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Do Government Pension Plan Sponsors Know Their Risk?

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It has been just over a year since the Actuarial Standards Board introduced Actuarial Standard of Practice No. 51 (*ASOP 51*) which requires actuaries to disclose certain risks to plan sponsors. ASOP 51 directs the actuary to assess and disclose risks to the pension plan, but it does not require detailed analysis of each risk be performed. Instead, it requires an actuary to recommend a more detailed analysis of specific risks when they believe it would be significantly beneficial to the plan sponsor.

While ASOP 51 applies to all pension plans, governmental plans have their own unique risks to consider. Let's discuss a few of those risks that impact governmental plan sponsors and where additional analysis may help you better understand the pension plan risks.

Contribution Risk

There have been several states that have enacted laws aimed at requiring governmental agencies to make a certain level of contribution to their pension plans, however, that is not the case in all states. Even with those laws, there may be a risk that contributions are not adequate to fund the pension plan if the law does not require appropriate actuarial consideration in setting the required contribution amounts. Making lower contributions than are actuarially sound increases the risk to the plan and plan sponsor. Inadequate contributions will increase future appropriate contributions, which may be hard or impossible to make. Negative press and possible intervention or solvency issues would be the worst result.

Plan sponsors should check their historical contributions relative to the Actuarially Determined Contribution (*ADC*). They should consider additional analysis for situations that may be possible. For example, a simple multi-year projection assuming that the plan funds a set percentage, like 80%, of the ADC to see how it impacts the plan. This can provide valuable information on how future contributions would increase.

Investment Risk

For governmental pension plans the accounting rules allow for the discount rate to be set to the expected Long-term Rate of Return (LTRR) of the plan's asset portfolio.

This can lead plan sponsors into choosing a more risky portfolio than is appropriate to increase the assumed discount rate; however, doing this adds market risk to the plan. If the assets have a large drop in a single year or do not perform as expected over time, then the ADC will increase.

While a stochastic study (randomly generated trials) of the assets will provide the best insight into the investment risk, government plan sponsors may not have the budget to pay for such a study. Instead you could look at shocks to the portfolio. Scenarios can be either historical, like asking. "What if the Great Recession were to happen again?", or simplistic, like asking, "What if we had a 20 percent loss on equities?" Then you could see how those scenarios impact the plan.

Demographic Risk

Governmental pension plans may have provisions for Cost-of-Living Adjustments (*COLAs*) or unreduced early retirement benefits. In all plans the assumptions used by the actuary are not going to exactly match participant behavior, but when the plan has an increasing benefit or additional subsidy like these provisions, these demographic differences have a more pronounced impact on the plan.

If your plan has COLAs, unreduced early retirement benefits, or other subsidies that may increase liabilities to the plan, you should consider additional analysis. Such analysis can be simple scenarios or more robust. However, frequent assumption analysis and appropriate revisions to the assumptions to the most recently available information is a good way to reduce demographic risk.

Questions? Do you need help in assessing risk to your public plan? Contact the Findley consultant you normally work with, or contact Matthew Gilliland at *matthew.gilliland@findley.com*, or *615.665.5306*.