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DC Pensions – Prudent Risk Management Pays Off

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With the amount of commentary related to plan sponsor fiduciary risks associated with Defined Contribution plans one would think the logical solution is just to steer clear of them. Fortunately, plan members have demonstrated that the lifetime value of this benefit is well worth the business resources required to ensure the risks are managed prudently. The 'benefits' definitely outweigh the 'risks' – provided you manage the risks well.

For DC plans, risk management starts with defining the responsibilities and reporting requirements for the various stakeholder levels. Typically, these levels include the board who hold ultimate responsibility for the program; the pension committee who are delegated with operational oversight responsibility; and, of course, plan members who are the beneficiary of the plan.

Further Defined

Responsibilities are further defined for sub-advised or delegated functions such as record-keepers, consultants, custodians, and investment managers. In short, define the levels of responsibility and the expectations for those within the board, operational, or plan membership role – keep in mind that ultimate responsibility falls on the highest level of stakeholder.

The next process, after identifying the requirements for various stakeholder levels, is delegation of responsibilities in managing risks associated with the plan. This includes having documentation and a structured process for monitoring items such as investments, suppliers, communications, funding, and compliance. While many organizations have the best intentions at heart for oversight, a lack of documented structure can undermine the best efforts of those charged with plan responsibilities. Develop, monitor, and follow the governance documents for your program – these documents are not static and should be updated at least annually. This ritual forms the process for annual oversight and documentation of this internal oversight process and is what forms the governance history for the plan.

The documents that are used by all levels of stakeholders must be relevant, understandable, and provide direction. Plan member communication that does not appropriately describe the actions required by employees to join a plan, select an investment mix, or elect a contribution level is not altogether uncommon. Review of employee communication for new members and communication for those who have been in the plan for years is an important process which should be conducted regularly to manage the risks of not just what you say, but how you say it.

Helpful Document

The same document requirement elements of relevance, understandability, and direction hold true for pension committee documents such as the investment policy. It is likely that the investment policy is not written by the user, but it most definitely should be a helpful document in the conduct of investment oversight by the pension committee member. There is no question that not having a document poses a risk – having one that is not followed or reviewed periodically to see if it is still applicable is clearly a larger risk. Plan sponsors that do not have extensive resources dedicated to pension oversight structure and document needs would be well advised to find a consultant to assist in a holistic overview of the process and elements in place and items that require attention.

The three levels of stakeholders noted above (board, pension committee, and plan members) require feedback on delegated responsibilities. For the board, this can be in the form of a report summarizing the plan and its funding for the current and coming year as well as material changes for suppliers, legislation which could impact the pension plan, and confirmation compliance and governance documents have been followed and reviewed. For plan members, there should be an annual statement to members outlining the activities of the pension committee. This flow through of communication helps in the transparency needs of good governance and provides better value for the activities conducted. As pension committees are looking after the interests of plan members, it is indeed logical to report on these activities.

Sound Governance

So, are there risks associated with sponsoring a DC plan? Absolutely, but one could argue that almost all of these risks can be managed through a sound governance structure. Some outcomes are not absolutely in control of the plan sponsor. For example, there is no requirement or expectation for a DC plan sponsor with a voluntary plan to ensure all employees join the plan – the expectation is that all employees have received the appropriate communication regarding the ability and benefits of joining the plan. Likewise, a volatile and protracted period of market volatility and declining asset values cannot be controlled by the plan sponsor – there is an expectation that members have received adequate resources to manage their accounts despite market volatility. The most significant risks for plan sponsors generally stem from lack of oversight or poor documentation of the oversight process.

Clearly, organizations that sponsor a pension program feel the risks of not sponsoring a pension plan (for example, the inability to attract and retain valuable employees) are likely greater than the risks above if managed correctly. I agree with this completely.

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