LEOFF Plan 2 Retirement Board

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Survivor Option Reelection

FINAL PROPOSAL

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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:

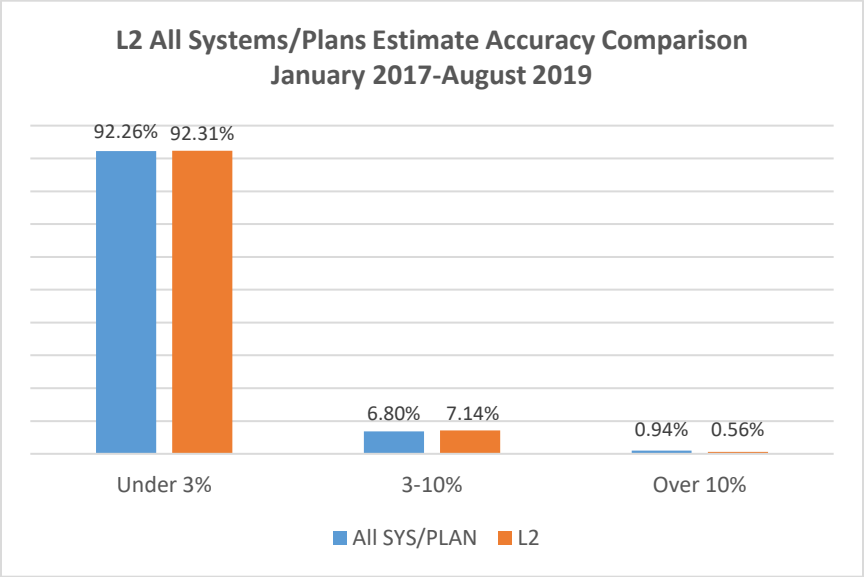
1. They designated someone other than their spouse to receive their survivor benefit. The non-spouse survivor can be removed (option 1) only.
2. They marry or remarry after retirement. To qualify, they must request the change between their first and second years of marriage.
3. They chose a survivor 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. However, DRS does not audit employers on a regular basis. In fact, there are some employers who have never been audited by DRS.

When a "recalc" occurs and a member's benefit is lowered, the member may also owe DRS an overpayment for the pension benefits they were incorrectly paid. The determination of whether the member or employer must pay the overpayment is governed by RCW 41.50.130 – 139. Typically, employers are only required to pay back the overpayment in the following situations:

- Failure to properly report retiree return to work hours[1]; and,
- Erroneously reporting that an employee has separated from service.[2]

[1] RCW 41.50.139
[2] RCW 41.50.139

In most instances, the member is responsible for paying back the overpayment. This includes overpayments for an employer misreporting earnable compensation to DRS. The Director of DRS, in certain instances, may waive the collection of overpayment under RCW 41.50.138.

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.[3] 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.[4] After the 30 day period has 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.[5]

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.[6] 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.

Cost Analysis

There was not adequate time for the Office of the State Actuary (OSA) to complete an actuarial analysis of these policy options. However, they did review a bill draft (See Appendix A) of policy options 1(b) and 2(b). OSA does not expect policy option 1(b) to have a material impact on LEOFF Plan 2. A window of 90 days directly after retirement, is not enough time for increased anti-selection to become a cost factor. However, OSA did identify that a window under option 2 could have a material impact to LEOFF Plan 2. OSA stated that costs could emerge to the plan if members reelect a larger joint and survivor benefit once long-term health prospects are known, and savings could emerge to the plan if members reelect a single life and pass away prior to a surviving spouse. If a policy proposal moves forward this year, OSA will prepare a formal actuarial fiscal note during the legislative session.

[3] https://www.oregon.gov/PERS/MEM/Tier-One-Tier-Two/Documents/TierOne-TierTwo-Preretirement-Guide.pdf
[4] https://www.opm.gov/faq/retire/Can-I-change-my-survivor-benefit-election-after-retirement.ashx
[5] https://www.mnpera.org/wp-content/uploads/2018/06/PF-Updated-1.pdf
[6] https://militarypay.defense.gov/Benefits/Survivor-Benefit-Program/Stopping-SBP/

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 the change is prospective only. The member must provide DRS with written spousal consent to change their survivor option.

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 base benefit amount of:

a) Any change in benefit amount
b) 3% or more
c) 5% or more

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 the change is prospective only. The member must provide DRS with written spousal consent to change their survivor option.

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.

SUPPORTING INFORMATION

Appendix A: Bill Draft – Option 1(B) and 2(C)

APPENDIX A

An Act relating to creating a window for certain retirees to change their survivor option election after retirement; amending RCW 41.26.460

Sec. 1. RCW 41.26.460 is amended to read as follows:

(1) Upon retirement for service as prescribed in RCW 41.26.430 or disability retirement under RCW 41.26.470, a member shall elect to have the retirement allowance paid pursuant to the following options, calculated so as to be actuarially equivalent to each other.

(a) Standard allowance. A member electing this option shall receive a retirement allowance payable throughout such member's life. However, if the retiree dies before the total of the retirement allowance paid to such retiree equals the amount of such retiree's accumulated contributions at the time of retirement, then the balance shall be paid to the member's estate, or such person or persons, trust, or organization as the retiree shall have nominated by written designation duly executed and filed with the department; or if there be no such designated person or persons still living at the time of the retiree's death, then to the surviving spouse or domestic partner; or if there be neither such designated person or persons still living at the time of death nor a surviving spouse or domestic partner, then to the retiree's legal representative.

(b) The department shall adopt rules that allow a member to select a retirement option that pays the member a reduced retirement allowance and upon death, such portion of the member's reduced retirement allowance as the department by rule designates shall be continued throughout the life of and paid to a designated person. Such person shall be nominated by the member by written designation duly executed and filed with the department at the time of retirement. The options adopted by the department shall include, but are not limited to, a joint and one hundred percent survivor option and a joint and fifty percent survivor option.

(2)(a) A member, if married or a domestic partner, must provide the written consent of his or her spouse or domestic partner to the option selected under this section, except as provided in (b) and (c) of this subsection. If a member is married or a domestic partner and both the member and member's spouse or domestic partner do not give written consent to an option under this section, the department will pay the member a joint and fifty percent survivor benefit and record the member's spouse or domestic partner as the beneficiary. Such benefit shall be calculated to be actuarially equivalent to the benefit options available under subsection (1) of this section unless spousal or domestic partner consent is not required as provided in (b) and (c) of this subsection.

(b) Written consent from a spouse or domestic partner is not required if a member who is married or a domestic partner selects a joint and survivor option under subsection (1)(b) of this section and names the member's spouse or domestic partner as the survivor beneficiary.

(c) If a copy of a dissolution order designating a survivor beneficiary under RCW 41.50.790 has been filed with the department at least thirty days prior to a member's retirement:

(i) The department shall honor the designation as if made by the member under subsection (1) of this section; and

(ii) The spousal or domestic partner consent provisions of (a) of this subsection do not apply.

(3)(a) Any member who retired before January 1, 1996, and who elected to receive a reduced retirement allowance under subsection (1)(b) or (2) of this section is entitled to receive a retirement allowance adjusted in accordance with (b) of this subsection, if they meet the following conditions:

(i) The retiree's designated beneficiary predeceases or has predeceased the retiree; and

(ii) The retiree provides to the department proper proof of the designated beneficiary's death.

(b) The retirement allowance payable to the retiree, as of July 1, 1998, or the date of the designated beneficiary's death, whichever comes last, shall be increased by the percentage derived in (c) of this subsection.

(c) The percentage increase shall be derived by the following:

(i) One hundred percent multiplied by the result of (c)(ii) of this subsection converted to a percent;

(ii) Subtract one from the reciprocal of the appropriate joint and survivor option factor;

(iii) The joint and survivor option factor shall be from the table in effect as of July 1, 1998.

(d) The adjustment under (b) of this subsection shall accrue from the beginning of the month following the date of the designated beneficiary's death or from July 1, 1998, whichever comes last.

(4) No later than July 1, 2001, the department shall adopt rules that allow a member additional actuarially equivalent survivor benefit options, and shall include, but are not limited to:

(a)(i) A retired member who retired without designating a survivor beneficiary shall have the opportunity to designate their spouse or domestic partner from a postretirement marriage or domestic partnership as a survivor during a one-year period beginning one year after the date of the postretirement marriage or domestic partnership provided the retirement allowance payable to the retiree is not subject to periodic payments pursuant to a property division obligation as provided for in RCW **41.50.670**.

(ii) A member who entered into a postretirement marriage or domestic partnership prior to the effective date of the rules adopted pursuant to this subsection and satisfies the conditions of (a)(i) of this subsection shall have one year to designate their spouse or domestic partner as a survivor beneficiary following the adoption of the rules.

(b) A retired member who elected to receive a reduced retirement allowance under this section and designated a nonspouse or a person not their domestic partner as survivor beneficiary shall have the opportunity to remove the survivor designation and have their future benefit adjusted.

(c) The department may make an additional charge, if necessary, to ensure that the benefits provided under this subsection remain actuarially equivalent.

(5) No later than July 1, 2003, the department shall adopt rules to permit:

(a) A court-approved property settlement incident to a court decree of dissolution made before retirement to provide that benefits payable to a member who meets the length of service requirements of RCW 41.26.530(1) and the member's divorcing spouse or domestic partner be divided into two separate benefits payable over the life of each spouse or domestic partner.

The member shall have available the benefit options of subsection (1) of this section upon retirement, and if remarried or in a domestic partnership at the time of retirement remains subject to the spousal or domestic partner consent requirements of subsection (2) of this section. Any reductions of the member's benefit subsequent to the division into two separate benefits shall be made solely to the separate benefit of the member.

The nonmember ex spouse or former domestic partner shall be eligible to commence receiving their separate benefit upon reaching the ages provided in RCW 41.26.430(1) and after filing a written application with the department.

(b) A court-approved property settlement incident to a court decree of dissolution made after retirement may only divide the benefit into two separate benefits payable over the life of each spouse or domestic partner if the nonmember ex spouse or former domestic partner was selected as a survivor beneficiary at retirement.

The retired member may later choose the survivor benefit options available in subsection (4) of this section. Any actuarial reductions subsequent to the division into two separate benefits shall be made solely to the separate benefit of the member.

Both the retired member and the nonmember divorced spouse or domestic partner shall be eligible to commence receiving their separate benefits upon filing a copy of the dissolution order with the department in accordance with RCW 41.50.670.

(c) The department may make an additional charge or adjustment if necessary to ensure that the separate benefits provided under this subsection are actuarially equivalent to the benefits payable prior to the decree of dissolution.

(6) (a) Retirees have a window of 90 days after the receipt of their first retirement payment to change their survivor election, including electing a standard allowance, made under subsection (1) of this section. If a member changes their survivor election, including electing a standard allowance, under this subsection the change is prospective only. The retiree must provide the department with the written consent of his or her spouse or domestic partner to the option selected under this subsection.

(b) Retirees may change their survivor election made under subsection (1) of this section if a recalculation of their benefit by the department results in a change to the base benefit amount of three percent or more. The retiree has a 90 day window from receipt of their first recalculated pension payment to elect a new survivor benefit option, including electing a standard allowance. If a member changes their survivor election under this subsection, including electing a standard allowance, the change is prospective only. The retiree must provide the department with the written consent of his or her spouse or domestic partner to the option selected under this subsection.