



# DO ALL STATE AND LOCAL WORKERS RECEIVE AN ANNUITY IN RETIREMENT?

By Jean-Pierre Aubry and Kevin Wandrei\*

## INTRODUCTION

The conventional wisdom is that all state and local government workers receive a lifetime annuity from their employer pension plan. This *brief* investigates the extent to which this presumption is correct by examining the payout options offered by state and local plans, including those for the roughly 6.5 million employees who *do not* participate in Social Security. Since these “noncovered” workers do not earn credit towards a Social Security annuity during their time in government, they need annuitized income from their employer plan more than their covered counterparts.

The discussion proceeds as follows. The first section describes the most common benefit payout options for major state and local defined benefit (DB) plans and highlights the fact that some plans allow retirees to convert a portion of their annuitized benefit into a lump-sum payout. The second section focuses on state and local workers with defined con-

tribution (DC) plans as their primary retirement plan and highlights the fact that most of these plans offer annuitization as an option but not as a default. The final section concludes that while most state and local workers receive an annuity, a small share do not.

## PAYOUT OPTIONS FOR DB PLANS

Eighty-eight percent of state and local workers – and 98 percent of noncovered workers – participate in a DB pension plan, in which retirement benefits are presumed to be paid out as an annuity until death. Within this annuity-first framework, the four most common payout options provided by state and local DB plans are:

- *Single-Life Annuity*: The retiree receives benefits for life. When the retiree dies, all payments cease.

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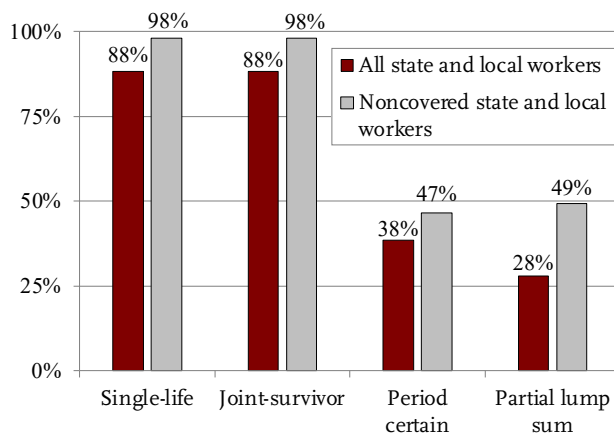
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- *Joint-Survivor Life Annuity:* The retiree receives benefits for life. When the retiree dies, the designated survivor – usually a spouse – receives an annuity for life.<sup>1</sup> When the survivor dies, all payments cease.
- *Joint-Survivor Period Certain Annuity:* This option guarantees survivor benefits for a specific period – often 10 years after the start of the retiree’s annuity. If the retiree dies within the guarantee period, the survivor receives an annuity for the remainder of the guarantee period only. If the retiree dies after the guarantee period, payments cease and the survivor receives no benefits.
- *Partial Lump Sum:* The retiree receives a portion of the promised annuity as a one-time payment, which is often deposited into a retirement account such as an IRA. The remaining annuity payout (either a single-life, joint-life, or period certain) is reduced to account for the lump-sum payout.

Figure 1 shows the share of state and local workers offered each payout option.<sup>2</sup> The main takeaway is that virtually all state and local workers are offered a single- and joint-life annuity, about 40 percent are offered a period certain annuity, and about 30 percent are offered a lump-sum option.<sup>3</sup>

FIGURE 1. PERCENTAGE OF STATE AND LOCAL WORKERS OFFERED VARIOUS PAYOUT OPTIONS THROUGH A DB PLAN, 2020

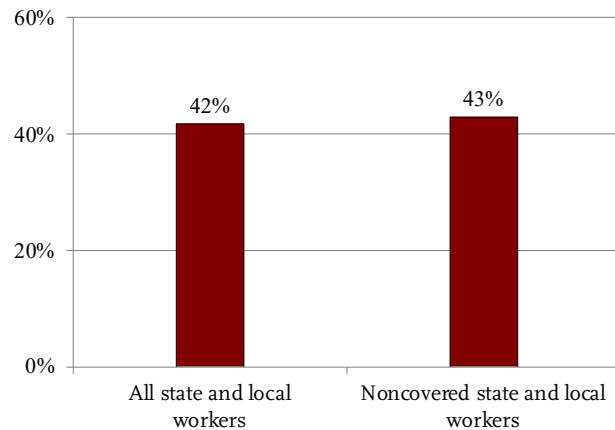


Source: Authors’ calculations based on various plan documents and direct communication with plan administrators.

## JOINT-SURVIVOR ANNUITIES

An important feature of Social Security is that spouses and/or other survivors of Social Security beneficiaries are automatically eligible to receive an annuity based on the beneficiary’s amount.<sup>4</sup> While the vast majority of state and local workers – covered and noncovered – are in DB plans that offer a joint annuity, less than half of retirees choose this option (see Figure 2).<sup>5</sup> Interestingly, given the potential lack of Social Security spousal coverage for noncovered workers, the joint-annuity take-up rate for these workers is about the same as for all workers.<sup>6</sup>

FIGURE 2. TAKE-UP RATE FOR JOINT ANNUITIES OFFERED BY MAJOR STATE AND LOCAL DB PLANS, 2020



Notes: The rates reported in this figure represent the average take-up rates across plans, weighted by the number of retirees in each plan.

Source: Authors’ calculations based on various plan documents and direct communication with plan administrators.

## PARTIAL LUMP-SUM PAYOUTS

A total of 42 major state and local DB pension plans, covering 28 percent of all state and local workers and 49 percent of noncovered workers, offer a lump-sum payout in retirement. Most of these plans limit the lump-sum amount to 36 months of the retiree’s promised annuity payments, although a few plans allow up to 60 months.<sup>7</sup> The limits ensure that retirees who choose the lump sum still maintain a substantial portion of their annuitized benefits.<sup>8</sup> For example,

a 36-month lump-sum payment would reduce the retiree's monthly annuity by a little more than 20 percent (see Table 1).<sup>9</sup>

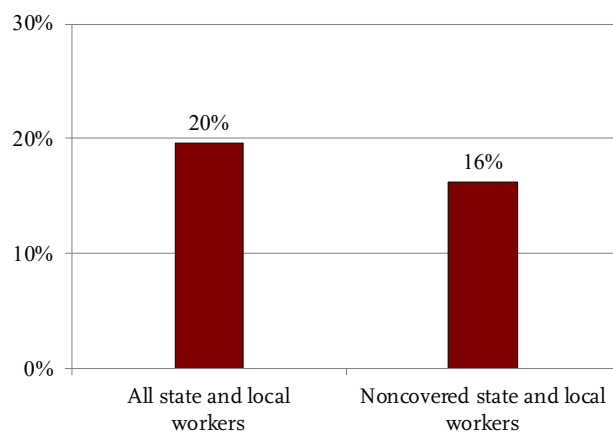
TABLE 1. REDUCTION TO MONTHLY ANNUITY PAYMENT FOR A 60-YEAR-OLD RETIREE TAKING A LUMP SUM

Lump-sum payout	12 months	24 months	36 months	60 months
Reduction	7%	15%	22%	38%

Note: Calculation is based on a 7-percent discount rate, the male RP-2014 mortality table, and a COLA of 2 percent.  
Source: Authors' calculations.

Only 20 percent of retirees in these plans choose lump-sum payouts – and only 16 percent of the retirees in the noncovered plans choose them (see Figure 3).<sup>10</sup>

FIGURE 3. TAKE-UP RATE FOR LUMP-SUM PAYMENTS OFFERED BY MAJOR STATE AND LOCAL DB PLANS, 2020



Notes: These take-up rates represent the number of workers who take a lump sum as a share of those who are offered one. The rates reported by plans that offer a lump sum were weighted by the number of retirees in each plan.  
Source: Authors' calculations based on various plan documents and direct communication with plan administrators.

Given the small fraction of workers in plans that offer a lump sum, the take-up rates suggest that only 6 percent of all state and local workers – and 8 percent of noncovered workers – choose the lump-sum option.

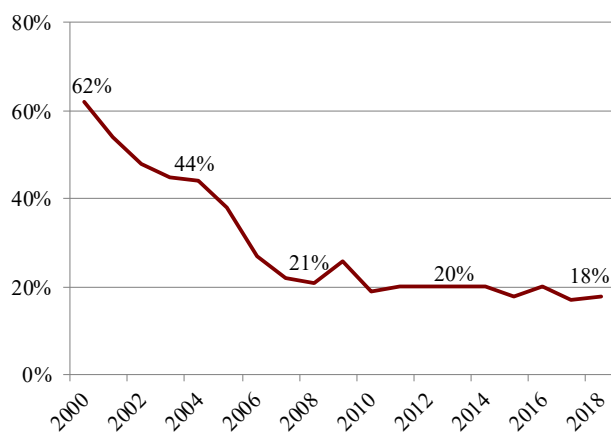
## PAYOUT OPTIONS FOR DC PLANS

In addition to the small share of state and local workers that “un-annuitize” part of their DB benefit, 12 percent of all state and local workers (and 2 percent of noncovered workers) currently participate in something other than a traditional DB as their primary retirement plan.<sup>11</sup> Instead, these workers participate in either a stand-alone DC plan, a hybrid plan (a DC plan combined with a reduced DB plan), or a cash balance plan (a DB plan that defines benefits based on the value of a DC-like nominal account).<sup>12</sup>

Similar to DB plans, the default payout option for public sector cash balance plans – which currently cover just 3 percent of state and local workers – is an annuity. However, among the public sector DC plans – which currently cover 9 percent of state and local workers – annuitization is never the default.<sup>13</sup> In fact, 3 percent of state and local workers participate in DC plans that do not offer an annuity option at all.

Because public sector alternative plans are not yet fully mature, useful data on the annuitization take-up rates are minimal. However, annuitization in the private sector may provide some insight. A recent study of TIAA participants found that only 18 percent chose an annuity distribution upon their first payout in 2018 – a stark drop from 2000 levels, but relatively constant since 2007 (see Figure 4).<sup>14</sup> If members of public sector DC plans annuitize at the same rate as TIAA members, that would equate to about 8 percent

FIGURE 4. ANNUITIZATION TAKE-UP RATES BY TIAA MEMBERS, 2000-2018



Source: Brown, Poterba, and Richardson (2019).

of state and local workers (and 1 percent of noncovered workers) receiving non-annuitized retirement benefits from alternative plans.<sup>15</sup>

## CONCLUSION

The presumption is that state and local workers will receive a lifetime pension annuity in retirement from their government employer. This *brief* confirms this presumption but also reveals that a small share of all state and local workers – about 6 percent – convert a portion of their pension annuity into a lump sum and another 8 percent will potentially enter retirement with un-annuitized DC assets. Among the 6.5 million state and local workers who do not participate in Social Security, about 8 percent take a partial lump sum while 1 percent will potentially enter retirement with un-annuitized DC assets. Given that noncovered workers do not earn credit toward a Social Security annuity during their time in government, the few who retire without annuitized income from their state and local government retirement plan may find that they lack steady household income in retirement.

## ENDNOTES

1 The amount of the survivor annuity is defined as a percentage of the retiree's annuity, generally either 50, 67.7, 75, or 100 percent. Some plans allow a retiree to choose from among many percentage options, while others plans simply set a single percentage for the survivor.

2 This analysis of benefit payout options is based on a review of the 210 major state and local DB plans in the *Public Plans Database* (PPD), which represent 95 percent of all state and local workers participating in a DB plan. In 56 of these plans, noncovered workers represent a meaningful share of plan participants. Payrolls for these noncovered plans amount to roughly 95 percent of noncovered state and local payrolls reported by the U.S. Government Accountability Office (2010).

3 Many state and local pension plans for covered workers also allow members to integrate their employer benefit with their Social Security retirement benefit. For example, if a member retired before the age of Social Security eligibility (i.e., age 62), they could choose to receive a higher benefit for the years between retirement and Social Security eligibility, and then a lower benefit thereafter. Additionally, many of the state-administered plans in Louisiana (a mostly noncovered state) offer various post-retirement cost-of-living-adjustments (COLAs).

4 The Social Security spousal benefit is different from the joint annuities provided by public pensions because, under Social Security, a spouse receives up to 50 percent of the retiree's benefit while the retiree is still *alive*.

5 We obtained data on the joint-annuity take-up rate for 101 plans, which represent 64 percent of all state and local employees in the 208 DB plans that offer a joint annuity.

6 A joint-survivor annuity is often the default payout method in private sector DB plans, and married individuals must get spousal consent to opt-out of a joint-survivor annuity. Joint-survivor annuities are rarely the default for public sector plans. That said, public safety plans are somewhat more likely than other state and local plans to set joint-survivor as the default.

7 Other methods of determining the lump-sum amount are as a percentage of the total present value of benefits or by simply allowing retirees to withdraw the balance of their own accumulated contributions and receive a reduced annuity based on their employers' contributions.

8 None of the DB plans in our sample allow retirees with a significant monthly annuity to convert their entire annuity into a lump sum.

9 Most state and local DB plans use their actuarially assumed rate of investment return to value future annuity payments.

10 We obtained data on the recent lump-sum take-up rate for 26 plans, which represent roughly 82 percent of all the state and local employees in the 42 DB plans that offer a lump sum.

11 This analysis focuses on 85 state and local primary DC plans, spanning 25 states and 35 large local districts. This sample accounts for all the primary DC plans offered to 99 percent of state and local workers. Of the 85 plans, only eight are for noncovered workers.

12 Most of the stand-alone DC plans were set up before the financial crisis to provide additional retirement plan options to state and local employees. In contrast, most hybrid and cash balance plans were set up in response to the Great Financial Crisis and are mandatory for workers hired after the plan was established. Once participation in these mandatory plans matures, about 21 percent of all state and local workers (and 2 percent of noncovered workers) will be participating in something other than a traditional DB plan as their primary plan.

13 The DB portion of public sector hybrid plans generally offers annuities as the default option.

14 For those who retired before age 70, the percentage that chose an annuity is 38 percent. TIAA's annuitization rates are informative because TIAA participants are predominantly university employees, which differ from the average private sector worker in many of the same ways that public sector workers do – they are more likely to be women, have longer tenures across fewer employers, and are more highly educated. And, with TIAA's long history of promoting annuities to its members (until 1989, TIAA required that retirees convert their savings into annuities), the decision to annuitize for TIAA's members may be similar to that for public sector DC participants who are working and retiring within an environment that is dominated by DB annuitization.

15 Three percent not offered an annuity + 82 percent of the 6 percent who are offered an annuity and choose not to annuitize.

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