# Select Committee on Pension Policy

## Annuity Purchase

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## What's The Issue?

- Legislation passed in 2014 Session granting LEOFF 2 members option to purchase expanded annuity
- Washington State Patrol Troopers Association requested consideration for WSPRS members
  - SCPP correspondence

## Committee Activity

- Briefings in September and October
- Executive Committee requested additional follow-up
  - Other states
  - IRS requirements
  - Risk analysis





## Today's Presentation

- Recap of prior briefings
- October follow-up questions
- Policy considerations
- Risk mitigation
- Possible next steps
- No action required today

## Highlights From Prior Briefings

- Currently, all members can purchase an annuity from the system
  - Pay expected cost
  - Usually less expensive than private market
- Costs to the system can emerge
  - Members live longer than expected
  - Investment returns lower than expected
- Two ways to buy an extra annuity from the system
  - Optional service credit purchase (limited) — all plans
  - Expanded annuity purchase (unlimited) — TRS and LEOFF 2
- Members in other plans would likely buy an expanded annuity
  - Based on analysis of annuity purchase data
  - Small percentage
  - Higher income





## October Follow-Up Questions

- Do other states allow annuity purchases from the system?
  - Peer states don't allow direct annuity purchases at retirement
  - Ohio and Wisconsin allow extra contributions by members
- Does the IRS require the same assumptions be used for funding and annuity purchase?
  - DRS is currently in consultation with tax counsel



## Up Next: Policy Considerations

- Key policy questions
- Implications of offering optional annuities
- Possible decision path
- Possible reasons for and against providing expanded annuities to additional groups





## Key Policy Questions

- Are the existing annuity purchase options sufficient?
- Should an expanded annuity purchase option be extended to all members?

## Optional Annuities Can Support Many Policy Goals

- Member flexibility at member cost
  - Offset early retirement reductions
  - Spread retirement income over lifetime
- Benefit portability
  - Transfer savings from other systems to the state's systems
- Adequacy of benefits
  - Supplement retirement income
  - Compensate for shorter careers or lack of Social Security
- Retirement security
  - Protect against the risk of outliving savings

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## Optional Annuities Can Impact Liabilities And Intergenerational Equity

- Intergenerational Equity (IE) calls for the cost of members' benefits to be paid by the taxpayers receiving the members' service
- Offering annuities exposes the plan to liabilities
- If plan experiences losses or gains on annuity purchases
  - Costs or savings can be passed to future taxpayers
  - Counter to IE

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## Possible Decision Path

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Are Existing Options Sufficient?

***No***

Who Else Should Receive An Expanded Annuity Option?

What Should The Expanded Annuity Look Like?

Should Potential Risks Be Mitigated?

***Yes***

Nothing Further At This Time



## Possible Reasons To Extend Expanded Annuity

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- Support increased member flexibility, benefit portability, benefit adequacy, and retirement security
- Provide benefit consistency across all systems
- Provide members a lower cost option than the private market
- Data suggests some members would likely use it
- Members pay the expected costs

## Possible Reasons To Not Extend Expanded Annuity

- Expansion of guaranteed benefits
- Risk that costs to the system could emerge
- State competing with private industry
- May not benefit the larger group
- Amount of risk is not known

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## Who Else Should Receive An Expanded Annuity Option?

- All members
  - Extend to PERS, SERS, PSERS, WSPRS, LEOFF 1
  - Consistency among all plans
- WSPRS and LEOFF 1
  - Consistency among police and firefighters
  - Expanded annuity can help offset lack of Social Security
- WSPRS
  - Only Troopers have asked for it
  - Expanded annuity can help offset lack of Social Security
- Other groups?
  - PSERS has second-highest rate of annuity purchase among the plans

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## What Should An Expanded Annuity Option Look Like?

| Features | LEOFF 2 Option | TRS Option | New Option |
|---|---|---|---|
| **Pricing approach** | Actuarial equivalence | Actuarial equivalence | ? |
| **Coordinated with** | State pension | State pension | ? |
| **Maximum amount** | Unlimited | Unlimited | ? |
| **Minimum amount** | $25,000 | None | ? |
| **Purchased using** | Funds from governmental plans | Any funds | ? |
| **Promotes** | Public service portability | Member flexibility | ? |

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## Up Next: Risk Mitigation

- Should potential risks of optional annuities be mitigated?
- Types of risk
- Risk analysis
- Options to mitigate risks


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## Should Potential Risks Be Mitigated?

- Answer may depend on type and magnitude
- Two main risks
  - Plan experiences a loss
  - Purchaser pays more than is necessary
- Experience loss on annuity purchases
  - Increase plan costs
  - Can negatively impact plan health
- Risk of purchaser paying more than necessary may be of less concern
  - Optional purchase
  - Value in guaranteed benefits
  - Doesn't negatively impact plan health



## How Much Potential Risk Is There?

- Extent of possible gains/losses on prior purchases isn't known
  - Insufficient data to quantify
- Analyze risk around assumptions used to price annuities
  - Investment
  - Mortality
  - Inflation
- Show impact if assumptions don't match experience
  - Hypothetical example

## Hypothetical Example: Scenarios

- Assume 3.5 percent of members buy extra $50,000 of benefits starting at age 65
  - About 10,000 purchases
- Scenarios
  - Investment return 1 percent higher/lower than assumed
    - 7.8 percent in statute
  - Investment return equal to long-term expected return
    - 7.5 percent
  - Members live three years more/less than assumed
  - Inflation is 1 percent higher/lower than assumed
    - 3.0 percent in statute



## Hypothetical Example: Potential Gains/Losses

| *(In Dollars)* | | Gain/(Loss)* (Per purchase) | Gain/(Loss)* (10,000 purchases) |
|---|---|---|---|
| **Investment Return Scenarios** *(7.8% assumed)* | | | |
| 1 | 6.8% | ($4,700) | ($47,000,000) |
| 2 | 7.5 % | (1,300) | (13,000,000) |
| 3 | 8.8% | 4,100 | 41,000,000 |
| **Mortality Scenarios**** | | | |
| 4 | Live 3 years longer | (3,200) | (32,000,000) |
| 5 | Live 3 years less | 3,400 | 34,000,000 |
| **Inflation** Scenarios *(3.0% assumed)* | | | |
| 6 | 2.0% | 4,300 | 43,000,000 |
| 7 | 4.0%*** | 0 | 0 |
| **Combination Scenarios** | | | |
| 9 | Multiple Gains 3,5,6 | 10,100 | 101,000,000 |
| 10 | Multiple Losses 1,4 | ($8,600) | ($86,000,000) |

**Probability of a gain or loss is not necessarily equal.*
***RP-2000, 100% Scale BB, Static Projection Year=2031, 50% male/50% female blend.*
****No experience loss if inflation exceeds assumption because COLA is capped at 3%.*

## Managing Risks Requires Balancing Member Value Against Risk Of Potential Plan Loss

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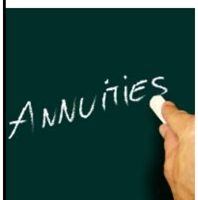
- Annuities can be priced lower in exchange for the plan taking on more risk
  - Lower price = more value to purchaser
- Risk/value can be adjusted along a wide spectrum
  - High value, high risk
  - Low value, low risk
- Annuities can be priced at lower risk and still provide value
  - Seen in private market annuities
- Actuaries can help balance risk/value when pricing annuities






## Many Options To Mitigate Risk Of Plan Loss

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- Limit exposure
  - Restrict eligibility
  - Limit the purchase amount
- Manage pricing risk
  - Actuarial assumptions designed for annuity purchases
  - Conservative pricing
  - Establish reserve
- One or more of these options could be explored

## Wrap Up

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- All plans provide annuity purchase options
  - Only TRS and LEOFF 2 provide unlimited purchase
- Providing optional annuities from the retirement systems
  - Supports many potential policy goals
  - Can impact liabilities and IE
- Managing annuity purchase risk requires balancing
  - Member value
  - Potential losses to the plan
- There are ways to reduce plan risk while still providing value to members



## Possible Next Steps

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- No further action at this time
- Prepare options to provide expanded annuity to other groups
  - LEOFF 2 or TRS approach
- Further study next interim
  - Risk mitigation for current programs
  - New expanded annuity purchase program