

Administrative Factors



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Presentation to: LEOFF Plan 2 Retirement Board



Today's Presentation

- Background Information on Administrative Factors
 - What are Administrative Factors?
 - How is an Admin Factor Developed?
 - Admin Factor Types
 - LEOFF 2 Admin Factor Updates
 - Anti-selection Risk and Risk Management
 - Next Steps
- No action required



Background: Why Is This Before The Board?

- The Board has authority to adopt factors
 - DRS adopts factors for all other plans
- The Board will be adopting factors later this fall

Background: What Are Administrative Factors?

- Admin factors convert benefits to varying forms
- Applied to optional benefit calculations and purchases
 - Specifically, optional benefits to offset the additional plan costs
 - Provides more ways to provide the same amount of money
- Give members flexibility without increasing plan costs
- Sometimes called “reduction” or “actuarial” factors

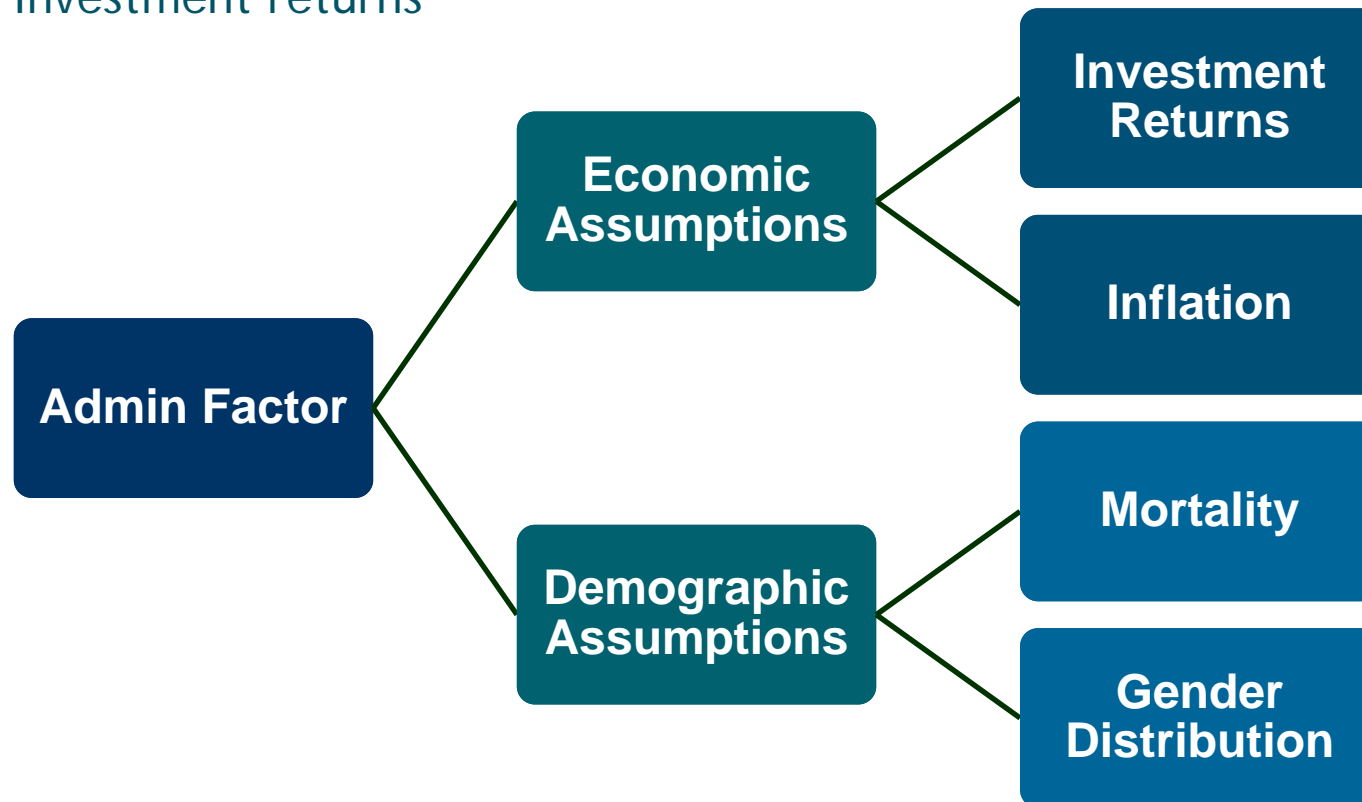


Background: Administrative Factor Example

- The total expected value of an age 55 retiree's pension is \$500,000
- Administrative factors transform \$500,000 in cost-neutral ways
- For example
 - A single lifetime pension of \$2,500/month
 - A J&S 100% pension of \$2,000/month

How Is An Admin Factor Developed?

- An administrative factor takes a lump-sum dollar amount and converts it to a stream of future cash flows and vice versa
 - Takes into account survivorship option, expected lifetime, and investment returns



Admin Factors Depend On Assumptions

- Example: Optional Annuity Purchase
 - At the time of annuity purchase, the age and plan of the retiree is known
 - Based on age and plan, assumptions are used to estimate future experience of the annuitant
 - The only thing we know for certain is that the future won't look exactly like what we assume

Two Basic Types Of Admin Factors

Reduction Factors

- ❖ Reduce monthly pensions to pay for optional benefits
 - Early Retirement
 - Joint and Survivor Benefits

Annuity Factors

- ❖ Convert between one-time and lifetime payments
 - Service Credit Restoration
 - Monthly Benefit per \$1 of Accumulation

LEOFF 2 Has Four Sets Of Factors To Update

- Reduction Factors
 - Early Retirement Factors (ERFs)
 - Joint and Survivor Option Factors (J&S Factors)
- Annuity Factors
 - Service Credit Restoration Factors (SCRFs)
 - Monthly Benefit per \$1.00 of Accumulation (Annuity Factors)

Early Retirement Factors

- ERFs reduce a member's benefit for early payments
- Applies to non-duty disability or death benefits prior to Normal Retirement Age
- When benefits start earlier, they are paid longer and the total cost of a member's expected lifetime benefits increases
- Example
 - LEOFF 2 member with \$500,000 in earned benefits choosing between \$2,500/month at normal retirement, or \$2,100/month two years earlier



Joint And Survivor Option Factors

- J&S factors reduce a member's benefit to provide an ongoing benefit for their survivor
- Three types of survivor benefits available under the plan
 - J&S 100%
 - J&S 66 2/3%
 - J&S 50%
- Example
 - Member with \$500,000 in expected benefits choosing between single life of \$2,500/month or, J&S 100 of \$2,000/month

Service Credit Restoration Factors

- Factors used to calculate the cost of the increase in a member's benefit if they restore prior service credit
 - Service withdrawn in the past and member wants to restore it after window to pay contributions with interest
- Dependent upon additional assumptions, because purchase is made before the member is at retirement
 - When the member will retire
 - How much their salary will increase
- Example
 - To restore service, the value the extra service is providing in total retirement benefit must be estimated before the time of retirement
 - If restoring service credit increases the value of a member's earned benefit from \$500,000 to \$550,000, how much will that cost 20 years prior to retirement?

Monthly Benefit Per \$1.00 Of Accumulation Factors

- “Annuity” factors convert a lifetime monthly benefit to a lump sum
- Calculation is made at retirement
- Applies to cash-out of small monthly pension or purchase of additional pension
 - “Air time” provides up to five years of service credit
 - Optional life annuity purchase
- Unlike SCRFs, the purchase is made at retirement
- Example
 - Age 55 plan member purchases an annuity with \$100,000
 - Results in additional monthly annuity of \$500



Actuarial Equivalence Depends On Assumptions

- Admin factors are intended to be actuarially equivalent
- However, experience can be different
 - Members may live longer than expected
 - Investment returns can have a lower future expectation
 - Members may anti-select based on their health.
- What happens if the factors aren't actuarially equivalent?
 - The costs or savings are passed on to current members and employers
 - No true-up for those retired
 - Example: ROR reduced from 8% to 7.4% and mortality improvements

Anti-Selection May Lead To System Risk

- Admin factors are designed so that positive and negative experience will offset in the long run
- Anti-selection occurs when a higher-cost group makes more purchases than a lower-cost group but at the price for the average member
 - Individual plan members have better information about expected lifespan
 - Example: If only the healthy half of LEOFF 2 retirees purchase annuities, then risks to the system may emerge
 - Anti-selection may also occur in other admin factors



Potential System Risks Could Be Managed

- Based on administrative policy, current annuity purchases are priced based on the same assumptions used to fund the plan
- Risk management strategies using admin factors are being studied by OSA
 - Different assumptions could be used for annuities
 - Longer lifespans could be adopted to manage anti-selection concerns
 - Assets could reflect shorter investment time frame
 - Annuity factors could be priced at inflation cap
 - Other methods could be put in place to protect against system risks
- Actuaries will report back with recommendations

Next Steps

- No action required
- OSA will provide additional information and tables of new factors
- Board adopts final factors
- DRS will communicate factor changes to members and implement new factors effective October 2019



Questions?

