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Author's Response to Comments by Evan Inglis

By Thomas Lowman

I would like to thank Evan Inglis and focus on the risk issues he raises. I do believe that (1) as public plans have matured, the investment risks have increased relative to the size of plan sponsors and (2) plans need to deal with risk better than they have to date. I also believe that the issues I dealt with in my paper are a higher priority for many plans in the first round, but if we do not do more to deal with risk, we will not have gone far enough (similarly, the issue of the impact of risk on funding was the first item in the "Items for future discussion" in the CCA white paper on funding policies). However, I also don't want risk reduction to become synonymous with freezing benefit accruals. ERISA single-employer plan funding evolved slowly post-ERISA and eventually dealt with risk, but participant coverage was largely lost. To be successful, we must convince sponsors and unions of the value of reducing risk, even if the benefits need to be smaller to be as sustainable as larger benefits that were created earlier in a plan's life.

Dealing with risk (largely investment risk in this context) may not be as formulaic as discussing amortization periods or funding methods. I see the following possibilities in dealing with risk as part of developing model legislation.

First, send signals via model legislation. Two potential signals that get stakeholders adjusting to risk and not just measuring risk are:

1. Require that any individual purchase of service credit that is intended to be on an actuarial basis be tied to bondlike rates (e.g., 417(e) or GASB 20-year bond rates).
2. Require that an employer leaving a cost-sharing plan settle liabilities at a bondlike rate (often employers are currently restricted from leaving cost-sharing plans).

Having plans use bondlike rates for some purposes such as these will help educate trustees (those who make investment decisions).

Beyond sending signals, model legislation could ask for a risk management plan. There are obviously many types of risk that could be included. However, it should include a plan that deals with investment risk, both current and what risk levels are expected to be in the future. I also want to be clear that I am not simply talking about disclosure. The Actuarial Standards Board (ASB) is dealing with disclosure of pension risks. Model legislation should be focused on actions that can be done through a risk management plan.

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