



Risk Sharing in Public Pension Plans

A major focus of public pension reforms in many states recently has been to broaden the use of risk-sharing plan design features. Risk-sharing refers to the distribution of the effects on retirement plan costs and benefits of future uncertain plan outcomes between employees and employers.

The primary types of risk inherent in a retirement plan are:

- Investment risk, pertaining to the risk of investment returns falling short of expectations
- Inflation risk, which refers to a decline in purchasing power
- Mortality risk, which refers to the risk of employees living longer than expected

Defined benefit plans, traditionally the mainstay of retirement benefits for employees of state and local government, place most of these risks on the employer. A defined contribution plan, which is more common for workers outside of the public sector, places most risk on employees.

Risk-sharing plan designs are intended to distribute risk more evenly between employers and employees. Although risk-sharing takes many forms, the use of risk-sharing plan design features in the public sector can be grouped into two broad categories:

- Hybrid plans, which combine elements of defined benefit and defined contribution plans. Primary types of hybrid plans are DB-DC and cash balance plans.
- Employee contribution rates, benefit levels, and cost-of-living adjustments that vary, or adjust, in response to such factors as the plan's investment performance or the actuarial funding level of the plan.

Although risk-sharing can reduce both the future cost and cost volatility of a retirement benefit, risk-sharing will reduce a plan's unfunded liabilities only if it results in a reduction in future benefit levels for current plan participants, either active (working), or retired.

NASRA has written extensively on public pension reforms around the country, including the pervasive use of risk-sharing plan design features. Some of these changes are discussed in the following resources:

- *In-Depth: Risk-Sharing Among Public Retirement Plans*, a compendium of risk-sharing plan designs, including hybrid plans and variable contribution, benefit, and COLA features implemented in states across the country:
<https://www.nasra.org/content.asp?contentid=124>
- Pension Reform@NASRA.org, an online resource documenting changes made to retirement benefits and financing arrangements for employees of state and local government since 2009:
<https://www.nasra.org/pensionreform>

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