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Rockefeller Institute Researchers Examine Appropriateness of Public Pension Fund Investment Risk-Taking

Albany, NY — In the most recent report of the Rockefeller Institute's Pension Simulation Project, Institute researchers examined the question of how much investment risk public pension funds should take. *Appropriateness of Risk-Taking by Public Pension Plans* examines the rise in investment risk-taking by public pension funds, and the regulatory incentives that encourage this risk-taking. It reviews insights from academic research, which generally suggests that public pension funds should hold more of their assets in fixed-income investments and less in equities. This, they indicate, would result in lower investment risk, but a lower expected return on average. Reducing investment risk would require higher contributions from government now, but would reduce risks to pension funds and to future taxpayers.

Public pension funds invest in stocks, bonds, and other assets with the goal of accumulating sufficient funds, in combination with employer and employee contributions, to pay benefits when due. Taxpayers and other government stakeholders bear the investment risk because state and local governments backstop these funds, paying higher contributions when investment returns are below expectations, and lower contributions if returns exceed expectations. Successful investing keeps pension contributions low, but unsuccessful investing creates difficulties for pension funds, their beneficiaries, and current and future taxpayers.

The authors note that there is no golden rule defining exactly how much risk plans should take, but policymakers can take two important steps that might temper future risk-taking. First, they should explore ways to change and counter the incentives and institutions that encourage U.S. public pension funds to take risk. Second, public pension funds should ensure that they analyze and communicate the risk they are taking, in ways that can be understood not just by their boards, but by the governments that contribute to their funds, and by the public that ultimately bears the risks they take.

This is the fifth report of the Pension Simulation Project at the Rockefeller Institute of Government. In addition to the authors, Donald J. Boyd, the Rockefeller Institute's director of fiscal policy, and Yimeng Yin, programmer and research analyst, the project team includes Kathleen Tempel, researcher and project manager, and Lucy Dadayan, senior policy researcher. The project is supported by the Laura and John Arnold Foundation and The Pew Charitable Trusts.

To read the report, go to www.rockinst.org/pdf/government_finance/2017-02-01-Risk_Taking_Appropriateness.pdf.

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