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Survivor Option Reelection

COMPREHENSIVE REPORT FOLLOW-UP

By Jacob White
Senior Research & Policy Manager
360-586-2327
jacob.white@leoff.wa.gov

ISSUE

Members must make an irrevocable decision to leave a survivor benefit prior to knowing exactly what their pension benefit will be.

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 Plan 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 Plan 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 only lasts for the member's lifetime. 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 during 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 during 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 during 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 Plan 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 Plan 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.

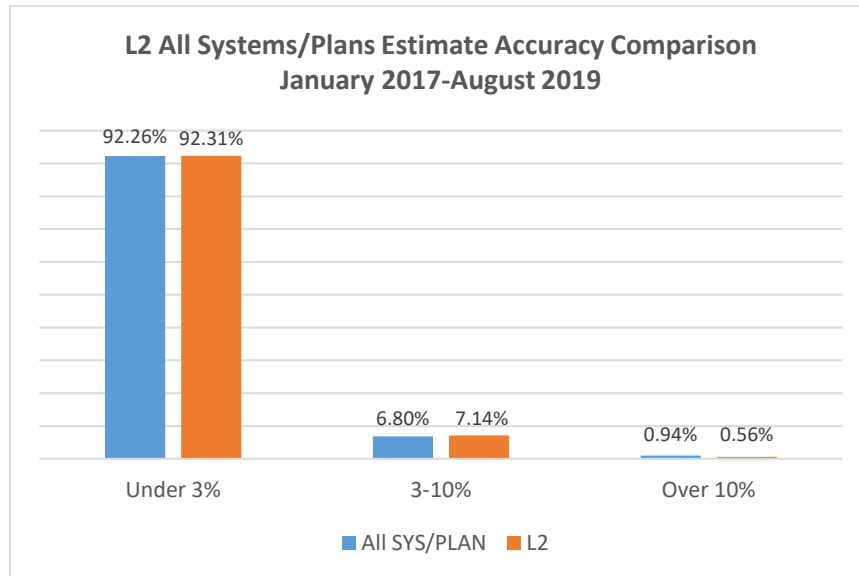
How does a member know what their benefit will be prior to retiring?

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 August 2019 there were 1,261 LEOFF Plan 2 retirements. Of those retirements:

- 1,164 (92.31%) estimates were within 3% of the member's actual benefit;
- 90 (7.14%) estimates were between 3% and 10% of the member's actual benefit; and
- 7 (.56%) were more than 10% different than the member's actual benefit.



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

In 2018 DRS recalculated 178 LEOFF Plan 2 retirees' pension payments (there were an additional 34 recalculations done that resulted in no change to a member's benefit). Of those 178 recalcs, 143 (80%) resulted in a decrease to a member's benefit. The largest amount of change in a monthly benefit was \$507.38 and the largest percentage in change in benefit was 16.35%. Below is a table of the percentage of change to these retirees' retirement benefit resulting from the recalc:

% Change in Benefit	# of Recalcs
.001 - .99%	126
1 – 4.99%	35
5%-9.99%	14
10% or more	3

The oldest LEOFF Plan 2 recalc completed in 2018 was more than 15 years after the member had retired. Below is the average turnaround time for LEOFF Plan 2 recalcs in 2018:

# of days after Retirement	# of Recalcs
Within 90 days	9
90-180 days	10
180-365 days	24
1 to 2 years	39
2 to 5 years	91
5 to 10 years	2
More than 10 years	3

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. 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, rather than individual life expectancies, the potential impact of anti-selection on LEOFF Plan 2 would be members could "game the system" to their advantage and the detriment of LEOFF Plan 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 Plan 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 Plan 2 mitigate the anti-selection risks of survivor benefits?

Currently, the impact of anti-selection on LEOFF Plan 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 Plan 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.¹ The change is retroactive to their effective retirement date, and overpaid benefits must be repaid to PERS. Oregon Public Employee Retirement System has approximately 50 to 60 retirees (approximately 0.7% of new retirees) per year change their survivor option selection.

The Federal Employee Retirement System has a window to change survivor election within 30 days of a member receiving their first regular annuity payment.² After the 30 day period has

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

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

passed, but less than 18 months from the beginning date of a 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.³

The United States Uniformed Services Retirement System allows retirees to terminate their survivor benefit in a one year window between the second and third anniversary following the first receipt of retired pay.⁴ 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 Plan 2 retirees have a 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.

- a) 60 day window
- b) 90 day window
- c) 120 day window

Option 2 – Qualifying Event Window: LEOFF Plan 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.

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

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

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 (a), (b), or (c) and 2 (a), (b), or (c)

Option 5 – Option 1 (a), (b), or (c) and 3 (a), (b), or (c)



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Issue

- Members must make an irrevocable decision for a survivor benefit prior to knowing exactly what their pension benefit will be

Follow-up

- Updated DRS recalculation data
- OSA feedback on potential impact of anti-selection risk mitigation option

Updated Recalc Data

- In 2018 DRS recalculated 178 LEOFF 2 retirees' pension payments

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- 143 (80%) resulted in a decrease to a member's benefit

Timeliness of DRS Recalcs

- The average turnaround time for LEOFF 2 recalcs in 2018:

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Anti-Selection Risk

- The further away from the original retirement date, the higher the risk for adverse selection because the member has more knowledge of their health and the health of their beneficiary
- Example: A member selects a J&S 100% on retirement and five years later there is a recalculation that lowers their benefit. If the member's beneficiary is no longer healthy, this proposal would allow the member to change their benefit to a life only with retroactive payments back to retirement. In this example, the member paid for 'insurance' they didn't need and now they can get their 'insurance premiums' back

Anti-Selection Risk Mitigation Options

1. Limit the Survivor Option Reelection to those who experience a recalculation above a specified limit, such as those with changes $>5\%$
2. Limit the potential for adverse selection by only providing Survivor Option Reelection within a certain time period following retirement
3. Limit the reelection options based on the time since retirement. Then, beyond the first year, only allow a lower/higher J&S option, depending on whether their recalculation is lower/higher
4. Only allow the retirement option to change prospectively when selecting a lower cost benefit payment form
5. Adopt new administrative factors, if needed, to maintain actuarial equivalence

Policy Option 1 – Window for all L2 Members

- All LEOFF 2 retirees have a 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.
 - a) 60 day window
 - b) 90 day window
 - c) 120 day window

Policy Option 2 – Qualifying Event Window

- LEOFF 2 retirees may change their survivor election if a DRS recalc results in a change to the benefit amount of more than:
 - a) Any change in benefit amount
 - b) 5%
 - c) 10%

Policy 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

Combination Policy Options

- Option 4 – Option 1 (a), (b), or (c) and 2 (a), (b), or (c)
- Option 5 – Option 1 (a), (b), or (c) and 3 (a), (b), or (c)

Next Steps

- Board action
 - Instruct staff to draft bill and identify costs with one or more of the policy options
 - Staff will present Final Report at the December Board Meeting
- Nothing further at this time



Thank You

Jacob White

Senior Research and Policy Manager

(360) 586-2327

jacob.white@leoff.wa.gov