In Brief

Issue

Members of certain plans in the state's retirement systems currently have the option to purchase an expanded actuarially equivalent annuity benefit at retirement. Should an expanded annuity purchase option be extended to all members?

Member Impact

Approximately 209,000 active PERS, SERS, PSERS, and WSPRS members in Plans 1, 2, and 3 do not have access to an additional annuity purchase option.

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 retirement in order to supplement their normal retirement benefit.

The Washington State Patrol Troopers Association (WSPTA) has requested consideration of extending this expanded annuity purchase benefit to all members of the Washington State Patrol Retirement System (WSPRS) after legislation passed during the 2014 Legislative Session allowing members of the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 2 to purchase an expanded annuity at retirement. The Select Committee on Pension Policy (SCPP) increased the scope of review to include all members of the state's retirement systems that do not currently have the option to purchase an expanded annuity benefit at retirement.

The following policy questions are currently before the SCPP:

- ❖ 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

What Is An Annuity?

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.

An annuity is a contract between an employee and the retirement plan where the employee makes an up-front lump sum payment in exchange for a set benefit payment for the rest of their lives.

Typically, annuities are discussed in relation to Defined Contribution (DC) accounts because outside of pensions, annuities are the only guaranteed, predictable income stream in retirement, regardless of investment performance. However, by purchasing an annuity with a DC account, a member is trading market risk and account growth for the guarantee of a steady stream of income for the remainder of their lives. While members will receive the security of a dependable monthly income, there is little to no flexibility with an annuity. If a member's living expenses fluctuate in

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retirement their annuity typically cannot adjust to meet changing needs.

This may be less of a concern for members of Washington's retirement systems because all plans contain a Defined Benefit (DB) component that guarantees a retirement benefit payment for life. If a DB member purchases an annuity they likely are doing so to supplement their pension and receive a higher guaranteed benefit payment for the rest of their lives.

There are multiple annuity purchase options available to members.

There are multiple options currently available to members of Washington’s retirement systems as discussed below.

Annuity Purchase On The Private Market

All state retirement system members currently have the option of purchasing an annuity on the private market at the time of retirement. These annuities may be offered by banks, insurance companies, or other financial service providers. Private sector annuities can often be highly customized for an individual purchaser. However, purchasing on the private market is typically more expensive than purchasing one through the retirement system.

For more discussion around the differences between private and public annuity purchase see the **Policy Analysis** section.

Optional Plan 3 Member Annuity

All Plan 3 members have the option of purchasing an annuity with their DC account.

The hybrid Plan 3 benefit consists of a DB component and a DC component. Employer contributions are deposited into the employee's DB account, while employee contributions are deposited into their DC account. All Plan 3 members currently have the option of purchasing an annuity with their DC account at the time of retirement. The amount of the annuity payment is calculated using many factors, including age and whether or not the member chooses to purchase a single life annuity, joint life annuity, or term certain annuity — each differing in how long the guaranteed benefit payment will be made.

Who provides the annuity for Plan 3 members varies based on whether the member chooses to self-direct their DC investments or to have the Washington State Investment Board (WSIB) invest their DC account in the Total Allocation Portfolio (TAP). With the former choice, annuity purchases are arranged through a private vendor and have distinctly different features and options than with the WSIB. The TAP is a diversified investment portfolio in Plan 3 that is designed for the long-term investor.

According to the Department of Retirement Systems (DRS), approximately 10 percent of Plan 3 retirees took advantage of an annuity invested in the TAP during the last fiscal year.

Optional Expanded Annuity Purchase

Since the early nineties, all members of the Teachers' Retirement System (TRS) have the option of purchasing an expanded annuity to increase their monthly retirement benefit.

All TRS and LEOFF Plan 2 members already have the option of purchasing an expanded annuity.

Similar to TRS members, members of LEOFF Plan 2 have the option of purchasing an expanded annuity at the time of retirement. For more information regarding the LEOFF Plan 2 annuity purchase benefit see the **Legislative History** section.

The key difference between the two options is the source of funds that can be used to purchase the annuity. TRS members can use any funds, LEOFF 2 members must use funds from a governmental retirement plan.

Optional Service Credit Purchase Up To Five Years

All members of the state's retirement systems have the option of purchasing up to an additional five years of service credit in order to increase their monthly retirement benefit for the rest of their lives. A member may only purchase additional "air time," as it is often called, at the time of retirement and cannot use the additional credit to qualify for retirement. Purchasing additional service credit is essentially purchasing an additional annuity but, in this case, with a limit of five years imposed.

All members of the state's retirement systems have the option of purchasing additional service credit at the time of retirement.

However, the limitations of purchasing optional service credit are different than purchasing an expanded annuity. Service credit is subject to some return-to-work rules. Should a retiree that has purchased additional service credit return to work, their normal retirement benefit and additional service credit benefit will be suspended until they fully separate from employment.

In order to calculate how much a member must pay to purchase additional service credit, DRS uses an annuity factor that the Office of the State Actuary (OSA) calculates. This annuity factor is based on a member's age and plan. See the **Example** below.

According to DRS, approximately 5 percent of retirees during the last fiscal year purchased additional service credit. Those who did purchase additional service, on average, purchased just over 51 months with an average cost of just under $80,000.

Example

Becky is a 65-year-old Public Employees' Retirement System (PERS) Plan 2 member who has 22 years (264 months) of service credit. Her Average Final Compensation (AFC) is $3,000 per month. She wants to purchase the full five years of additional service credit (60 months).

Estimated Monthly Retirement Benefit	
Normal Benefit Without Purchase of Service Credit	Benefit With Purchase of Five Years Additional Service Credit
$1,320	$1,620

To calculate the cost of purchasing additional service, Becky will divide the amount of the benefit increase ($300) by an annuity factor for her age and plan (in this case, 0.0069798). This calculation results in a cost of $42,981 for the purchase of five years of service credit.

The above illustration is taken from DRS's webpage and shows the possible cost of purchasing service credit. The annuity factor used is for illustrative purposes only. See the Administrative Factors page on DRS's website for more information. For more detail on the example above see the Purchasing Additional Service Credit page.

Legislative History

A bill passed in 2014 allowing LEOFF Plan 2 members to purchase an additional annuity from the LEOFF Plan 2 trust fund.

During the 2014 Legislative Session, a bill passed allowing members of the LEOFF Plan 2 to make an optional one-time lump sum annuity purchase through the LEOFF Plan 2 trust fund. The purchase must be made by rolling over funds from an eligible governmental plan at a minimum purchase amount of $25,000. The resulting expanded annuity is actuarially equivalent to the additional amount contributed by the retiree.

If the retiree dies before the total monthly payments equal or exceed the purchase price of the annuity, the balance of the purchase price will be refunded to the selected beneficiary.

The annuity will also include: 1) an annual Cost-Of-Living-Adjustment (COLA), calculated the same as the COLA for LEOFF Plan 2 retirement benefits; and 2) the same survivor option as the retiree has chosen for his or her LEOFF Plan 2 retirement benefit.

Under this new law, retirees that choose this optional expanded annuity purchase may rescind or alter the contract within 15 days of DRS receiving the contract.

Other States

None of Washington's peer states provide an option to directly purchase an annuity at retirement from the retirement system for teachers, general public, and school employees. However, two peer states—Ohio and Wisconsin—allow members to make additional contributions to the retirement system over their working careers. The accumulated value of the contributions, which are invested in the trust fund, can be converted to an annuity at retirement.

This research is based on information obtained from the plan administrator web sites and member handbooks for the ten staff-identified peer states.

Policy Analysis

This issue raises the following key policy questions:

The issue raises the key policy question of whether the current annuity options available to members are sufficient.

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

In responding to this issue, policy makers may wish to consider the potential policy goals and value of providing optional, annuities from the retirement system, benefit consistency, expected costs, and potential risks to the system and member.

Providing Optional Annuities Can Support Many Potential Policy Goals

Optional annuities can support member flexibility, portability, benefit adequacy, and retirement security.

Allowing members to purchase an optional annuity from the retirement system can support many potential policy goals such as member flexibility at member cost, benefit portability, adequacy of benefits, and retirement security. Optional annuities can be used by members to offset early retirement reductions or spread income from retirement over their lifetime. This can be viewed as providing member flexibility at member cost. Some members may be able to purchase an optional annuity from the state retirement systems by using funds accumulated in other private-sector or governmental retirement plans. This effectively allows them to transfer the value of their benefit to the state's system, which can be viewed as promoting benefit portability between state and other retirement systems. Members may also use optional annuities to supplement retirement income, which can be viewed as supporting adequacy of benefits. Finally, since optional annuities provide a guaranteed lifetime benefit, members may use them as a means to protect against the risk of outliving retirement savings. This can be viewed as promoting retirement security.

Optional annuities have implications for liability and intergenerational equity.

While optional annuities can serve many potential policy goals, they also have implications for liability and intergenerational equity. Allowing members to purchase an annuity from the retirement system represents an expansion of the guaranteed benefits provided by the systems. This exposes the systems to potential liability if the purchase price doesn't cover the full cost of providing the annuity. Since optional annuities are purchased at retirement, any funding shortfall would be passed on to future generations of taxpayers who won't benefit from the services of the member. This runs counter to the principal of intergenerational equity.

The risks associated with optional annuities and ways to manage them are further discussed later in this paper.

Optional Annuities Are A Valuable Benefit

A member who chooses to purchase an optional annuity at the time of retirement will increase their retirement benefit payment for the remainder of their life; or a survivor's life should they choose to purchase a survivor option. A guaranteed lifetime benefit can increase retirement security for members leaving the work force and be a valuable benefit—if the member has the means to purchase one.

Optional annuities are a valuable benefit to members who can afford to purchase them. However, it may be cost prohibitive for many.

As shown in the earlier **Example**, purchasing an additional annuity can be very expensive. According to data provided by DRS, the average purchase price for members buying optional service credit during the last fiscal year was just under $80,000. This type of expenditure may be cost prohibitive for many members.

The ability to purchase an optional annuity may be of additional value to members:

- ❖ Working in physically demanding or high-stress jobs.
- ❖ Not covered by Social Security.

Members working in physically demanding or highly stressful jobs may work shorter careers due to the demands of the job. Since pensions are based on length of service, members with shorter careers will receive pensions that replace a smaller proportion of their pre-retirement salary than members with longer careers. Most members are eligible to receive additional retirement benefits from Social Security based on their state service. However, many police officers and fire fighters are not covered by Social Security and will not receive these additional benefits. In both cases, an optional annuity can help make up for an otherwise smaller pension.

Retirement Systems Can Usually Provide Optional Annuities At A Lower Cost

Annuities purchased on the private market typically cost more than annuities offered through the retirement system.

All retirement system members have access to annuities on the private market. However, annuities purchased on the private market typically cost more than annuities offered through the retirement systems.

As shown in the table below, a LEOFF 2 member purchasing a $10,000/year life annuity through the state will likely save a sizeable amount of money when compared to purchasing the same annuity on the private market.

	Interest Rate	Cost of Annuity To Member
Private Insurer	4.0%	$236,000
DRS	7.5%	$157,000

Based on a LEOFF Plan 2 member aged 56, buying a $10,000 life annuity, including a 3% COLA.
Used for illustrative purposes only.
Source: House Bill 2577 (2014) Actuarial Fiscal Note.

There are many likely reasons the state retirement systems can provide lower-cost annuities.

There are many likely reasons that the state retirement systems can provide lower-cost annuities than the private market, including:

- ❖ Lack of a profit margin.
- ❖ Lower administrative costs due to economies of scale and utilizing the existing administrative structure for pensions.
- ❖ The ability to pool risks over the entire system and not just the members buying the annuities.

Offering optional annuities from the retirement systems may be viewed as the state competing with private sector businesses. This may be a concern for some policy makers—particularly if members can purchase the annuities using savings not associated with governmental service.

The ability of the retirement system to provide annuities at a lower cost is likely a key driver of member requests for an expanded annuity purchase option. However, before extending this option to additional groups, policy makers may wish to evaluate the likely demand for expanded annuity purchases above what is already offered to all members.

Some Members Would Likely Take Advantage Of An Expanded Annuity Purchase Option

As discussed earlier, all members of the state's retirement systems have the option of purchasing up to five years of additional service credit. This optional service purchase increases the retirement benefit for the rest of the member's life—just like an annuity purchase. However, the annuity that can be purchased using optional service credit is general smaller than allowed under an expanded annuity option.

In considering whether current options are sufficient to address member need for additional annuity benefits, policy makers may consider to what extent the current annuity purchase options—both the limited and expanded—are being utilized. Policy makers may also consider to what extent members may have retirement savings available to purchase an expanded annuity.

Annuity purchase data provided by DRS suggests that a small percentage of members not currently eligible would likely take advantage of an expanded annuity purchase option, if offered, and that these members will tend to be higher-income.

A small percentage of members would likely take advantage of an expanded annuity purchase option.

The data shows a relatively small percentage of retirees purchase an optional annuity at retirement in the last fiscal year. Less than 5 percent of recent retirees purchased optional service credit, while less than one percent of eligible retirees purchased an expanded annuity. However, nearly 70 percent of retirees purchasing optional service credit buy the maximum amount. The high percentage of members buying the maximum optional service credit suggests some may be willing to purchase even more annuity benefits than allowed under that option. The data further shows that the average salaries of members purchasing optional annuities exceed the average salaries for all retired members. The average salary is 22 percent higher for members purchasing optional service credit, and 25 percent higher for members purchasing an expanded annuity. This suggests that members with higher incomes are more likely to take advantage of an annuity purchase option.

Even if members are willing, they may not have the means to purchase more annuity benefits than currently offered under the service credit purchase option. One way to gauge the ability of members to purchase a larger expanded annuity is to look at savings that may be available to them. One readily available source of data is the state's Deferred Compensation Program (DCP). The DCP is an employee savings program administered by DRS and available to many retirement system members—including all state employees. Data provided by DRS shows that just under 30,000 DCP participants have an account balance of at least $25,000. The average account balance for these participants who are at least age 56 is $127,000, which exceeds the $80,000 average purchase price for optional service credit. This suggests that some members will likely have sufficient savings in DCP to purchase a larger annuity under an expanded annuity purchase option.

Some members will likely have sufficient savings to purchase an expanded annuity.

If policy makers feel the current service credit purchase option is well-utilized and that members likely have desire and ability to purchase more, they may see value in extending an expanded annuity purchase option to more members. However, if policy makers feel the annuity purchase options are not serving the larger membership, they may be reluctant for a further extension. Policy makers will likely weigh the benefits of extending an optional annuity purchase to all or some members of the state's retirement systems against the existing benefit options and the potential risks to the system.

Allowing All Members To Purchase An Optional Expanded Annuity Would Create Benefit Consistency

Over 90 percent of active members do not currently have an option of purchasing an expanded annuity through the state. TRS members gained the ability to purchase an expanded annuity in the early ‘90s, likely due to teacher shortages and the need to recruit out-of-state teachers. LEOFF Plan 2 members were granted the option of purchasing an additional annuity during the 2014 Legislative Session as a means to take advantage of the WSIB investment performance and lower administrative fees.

Policy makers primarily concerned with benefit consistency may wish to extend expanded annuity purchase benefit to all members.

If policy makers are primarily concerned with benefit consistency, they may wish to extend the expanded annuity purchase option to all members of the state's retirement systems. However, some policy makers may place more emphasis on recruitment and retention. They may wish to only extend this benefit to groups with similar workforce needs as the groups already provided this benefit: teachers, police officers, and fire fighters.

There Are No Expected Costs If All Assumptions Are Realized

The cost of an actuarially equivalent purchase of annuity is expected to be borne by the purchaser.

Currently, most annuity purchase options are priced on an actuarial equivalence. In other words, the cost of the annuity purchase is calculated so that the member bears all the expected cost. However, if the expectations are not realized, the purchase payment made by the member may be more or less than the actual value of the annuity, resulting in a gain or loss to the system.

When a member elects to purchase an optional annuity at the time of retirement, DRS calculates the cost using an administrative factor that is calculated by OSA. This administrative factor is one of many that are updated periodically to account for updated assumptions and gains or losses to the system.

When a member purchases an annuity at retirement, DRS calculates their payment using annuity factors that incorporate assumptions about the future. There are three primary assumptions that impact the cost calculation.

- Expected rate of investment return.
- Expected rate of mortality.
- Expected rate of inflation.

These demographic and economic actuarial assumptions are updated periodically. However, as with any actuarial calculation that involves estimating future events, actual experience may differ from the underlying assumptions made. In instances where this happens the entire system will experience an actuarial gain or loss. When this happens, any impacts from potential gains or losses are borne by employers and members, not the annuity purchaser.

If actual experience differs from the actuarial assumptions that went into pricing the cost of a member's annuity, there will be an impact to the system.

If, for example, members who purchase annuities, on average, live longer than assumed, the system will experience a loss in the future. However, if actual investment returns are greater than assumed at the time of the annuity purchase, the system will experience a gain.

Risks To The System Could Emerge Over Time

As mentioned above, there is a possibility that experience over time may not align with the assumptions made at the time a member purchases their annuity.

Costs to the system can arise if members live longer than expected or investment returns aren't as high as expected.

Costs to the system can arise if members who elect to purchase an annuity at the time of retirement live longer than expected. For example, mortality assumptions are updated every six years in the Demographic Experience Study, conducted by OSA. During the most recent update, the mortality assumption was updated to reflect a sizable increase in life expectancy. Because the mortality assumption is only updated every six years, some members who purchased an annuity in recent years may have paid less than the expected value under the updated assumptions.

Anti-selection can also impact system costs.

There may also be a risk of anti-selection. This is defined as a risk where members with above-average costs make a choice (in this case, to purchase an annuity) resulting in higher costs for the plan. For example, members in poor health may be less likely to annuitize their savings, while members in relatively good health may be more inclined to do so.

In addition, if long-term investment returns are lower than assumed, there would also be a cost to the system.

In contrast, if the actual inflation over a member's lifetime is lower than expected, they may end up paying more than required to fully fund their annuity. However, the guarantee of a fixed benefit payment for the rest of their life may outweigh the potential for slightly overpaying.

For each of the assumptions mentioned above, any potential gains or losses to the system would not be known for decades — until DRS has made all payments under the annuity contract.

The extent of gains or losses on prior purchases can't be quantified at this time due to insufficient experience data. However, it is still possible to analyze risk around annuity purchases by means of a hypothetical example. Such an example can illustrate the potential impacts if assumptions don't match actual experience for the key pricing assumptions of investment return, mortality, and inflation.

Hypothetical Example

The example shows the potential cost impacts if 3.5 percent of members buy an extra $50,000 of annuity benefits.

The following example shows potential cost impacts assuming 3.5 percent of members purchase an extra $50,000 worth of expanded annuity benefits starting at age 65.

The example illustrates the potential gains or losses under the following scenarios for one, 250, and 10,000 purchases:

- Investment return 1.0 percent higher/lower than the 7.8 percent assumed in statute for all systems other than LEOFF 2.

- Investment return equal to the long-term expected return of 7.5 percent, based on WSIB's capital market assumptions.
- Members live approximately three years more/less than assumed
- Inflation is 1 percent higher/lower than the 3.0 percent assumed in statute.
- Multiple gains: investment return 1.0 percent higher, members live approximately three years less, inflation 1.0 percent lower.
- Multiple losses: investment return 1.0 percent lower, members live approximately three year longer, inflation 1.0 percent higher.

Hypothetical Example Annuity Purchase Potential Gains/Losses			
(In Dollars)	**Gain/(Loss) Per Number Of Purchases***		
Scenarios	**1**	**250**	**10,000**
Investment Return *(7.8% assumed)*			
1. 6.8%	($4,700)	($1,175,000)	($47,000,000)
2. 7.5%	(1,300)	(325,000)	(13,000,000)
3. 8.8%	4,100	1,025,000	41,000,000
Mortality**			
4. Live 3 years longer	(3,200)	(800,000)	(32,000,000)
5. Live 3 years less	3,400	850,000	34,000,000
Inflation* *(3.0% assumed)*			
6. 2.0%	4,300	1,075,000	43,000,000
7. 4.0%***	0	0	0
Combination			
8. Multiple Gains 3,5,6	10,100	2,525,000	101,000,000
9. Multiple Losses 1,4,7	($8,600)	($2,150,000)	($86,000,000)

**For illustration only. The probability of a gain or loss is not necessarily equal, and the actual gain or loss could be higher or lower than shown.*
***RP-2000, 100% Scale BB, Static Projection Year=2031, 50% male/50% female blend.*
****No expected loss since COLAs are generally capped at 3%.*

The percent purchasing assumption is based on percentage of recent retirees purchasing the maximum amount of optional service credit. Data showed 5 percent of recent retirees purchased optional service credit, and 70 percent of retirees purchased the maximum (5% X 70%=3.5%).

The purchase amount assumption is based on the difference between the average DCP account balances and the average purchase price for optional service credit purchases. The average account balance for DCP participants who are at least age 56 is $127,000. This exceeds the $80,000 average purchase price for optional service credit purchases by $47,000.

The 250 and 10,000 purchases represent 3.5 percent of an average year's retirements, and 3.5 percent of all active members respectively. The average year's retirements is based on average new retirements from 2004-2013, and the active member count is based on 2013 data.

Policy makers concerned about potential financial risks may seek ways to manage those risks before extending an expanded annuity option to other groups.

Policy makers concerned about the potential financial risks of providing optional annuities from the retirement system may seek ways to manage those risks before extending the expanded annuity option to other groups. Policy makers may avoid further extension they feel the potential risks to the system outweigh the potential benefits.

There Are Ways To Manage The Potential Risks Of Annuity Purchases

Managing the risks of annuity purchases requires balancing the value to members against the risk that the retirement system will experience a loss. Generally speaking, the more risk the system is willing to take, the lower annuities can be priced. However, the private sector annuity market shows that annuities can be priced with very low risk to the provider and still be perceived as valuable by purchasers. Private sector annuities are sold with the expectation of a profit, and people still buy them for the value of the guaranteed benefit.

There are ways to reduce the risk that the retirement systems will experience a loss on annuity purchases while still providing a valuable benefit to members.

There are ways to reduce the risk that the retirement systems will experience a loss on annuity purchases while still providing a valuable benefit to members. One approach is to limit the amount of liability the systems are exposed to in offering optional annuities. Another approach is to manage the risk of underpricing an annuity purchase. Possible options for each approach are shown below.

Possible options to limit liability exposure include:

- ❖ Restricting eligibility to specific groups.
- ❖ Limiting the amount of annuity that can be purchased.

Possible options to manage pricing risk include:

- ❖ Using actuarial assumptions designed specifically for annuity purchases including mortality and investment return.
- ❖ Build additional conservatism into the pricing of annuities.
- ❖ Charging purchases a reserve fee to offset potential losses.

Policy makers may wish to further study one of more of these options before extending an expanded annuity option to additional groups.

Conclusion

Allowing members to purchase an optional annuity from the retirement system can support many potential policy goals such as member flexibility at member cost, benefit portability, adequacy of benefits, and retirement security. However, it also represents an expansion of guaranteed benefits and can expose the systems to potential liability if members live longer than expected or investment returns are not as high as expected. While members could purchase an annuity on the private market, private-market annuities typically cost more than annuities offered through the retirement systems.

Currently, all members of the state's retirement system have access to some type of limited annuity purchase option from the retirement system as a means to increase their fixed monthly benefit payment for life. However, only TRS members and LEOFF Plan 2 members have the option of purchasing an expanded annuity at the time of retirement. Data suggests a small percentage of members not currently eligible would likely take advantage of an expanded annuity purchase option, if available, and that these members will tend to be higher-income.

Managing the risks of annuity purchases requires balancing the value to members against the risks to the retirement systems.

Managing the risks of annuity purchases requires balancing the value to members against the risks to the retirement systems. There are ways to reduce the risk that the retirement systems will experience a loss on annuity purchases while still providing a valuable benefit to members including limiting liability exposure and managing pricing risk.

Attachment A

Possible Options

Expanded Annuity Purchase Options

<u>Option 1: Do not provide an expanded annuity to additional groups.</u>

This option maintains the status quo and may be preferred by policy makers who view the current annuity purchase options as sufficient for most members, or who are concerned about the financial risks of offering annuities from the retirement systems. Some policy makers may view the current annuity purchase options as sufficient since only a small percentage of members utilize them to the fullest extent. Data does suggest that a small percentage of higher-income members would likely take advantage of an expanded annuity purchase option, if offered. However, these members could purchase similar benefits on the private market, albeit at a likely higher cost. The potential risks of the current annuity purchase options are not well known at this time due to insufficient data and lack of analysis. Some policy makers may prefer to not further extend this benefit until additional analysis can be done.

<u>Option 2: Provide the TRS expanded annuity to additional groups.</u>

This option gives members the most flexibility in purchasing annuity benefits from the retirement system. Members may use any source of funds and may purchase annuities larger than those allowed under the service credit purchase option. This option may raise more concerns about the state competing with private sector annuity providers since members could purchase an annuity using funds not related to public employment. Unlike the service credit purchase, there is no maximum annuity purchase amount under this option. However, the purchase amount may be limited by Internal Revenue Service (IRS) regulations.

<u>Option 3: Provide the LEOFF 2 expanded annuity to additional groups.</u>

This is the option requested by stakeholders. This option promotes public service portability while limiting some member flexibility. Members may only purchase annuities using funds from qualified governmental plans and may purchase annuities larger than those allowed under the service credit purchase options. This option may reduce possible concerns about competition with private sector annuity providers since funds in governmental plans would likely be related to public service. Unlike the service credit purchase, there is no maximum annuity purchase amount under this option. However, the purchase amount may be limited by IRS regulations.

Option 4: Develop a new expanded annuity option.

A new option could include different policy goals and additional risk mitigation measures than the TRS or LEOFF 2 expanded annuity purchase options. This option may be preferred by policymakers seeking to provide expanded annuities to more members while reducing potential financial risks to the retirement systems. Staff could work with OSA, DRS, and WSIB to bring new options back to the committee next interim.

Eligibility Options

Policy makers seeking to extend an expanded annuity purchase option may also consider which additional groups should be provided with this benefit. Eligibility options include:

- **Provide expanded annuity to all members.**

  This would improve benefit consistency among all plans by extending the benefit to the PERS, the School Employees' Retirement System (SERS), the Public Safety Employees' Retirement System (PSERS), WSPRS, and LEOFF 1. This would cover the largest number of members and likely expose the retirement systems to the most potential liability.

- **Provide expanded annuity to WSPRS and LEOFF 1.**

  This would improve benefit consistency among police and firefighters. An expanded annuity can also help offset lack of Social Security benefits for many members in this group.

- **Provide expanded annuity to WSPRS only.**

  This would improve benefit consistency among the open police and firefighter plans. An expanded annuity can also help offset lack of Social Security benefits for members in this group. At this time, only the Troopers have approached the SCPP to ask for this benefit. Since WSPRS has the smallest number of members of any open plan, this option would likely expose the retirement systems to the least potential liability.

- **Provide an expanded annuity to other groups.**

  There may be additional groups whose members would likely utilize this benefit, or where providing this benefit could help with recruitment. For example, PSERS has second-highest rate of annuity purchase among the retirement plans.

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