Yesterday, we outlined how a VUCA screen—assessing volatility, uncertainty, complexity and ambiguity—can be used in the context of pension management in order to better define an agenda for the Chief Investment Officer (CIO).

Today, we look at the systemic risks pension fund CEOs must assess and navigate.

Systemic risks were laid out crisply in a World Economic Forum report last year. Beyond financial risks, they include economic risks, environmental risks, geopolitical risks, societal risks and technological risks, and it would be no surprise if the 2020 edition recognizes pandemic risks as a specific category.

These systemic risks and their interconnections establish a set of priorities for a pension fund’s CEO agenda. For instance, the aftermath of the 2008 financial crisis has led to very sophisticated risk management policies, techniques and metrics like strategic cash reserves, risk appetite statements, etc. Concepts like risk parity and other numerical tools have been added to portfolio management.

But today, the CEO agenda is governed by trying to answer three key questions on the scenarios from which analyses are completed.

1 – The macroeconomic question

What is the macroeconomic scenario for the next two to three years as this pandemic comes under control and government support vanishes? What will be the capacity of governments to support the recovery, and will central banks continue to be able to accommodate? How long will these rates remain low? Is there a ceiling to the government debt level? Is inflation at our door?

Part of the answer is a better understanding of how digitization is transforming business dynamics and consumer and worker behaviours, and how this all puts pressures on disinflation, if not on deflation.

Part of the answer is also a careful study of how environmental disasters and extreme weather events, along with the consequences of the pandemic, will keep governments deeply involved in their economies.

Part of the answer is also in deep research on how swiftly the developed world is facing a major imbalance between income, wealth and health across the population and the ineffective governance model of public policies to cope with these challenges. Are we close to massive social unrest?

Part of the answer is also in the new world trade dynamics resulting from the political-technological war between China and the West.

In other words, the macroeconomic scenarios will be significantly affected by the technological and AI disruption, environmental challenges, public policy governance and the new international political dynamic.

2 – The environmental question and the purpose of companies

ESG 4.0 is currently happening.

Strained assets, as Mark Carney called them, are a reality, and the pressures on asset and pension fund managers to lead on green finance and inclusiveness will continue to increase dramatically. Greenwashing will be under intense scrutiny as more transparency will be less costly in a digital world.

Participants in pension funds will have great expectations on these issues to a point where CEOs of pension funds will have to explain what they do, where they invest and how they vote.

3 – The “buying local” question

Similar to pressures to eat locally and to build and manufacture locally, we should expect increasing demands on pension funds to invest locally and to protect local ownership. Moreover, public opinion is more polarized than ever and in the absence of consensus, activists of all sorts can dominate the “news” on social and traditional media. In this world, elected leaders have to demonstrate their capacity to lead and decide almost every day. In this context, CEOs of public pension funds are facing new arbitrages between the “best investment decision” and the best outcome defined and framed in the “news.”

The CEO and the CIO agendas must converge, and for that, an explicit review process is a requirement. However, in coming years, this exercise will be increasingly difficult on the one hand, the CIO agenda is becoming much more demanding on all fronts as the CIO needs to invest in a world of low interest rates, high asset values, greater volatility and great uncertainty. At the same time, the great technological disruption and the pressing environmental issues, combined with the rise of “buying local” and other populist forces, will impose a more political agenda on the CEO. Not least, pension funds will have to adopt a vigorous communication plan to manage pensioner expectations, and address the multiple interrogations by stakeholders and the media that are a feature of the new world order.

To be successful, and to paraphrase Harvard’s Bill George, VUCA situations call for a leadership response in the form of VUCA 2.0: Vision, Understanding, Courage and Adaptable.