Insuring Public Pension Investments
Hank Kim, Esq.
Executive Director & Counsel

Public Pension Challenges

• Regular and full sponsor contributions.
• Discount rate and low expected returns in the near future.
• Mortality risks.
• Media and legislative attacks.
• Lack of understanding by the public.
• Black Swan economic event.
20th & 21st Century Market Crashes

- 1929-32 Great Depression: S&P 500 peak to bottom 86.1% loss.
- 1946-49 Post-WWII Recession: S&P peak to bottom 29.6% loss.
- 1973-74 Oil embargo: S&P peak to bottom 48.0% loss.
- 1980-82 Stagflation: S&P peak to bottom 27.8% loss.
- 1987 Black Monday: S&P peak to bottom 33.5% loss.
- 2000-02 dot-com: S&P peak to bottom 49.1% loss.
- 2007-09 Great Recession: S&P peak to bottom 56.4% loss.

Source: Global Financial Data, msnbc.com research

Pension Asset Insurance: Is it possible?

- Captive Insurance Fund
- Pooled Risk
- Multiple Sources of Reserves

Insuring Against Risk

- Terms for Participation
- Maximum Amount of Coverage
- Limited Number of Events

Participation Parameters

- Trigger Event
- Investment Policy Accreditation
- Asset Allocation Parameters
- Prior Event Asset Level Recapture
- Asset Replacement Cap

Asset Replacement Criteria

How is the reserve capitalized:
- Reinsurance Market
- Large Public Pension Funds
- Federal Reserve
- Hedge Funds

Can it work? At What Cost?

- Is this a potential investment opportunity for large PERS to create a captive insurance fund?
- Can Market Risk be insured at affordable rates?
- How would multiple events in a decade be funded?
- Is this a guaranteed line of credit?
- Is this a better approach than Pension Obligation Bonds?
- Is this just shifting the risk, rather than smoothing risk?

Will this approach dampen stakeholders perceived risk of DB plans?
Public Asset Insurance Corporation (PAIC)

- Issues policies insuring against rapid loss of asset value.
- Triggering threshold is 30% loss on value of AUM.
- Claim paid 3/6 months after end of recession.
- Insurance has provisions to limit moral hazard.
  - Must adhere to investment policy (annually audited).
  - Insurance could cover only a percentage of loss.
  - 10 years of mandatory participation.
  - Up to 10 years of supplemental premiums.
  - No additional claims during 10 year period.*

*Unless fully repaid claim amount.

Why Would Plans Insure Assets?

- Stabilize cash flow.
- Reduces need to sell depressed assets.
- Has autonomy advantage over POBs.
- Arbitrage opportunities.
- Defense against anti-public pension critics.
- Reduces likelihood of contribution spikes.
- Fiduciary prudent?
PAIC Financing

Layer one
• A consortium of mega public plans, investments boards, and/or plan sponsors provide seed financing.
• Other investors may be sought.
• Annual base premiums from insured plans will provide operational costs and build reserves.
• Supplemental premiums (asset recapture) if claim is made.
• Use hedges, reinsurance, and other risk management strategies.

Layer two (backstop)
• Federal Reserve.

Supplemental Premium

• After a claim is made, for the next 10 years plan is obligated to continue PAIC coverage and pay annual base premiums.
• After a claim is made, for up to 10 years plan ALSO is obligated to pay a supplemental premium equal to 20% of annual investment earnings.
• If zero or negative earnings, NO supplemental premium for that year.
Supplemental Premium Example

- PERS is a $1 Bln plan and has PAIC insurance.
- In year 0, PERS experience a 30% loss and triggers the policy. PAIC pay $300 MM.
- In year 1 PERS earns 10% return on its assets. PERS would pay the base premium and $20 MM ($100 MM x 20%) as a Supplemental Premium.
- In year 2 PERS breaks even. It pays the base premium only.
- In year 3 PERS experiences 15% return ($162 MM) and therefore would pay base premium plus $32.5 MM.
- In year 4 PERS experiences negative returns. It pays the base premium only.
- This would continue until PERS either pays off the $200 MM (nominal or real?) or the 10 year period expires.
- After 10 years, if PERS would like to continue with insurance coverage can participate by paying the PAIC annual base premium.

Next Steps

Phase I
- Get temperature read/interest level from community.
- Start information gathering and preliminary research.

Phase II
- In-depth research culminating in publication of paper.
- Get feedback and refine proposal.

Phase III
- Implement PAIC.
Thank You

NCPERS
444 North Capitol Street, NW
Suite 630
Washington, DC 20001
202-624-1456
info@ncpers.org
www.NCPERS.org