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## Annuity Options in Public Pension Plans

*Dr. Robert Clark, North Carolina State University*

*North Carolina Treasurer Janet Cowell*

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*North Carolina*   
Department of State Treasurer

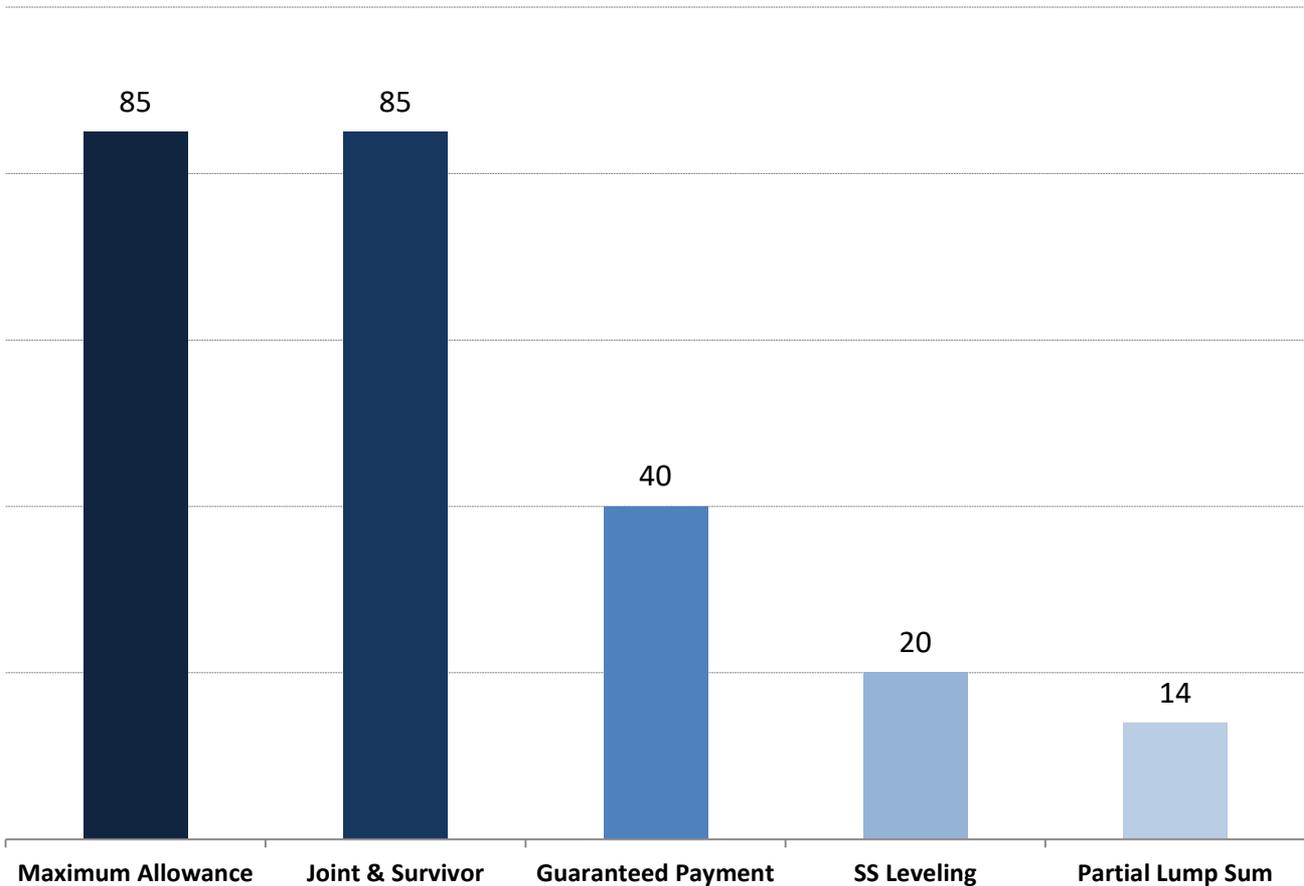
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# Annuity Options: A Timely Renovation for Public Pensions



# Question: Benefits of Additional Annuity Options

Distribution of Major Annuity Options by Plan



# Some Uncommon Questions Yield Important Insights

## Percent of Retirees Selecting Annuity Options

| State          | Plan  | Maximum Allowance | Joint & Survivor | Social Security Leveling | Guaranteed Payment | Partial Lump Sum |
|----------------|-------|-------------------|------------------|--------------------------|--------------------|------------------|
| California     | PERS  | 44.5              | 37.3             | 1.3                      | N/A                | N/A              |
| California     | TRS   | 52.1              | 46.9             | N/A                      | N/A                | N/A              |
| Delaware       | SEPP  |                   | 100              | N/A                      | N/A                | N/A              |
| Iowa           | PERS  | 9.4               | 38.2             | 0.4                      | 32.8               | 19.2             |
| Maryland       | SRPS  | 40.0              | 34.0             | N/A                      | N/A                | N/A              |
| Mississippi    | PERS  | 65.8              | 22.0             | N/A                      | 7.6                | 21.1             |
| Nebraska       | SPP   | 14.1              | 38.8             | N/A                      | 30.2               | N/A              |
| North Carolina | TSERS | 56.2              | 25.9             | 17.9                     | N/A                | N/A              |
| North Carolina | LGERS | 55.7              | 34.6             | 9.7                      | N/A                | N/A              |
| South Carolina | SCRS  | 64.3              | 30.4             | 4.6                      | 0.4                | N/A              |
| Washington     | PERS  | 65.2              | 34.8             | N/A                      | N/A                | N/A              |
| Washington     | TRS   | 38.8              | 21.4             | N/A                      | N/A                | 39.8             |
| Wyoming        | WRS   | 43.1              | 52.9             | N/A                      | 4.1                | N/A              |

# Conference Theme and Annuity Choices

- The theme of this year's conference is "Financial Decision Making and Retirement Security in an Aging World."
- Our paper documents the:
  - Current annuity options provided by public pensions, and
  - Choices retirees are making concerning lifetime benefits
- Are the current annuity options the best options for future retirees as life expectancy increases?

# Developing New Annuity Options

- Public pensions typically provide incentives for employees to retire at relatively young ages, often in their 50s.
- Retirees in this age range are not immediately eligible for Social Security benefits.
- Consider two types of retirees:
  - A. Healthy individuals who plan on working on new jobs for a number of years
  - B. Individuals who are not or do not plan on working after leaving their career jobs

# Young and Healthy Retirees

- Healthy individuals who retire at age 55, for example, may plan to continue working.
- Current options strongly encourage individuals to start their pension annuity immediately after they qualify for benefits.
- Would a deferred annuity be a better option?
  - Assume the individual shifts to a new job with comparable annual earnings.
  - Public plans could offer a present value neutral annuity beginning at some point in the future—for the 55-year-old retiree, perhaps age 60 or 65.
  - By deferring the annuity, the annual pension benefit would be substantially higher beginning at a later age.

# Impact of Deferred Annuity Option

| <u>Annuity Option</u>   | <u>Annual Payout</u> | <u>PV @ 55</u> | <u>PV@ 60</u> | <u>PV@65</u> |
|---|----------------------|----------------|---------------|--------------|
| <b>Maximum Allowance</b>  |                      |                |               |              |
| 3% interest   | \$30,000             | \$588,013      |               |              |
| 7.25% interest  | \$30,000             | \$363,110      |               |              |
| <b>Deferred Annuity: First benefit is deferred until age 60</b> |                      |                |               |              |
| 3% interest   |                      |                |               |              |
| Ages 55-64  | \$0                  | \$588,013      | 683,174       |              |
| Ages 65-84  | \$39,233             |                |               |              |
| 7.25% interest  |                      |                |               |              |
| Ages 55-64  | \$0                  | \$363,110      | \$522,878     |              |
| Ages 65-84  | \$45,884             |                |               |              |
| <b>Deferred Annuity: First benefit is deferred until age 65</b> |                      |                |               |              |
| 3% interest   |                      |                |               |              |
| Ages 55-64  | \$0                  | \$588,013      |               | \$793,735    |
| Ages 65-84  | \$53,351             |                |               |              |
| 7.25% interest  |                      |                |               |              |
| Ages 55-64  | \$0                  | \$363,110      |               | \$749,724    |
| Ages 65-84  | \$72,150             |                |               |              |

# Young Retirees with No Plans to Reenter the LF

- Individuals who retire young and who are not able or do not plan to reenter the labor force
- 20 of the 85 plans we reviewed have a Social Security leveling annuity option
  - This option generally encourages retirees to claim their Social Security benefits at age 62.
  - Recent research shows that the present value of Social Security benefits for most individuals rises with delayed claiming.
  - Why do public pension plans have this option and why do most set the age of leveling at age 62?
- We examined a flexible Social Security leveling option that would allow retirees to set the age of leveling between 62 and 70.

# Aging, Annuity Options, & Public Pension Plans

- Public pension plans provide a number of options for retiring workers.
- Are these options sufficient as life expectancy increases?
- We examined two annuity options that should increase well-being for two types of public retirees.
- These options are presented as present value neutral to pension systems.

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Thank you!

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