Select Committee on Pension Policy

Plan 2/3 Default

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How Did This Issue Come Before The SCPP?

- Stakeholders are requesting the SCPP
  - Revisit the issue of changing the default plan for new hires
  - Consider making a recommendation to 2011 Legislature
- Executive Committee scheduled a public hearing on two bills from past sessions addressing the default plan

Today's Briefing

- Background
- Committee/legislative activity
- Policy considerations
- Next steps

Background

- New employees in PERS, TRS, and SERS choose a retirement plan
  - Either Plan 2 or Plan 3
- Those that don't choose are defaulted into Plan 3
- Plan membership is permanent
  - Chosen or defaulted

Plan Designs Represent Different Trade-Offs

- Plan 2 is a DB plan
  - Geared toward career employees
  - Less member benefit control or risk
- Plan 3 is a hybrid plan
  - Part DB and part DC
  - Geared toward mobile workforce
  - Greater member benefit control and risk

Committee/Legislative Activity

- SCPP studied this issue in 2008
  - Recommended bill changing the default to Plan 3 for PERS only
  - Didn't pass Legislature (HB 1722/SB 5307)
- SCPP revisited this issue in 2009
  - Considered changing the default plan for all systems
  - No recommendation
- Non-SCPP bill introduced in 2010 that changed default plan for all systems
  - Didn't pass Legislature (SB 6516)

Policy Considerations

- Have views around the preferred plan design for new hires changed?
  - Different preferred balance of control/risk?
- Many ways to pick a new default
  - Data driven approach
  - Determine which plan best serves the needs of new hires
    - Single default for all systems
    - Different defaults for different groups
- Potential issues with changing at this time
  - Markets
  - Litigation

Potential Timing Issues

- Market conditions
  - Members showed a strong preference for Plan 3 in the 90s when markets were doing well
  - When markets improve will Plan 3 be more appealing?
- Legal implications for current gain-sharing litigation
  - TRS and SERS plan choice is a replacement benefit for gain-sharing
  - Plan default is tied to plan choice
  - May wish to review with AAG

November Executive Committee Activity

- Scheduled a public hearing/possible executive session on two bills from past sessions changing the default to Plan 2
  - PERS only
  - All systems (PERS, TRS, and SERS)
- Asked the state actuary to assess impact on risk measures

Fiscal Impact Summary: Changing Plan 2/3 Default

- Proposal does not have a typical fiscal impact
  - Affects future cost sharing
  - Not current liabilities
- No immediate rate impact
- Slight decrease in rates in future biennia

($ in millions)	PERS Only HB 1722		All Systems SB 6516	
	Fiscal Cost 25-Year	% Salaries 25-Year	Fiscal Cost 25-Year	% Salaries 25-Year
Total GFS	(10.1)		(15.3)	
Total Employer	($50.8)	(0.011%)	($60.5)	(0.008%)

Note: Costs taken from 2010 fiscal notes and will be updated if a bill is introduced for the 2011 Session.

Fiscal Note Is Atypical

- Not a decrease in expected employer liabilities
- Savings doesn't imply Plan 2 is less expensive than Plan 3
- Savings driven by
  - Cost sharing
  - Timing

Plan 2 Members Share In Plan Costs

- New hires and current members
  - Single rate charged
- Future new hires in Plan 2 will help pay for
  - Recent asset losses
  - Past underfunding
  - Retroactive benefit improvements for current members
  - Until shortfalls made up
- Rates are lower when costs are spread over more people

Timing Affects Fiscal Impact

- When future contribution rates are increasing
  - New hires share in rising costs
  - Savings for current members/employers
  - Increases are spread further
- When future contribution rates are decreasing
  - New hires share in falling costs
  - Cost to current members/employers
  - Savings are spread further
- Timing matters when changing membership mix
  - Same proposal in 2000 would likely have shown a cost
  - Large surpluses, falling rates

OSA Evaluated Impact On Plans And Risk Measures

- Proposal would cause a relatively small shift in Plan 2/3 population over time
- OSA looked at demographic and risk impact of changing default for all systems (PERS, TRS, and SERS)
  - Population
  - Benefit payments
  - Pay-go risk
  - Affordability

Demographic Impacts – Change Default, All Systems

- Population
  - We expect about 8 percent of future new entrants to shift from Plan 3 to Plan 2
- Benefit Payments
  - We expect a 1-2 percent increase in annual Plan 2/3 benefit payments in 50 years

Risk Measures Impact – Change Default, All Systems

($ in billions)	Current	Proposal	Change	% GFS
Affordability				
5% Chance GFS Consumption Exceeds	9.88%	9.87%	(0.01%)	N/A
<1% Chance GFS Consumption Exceeds	15.89%	15.88%	(0.01%)	N/A
Pay-Go Risk				
5% Chance Annual Open Plan Pay-Go Exceeds	$4.035	$4.048	$0.013	0.01%
<1% Chance Annual Open Plan Pay-Go Exceeds	$12.868	$13.670	$0.802	0.32%

Model May Not Show All The Risk

- Employer bears more long-term risk under the Plan 2 design
  - Guarantees a larger benefit
- Pay-go and affordability risks emerge over time and usually under worst-case scenarios
  - Model only looks at next 50 years
  - Model might not anticipate the truly worst-case scenario
- May be other risks model doesn't/can't measure
  - Reduction in member benefit risk

Recap

- Two proposals for changing default
  - PERS only
  - All systems (PERS, TRS, and SERS)
- Fiscal impact is atypical
  - Savings is not from a reduction in employer liability
- Small change in risk measures over next 50 years
  - Model may not show all risks

Possible Next Steps

- No further action
- Recommend a bill changing default to Plan 2 for PERS only
  - Staff would update HB 1722 and fiscal note for 2011
  - Sample motion
    - I move the committee recommend a bill changing the default to Plan 2 for PERS only to the 2011 Legislature
- Recommend a bill changing default to Plan 2 for all systems (PERS, TRS, and SERS)
  - Staff would update SB 6516 and fiscal note for 2011
  - Sample motion
    - I move the committee recommend a bill changing the default to Plan 2 for all systems to the 2011 Legislature
- Other action?