Pension Plan Fix-It Handbook

Employee Benefits Series THOMPSON October 2015 | Vol. 23, No. 1

Market Volatility: How Concerned Should Retirement Plan Fiduciaries Be?

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Financial market volatility is not new; we have experienced it before and no doubt will experience it again. But regardless of how many times we live through it, market volatility can be unsettling. Its impact is felt by both defined benefit and defined contribution plans. It raises questions and concerns for both plan participants and fiduciaries. However, the presence of market volatility provides an opportunity to revisit existing investment policy statements and risk management strategies.

What can a plan sponsor do to help ensure it is fulfilling its fiduciary responsibilities?

Go Back to the Basics

Always keep ERISA's basic fiduciary requirements as your guideposts as you address market volatility:

- act solely in the interest of plan participants and their beneficiaries;
- carry out duties prudently and call in the experts when needed;
- follow the plan documents (unless inconsistent with ERISA);
- diversify plan investments; and
- pay only reasonable plan expenses.

Recognize what you can control and what you cannot. Develop a risk mitigation plan for those items that you cannot control.

Sources of Volatility Outside Sponsors' Control

There are many sources of market volatility beyond the control of plan sponsors, including:

- global economic conditions;
- political environments;
- speculative investing by others; and
- knee-jerk investing or panic buying and selling, such as dumping equities and buying bonds as equity markets drop.

Addressing Volatility Within Sponsors' Control

While a plan sponsor cannot control the external forces that affect financial markets, plan sponsors *can* mitigate risk for their retirement plans by:

- Following a documented decision-making process.
- Identifying the key internal and external players and ensuring that all parties know their responsibilities.
- Working with investment advisers to develop a defined contribution plan fund line-up that suits the plan's participant demographics.
- Developing a defined contribution plan investment policy based on your study of participant demographics and reviewing both the policy and demographics periodically.
- Working closely, if a defined benefit plan, with the plan's actuaries and investment advisers, to develop an investment strategy to match plan benefit liabilities with assets. Reviewing the investment strategy periodically.
- Monitoring any investment decisions/policies/strategies periodically to ensure that what you expected is happening. Each actuarial valuation presents the perfect opportunity to review the investment strategy but should not prevent more frequent reviews between annual valuations. Quarterly reviews for defined contribution plans might be warranted during turbulent markets.
- Documenting the process and the decisions.

Possible Actions to Take Now

Whether the financial markets continue their recent gyrations or not, think about which of these steps you can take now.

See *Andersen*, p. 2

Andersen (continued from p. 1)

1. Consider calling a meeting of the appropriate plan fiduciaries (for example, the Benefits Committee and the Investment Committee). It is important that all accountable parties come to the table and understand their responsibilities to the plan, especially in volatile markets.
2. Defined contribution plans should refer to their IPS. Does it address market downturns or decreases in the value of particular funds? Does the IPS have trigger points that will require action? Your investment selection was based on your plan's demographics. If the demographics haven't shifted, should you really change your investment lineup?
3. Defined benefit plans should refer to their portfolio risk management strategy. Does your strategy include portfolio modeling that explores the ramifications of interest rate rises? How will the plan's funding status be affected by portfolio value decreases at various percentages (for example, drops of 3 percent, 5 percent, 8 percent, 10 percent or more)? If you did portfolio modeling, is there any better time to review those forecasts than now? If you are in the middle of preparing next year's budgets, will the current market volatility warrant an increase in contributions? Understand and be prepared to inform senior management how continued volatility might affect defined benefit plan liabilities, and therefore the company's financials. How will falling equity markets and low interest rates affect your defined benefit plan's funding status? Will it cause a large-enough drop in funded status to trigger benefit restrictions?

It might be prudent to bring in the experts (such as actuaries, investment advisers, counsel) to meet with the plan fiduciaries. Is it time to fine-tune any defined benefit plan modeling? Does the existing investment strategy work in volatile times? Is it time to reconsider "derisking" the defined benefit plan? Is it time to increase the equity portfolio given generally low stock prices? Is an increased equity position prudent, given the volatile environment?

What, if anything, will you communicate to plan participants? In many defined contribution plans, the plan service provider call center answers participant questions Do you know what they are telling your participants during volatile times? It might be wise to share with your HR department what the third-party administrator's call center is telling employees.

Consider developing a standard message for HR to share with participants. Remind participants of the long-term horizon of retirement investment. Such a message works for all ages of participants, whether they are far from, or near, retirement and potentially facing the need to finance 20 years of retired life.

Remain cognizant of any recently enacted or pending changes that also could affect plan costs (for example, mortality tables for defined benefit plans or accounting changes that involve valuing plan assets).

The Bottom Line

Keep everything in perspective.

- Remember, the basic purpose of the plan is to provide retirement income. Maintain a long-term horizon view.
- Have a strategy for dealing with volatility and act upon it.
- Document meetings and decisions.
- Have periodic check-ins with your advisers regarding any proposed or recently enacted legislation that, together with market volatility, may affect your plans.
- Keep senior management informed.
- Be prepared.

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