

Risk Assessment Findings, Strategies, And Options

Issue

The Executive Committee of the SCPP identified managing the future health of the retirement systems as a strategic priority for the 2009 and 2010 Interims. The Executive Committee further recommended the SCPP undertake an assessment of the health risks facing the state's retirement systems and develop recommendations to the Legislature for managing those risks.

Background

In support of the SCPP's risk management efforts, the Office of the State Actuary (OSA) conducted an independent assessment of the financial risks facing the retirement systems. OSA completed its work on the risk assessment in the fall of 2010 and published its findings and recommendations in the [2010 Risk Assessment](#) report.

Key Findings Of OSA Risk Assessment

- ❖ Over the past twenty years:
 - Investment policy was on track and met its long-term rate of return target.
 - Funding policy has resulted in consistent funding shortfalls—especially over the last decade.
 - Benefit improvements have added significant costs to the plans.
 - Benefits and funding policy reacted to short-term investment and revenue volatility in ways that increased financial risks.
- ❖ Plan 1 legacy costs persist and remain a significant unfunded liability today.
- ❖ Past funding and benefit improvement practices have created significant affordability challenges—especially in the short term.
- ❖ If past practices continue, some plans have a significant risk of prematurely running out of money.
- ❖ The key financial risks to the retirement systems include:
 - Underfunding.
 - Costly benefit improvements.
 - Untimely asset losses.

- ❖ The sources of key financial risks to the retirement systems include:
 - Reactions to short-term investment and revenue volatility.
 - Lack of revenue when needed.
 - Market risk combined with poor funded status.

Policy Highlights

- ❖ Funding and benefits policy can help manage controllable risks that surface due to adverse reactions to short-term investment and revenue volatility.
- ❖ Some risks, such as market risk and unavailable revenue, are beyond the control of pension policy makers and can't be managed through funding and benefits policy.
- ❖ Managing controllable risks helps mitigate uncontrollable risks by improving the overall funded status of the retirement systems.
- ❖ Policy makers seeking to manage retirement system risks through funding and benefits policy may pursue statutory changes or a constitutional amendment.
 - These approaches are not mutually exclusive.
 - Multiple risk management options exist for either approach.
- ❖ Policy makers may wish to consider how contractual rights may impact risk management strategies.
- ❖ Managing risks is a balancing act between risk reduction and affordability.

Committee Activity

The committee considered this issue at the July, September, and October meetings and decided to focus its efforts on a constitutional amendment for managing pension risks. More information about the committee's work on a constitutional amendment is available in the "Options for Managing Pension Risks: Constitutional Amendment" Executive Summary.

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