Select Committee on Pension Policy

SCPP Strategies for Risk Management

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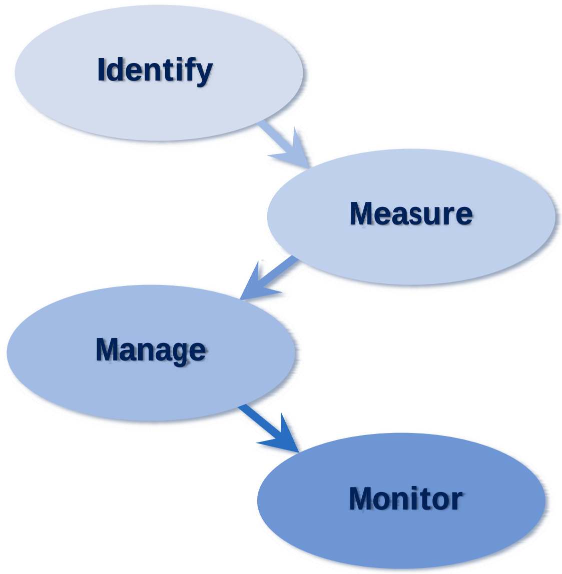
Today's Presentation

- Help you prepare strategies
  - Financial risk management
  - Where to focus and why
- Understanding financial risk for pensions
- Identifying root sources
- Controllable vs. non-controllable risks
- Discussing opportunities
- Next steps

General Process For Risk Management



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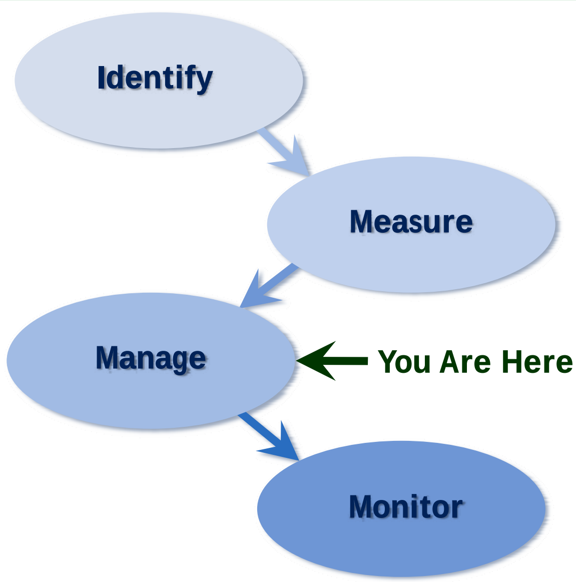
2

General Process For Risk Management



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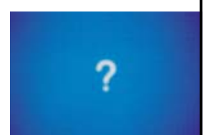
3

What Is Risk?

- Multiple definitions exist
- "Exposure to the chance of injury or loss" (dictionary.com)
- "An uncertain event or condition that, if it occurs, has a positive or negative impact on a project's objectives" (wikipedia.org)



What Is Financial Risk?

- "An umbrella term for any risk associated with any form of financing" (wikipedia.org)
- "The risk that a company will not have adequate cash flow to meet financial obligations" (dictionary.com)

Financial Risk For A Pension Plan

- Chance of having insufficient assets to pay promised benefits
- Possible outcomes
  - Plan closure
  - Pay-go funding
- Symptoms
  - Low funded status
  - Unaffordable contribution rates

Sources Of Financial Risk For Pensions

- Funding deficiencies
- Unaffordable benefit improvements
- Untimely asset losses

Digging Deeper Identifies Root Sources

- What are some root sources for funding deficiencies, unaffordable benefit improvements and untimely assets losses?
- We'll review each separately

Root Sources For Funding Deficiencies

- Reaction to increasing contribution rates
  - We can't afford it
- Reaction to unsustainable asset growth
  - We think the plan costs less than it really does
- Lack of revenue when needed
  - We don't have the money

Root Sources For Unaffordable Benefit Improvements

- Reaction to unsustainable short-term revenue and/or asset growth
- Reaction to unsustainably low contribution rates
- In both cases we adopt permanent benefit improvements with one-time extra money

Root Sources For Untimely Assets Losses

- Market risk combined with poor funded status
- Market rewards come with risk
- A poorly funded plan may have little time to recover from market loses

Findings From Risk Assessment

- Twenty-year look back
- Funding deficiencies
  - On average, plans received 80 percent of required contributions
- Unaffordable benefit improvements
  - Consistent growth in liabilities from past benefit improvements
  - Time will tell whether they're affordable
- Untimely asset losses
  - Investment income on target but with large asset losses at end of PERS 1 and TRS 1 life cycle

Possible Future Outcomes From Risk Assessment

- Continuing past practices leads to increased financial risk
  - Affordability challenges
  - Significant pay-go risk in closed plans
- Risk assessment measured those risks (earlier presentation)

Controllable Vs. Non-Controllable Risks

- Can we control some of these risks?
- Pension system can control reactions
  - To increasing or unsustainably low contribution rates
  - To unsustainable short-term revenue growth
  - To unsustainable asset growth
- Pension system can't control
  - Market risks
  - Available revenue

Managing Controllable Risks

- How can we manage controllable risks?
  - Through funding and benefit policy
- Fully fund the plans
- Anticipate revenue volatility and capitalize on short-term revenue growth when available
  - Fund more when you can
- Recognize unsustainable revenue and asset growth
  - Maintain minimum levels of funding
  - Sustainability analysis before significant benefit improvements

Managing Controllable Risks Helps Manage Non-Controllable Risks

- Pension system can't control market risks and available revenue, but …
- Fully fund plans
  - Less vulnerable to market risk with higher funded status
- Fund more when you can
  - Provides a "reserve" or "insurance" when revenue falls short
  - Capitalizes on strengths to address known weaknesses
- Maintain minimum levels of funding and sustainability analysis before significant benefit improvements
  - Decreases chance of adopting unaffordable benefit improvements and unsustainably low contribution rates
  - Improves funded status and protection against market risk

Back To Basics

- Risk management basics
- Identifying sources of financial risk
- Measuring these risks
- Developing plans or strategies to manage risks
- Measuring and monitoring on an on-going basis

Recap

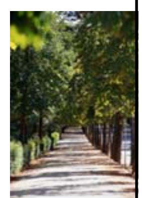
- Financial risk for a pension plan
  - Chance of having insufficient assets to pay promised benefits
- Three root sources of financial risk for pensions
  - Funding deficiencies
  - Unaffordable benefit improvements
  - Untimely asset losses
- Manage controllable risks (examples)
  - Fully fund plans
  - Fund more when you can
  - Maintain minimum levels of funding
  - Sustainability analysis before significant benefit improvements
- Managing controllable risks helps manage other risks

Questions To Consider

- Which financial risks or outcomes do you want to
  - Accept?
  - Avoid?
  - Mitigate?
  - Transfer (if possible)?
- Answering these questions will help you prepare specific risk management strategies

Next Steps

- Executive Committee direction on which strategies to explore
- Staff available to consult as you develop and evaluate strategies
- Staff will report back to full committee



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