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Is it time for pension plan sponsors to revisit risk tolerance?

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The coronavirus crisis may be a signal for some pension plan sponsors that it’s time to revisit their appetite for risk.

A typical asset-liability study involves stochastic modelling to project thousands of future economic scenarios and see how a pension plan would react under those scenarios, notes Dean Newell, vice-president at Actuarial Solutions Inc. Particularly, the plan sponsor would look at implications for funded status, contribution requirements and expenses, among other factors, under the various scenarios and use the outcomes to inform potential plan changes or risk budgeting.

When the coronavirus hit, pension plan sponsors paused asset-liability studies and were more focused on immediate concerns, says Gavin Benjamin, senior director of retirement at Willis Tower Watson. “But once everyone got settled in their work-from-home routines and the markets did settle down a bit and recover somewhat, we continue to see an interest and desire in doing asset-liability studies.”

While pension plan sponsors are now restarting these studies, they’re not necessarily taking the same form as before, says Daniel Dine, a principal for asset and risk management at Morneau Shepell Ltd. When looking longer term, plan sponsors use stochastic analysis, but in the current environment they’re using more deterministic analysis or shorter-term scenario analysis focusing on the recovery’s potential shapes. “And the question is: if one of those scenarios were to play out, how would your plan be impacted and whether or not there’s any changes that should be looked at today to mitigate any uncovered risks when we’re looking at those different scenarios. That’s really what we’re seeing more of now. It’s that shorter-term scenario analysis to try to get at those risks that are really under the surface.”

On the other hand, Benjamin doesn’t see the form of asset-liability studies changing since the coronavirus. But he has noticed that some plan sponsors are more aware of existing risks and that outlier events can, and do, happen. “The thinking is to conduct an asset-liability study with one of the key objectives to be ready, or to address the risk in your pension plan if needed, to be ready for the next downturn when it occurs down the road.”

While generally, it’s best practice for plan sponsors to conduct an asset-liability modelling study every three to five years, it may be prudent to do so earlier based on plan design changes, market turmoil or changes to a plan’s risk tolerance, Dine notes. “I think today, with COVID-19, a lot of plan sponsors should be considering doing an asset-liability study sooner, maybe in a different form than might have been completed in the past, but not necessarily for changes in the macro-economic environment, but because their risk tolerance . . . or even their capacity to take risk, may have changed due to COVID-19.”

He adds that it’s worth asking if a plan sponsor will be the same coming out of the crisis as it was going into it. For instance, it may not have the same capacity to take risk or contribute additional amounts to the plan if needed. “It may not be as able to come up with that money, therefore the capacity to take on risk has been diminished and that could mean the best strategy for the plan has now changed and maybe risk needs to be taken off the table."

Since the beginning of the year, markets have recovered to a significant extent, but the events that occurred over the last few months may make a plan sponsor uncomfortable with its risk level, Benjamin adds. "To the extent that they're not comfortable with the level of risk, then it would make a lot of sense to conduct an asset-liability study. . . . One of the key objectives of an asset-liability study is to get an understanding of the risk-reward tradeoffs and, to the extent that the plan sponsor's not comfortable with the level of risk, then the plan sponsor can adjust the risk profile of the pension plan."
