



September 26, 2018  
Survivor Option Election

## COMPREHENSIVE REPORT

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## ISSUE STATEMENT

It may be considered unfair to have a member make their irrevocable retirement election for a survivor option without all the information that is important to them.

## OVERVIEW

This report will provide information on the irrevocable election of a member's survivor option. It will also explain how a member receives an estimate of their benefit prior to retirement, the accuracy of those estimates; policy reasons for why the decision to leave a survivor benefit is irrevocable; and information on how other state retirement plans treat survivor options.

## BACKGROUND AND POLICY ISSUES

### What is a survivor option?

LEOFF 2 members may elect to take a reduction in their monthly benefit in order to leave an ongoing benefit to a survivor. The survivor will receive the ongoing benefit for their lifetime. This feature of LEOFF 2 is referred to as a survivor benefit option. The member must make this election when they apply for retirement. There are four options for a survivor benefit:

1. **Single Life** - This option pays the highest monthly amount of the four choices, but it is for the member's lifetime only. No one will receive an ongoing benefit after the retiree dies. If the retiree dies before the benefit they have received equals their contributions plus interest (as of the date of their retirement), the difference will be paid in a lump sum to the retiree's designated beneficiary.
2. **Joint and 100% Survivor** – The retiree's monthly benefit under this option is less than the Single Life Option. But after the retiree's death, the retiree's survivor will receive the same benefit the retiree was receiving for his or her lifetime.
3. **Joint and 50% Survivor** – This option applies a smaller reduction to the retiree's monthly benefit than Option 2. After the retiree's death, the retiree's survivor will receive half the benefit the retiree was receiving for his or her lifetime.

4. **Joint and 66.67% Survivor** – This option applies a smaller reduction to the retiree's benefit than Option 2 and a larger reduction than Option 3. After the retiree's death, the retiree's survivor will receive 66.67% of the benefit the retiree was receiving for his or her lifetime.

The survivor is typically a spouse, but can be someone else. If a member is married they are required to get spousal consent to choose an option other than option 3.

### **What are the survivor options for other retirement plans?**

Plans 1, 2, and 3 in PERS, SERS, and TRS all have the same survivor benefit options as LEOFF 2. LEOFF 1 has an automatic Joint and 100% Survivor Benefit. In LEOFF 1 the member does not take a reduction in their benefit to leave this survivor benefit.

### **How much of a reduction in benefit will a member take to leave a survivor benefit?**

The amount of the reduction in benefit a member takes when selecting a survivor option benefit is based on administrative factors. These factors are recommended by the Office of the State Actuary and adopted by the LEOFF 2 Board. The factors are based on various actuarial assumptions and assembled into a table categorized by the difference in age between the retiree and their survivor. If the survivor is younger than the retiree the reduction in benefit will be greater. If the survivor is older than the retiree there is still a reduction in benefit; however, the reduction will be less. The intent of these factors is to make the amount of pension funds paid over a single life (survivor option 1) equal to the amount of pension funds paid over two lives (survivor option 2, 3, or 4).

### **Can a member change their decision to leave, or not leave, a survivor benefit?**

A retiree's survivor option choice is irrevocable unless the following occur:

1. They designated someone other than their spouse to receive their survivor benefit. The non-spouse survivor can be removed (Option 1) only.
2. They marry or remarry after retirement. To qualify, they must request the change between their first and second years of marriage.
3. They chose a survivor option, and their survivor dies before they do. Their benefit is adjusted to Option 1.
4. They return to membership. If they go back to work for any period of time as a contributing retirement plan member, they can retire again and select a new benefit option and/or survivor.
  - a. PERS members must return to work for two years before they are able to re-retire and change their survivor option.

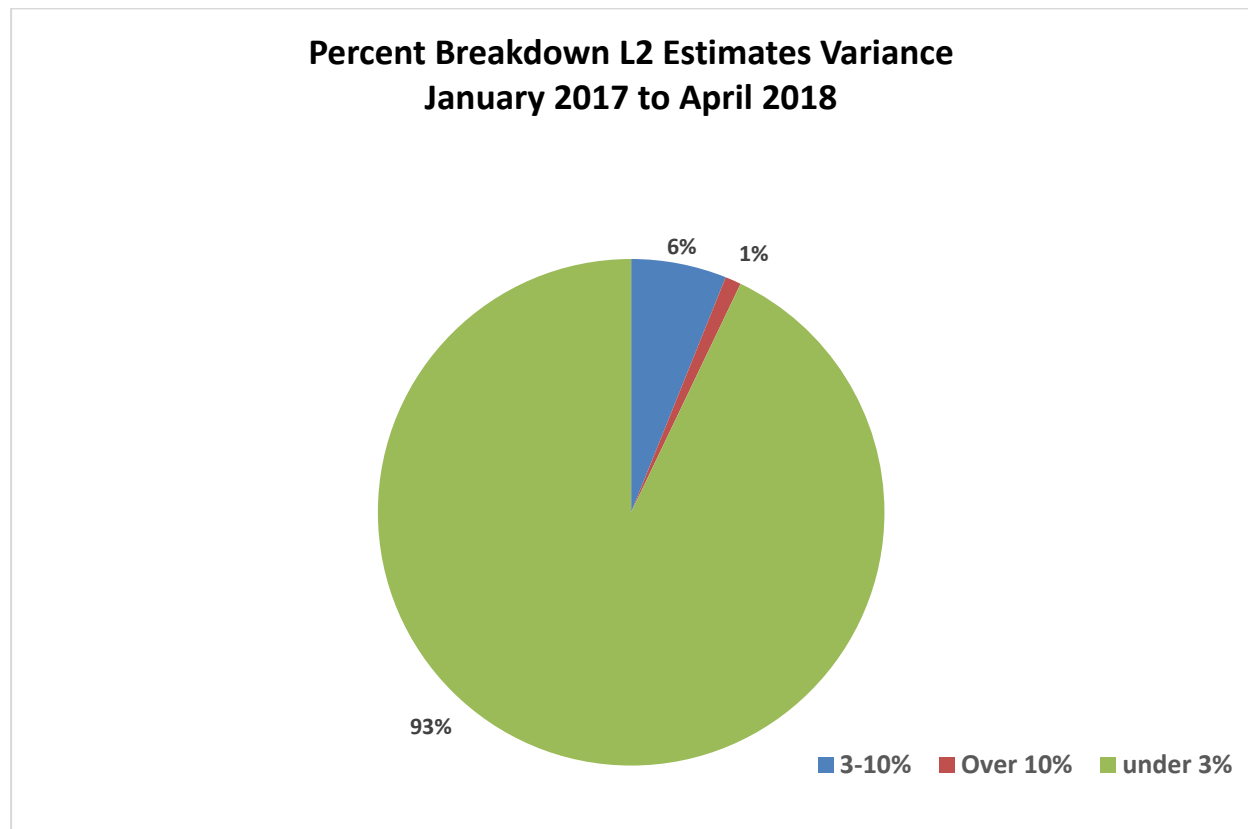
**How does a member know what their benefit will be prior to retiring?**

Members are encouraged by the Department of Retirement Systems (DRS) to request an estimate of their retirement benefit, within a year of when they plan to retire. If a member does not request an estimate, DRS still ensures they receive an estimate of their benefit before retiring. When members make their request they may select multiple estimates based on different survivor options. In addition to what survivor option the member selects, the estimate is calculated based on multiple assumptions, including how long the member will continue to work and what their Final Average Salary will be.

**How accurate are benefit estimates?**

DRS tracks the accuracy of estimates as part of their ongoing performance metrics. From January 2017 to April 2018 there were 591 LEOFF 2 retirements. Of those retirements:

- 549 (93%) estimates were within 3% of the member's actual benefit;
- 36 (6%) estimates were between 3% to 10% of the member's actual benefit; and,
- 6 (1%) were more than 10% different than the member's actual benefit.



There are many reasons an estimate could be different than what a member's actual benefit is. However, according to DRS the most common reasons for an estimate to be more than 10%

different than the actual benefit, is the member choosing a different retirement date or choosing a different survivor option than they requested for the estimate.

### **Can a member's benefit change after retirement?**

When DRS receives additional information about an employee's Final Average Salary or Service Credit they are required under RCW 41.50.130 to recalculate the retiree's retirement benefit. This is referred to as a "recalc". Current law does not allow a member to change their survivor option after a recalc. A recalc may result in either an increase or a decrease to a member's benefit. The recalc is both retrospective and prospective. Therefore, in addition to the change in retirement benefit moving forward, DRS must pay the retiree an additional payment or collect from the retiree the difference in the pension payments they have received and the recalculated benefit amount they should have received.

Last fiscal year DRS recalculated 256 LEOFF 2 retirees' pension payments. 46 (18%) of those recalcs resulted in a decrease to a member's benefit. Below is a table of the percentage of change to these retirees' retirement benefit resulting from the recalc:

<b>% Change in Benefit</b>	<b># of Recalcs</b>
<b>.001 - .99%</b>	158
<b>1 – 4.99%</b>	60
<b>5%-9.99%</b>	20
<b>10% or more</b>	18

The majority of recalcs occur shortly after a member retires; however, in some instances may occur years after retirement. The average turnaround time for LEOFF 2 recalcs from 1/2017 to 7/2018:

<b># of days after Retirement</b>	<b>% of Total Recalcs</b>
<b>Within 90 days</b>	67%
<b>90-180 days</b>	13%
<b>Over 180 days</b>	20%

DRS prioritizes recalcs that are a result of an audit finding, as those are most likely to have the largest impacts on members.

**Why is the decision to leave a survivor benefit irrevocable?**

The decision to leave a survivor benefit is irrevocable because it helps mitigate the risk of anti-selection. The policy concern for allowing a retiree to change their survivor benefit option is anti-selection. Anti-selection is the tendency of a person to recognize his or her health status in selecting the option under a retirement system which is most favorable to him or herself. If anti-selection risks are not effectively mitigated it can increase the costs of the retirement system.

Since the survivor option administrative factors are based on average life expectancies, not individual life expectancies, the potential impact of anti-selection on LEOFF 2 would be members could “game the system” to their advantage and the detriment of LEOFF 2. For example if a member is aware they have a terminal disease they could choose to leave a larger survivor benefit than they would have selected if not for their knowledge of their terminal disease.

Anti-selection may impact members through either increased contribution rates and/or less favorable administrative factors for survivor options. Since contributions into LEOFF 2 are paid by both employers and members, the impact of anti-selection risks are paid for by both. If a change in policy increased anti-selection risks to the point of impacting contribution rates, this would likely result in intergenerational inequity because the benefit being utilized by recent retirees would be funded by active members.

**How does LEOFF 2 mitigate the anti-selection risks of survivor benefits?**

Currently, the impact of anti-selection on LEOFF 2 is minimized by requiring members to make an irrevocable survivor option election at the time of retirement. The more opportunity a member has to make or change that election, the more likely anti-selection risks to LEOFF 2 will increase.

The risk of anti-selection is minimized in the post-retirement marriage survivor option provision by requiring the member to make the election after they have been married for a year, but prior to the second year of marriage. This helps mitigate the risk that a retiree finds out they have a terminal disease and decides to marry for the purpose of leaving a survivor benefit.

The requirement that the retiree make this decision prior to the second year of marriage further mitigates anti-selection risk by ensuring they do not prolong the decision until they become aware of additional information, such as a terminal disease.

### **Do other state or federal pension systems allow retirees to change their survivor election?**

A review of other public retirement plans showed that the vast majority of plans have irrevocable survivor elections that must be made at the time of retirement, with limited opportunities (typically tied to divorce or remarriage) to change that election. However, there are some plans which include a limited window for retirees to change their survivor option election.

The Oregon Public Employee Retirement System allows a retiree to change their survivor option selection within 60 days after the date of receiving their first benefit payment.<sup>1</sup> The change is retroactive to their effective retirement date, and overpaid benefits must be repaid to PERS.

The Federal Employee Retirement System has a window to change survivor election within 30 days of a member receiving their first regular annuity payment.<sup>2</sup> After the 30 day period has passed but less than 18 months from the beginning date of member's annuity, a member can change their election only to choose a survivor annuity or to increase a reduced survivor annuity amount.

The Minnesota Public Employees Retirement Association Police and Fire Plan allows a survivor option selection to be rescinded if both the member and designated survivor mutually agree to allow the benefit to be recomputed as a single-life pension.<sup>3</sup>

The United States Uniformed Services Retirement System allows retirees to terminate their survivor benefit in a one year window between second and third anniversary following first receipt of retired pay.<sup>4</sup> None of the premiums the member paid for the survivor benefit are refunded and no annuity will be payable to a survivor upon the member's death. The covered spouse, or former spouse, must consent to the withdrawal. Termination is permanent and participation may not be resumed under any circumstance.

## **POLICY OPTIONS**

**Option 1 – Window for all L2 Members:** All LEOFF 2 retirees have a 90 day window after the receipt of their first retirement payment to change their survivor election. If a member changes their survivor election they must pay or be refunded the difference in their pension payments

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<sup>1</sup> <https://www.oregon.gov/PERS/MEM/Tier-One-Tier-Two/Documents/TierOne-TierTwo-Preretirement-Guide.pdf>

<sup>2</sup> <https://www.opm.gov/faq/retire/Can-I-change-my-survivor-benefit-election-after-retirement.ashx>

<sup>3</sup> <https://www.mnpera.org/wp-content/uploads/2018/06/PF-Updated-1.pdf>

<sup>4</sup> <https://militarypay.defense.gov/Benefits/Survivor-Benefit-Program/Stopping-SBP/>

that they have already received. The member must provide DRS with written spousal consent to change their survivor option, if the survivor option provides the spouse with a decreased survivor benefit.

**Option 2 – Qualifying Event Window:** LEOFF 2 retirees may change their survivor election if a DRS recalculation of their benefit results in a change to the benefit amount of more than:

- a) Any change in benefit amount
- b) 5%
- c) 10%

The retiree has 90 days from receipt of the first recalculated pension payment to elect a new survivor benefit. The member will need to request a new estimate from DRS of their recalculated benefit with survivor options. If a member changes their survivor election they must pay or be refunded the difference in their pension payments that they have already received. The member must provide DRS with written spousal consent to change their survivor option, if the survivor option provides the spouse with a decreased survivor benefit.

**Option 3 – Qualifying Event Window with Further Anti-selection Risks Mitigation:**

The same as Option 2 except to further mitigate anti-selection risks a retiree's ability to change their survivor option election is limited based on the impact of the recalculation.

- If a retiree's benefit increases due to a recalculation they may only select a larger survivor option.
- If a retiree's benefit decreases due to a recalculation they may only select a smaller survivor option.

This option helps further limit retirees using the qualifying event window as an opportunity to change their survivor option election not because of the change in their benefit amount due to the recalculation but instead because of additional information about their life expectancy or their survivor's life expectancy.

**Option 4 – Option 1 and either option 2 or 3**



# Survivor Option Election

Comprehensive Report



# Issue

- It may be considered unfair to have a member make their irrevocable retirement election for a survivor option without all the information that is important to them

# Overview

- What is a survivor option?
- How accurate are retirement estimates?
- How does a “recalc” impact a members benefit and survivor option election?
- What are the policy reasons for why the decision to leave a survivor benefit is irrevocable?
- How do other retirement plans treat survivor options?

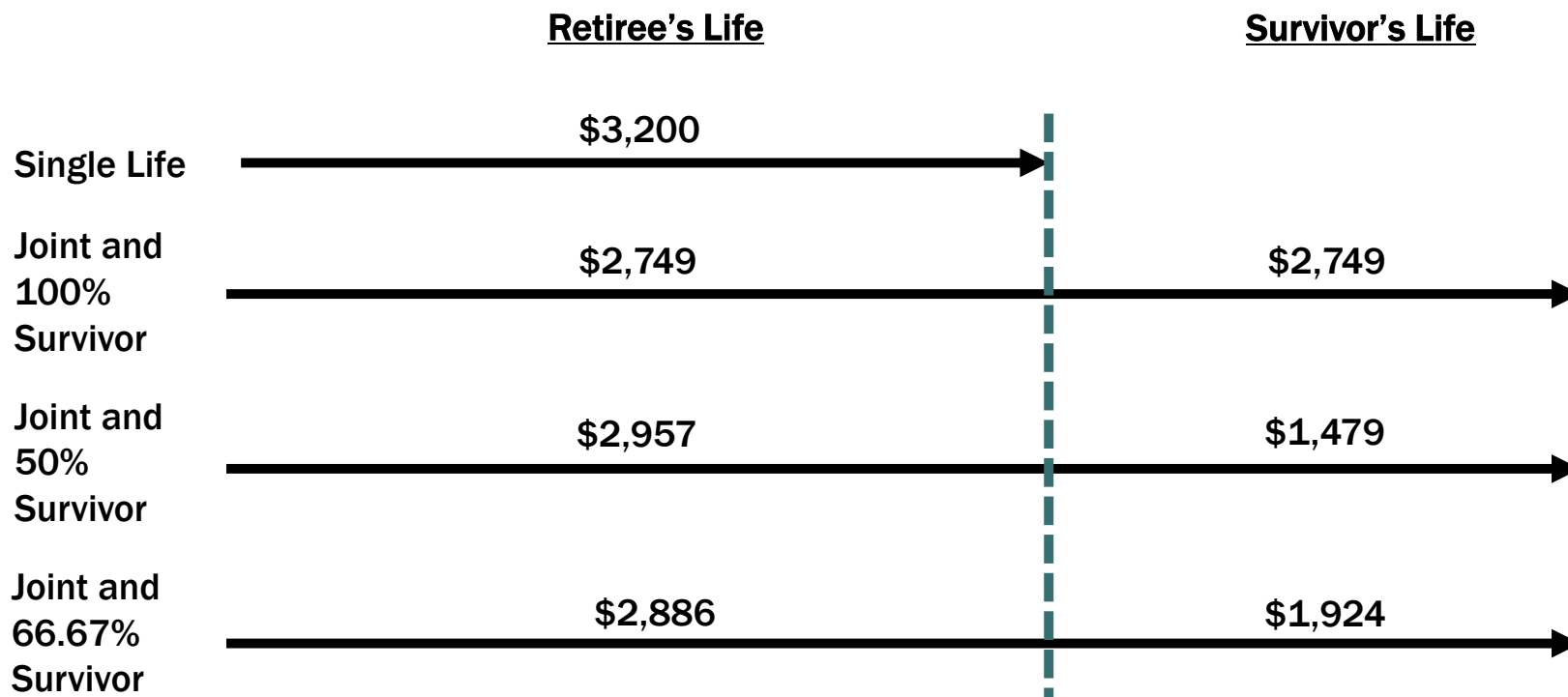
# What is a survivor option?

- LEOFF 2 members may elect to take a reduction in their monthly benefit in order to leave an ongoing benefit to a survivor. The survivor will receive the ongoing benefit for their lifetime.
- There are 4 survivor options:
  1. Single Life - No one will receive an ongoing benefit after the retiree dies
  2. Joint and 100% Survivor - The survivor receives the same benefit the retiree was receiving
  3. Joint and 50% Survivor – The survivor receives half the benefit the retiree was receiving
  4. Joint and 66.67% Survivor - The survivor receives  $\frac{2}{3}$  of the benefit the retiree was receiving

# Survivor Option Example

- Member: Age 53
- Spouse: Age 50
- Final Average Salary: \$8,000/month
- Service Credit: 20 years
- $2\% \times 20 \times \$8,000 = \$3,200$  Monthly Pension Benefit

# Survivor Option Example



# When can a member change their survivor option?

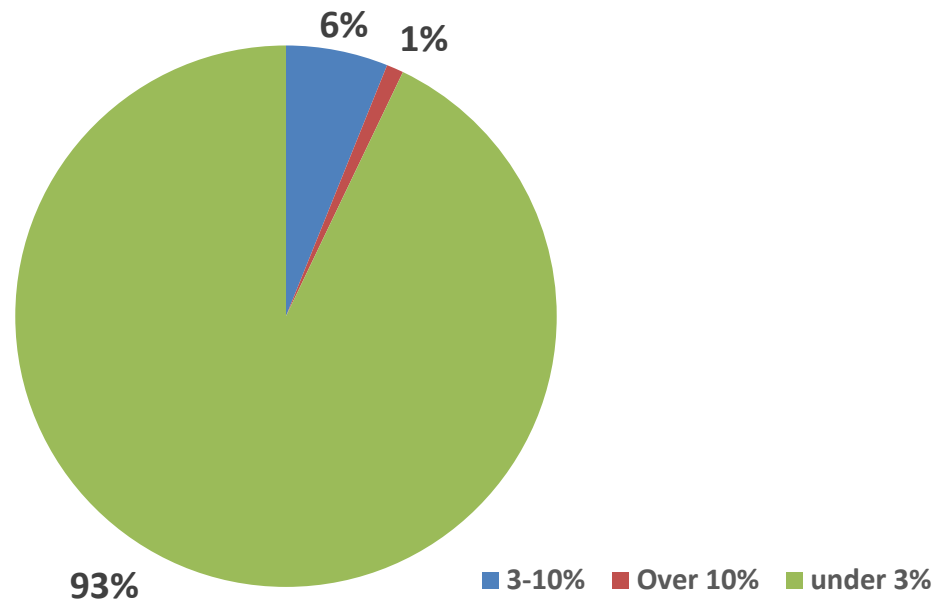
- A retiree's survivor option choice is irrevocable unless the following occur:
  - They designated someone other than their spouse to receive their survivor benefit. The non-spouse survivor can be removed only
  - They marry or remarry after retirement. To qualify, they must request the change between their first and second years of marriage
  - They chose a survivor option, and their survivor dies before they do. Their benefit is adjusted to Option 1
  - They return to membership. If they go back to work for any period of time as a contributing retirement plan member, they can retire again and select a new benefit option and/or survivor

# How does a member know what their benefit will be?

- DRS encourages members to request a benefit estimate within a year of retirement
  - To create an estimate, DRS asks a member their expected retirement date and what survivor option they would like to select
  - The estimate also takes into account the expected Final Average Salary
  - A member can receive multiple retirement estimates

# How accurate are benefit estimates?

Percent Breakdown L2 Estimates Variance  
January 2017 to April 2018





# Why are estimates different than actual benefits?

- Common reasons for estimates to be different than benefit, include:
  - Member selecting a different survivor option
  - Member retiring at a different date than they expected
  - Changes to Final Average Salary
    - Pay raise or decrease
    - Employer error in reportable compensation
  - Incorrect birth date for survivor

# Can a member's benefit change after retirement?

- When DRS receives additional information about an employee's Final Average Salary or Service Credit they recalculate the retiree's retirement benefit (recalc)
- A recalc may result in either an increase or a decrease to a member's benefit
- Current law does not allow a member to change their survivor option after a recalc

# Recalc Data

- Last fiscal year DRS recalculated 256 LEOFF 2 retirees' pension payments
  - 46 (18%) of those recalcs resulted in a decrease to a member's benefit

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# Why can't a member change their survivor option?

- Increased risk of anti-selection
  - Anti-selection is the tendency of a person to recognize his or her health status in selecting the option under a retirement system which is most favorable to him or herself
- Risks of anti-selection are currently mitigated through:
  - Survivor option election at the time of retirement
  - A window for post-retirement marriage survivor option election
- The more opportunity a member has to change that election the more likely anti-selection will impact LEOFF 2

## How could anti-selection impact LEOFF 2?

- Increased anti-selection risks may impact LEOFF 2 through:
  - Increased contribution rates
  - Less favorable administrative factors for survivor options
  - Intergenerational inequity

# Other Pensions Systems

- **Oregon Public Employee Retirement System**
  - 60 day window
- **Federal Employee Retirement System**
  - 18 month window to increase survivor benefit option
- **Minnesota Public Employees Retirement Association Police and Fire Plan**
  - Rescind survivor benefit option
- **United States Uniformed Services Retirement System**
  - Rescind survivor benefit option

# Policy Options

- **Option 1 – Window for all L2 Members:** All LEOFF 2 retirees have a 90 day window after the receipt of their first retirement payment to change their survivor election. If a member changes their survivor election they must pay or be refunded the difference in their pension payments that they have already received. The member must provide DRS with written spousal consent to change their survivor option, if the survivor option provides the spouse with a decreased survivor benefit



# Policy Options

- **Option 2 – Qualifying Event Window:** LEOFF 2 retirees may change their survivor election if a DRS recalculation of their benefit results in a change to the benefit amount of more than:
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# Policy Options

- **Option 3 - Qualifying Event Window with Further Anti-Selection Risks Mitigation:**  
The same as Option 2 except to further mitigate anti-selection risks a retiree's ability to change their survivor option election is limited based on the impact of the recalculation
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  - If a retiree's benefit decreases due to a recalculation they may only select a smaller survivor option
- **Option 4 –Option 1 and either option 2 or 3**



**Thank You**

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