Marris Miller

Bad Times are Good Tests: Pension Security in the Time of COVID-19

The Pension Papers™

The stock market, as we all know, is in the midst of a panic, plummeting heavily as the overwhelm of COVID-19 is taking hold. Headlines suggest that some of the world's biggest companies are in crisis, especially those that rely on the travel industry, like Boeing, who has just asked for US$60B in bailouts, as well as countless hotels and restaurants. The New York Stock Exchange and the Dow Index are closing at record lows, some calling the situation closer to the 1929 crash, than to the drops experienced in the global economic crisis of 2008.

But now is not the time to change direction quickly or to panic. It's actually a time for pension members to take a deep breath, and wait.

As Annie Lowrey at The Atlantic[1] warned her readers last week, bad times are good tests for the strength of pension security. Worldwide recessions, our view of the economy and global events that drive panic and challenges to our collective confidence, will always be tests for the quality of pension resilience.

M. Catherine Miller
Managing Partner, Marris + Miller

[1] https://www.theatlantic.com/ideas/archive/2020/03/dont-touch-your-stocks-during-coronavirus-crisis/607672/

CONTENTS

Bad Times are Good Tests

No Pension Manager Should Be Taken By Surprise When A Crisis Happens

Let's look at the Colleges of Applied Arts and Technology (CAAT) Pension Plan. As they reinforced to their members via a message sent on March 10th, the plan's benefits remain very secure. In fact, the value of the plan is currently sitting at 118%, with funding reserves of $2.9 billion. With a massive set of asset smoothing reserves and realistic valuation assumptions in place, CAAT had planned for just this eventuality. Not only that, the plan knew exactly what was needed, in terms of their communication and management strategy, to ensure that their members had confidence in their strategy and would remain aligned with CAAT's leadership team, as they headed into the eye of the storm.

These advanced-level pension management practices, where pension communications are marked by clarity and calm, even in a crisis, do not happen overnight.

As Patrick Collinson in The Guardian reports, the vast majority of pension schemes are built to last, so, for example, a 5% fall in the market does not equate to a 5% fall in the total value of the fund.[2] That's because most funds include a solid mix of market-based equity, some government and corporate bonds and property. Most funds are built on this kind of foundation, with long obligations, which makes them stronger because of their long term orientation.

In fact, we need to expect volatility in the market, even without COVID-19. Pensions need to be built to handle the implications of and recovery from any volatile market situation, such as a smaller market crash that takes place because of, for example, a change in regulations or a shift in a core industry.

All pensions should be created to:

- **Handle liquidity risks.** Pension payments and contributions should not be interrupted, so that the plan is not cashed out at the bottom, when the plan is facing layoffs. This means that a liquidity risk assessment should be a priority in planning.

[2] https://www.theguardian.com/money/2020/mar/09/what-the-coronavirus-market-fall-means-for-your-pension

- **Handle system and technology risks**. During a crisis, it is important to streamline record-keeping and processes; if workers are working from home, for example, protocols should already be in place to ensure data security, and a refresher on how to protect data while away from office, should be forthcoming to all employees.
- **Handle communication risks.** When challenges crop up, pension providers may need new ways to communicate with members. As well, electronic signatures may need to be used because people are not in the office to sign documents. Even so, pension data is sensitive, so it is critical that companies invest in the most secured channels and encryptions.

Pensions that stand these crucial tests are those that are carefully structured and planned, well in advance, to manage the unexpected. Crises will always happen, and always in new forms, and so the key focus is to ensure that your pension management protocols have an operational risk management strategy in place. The last thing you want to do is to employ last-minute counter-moves when things go bad, so lesson number one, is be proactive and plan ahead for any eventuality.

COVID-19: Exposing Vulnerabilties

Even though many pensions have built-in checks and balances, COVID-19 can reveal the vulnerability of singular pension accounts.

In direct contribution (DC) plans, each member of the plan (and sometimes his or her employer) pays into an account each month. These contributions are used to purchase assets, such as mutual funds or some other asset. At retirement, these assets can be withdrawn. This means that the risks associated with DC plans are linked to the performance of the asset: if the assets are non-performing or the employee chooses the wrong asset in a large list of possible assets, such as mutual funds, then that employee’s future earnings are uncertain. These accounts are therefore very different than defined benefit (DB) plans, in which the plan risk is shared among all stakeholders, managed by a pension management team and monitored by a panel of trustees.

For DC members, this means that there are very few options for crisis management, unless they have been building up a reserve to counter market lows which eventually increase, even after massive market failures. But, due to the fact that DC plans have lower contribution rates and higher administrative expenses, it is unlikely that an individual could have built a reserve in the plan.

The other risk of a DC plan is that individuals will require a significantly higher level of personal savings, for an adequate retirement standard. And, unfortunately, there are people who are forced into retirement during business crises, many of whom are suddenly left with a fraction of their account balances. If these individuals start pulling money from their accounts during this time, they risk depleting their account even faster.

Singular DC accounts, in contrast with DB plans, are therefore less efficient and the more risky during a crisis. They do not offer the benefit of risk pooling or building up reserves in the same way that DB plans do.

Pension Implications In Coronavirus Times: Plan Now And For The Future

Proactive planning is what builds a strong DB plan, and, at this critical time, it's what all pension managers should be thinking about. It's not too late to turn in the right direction for the future.

In fact, while we are facing the challenges of COVID-19 in the short term, this may be an expected – and positive – opportunity to test our vulnerabilities and assess where we may have risks that need to be addressed. This is a time when we can actively reflect on where we can build up our risk management tool kit and deliver a better pension strategy for the future.

There are four key processes that will help pension managers plan cohesively to expect the unexpected:

1. **For pensions plans, building a reserve should not happen merely for the sake of compliance, but to truly prepare the plan for the unknown.** Just like an architect needs to consider what happens in the case of an earthquake, rather than what happens with regular foot traffic down a building's hallways, pension managers also need to consider the likelihood of a large scale event, getting in the way of perfect predictions. For example, when companies go bankrupt, or even economies melt down, as they did in 2008, we realize that some risks are truly unknown.
2. **It's important to manage pensions in the same way that you manage other assets: through constant risk management techniques.** Research in the field shows that the probability of distributions of different risks can have different forms. Some risks are linear, others are barrier-like, others are logistical, and, as a result, not all risks can be presented by a single numerical estimate[3]. It's important to work through all of the risks that specifically affect your business and your fund. A risk management strategy ought to create checks and balances for every possible outcome.
3. **Good communication planning should be a priority during good times and bad.** The last thing that you want when addressing a crisis such as COVID-19, is to deal with individuals who are fearful and who need answers. Communication strategies should be practiced and forthright, so that people feel like they have transparent and helpful information when they need it.
4. **Use this time to do a critical plan assessment.** It's time to take a clear look at everything that is happening in your pension plan right now. Even if things are going well, there are a lot of new changes that will be taking place, as the result of this global crisis. Talk to your Marris + Miller team member for up-to-date information on how you might want to shift your strategy going forward.

[3] Turchin, A., & Denkenberger, D. (2018). Global catastrophic and existential risks communication scale. Futures, 102, 27-38.

It is always the unknowns that impact performance, which means that true resilience comes from managing the unexpected. It's a pension manager's job to ask questions early and often. Even though we will always be looking for better ways to assess risk, pension managers have to be the first point of contact when it comes to decision making, and it's necessary for you to explore all of the possible internal and external factors, that are specific to your industry and company, that may have an effect on your pension outcomes.

Pension managers can get through these difficult times if we stay focused on what matters: learning, improving and understanding risk, even better than we ever have before.

Follow us on Twitter
@MarrisMiller
Connect with us on LinkedIn
linkedin.com/company/marris-miller
To change your mailing address
Marris + Miller Clients and Other Recipients
support@marrismiller.com
Marris + Miller Partners
partner_connections@marrismiller.com
To provide feedback or request copies
publications@marrismiller.com

April 2020

Marris + Miller publications meet the Forest Stewardship Council® chain-of-custody standards. The paper used in this publication is certified as being produced in an environmentally responsible, socially beneficial and economically viable way.
Printed in Canada.