

# Managing risks associated with retirement plan mergers

NOVEMBER 2009

Steve Kirschner,  
Head of Transition  
Management, Americas

Investment committees face a number of periodic implementation challenges in the day-to-day management of retirement plan assets—cash management, manager changes, policy rebalancing and asset allocation shifts – each introducing varying levels of risk into their portfolios. But a plan merger, with its elevated project management requirements and impact across all aspects of the plan, is often the most volatile time period a plan portfolio may experience.

## Challenges when merging retirement plans

Clearly, a corporate merger severely affects all aspects of a business. For retirement plans, consolidating assets, trustees, plan administration and technology platforms are unique challenges and can be some of the most complex assignments to manage. For this reason, many firms turn to specialists, such as their transition manager, to assist with project oversight and coordination to alleviate operational risk and minimize asset performance impact.

## ASPECTS OF PLAN MERGERS

Combining retirement plans includes a number of large projects that can be managed either separately or concurrently:

- Consolidation of investment/benefit consulting relationships
- Consolidation of custodial relationships
- Consolidation of plan administration, technology and, in the case of defined contribution plans, recordkeepers
- Asset allocation or asset-liability studies
- Implementation of investment policy and asset allocation changes
- Implementation of manager lineup and structure changes

Each of these aspects of a plan merger include both portfolio performance and operational oversight issues that must be properly managed for an effective outcome.

---

## MANAGING RISK EXPOSURES DURING THE MERGER

From a performance perspective, the first conversation to take place when planning a plan merger must focus on risk management and strategies for mitigating risk. Managing the risks to plan investors' asset value throughout the plan merger process is where an investment advisor can demonstrate excellence. The portfolio management and trading process is designed to ensure the portfolio remains dollar neutral (i.e., not a net raiser of cash nor leveraged) and properly exposed to the markets. In this manner the portfolio profile can be best managed as the trading is constrained with respect to the desired factor exposures (e.g., countries, sectors, capitalization, duration, credit quality). Managing the portfolio characteristics and stock-specific residual risk is how tracking error (i.e., possible performance deviation from target structure's return) is minimized.

### **Key components of properly managing exposures during a plan merger are:**

- Can risks be managed effectively in physical space, or will synthetic tools provide value?
- Are all future managers identified with completed contracts, or will interim investment management be required of a transition provider?
- Where pooled vehicles are involved, can settlement cycles be coordinated (minimizing the required trading) or will cash be unexposed for a period of time (necessitating a synthetic overlay)?
- For pooled vehicles, what is the cost benefit of taking cash or taking securities? Is 'free' cash really free or are the costs applied directly to plan assets through an isolated purchase-redemption process?
- If futures are required to maintain exposure, accounts must be opened and a plan must be put in place to manage collateral and variation margin needs.

Answering these questions and coordinating activity across all of the managers, custodians, consultants, record keepers and client teams can be a daunting project management exercise. These responsibilities can (and probably should) be outsourced to a qualified transition manager with the core capabilities, tools and expertise to act on behalf of the plan and its beneficiaries in coordinating this activity. While performance risk receives the lion's share of attention, these operational issues are highly elevated in a plan merger and can lead to performance deterioration if not managed properly. When choosing a provider, plan managers should place additional weight on the depth of experience a transition manager has with overseeing complex assignments.

The goals of maintaining asset value and adherence to expectations of all stakeholders – from realizing policy weights, to minimizing costs, and to having a proactive stance towards the many forms of risk throughout – must be met. Investment committees must have confidence in the ability of their transition providers to deliver on all these aspects of a successful merger.

Russell has been assisting investors in complex portfolio transitions, including the merger of plan assets, for more than 25 years. Our ongoing role in the implementation of our own multi-manager funds provides us with the core competencies and experience to apply to portfolio transitions, no matter how complex.

*While performance risk receives the lion's share of attention, these operational issues are highly elevated in a plan merger and can lead to performance deterioration if not managed properly.*

## Plan merger implementation checklist

To assist in your planning and to provide clarity into the issues involved, we provide the following portfolio merger implementation checklist. While not necessarily all-inclusive, the answers to these questions will help derive the optimal strategy for your specific transaction and determine whether it was completed successfully.

### CONSIDERATIONS BEFORE THE EVENT

- What types of plans are being merged?
- Which structure, if any, will be the survivor?
- Will any of the legacy funds or accounts continue separately?
- What will the end-structure hold as funds: mutual funds, commingled funds, separate accounts?
- Have the plan sponsors considered unitizing their DB plans, for DC plan participation?
- Have the necessary stakeholders been advised?
- How will costs be allocated among investors?
- What is the role of the Trustee in the day-to-day management of the plan?
- Will changes be made to plan documents that may affect the ability to use instruments such as futures?
- Have any new managers been selected?
- Are there limitations narrowing the set of managers (such as emerging regional allocations, or legacy socially responsible investing mandates)?
- Can these be accommodated within the new structure, or must a legacy structure be maintained?
- Are there specific manager or fund notification requirements?
- Do funds have non-daily redemption/subsription periods?
- Are there any securities lending issues with the funds involved?
- What are the desired asset classes?
- What are the desired asset weights?
- What is the time frame for completion?
- Are blackout periods required?
- Have the pros and cons of blackout periods been weighed?
- How will the transition of assets be managed?
- What security lending issues might there be?
- Do any derivatives contracts need to be put in place?
- Will it be possible to accommodate investor cash flows that occur during a transition?
- Are there requirements for using particular brokers for execution?

### CONSIDERATIONS AFTER THE EVENT

- Were the investment outcomes achieved?
- Was the Net Asset Value (NAV) pricing of fund assets timely and accurate?
- Were things operationally smooth?
- Was risk adequately planned for and managed?
- Did the transition Investment Manager perform per expectations?
- Were the interests of the investor maintained?

**If, at the end of the merger, the key stakeholders are satisfied, costs have been kept in line with expectations and risks managed, then the event can be called a success.**

---

### About Russell

Russell Investments is a global investment company with \$174 billion in assets under management as of September 30, 2009. Russell serves individual, institutional and advisor clients in more than 40 countries and provides investment solutions including mutual funds, retirement investments, institutional asset management, implementation services and global stock market indexes. Russell is world-renowned for its depth of manager research, quality of manager selection and access to some of the world's leading investment managers. It helps investors of all sizes put this access to work in corporate defined benefit and defined contribution plans, and in the life savings of individual investors. Founded in 1936, Russell is a subsidiary of Northwestern Mutual Life Insurance Company.

### For more information:

Call Russell at **800-426-8506** or visit [www.russell.com/institutional](http://www.russell.com/institutional)

### Important information

---

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Unless otherwise noted, source for information is Russell Investments.

Copyright © Russell Investments 2009. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an "as is" basis without warranty.

The Russell logo is a trademark and service mark of Russell Investments.

Russell Investment Group is a Washington USA corporation, which operates through subsidiaries worldwide, including Russell Investments and Russell Implementation Services, Inc., and is a subsidiary of The Northwestern Mutual Life Insurance Company.

First used: November 2009

USI-5512-12-11