THE EXCELLENT FIDUCIARY

A Volatile Stock Market is a Menace for Fiduciaries

*Ronald E. Hagan**

Finance executives and human resources leaders face peculiar challenges when securities markets swing wildly. The novel coronavirus (COVID-19) pandemic ushered in a period of severe volatility in the stock and bond markets. Combine that with employees riddled with anxiety about the safekeeping of their retirement plan assets, and the scope of a fiduciary's burden seems unmanageable. On any regular day, the legal duty imposed on the members of investment and benefit plan committees is already formidable. The antidote for such challenging conditions is a precise and disciplined management process built on a foundation of principled standards. We will discuss ways duty-bound executives can cut their legal risk and sustain peace of mind despite our chaotic times.

SOPHISTICATED LEADERSHIP NEEDED

What some are calling the "2020 stock market crash" erupted Monday, March 9, 2020. The DOW Jones Industrial Average dropped by nearly 8% that day, which was the single-day worst decline in the history of the U.S. equity securities markets. The resulting radical swing in the value of retirement plan assets held in defined contribution and defined benefit retirement plans validates an inquiry into the response of retirement plan fiduciaries. Wild swings in the securities markets are not a new phenomenon; they are, however, always disquieting. For the foreseeable future, persistent uncertainty triggered by the COVID-19 pandemic ensures that concerns over investing outcomes will haunt executives who serve their organizations' retirement plans in a fiduciary capacity. We call such executives the "Responsible Persons." The road ahead brings into focus the demands of prudent decision-making inherent in the investment fiduciary role. Sophistication with new technology tools, navigating the work from home culture, and process standards are a must. How it turns out for many enterprises will rely on how well they measure up.

**RONALD E. HAGEN* is Chairman of the Risk Standards Committee of Roland|Criss, which is the premier risk manager for retirement plan sponsors, foundations, and endowments. Mr. Hagen has a lengthy career in risk management, and has pioneered many of the certification, standards practices, and fiduciary risk management strategies that are preferred by boards of directors and human resources executives. He is the host of The Excellent Fiduciary podcast on Stitcher, Google, and iTunes. He can be reached at ronhagan@rolandcriss.com.

REGULATORY CLARITY

Responsible Persons should be informed about what they can and cannot control. More specifically, under federal pension law and other fiduciary statutes, those activities for which they are and are not responsible. Many sources of market volatility fall beyond the control of fiduciaries, including global economic conditions, political environments, speculative investing, and “panic” buying and selling (such as dumping equities and buying bonds as equity markets drop).

Responsible Persons must recognize that they are not legally accountable for the state of securities markets. Instead, regulations governing their management tactics require them to maintain a clear direction amidst market volatility. Their primary duty is to serve the interest of their retirement plans’ participants based on best practices.

The investment fiduciary role carries with it significant risks: regulatory risk, reputational risk, and even personal risk for Responsible Persons. Consequently, regulatory intelligence is essential.

An action plan for traversing the regulatory environment in which Responsible Persons operate includes these steps:

- Know which fiduciary regulations apply to your enterprise (for example, the Employee Retirement Income Security Act of 1974 (ERISA), which is federal pension law; the Uniform Prudent Management of Institutional Funds Act (UPMIFA), a state-level statute for nonprofits and charitable organizations; and the Uniform Management of Public Employee Retirement Systems Act (UMPERSA), a state-level law for public retirement systems);
- Understand how those regulations impact your enterprise’s risk tolerance policy;
- Adopt an authentic governance, risk management, and compliance (GRC) management system to ensure the presence of a solid fiduciary best practices foundation;
- Assess the investment decision-making risks to your employer, its reputation and the reputations of all relevant Responsible Persons;
- Examine the policies, controls, fiduciary training programs, and vendors’ data security systems;
- Recognize any gaps that may exist between your GRC methodology and the retirement plan’s operations and your investment decision-making practices; and
- Add automaton to the task of managing fiduciary controls. The more you can replace old tracking methods with computer-based tools; the more effective oversight becomes with less effort.

MAINTAINING A STEADY COURSE

A complex financial environment such as the one facing Responsible Persons brings with it a barrage of investment opinions from external advisors and an influx of inquiries from employees and even their beneficiaries. This constant theorizing on potential investment strategies, adjustments, and outcomes can make the idea of adhering to simple principles a challenge. Fortunately, there are tangible steps Responsible Persons can take to help keep them on a steady course, regardless of turbulent external factors.

Investment risk management is persistent, ongoing, and intricately linked to every aspect of GRC in a fiduciary setting. It is not a one-time-only undertaking. The continuous nature of changes in pricing, investment structures, and the needs of a retirement plan's participants require unremitting learning about threats and opportunities. For example, decisions to realign asset class choices, fund managers, and managed account programs hinge on the prudence of Responsible Persons. A GRC management system offers a disciplined way to ensure understanding of the principles by which regulatory watchdogs and plan participants judge those decisions.

To be clear, GRC is not a technology. GRC is not a department. It refers to the people, processes, technology, and information that help enterprises take full control of the retirement plans they sponsor. In all too many cases, power was allowed to gradually leak to vendors who are not legally accountable by federal pension and state trust laws for their actions. GRC helps Responsible Persons retake control and fulfill their moral and legal obligations reliably and with certainty.

THE TYRANNY OF HINDSIGHT

Responsible Persons must rectify any shortcomings in their investment decision-making methods in order to adjust their practices to the COVID-19 pandemic atmosphere. Fiduciary laws emphasize the burden to take into account current facts and circumstances. A radical change in investment market conditions, like the one caused by the pandemic, intensifies the weight of that burden. It sets the stage for investment strategies and fiduciary conduct to be called into question after the fact by activist plan participants and relevant regulatory agencies. Hindsight has no value when Responsible Persons find their activities challenged without adequate procedures and records to back up their decisions. The potential for investment decisions to be disputed long after deliberation is a serious challenge. A defined and consistently executed governance, risk management, and compliance system can prepare Responsible Persons to meet it confidently head-on.

AN ACTION PLAN FOR VOLATILE MARKET CONDITIONS

Adopting a GRC management system for your retirement plan holds the promise of organizing and simplifying investment management duties. For employers who have yet to install a GRC workflow and controls system, current conditions may dictate the need for more immediate action. In response to the pressing need to manage investment risk factors attributable to COVID-19 related market volatility, finance and human resources leaders may want to consider the following four steps.

Identify the Key Players and Ensure That All Parties Know Their Responsibilities

Most Responsible Persons rely on at least one, if not several, outside experts for guidance, given the esoteric nature of the investment industry and the various demands on their time. Indeed, this strategic outsourcing is a recommended practice under fiduciary laws. It may be true that each of these retirement plan service providers is suitable for guidance regarding the selection of plan investments. It is essential to know, however, which of these advisors (if any) is legally accountable for providing that type of advice. For example, recordkeeping firms can be considered a resource for investment counsel. By their choosing, though, few accept a legal investment fiduciary obligation. While nothing about this arrangement is inherently wrong, a Responsible Person must be clear about the delineations in this type of relationship. Only then will all parties understand where the ultimate discretion and decision-making power resides (both for practical and legal purposes).

Maintain Regular Communication with the Plan's Participants

Employee communication is perhaps the most challenging aspect of a Responsible Person effectively carrying out their fiduciary duty. The creation and execution of a program to distribute consistent, relevant information for plan participants about investment options and performance are essential. An employer can team with an investment provider to create and disseminate this type of information. Still, the Responsible Persons must play an instrumental role in designing the strategy for this type of campaign. After all, the Responsible Persons have the advantage of knowing the participant audience, demographics, and needs intimately. A study of these factors is essential when determining the medium (print or electronic, or both), frequency, and information scope that participants receive on an ongoing basis. A well-executed communication plan can be the difference between having a group of agitated employees and a team that believes their leadership is doing everything it can to protect their interests.

Document the Decision-Making Process

When talking with Responsible Persons, we find that most believe they spend an adequate amount of time managing their retirement plans. The U.S. Department of Labor's (DOL) enforcement activity over the last few years reveals, however, that many Responsible Persons who spend significant time monitoring their retirement plans lack evidence of their efforts. Specifically, the DOL seeks documentation that provides proof of a careful decision-making process. One of the DOL's strong recommendations includes recording minutes of any formal meetings involving the retirement plan, including sessions for the investment committee, advisor reports or updates, management discussions, and vendor evaluations.

Make Sure the Investment Policy is Relevant to the Current Market Setting

Even if the Responsible Persons have not prioritized a regular review of the plan's investment policy in the past, current volatility prompts the need for an up-to-date analysis. That is especially vital to ensure fidelity by all parties involved in the retirement plan's decisions. The investment policy details how an organization will enable its participants to be "retirement ready" and specifies the plan's risk tolerance and diversification metrics. In a shifting financial market landscape, Responsible Persons and their advisors must be confident that; (1) the parameters of the investment policy serve participants' best interests, and (2) all investment activities align with that strategy. A review of the investment policy with an independent risk management specialist can ensure that all four fiduciary disciplines are in harmony (that is, governance, administration, investments, and controls). Such a specialist can also confirm that all parties, including vendors, that take care of the plan, are successfully fulfilling their role under fiduciary rules.

CONCLUSION

Turmoil in the stock and bond markets does not have to be a source of fear for well-meaning Responsible Persons. By contrast, well-prepared fiduciaries can feel confident that they adhere to best practices while helping their constituents weather economic uncertainty.

Fiduciary laws do not require that Responsible Persons control the markets. Instead, their responsibility centers on the management of a process. Properly structured, it will ensure that a retirement plan's investment structure is best for the plan's participants. An appropriate process framework will also show a track record of prudent decision-making that is defensible in the face of any third-party challenge.