



Deferred Retirement Option Plan

*How Is It
Working?*

Public Safety Conference
October 2001

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Great !



Creation and Modification of Your DROP Program

Imagination

Membership Concerns

Creativity

Political Inputs

Actuarial Constraints



Recent Changes in DROP Plans

- ⌘ San Antonio Fire & Police—Increased back drop to 3 years from 2 years
- ⌘ Louisiana Fire—Retiree DROP feature added
- ⌘ Montgomery County Maryland—DROP plan added



Recent Changes in DROP Plans

- ⌘ Dallas Police & Fire—Transfers to 401k plan and Retiree DROP Program
- ⌘ Houston Fire—1999 last changes to 10-year DROP, allows retirees to keep their DROP balances invested in plan and initiated a back DROP
- ⌘ Houston Police—2001 added a back DROP, allow revocation of DROP, and at retirement will recalculate benefit to account for higher salaries

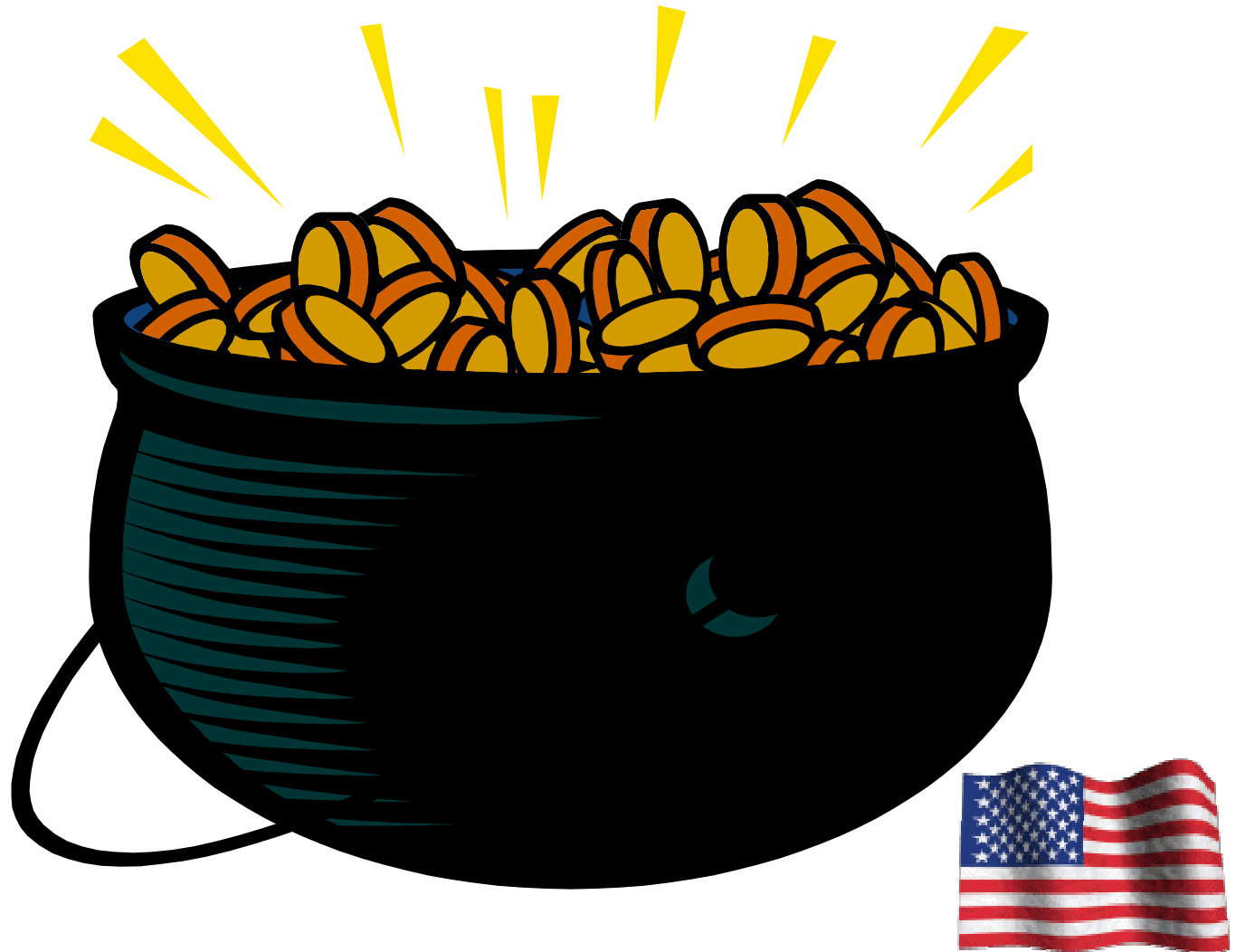


Recent Changes in DROP Plans

- ⌘ Southfield Michigan Fire & Police—Added forward DROP, 5-year limit, 4% interest, and review at the end of 5 years
- ⌘ LA Fire & Police—Added forward DROP in 2002, 5-year limit, 5% interest, must be cost neutral, review in 2.5 years



What Is DROP?



What Is DROP?

⌘ A benefit program that allows participants to maximize their savings and create a “lump-sum option” in a defined benefit plan



What Is DROP?

⌘ Example: Participant who joins DROP with a calculated benefit of **\$2,500** per month could have almost \$225,000 in his or her DROP account after 5 years

<u>Monthly</u>	<u>Accumulated</u>
\$2,500	
\$2,500	\$5,000
\$2,500	\$7,500
\$2,500	\$10,000



What Is DROP?

⌘ Some DROP plans have:

- Interest adjustments
- Cost-of-living adjustments
- Employee contributions
- Time limits
- Disability limitations



What Is DROP?

*Remember—
No two DROP
plans are
alike!!!!*



The Three-Legged Stool

Leg 1

Personal Savings

Leg 2

Retirement Plans

Leg 3

Social Security



The Three-Legged Stool

DROP—

Substitutes for either

Personal Savings or the

lack of **Social Security**

for many public employees



Types of DROP (The Basics)



Types of DROP



“the original”

- ⌘ Locks employee decision on retirement date (date member’s benefit is calculated)
- ⌘ “Account Balance” used to lure older employees to stay longer, which reduces the employer’s recruiting and training costs



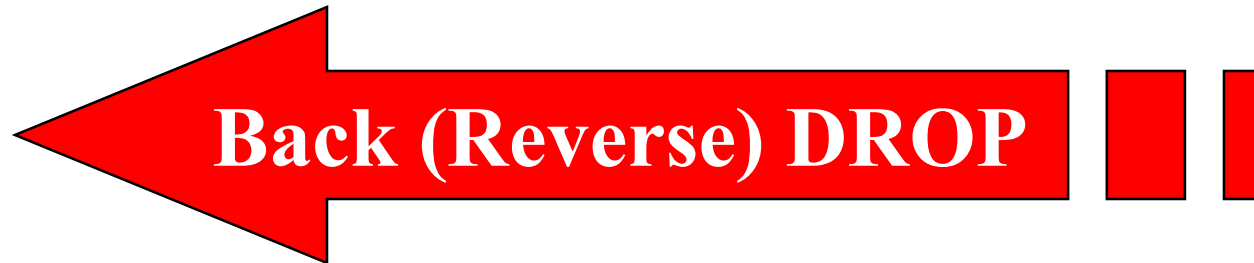
Types of DROP



⌘ Reduces the number of older employees applying for a disability for “old age” ailments



Types of DROP



- Employee selects the retroactive DROP date (one, two, three, or five years prior)
- No DROP account, therefore no record keeping needed
- Staff, with actuary, calculates the DROP account amount with interest, if any



Deferred DROP

- ⌘ New feature
- ⌘ Allows those who have “retired” to begin or continue deferring their pensions into their DROP accounts
- ⌘ They also earn the same interest rate as the active members



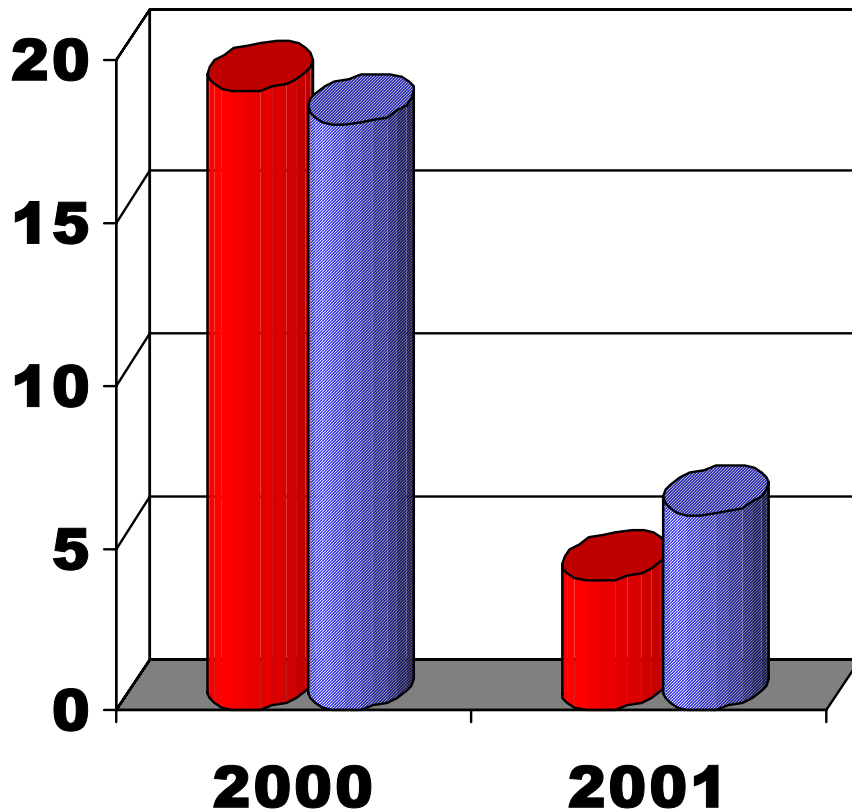
Deferred DROP

- ⌘ Great for those who retire and have a second career
- ⌘ For more information on DROP and Deferred DROP—see our Web site at

www.dpfp.org



Deferred DROP



■ Fire ■ Police

⌘ Year 2000
Fire: 19
Police: 18

⌘ Year 2001
Fire: 4
Police: 6



DROP Transfers to 401(k)

⌘ Allows active DROP participants to transfer DROP funds to their 401(k) accounts with the City of Dallas

⌘ Allows DROP participants to make the investment decision if they want to try to get a higher return



DROP Transfers to 401(k)

- ⌘ Dallas Police & Fire Pension System effective date was February 2001
- ⌘ “Their goal is to invest in the market”
- ⌘ Year 2001
 - Fire: 8**
 - Police: 7**
- ⌘ Total Assets moved: \$1.2 million



Effects of DROP

⌘ Retirement Pattern—Members stay longer

- Some members do not want to leave
- DROP participants vs. rest of membership—the jealousy or envy factor

⌘ Disability rate—dramatic decrease

- In Dallas, 1 out of 4,500 active members so far this year



Effects of DROP

⌘ Interest rate paid on DROP account can determine whether or not they leave the money with you or not (if allowed to)



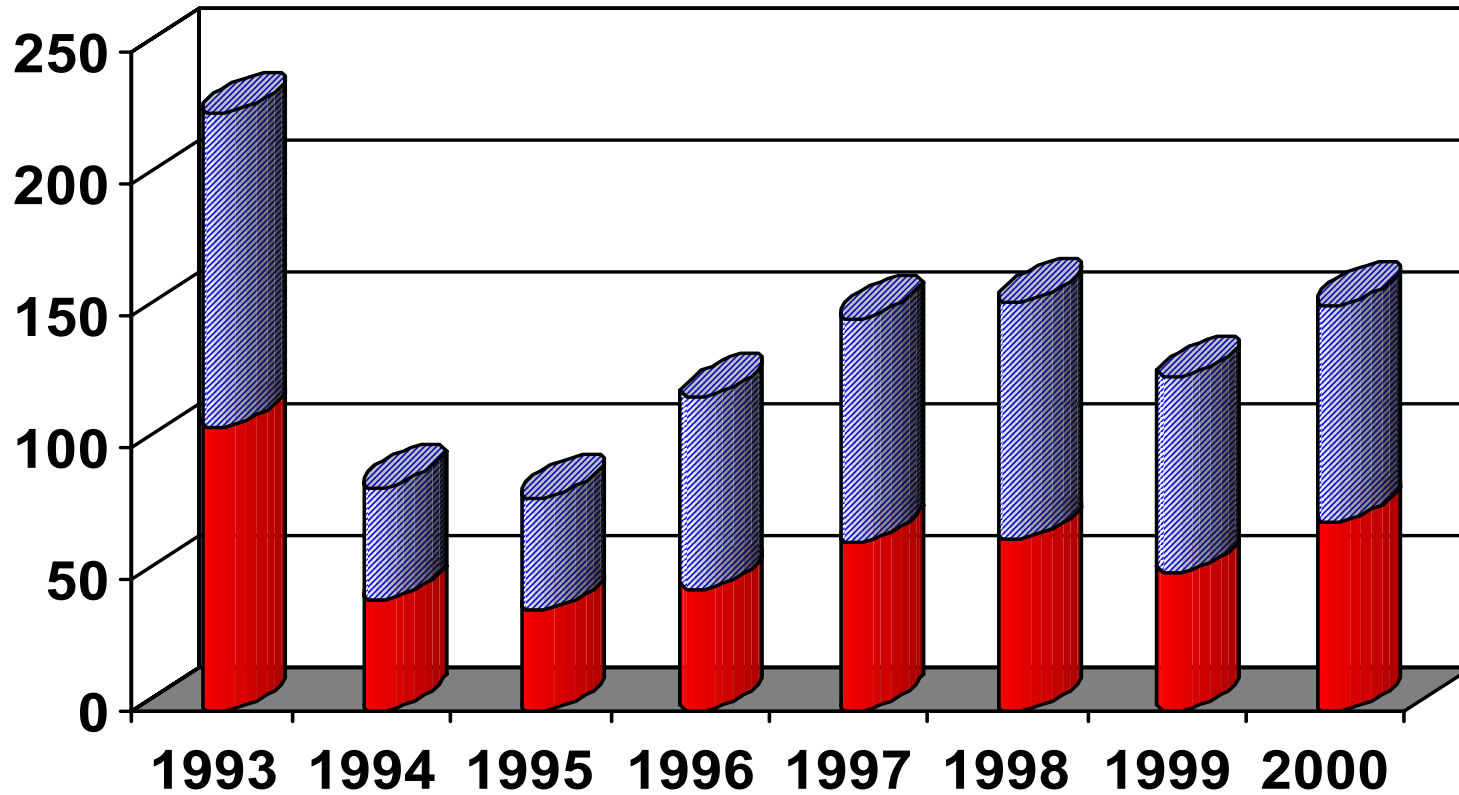
Review of the Dallas DROP Program



- ⌘ Began January 1, 1993
- ⌘ “Unlimited Forward DROP”
- ⌘ Membership Statistics
- ⌘ Actuarial Review September 1997
- ⌘ Changes to Plan



Dallas DROP Review

New DROP Membership

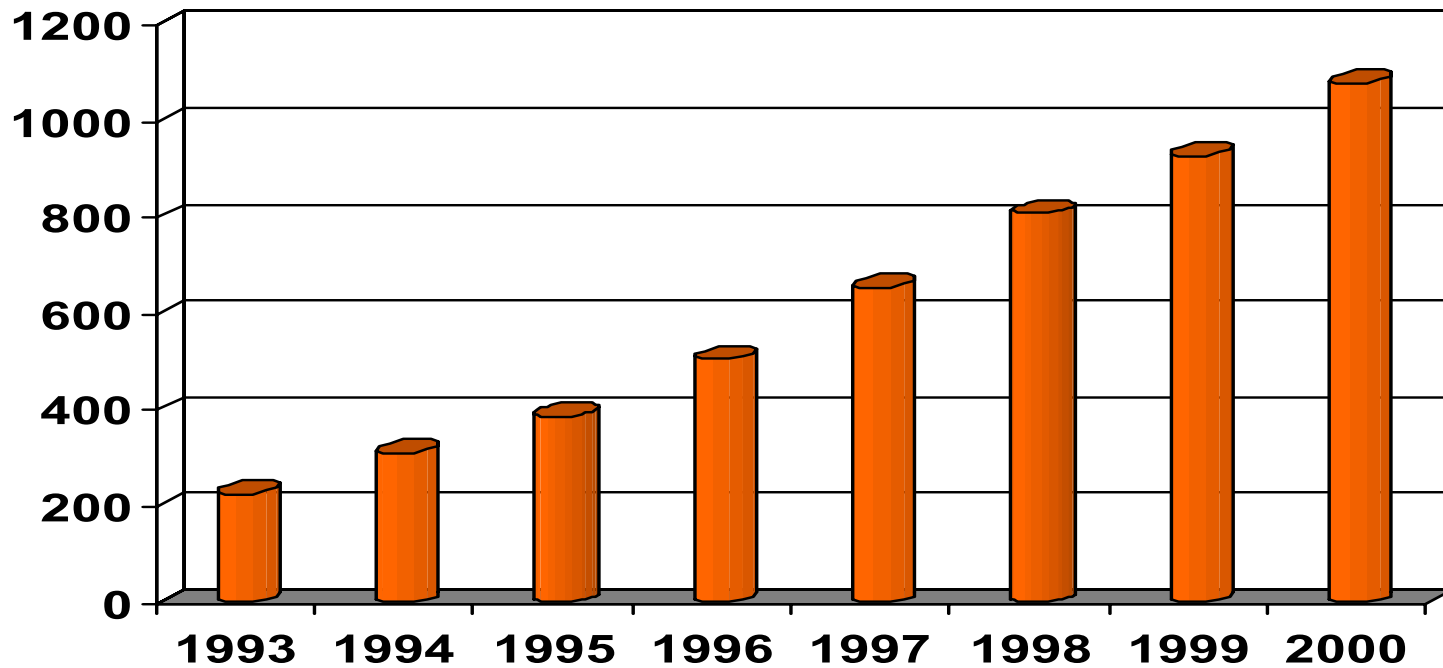


 **Fire**  **Police**



Dallas DROP Review

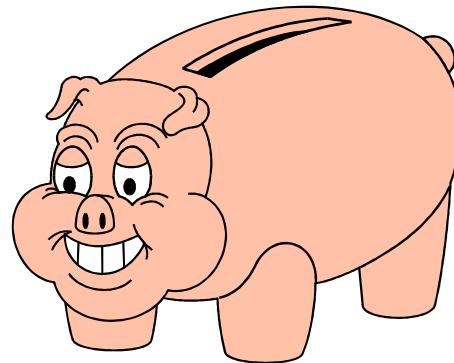
Total DROP Membership



Dallas DROP Review

As of 3/31/2001

⌘ Number of DROP accounts: 1,081
(including those who left active
service and retain money in their
accounts)

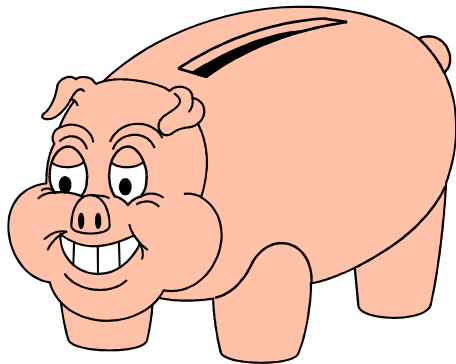


Dallas DRDP Review

As of 3/31/2001

⌘ The average DRDP account is
\$135,657

⌘ The overall DRDP enrollment rate is
excellent (93%)



Dallas DROP Review

A Look Forward

- ⌘ The number of DROP participants is increasing
- ⌘ After leaving active service, most DROP participants leave their funds in their DROP accounts



Dallas DROP Review

A Look Forward

⌘ Evolving DROP rules

- Allowing participants to transfer funds to the City of Dallas 401(k) plan
- Allowing retirees to participate

⌘ The disbursement method must accommodate the increasing number of participants



Actuarial Review

Initial Assumptions

- ⌘ Cost of DROP estimated to be 0.24% of payroll
- ⌘ Assumed members would delay leaving active service (retiring) at least 1.6 years



Actuarial Review

Initial Assumptions

- ⌘ Assumed originally that all members would join DROP as soon as eligible
- ⌘ Five-year (initial) sunset provision on DROP if actuarial costs were out of line with expectations



Actuarial Review

Findings

⌘ Average age at LAS (retirement)

- Prior to DROP 52.4 years
- After DROP 57.7 years
- Difference 5.3 years

⌘ There are a few members who actually do not join DROP or who wait several months to join



Actuarial Review Conclusions

- ⌘ DROP costs less than initially assumed
- ⌘ DROP may actually save the System money
- ⌘ The average age of retirement has increased more than expected



Retirement Patterns

- ⌘ Members are working longer
- ⌘ After 5 years of DROP, we are getting close to a normal number of members leaving active service (retiring)



Tax Implications for Members

- ⌘ Beware of the 10% penalty tax on early distributions
- ⌘ DROP literature must warn member without giving tax advice



Tax Implications for the Plan

- ⌘ Staff and Board members must be made aware of the rules concerning age of leaving active service
- ⌘ Preserve your plan's tax qualification
- ⌘ Get IRS determination letter prior to allowing members to join DROP



The End

www.dpfp.org



TOPICS

- ⌘ What is DROP?
- ⌘ Types of DROP accounts
- ⌘ Deferred DROP and DROP Transfers
- ⌘ Why Is DROP so popular?
- ⌘ Review of Dallas' DROP program,
including a special actuarial report
- ⌘ Retirement patterns
- ⌘ Tax implications



Why Is DROP so Popular?

DROP Example

John Doe - Normal
S.S. Number 000-11-2345

Date	Prior Balance	Interest	Benefit	Adjust	Bene Supp	Rate	EOM Balance
03/31/2001		\$0.00	\$3,128.18			8.250	\$3,128.18
04/30/2001	\$3,128.18	\$20.45	\$3,128.18			8.250	\$6,276.81
05/31/2001	\$6,276.81	\$42.40	\$3,128.18			8.250	\$9,447.39
06/30/2001	\$9,447.39	\$61.76	\$3,128.18			8.250	\$12,637.33
07/31/2001	\$12,637.33	\$85.37	\$3,128.18			8.250	\$15,850.88
08/31/2001	\$15,850.88	\$107.08	\$3,128.18			8.250	\$19,086.14



Why Is DROP so Popular?

DROP Example

John Doe - Normal
S.S. Number 000-11-2345

Date	Prior Balance	Interest	Benefit	Adjust	Bene Supp	Rate	EOM Balance
09/30/2001	\$19,086.14	\$124.76	\$3,128.18			8.250	\$22,339.08
10/31/2001	\$22,339.08	\$150.91	\$3,128.18	\$125.13		8.250	\$25,743.30
11/30/2001	\$25,743.30	\$168.28	\$3,128.18	\$125.13		8.250	\$29,164.89
12/31/2001	\$29,164.89	\$197.02	\$3,128.18	\$125.13		8.250	\$32,615.22
01/31/2002	\$32,615.22	\$220.33	\$3,128.18	\$125.13		8.250	\$36,088.86
02/28/2002	\$36,088.86	\$220.13	\$3,128.18	\$125.13		8.250	\$39,562.30
03/31/2002	\$39,562.30	\$267.26	\$3,128.18	\$125.13		8.250	\$43,082.87
04/30/2002	\$43,082.87	\$281.63	\$3,128.18	\$125.13		8.250	\$46,617.81
05/31/2002	\$46,617.81	\$314.93	\$3,128.18	\$125.13		8.250	\$50,186.04
06/30/2002	\$50,186.04	\$328.06	\$3,128.18	\$125.13		8.250	\$53,767.41
07/31/2002	\$53,767.41	\$363.23	\$3,128.18	\$125.13		8.250	\$57,383.94
08/31/2002	\$57,383.94	\$387.66	\$3,128.18	\$125.13		8.250	\$61,024.91



Why Is DROP so Popular?

Balances as of 3/31/2001

Dollar Range	Number of Participants	Total Dollars
0 to 9,999	35	186,490
10,000 to 49,999	224	6,784,449
50,000 to 99,999	245	16,185,656
100,000 to 149,999	192	23,711,728
150,000 to 199,999	139	24,271,222
200,000 to 249,999	93	20,537,675
More than 250,000	153	52,968,602
Total	1081	146,645,824



Deferred DRDP



Types of DROP Accounts



Tax Implications

For the Members and for the Plan



Effects of DROP



DROP
Transfers to
401(k)

