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AON

Managing Risk While Keeping the Pension Promise

TexPERS

August 14, 2023

10:25 AM - 11:10 AM

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Session Overview

What are the biggest risks preventing public pension plans from achieving positive results?

How can you evaluate/ measure these risks?

What can plan sponsors/ trustees do about these risks?

Why are we taking these risks?

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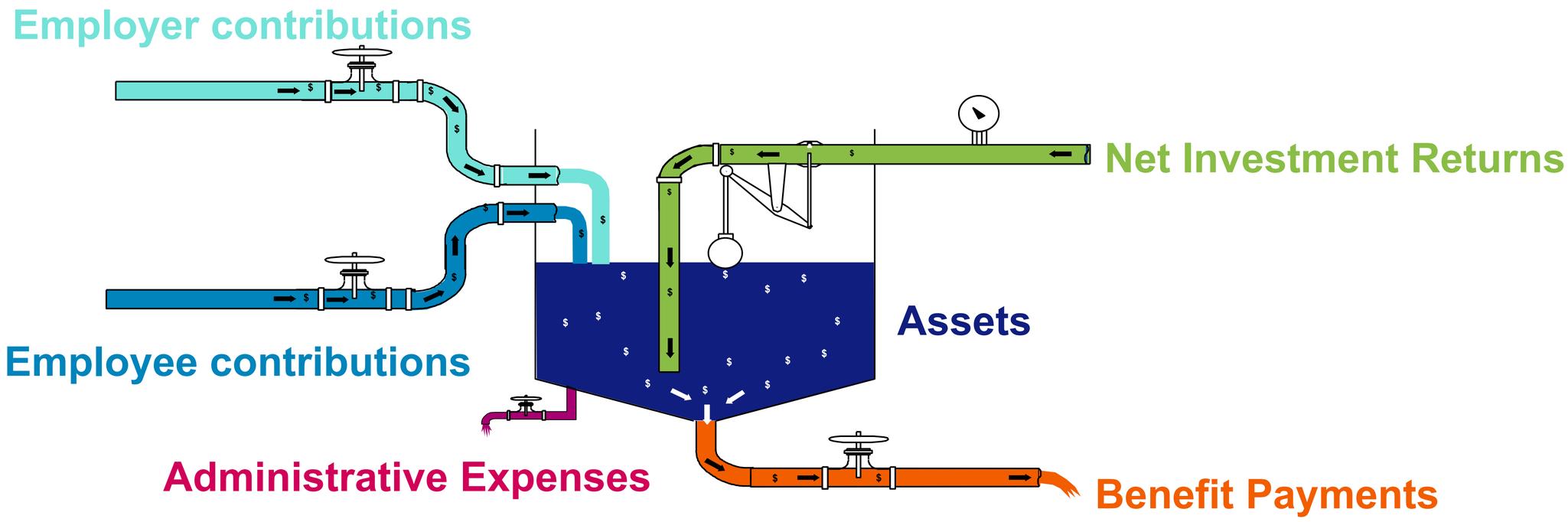
The “Big” Picture

Contributions (C) + Investment Return (I) = Benefits (B) + Expenses (E)



Assumptions and funding methods affect only the <u>timing</u> of costs

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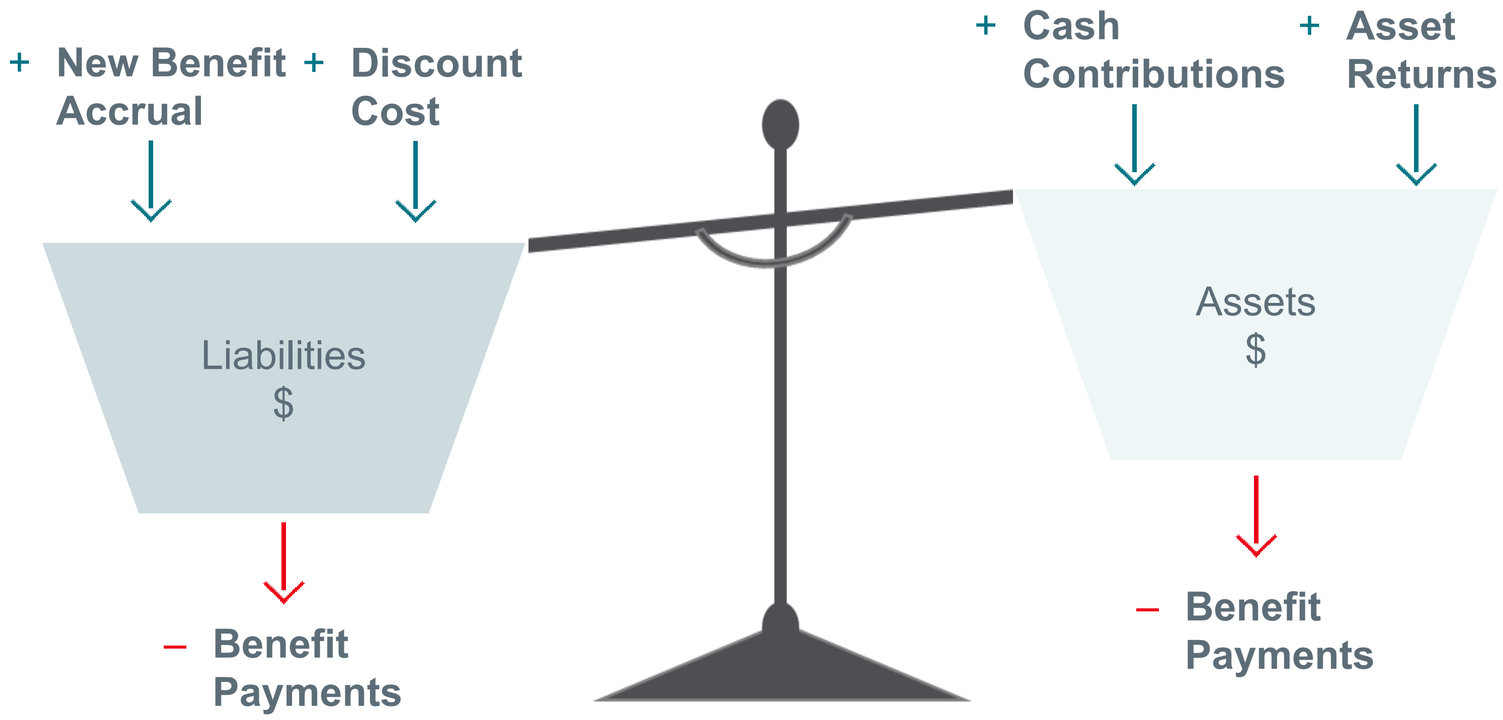
Keeping Assets and Liabilities in Balance

Retirement Plan



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What Makes a “Healthy” (or Less Risky) Plan?

Plan Sponsor

- Credit rating
- Affordability
- Revenue sources
- Reserves

Demographics

- Longevity risk
- Future workforce
- Actual experience
- Plan maturity

Governance

- Investment process
- Benefit administration
- Stakeholder engagement

Investments

- Optimizing the portfolio
- Positioning on the risk spectrum
- Probability of achieving assumed rate of return

Do’s and Don’ts For Public Pension Plans

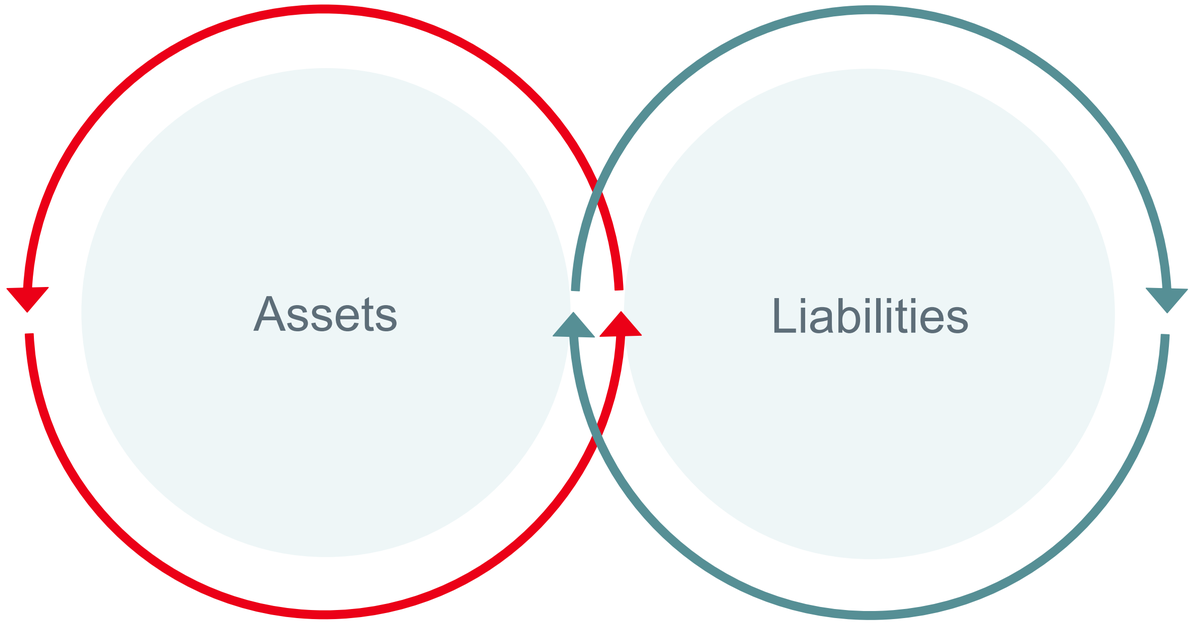
Do

Don’t

What Are The Biggest Risks?

Investments

Funding



Assumptions

Plan Design

Governance

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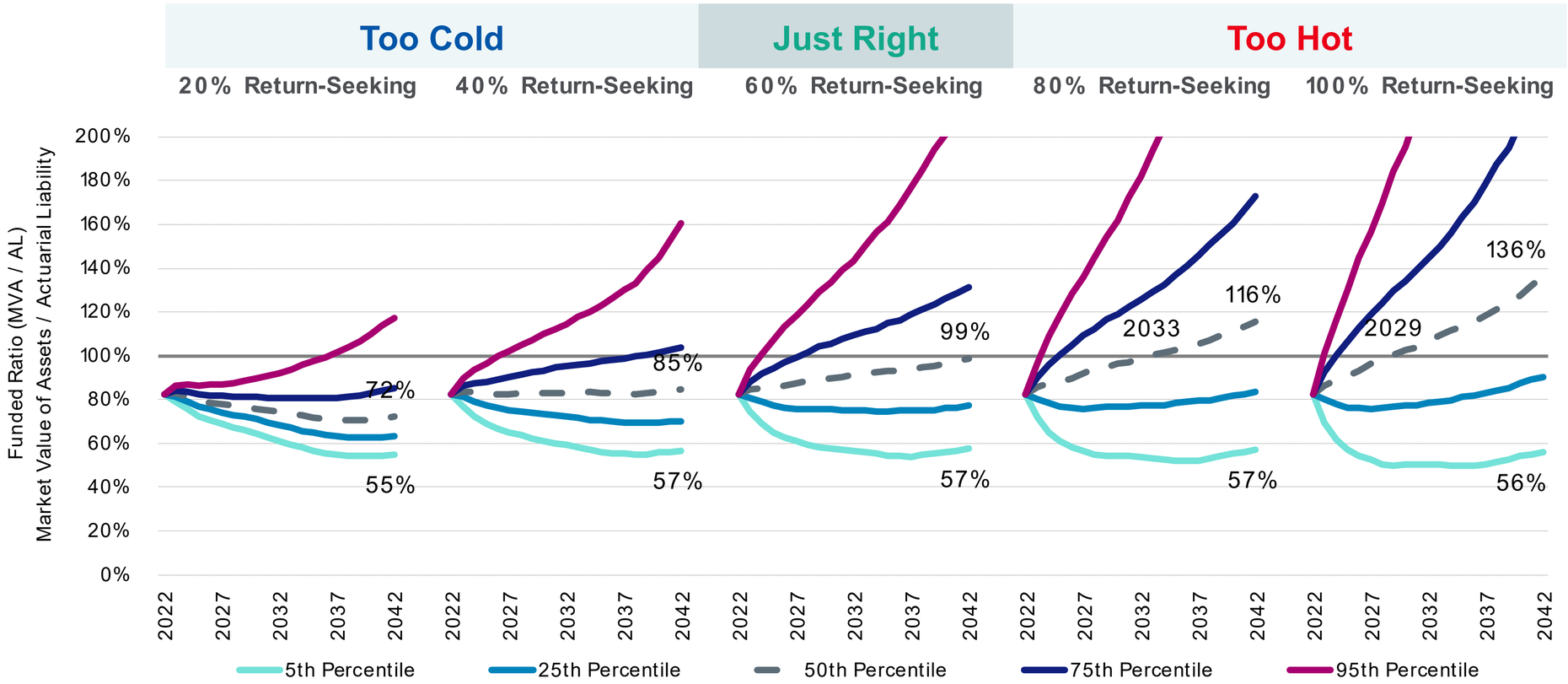
Asset Risks

Investments

Setting long-term investment strategy within the context of the Plan

(illustrative results)



* Illustrative projections assume a constant discount rate for pension liabilities for all investment policies studied.

Key Observations

Too low risk will not get the Plan to full funding

Too much risk will overshoot the mark

Plans should study the full spectrum of risk and identify the position on that spectrum that best suits their Plan

Funded ratio is only one variable to consider

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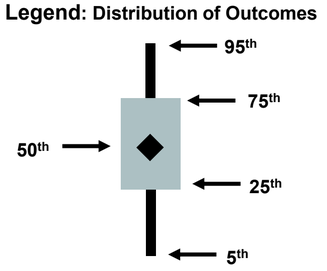
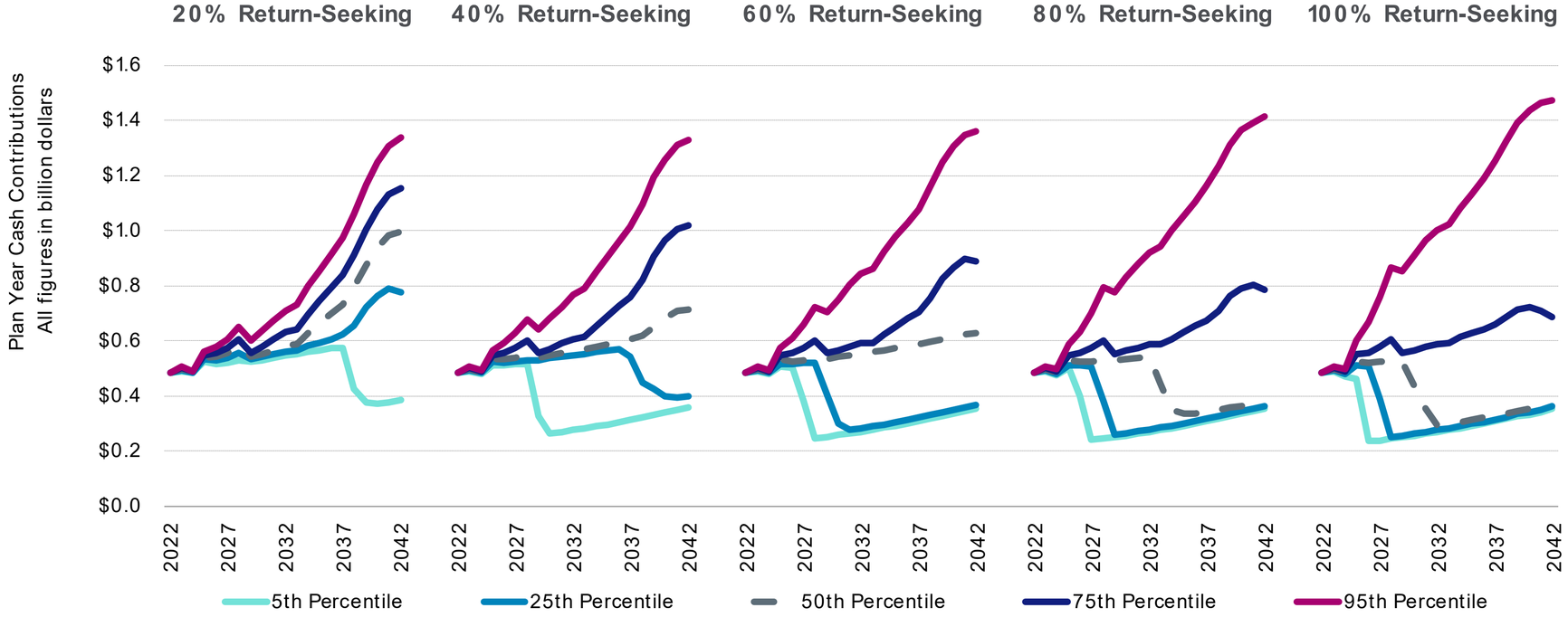
Asset Risks

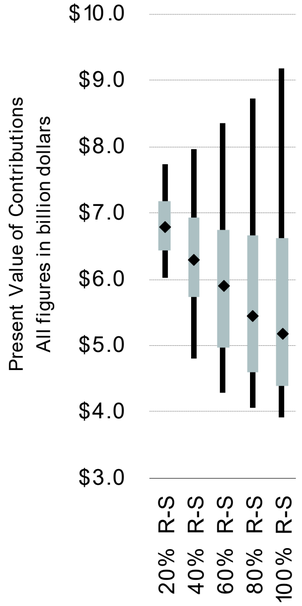
Funding



Setting long-term investment strategy within the context of the Plan

(illustrative results)





Strategy	20% Return-Seeking	40% Return-Seeking	60% Return-Seeking	80% Return-Seeking	100% Return-Seeking

Key Observation Higher risk portfolios are assumed to have lower expected (50th percentile) contributions, but with more volatility

* Illustrative projections assume a constant discount rate for pension liabilities for all investment policies studied.

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Governance

Asset Risks

Investments

- Asset-liability studies
- Investment policy statements
- Periodic review of performance

Funding

- Developing sound funding policy
- Adherence to funding policy

Liability Risks

Assumptions

- Actuarial experience studies
- Periodic review of economic assumptions

Plan Design

- Administering benefits properly
- Auto-triggers

Liability Risks

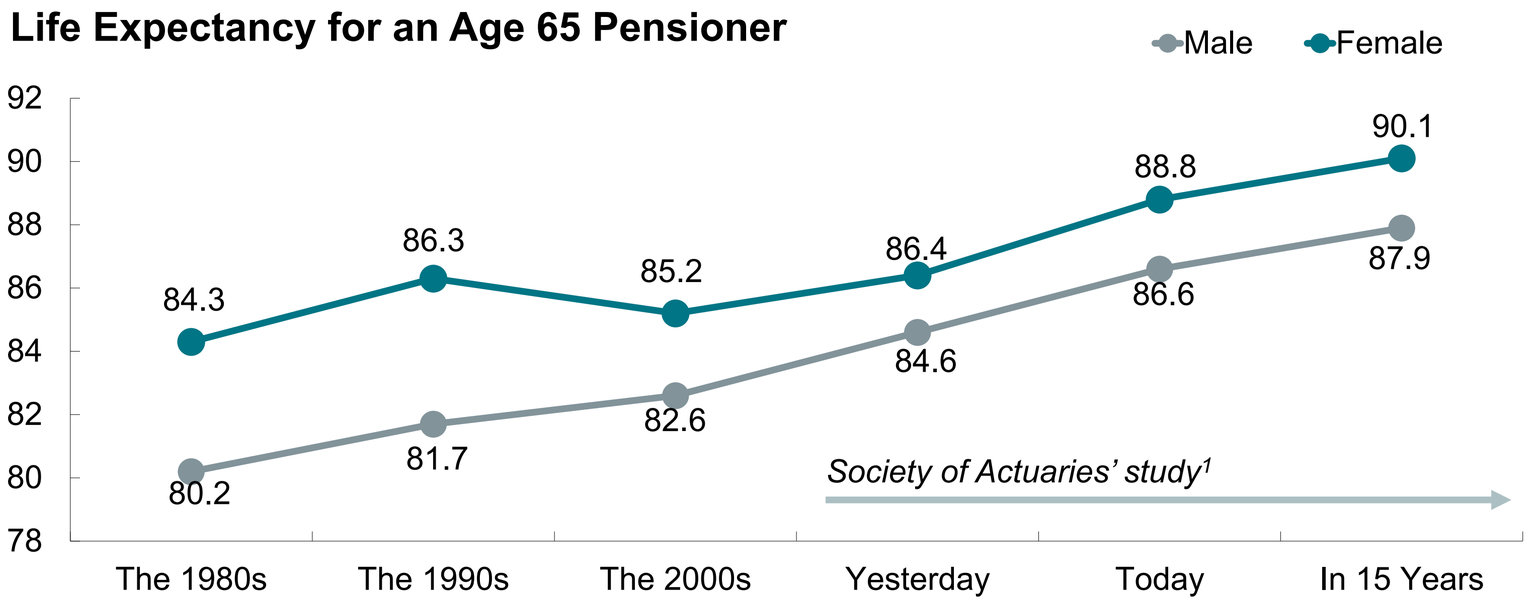
Demographic Assumptions

Key Demographic Assumptions

- Mortality
- Retirement
- Termination

Key Take-aways:

- Mortality risk higher for smaller plans and/or plans with COLAs
- Retirement risk mostly asymmetrical since don't have actuarial increases beyond normal retirement
- Higher turnover leads to savings temporarily – but too much turnover brings into question if plan meeting objectives



[1]RP-2014 with MP-2014.

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Liability Risks

Economic Assumptions

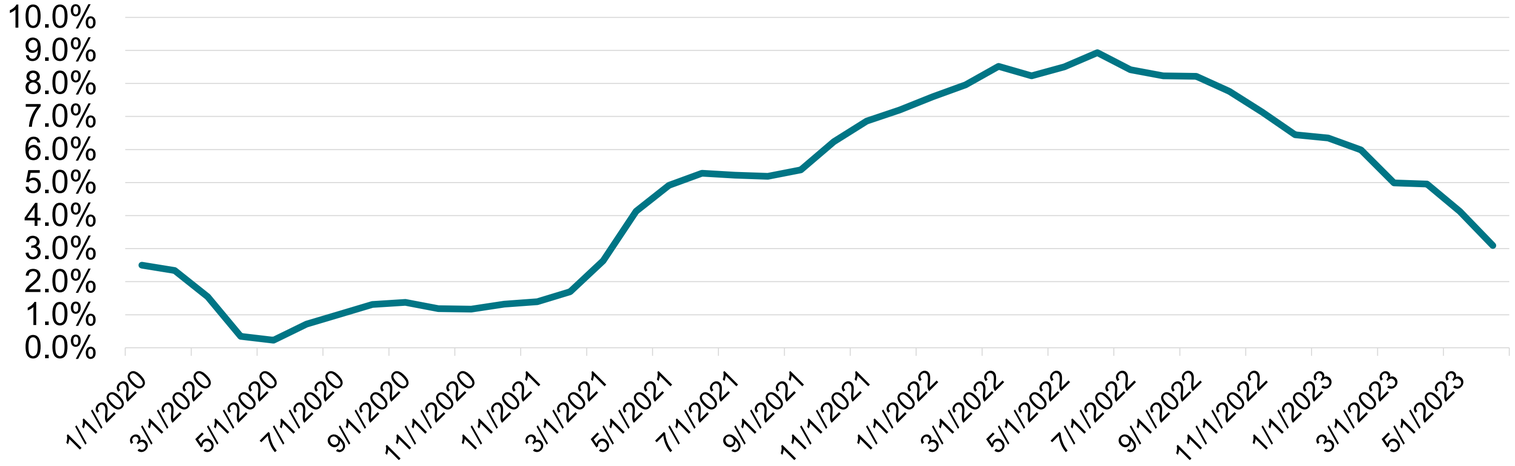
Key Economic Assumptions

- Inflation
- Salary Scale

Deeper Dive

- Average inflation:
  - Last 5 years: 3.9%
  - Last 10 years: 2.7%
  - Last 20 years: 2.6%
- Loss of purchasing power (for plans without COLAs) may impact future behavior
- Prior to pandemic, lowering of salary scale offset decreases in discount rate

Rolling 12-month CPI



Source: St. Louis Federal Reserve (CPIAUCSL)

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Liability Risks

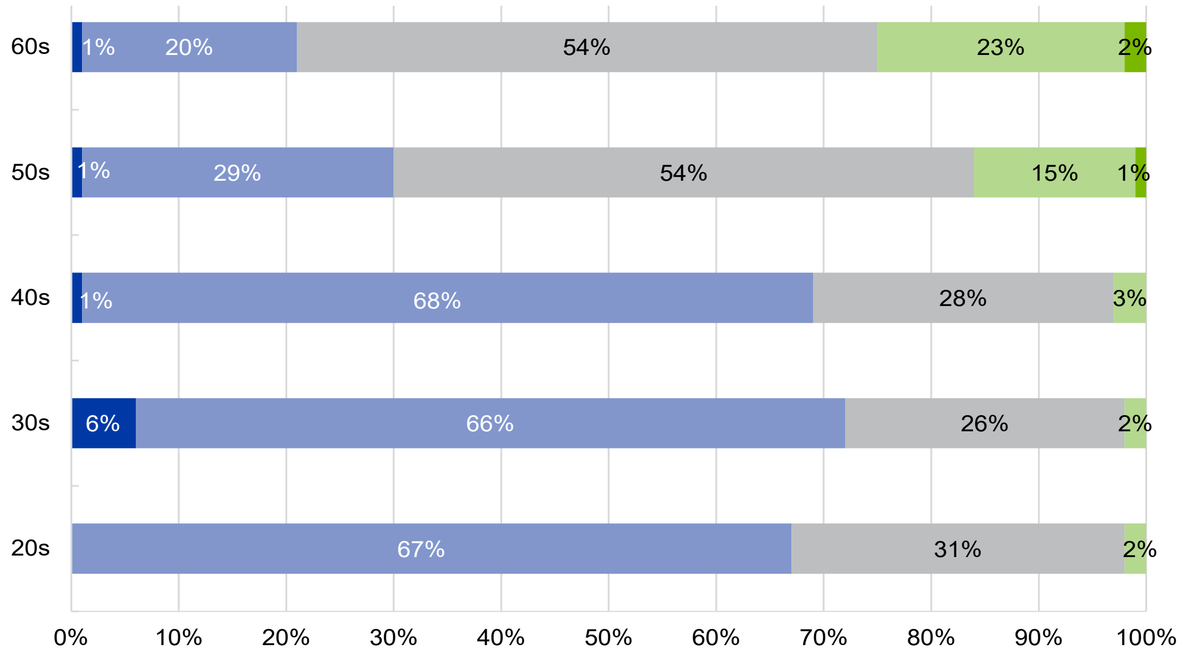
Plan Design

- Recruitment
- Retention
- Equity

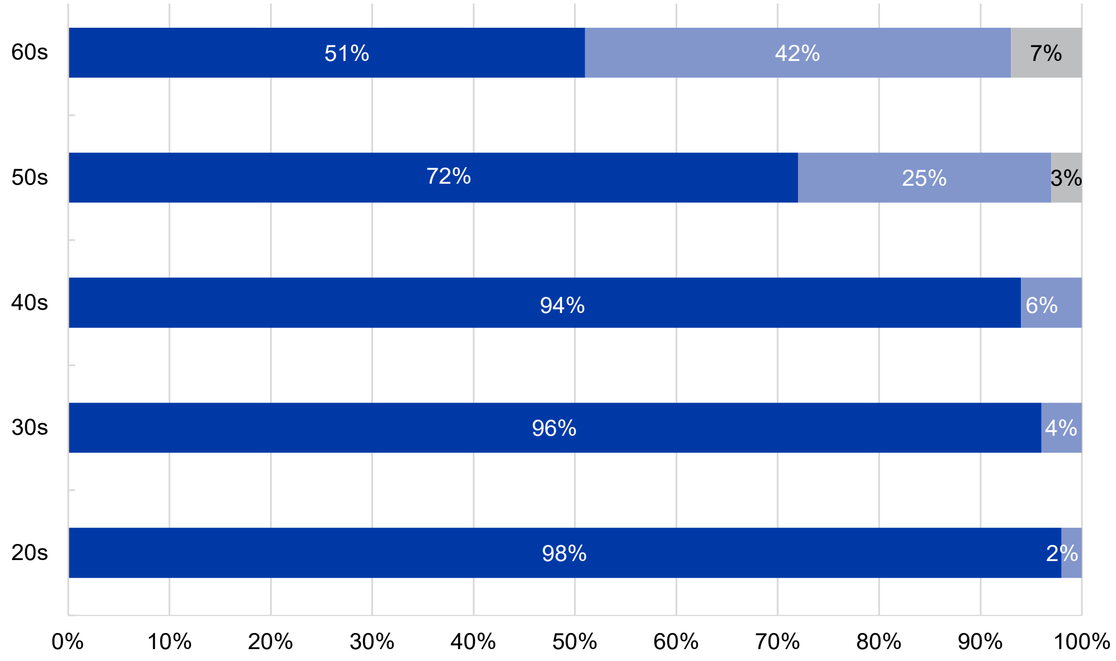
Public Sector Retirement Readiness

Results by Generation

Defined Benefit Pension Plan



Defined Contribution Plan



Significantly Below Target
Below Target
Just Below Target
Just Above Target
Above Target

Source: https://www.nirsonline.org/reports/realdeal/

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Managing Risk
Considerations

1. Risk Review

- Actuarial Standards of Practice (ASOP) No. 4 and No. 51 – understand key risks and their implications
- Stress Testing
- Sensitivity Analaysis

2. Experience Review and Actuarial Audits

- Evaluate gain/loss by decrement annually
- Conduct detailed review of experience every 3 to 5 years
- Perform actuarial audits regularly to validate liabilities and risk

3. Asset-Liability Studies

- Aon suggests conducting asset-liability studies **every 3 to 5 years** depending on client specifics, or more frequently should circumstances dictate

4. Plan Design

- Evaluate adequacy and competitiveness
- Review Administration system/process
- Understand changes in behavior with plan design
- Auto-triggers

Contact Information

Please reach out with any questions!

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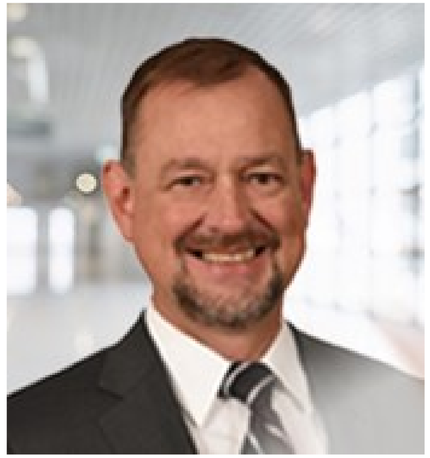

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