



June 20, 2018

Survivor Option Election

INITIAL CONSIDERATION

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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 what survivor options are and how they work. It will also explain how a member receives an estimate of their benefit prior to retirement, the accuracy of those estimates; and why the decision to leave a survivor benefit is irrevocable.

BACKGROUND

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. The larger the difference in age, the higher the reduction in benefit. 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.

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

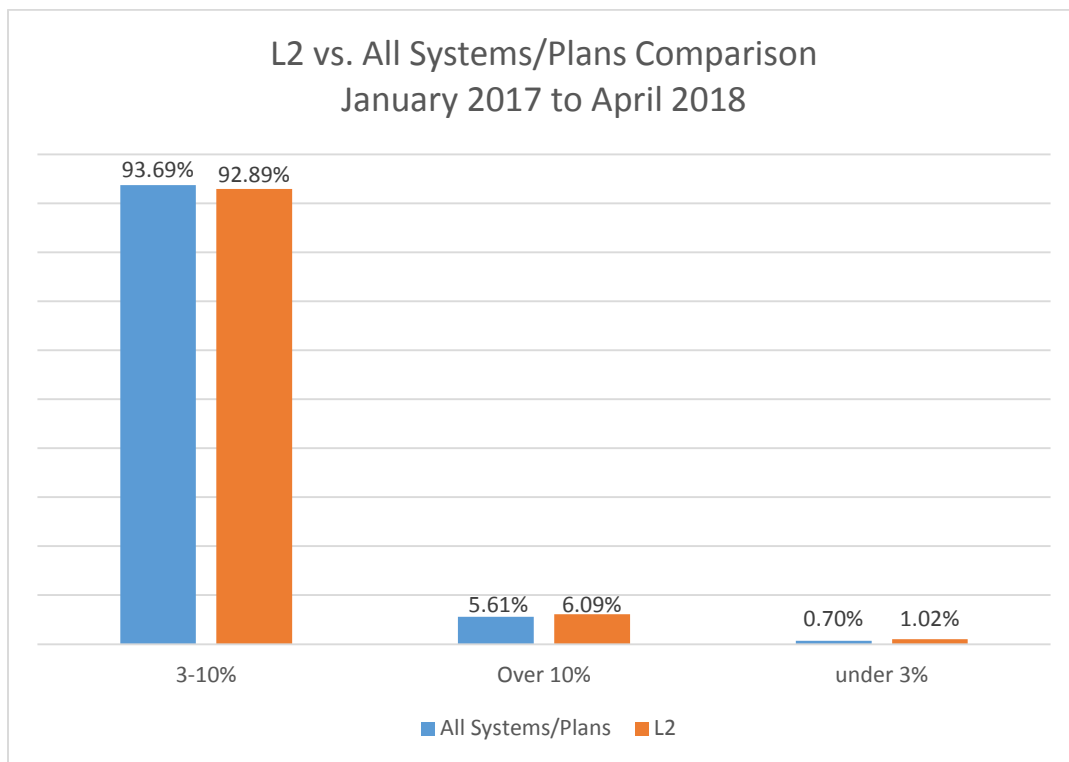
different survivor options. In addition to what survivor option the member selects, the estimate is calculated based on multiple assumptions including how long the member will continue to work and what their Final Average Salary will be.

How accurate are benefit estimates?

DRS tracks the accuracy of estimates as part of their ongoing performance metrics. From January 2017 to April 2018:

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

The following chart shows how the accuracy of LEOFF 2 estimates compared to the overall accuracy of estimates.



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.

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 anti-selection risks were to occur the impacts of increased contribution rates 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 will impact LEOFF 2.

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.



Survivor Option Election

Initial Consideration
June 20, 2018

Issue

- It may be considered unfair to have a member make their irrevocable retirement election for a survivor option without knowing exactly what their pension benefit will be

Overview

- This presentation will cover:
 - Background on Survivor Options
 - Retirement Benefit Estimate Accuracy
 - Anti-selection Risks of 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

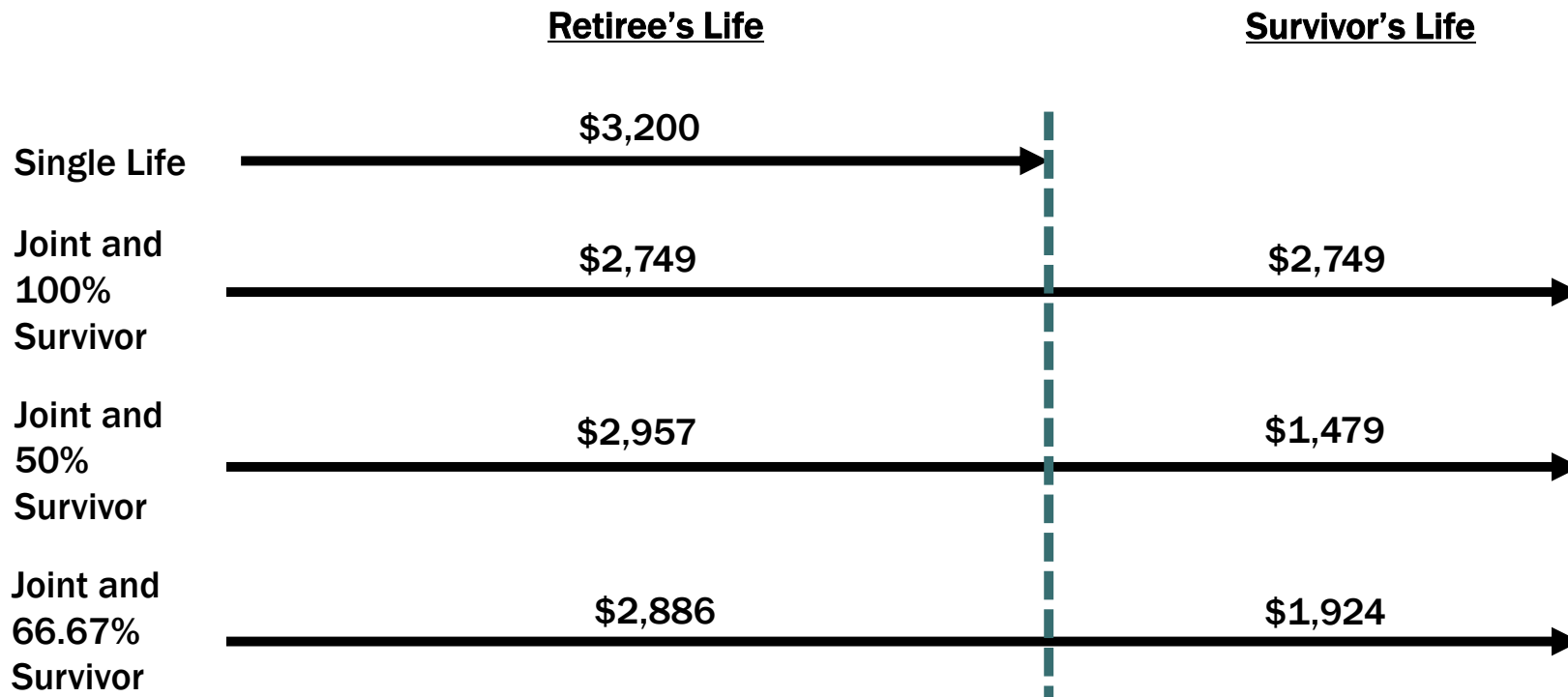
What are the survivor options in other plans?

- 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 that is not optional.
 - No reduction in member's benefit

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?

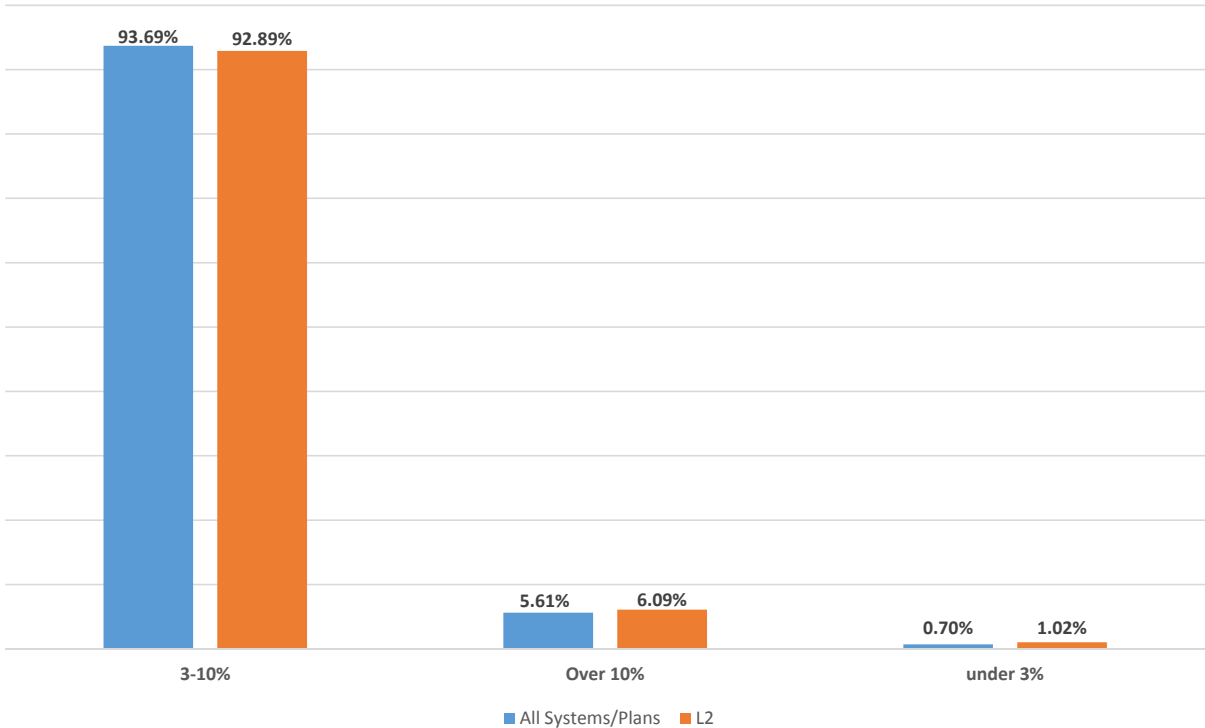
- A retiree's survivor option choice is irrevocable unless the following occur:
 - They designated someone other than their spouse to receive their survivor benefit. The non-spouse survivor can be removed only.
 - They marry or remarry after retirement. To qualify, they must request the change between 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?

L2 vs. All Systems/Plans Comparison
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**

Why can't a member change their decision?

- **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



Thank You

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