Annuity Purchase

Issue

Members of certain plans in the state's retirement systems currently have the option to purchase an expanded actuarially equivalent annuity at the time of retirement in order to supplement their normal retirement benefit.

The Washington State Patrol Troopers Association has requested consideration of extending this expanded annuity option to members of the Washington State Patrol Retirement System. The Select Committee on Pension Policy (SCPP) expanded the scope of review to include all members that do not currently have the option to purchase an expanded annuity at retirement.

The issue raises the following key policy questions.

- Are the existing annuity purchase options sufficient?
- Should an expanded annuity purchase option be extended to all members of the state's retirement systems?

Background

An annuity is a one-time, lump sum payment made by an employee in exchange for a guaranteed fixed monthly benefit payment for the rest of their life. Currently, there are multiple options available to members to purchase various forms of annuities.

During the 2014 Legislative Session, a bill passed allowing members of the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 2 the option of purchasing an expanded annuity at the time of retirement.

All members have the option of purchasing up to five years of additional service credit at the time of retirement as a way to increase their lifetime benefit payment. Plan 3 members also have the ability to purchase an annuity with their defined contribution account. Only the Teachers' Retirement System and LEOFF Plan 2 members have the option of purchasing an expanded annuity in order to supplement their defined benefit at the time of retirement.

Highlights Of Analysis

- Optional annuities are a valuable benefit to members who can afford to purchase them. However, it may be cost prohibitive for some.
- The various annuity purchase options available to members all differ in their limitations. Some options may be perceived as better than others.

- The only mechanism available to members who can afford to purchase an annuity above the existing five-year service credit limit is in the private market, which is more expensive than the state.
- The cost of an actuarially equivalent annuity is expected to be borne by the purchaser. However, if actual experience differs from the actuarial assumptions that went into pricing the cost of the member's annuity, there will be an impact to the system.
- Costs to the system can arise if members live longer than expected or investment returns are not as high as expected.
- If inflation is less than assumed, the member bears the cost. However, the guarantee of a fixed benefit payment for life may outweigh the potential for slightly overpaying.
- There are potential ways to manage the risk of annuity purchases. Further direction from the SCPP may be required for further analysis.
- Policy makers will likely wish to weigh the benefits of extending an expanded annuity purchase option to all or some members of the state's retirement systems against the existing benefit options and potential risks.

Staff Contact

Devon Nichols
Policy Analyst
360-786-6145
devon.nichols@leg.wa.gov

O:\SCPP\2014\10-21-14_Full\4.Annuity_Purchase_Exec_Summary.docx