natural staff turnover' at retirement age is deferred if employees simply have inadequate retirement provision. This can potentially lead to employers having an ageing workforce that may impact their business, dependent on sector. Whilst it's great to encourage people to remain productive later in life and continue to work, it is just not practical for some occupations.

This dynamic of uncertainty around retirement age should not be underestimated for both employees and employers. Reviewing an investment strategy that de-risks and reduces investment returns is one action that should be considered. Having in place a DC investment design that delivers a targeted return with dampened volatility can help manage through uncertainty around retirement age and produce returns that will ultimately support employees income when they finally do stop work.
Standard Life Investments investment director Andy Dickson

Inadequate retirement outcome may result in employees being unable to retire, causing a knock-on problem for the employer. The member may also complain or even attempt to sue if the

default option has been inappropriate. This can also create a reputation risk for the employer if poor outcomes for employees become public.
PTL client director Donny Hay

Regulatory risk

The increased governance requirements also come with more proactive scrutiny by regulators and this has been accompanied by greater visibility of non-compliance and fines. This can cause undesirable reputational damage, both externally and with employees. Also, governance standards and requirements for DC schemes have increased in the last few years, especially with the introduction of auto-enrolment. For employers, this means increased outgoings, especially when the auto-enrolment default charge cap limits the extent to which these costs can be passed on to members.
Independent Trustee Services client director Dianne Day

Fines for non-compliance may occur, for instance for late chairs statement, scheme return or annual accounts. However, trustees tend to be indemnified so it would be the sponsor that has to pay.
PTL client director Donny Hay

Ambivalence

For many, pension provision has always been a positive part of an employee benefits package, helping to attract and retain the best employees. The days of generous DB packages are gone, but that does not mean the DC equivalent cannot be used as a loyalty tool. In today's transient economic workforce, employers should avoid the ambivalence risk by using every tool they have to retain employees. However, if employers dilute both contribution levels and employee engagement, they only have themselves to blame for high staff turnover, lack of loyalty and an ambivalent attitude in return.
Ensign Retirement Plan pensions director Ivan Laws

Pension schemes are part of the overall benefits package provided by employers. Companies with a more paternalistic culture and those with better governance over their pension arrangements often achieve a higher level of recognition from their staff, improving their loyalty. Conversely, less caring employers and those whose approach to pensions is merely coming from a compliance perspective risk seeing a disengaged, undervalued and unmotivated workforce.
JLT Employee Benefits head of DC investment consulting Maria Nazarova-Doyle

Risk of errors

DC administration is a lot more complex than it appears and the risk of systemic error is greater the more intricate the investment strategies and options are. Rectification projects are extremely costly and time consuming. There's a balance to be struck between some of the more complex default investment strategy designs and the risks involved in implementing them by administrators, eg implementing lifestyling at the right time, switching, etc. In addition, security of assets and data are risks to be managed, with increased regulations and protections.
Independent Trustee Services client director Dianne Day

Counterparty risks

Counterparty risks could be, for example, the risks arising from investing in platforms, which are becoming more common for DC schemes. These risks include if a platform provider defaults, and the difficulty in recovering costs if an investment goes wrong and the manager is deemed to be at fault.
PTL client director Donny Hay

Helping members with DC decision-making

Many trustee boards and employers debate the extent to which they should provide guidance to members on making decisions about investments, contributions and adequacy in DC. This is an area of risk because members may rely heavily on communications from trustees and employers to make decisions and this could be an area of future member complaints. Is doing a poor job riskier than doing nothing? TPR's DC code states that trustees should regularly communicate the importance of contribution levels to retirement outcomes. Many trustee boards, especially those with DB experience, want to do more but are unsure where their responsibility begins and ends. In addition, the ability to provide good member communications and for the employer to fund individual financial advice is impacted by cost constraints.
Independent Trustee Services client director Dianne Day