



Public Pension
Professionals, Inc.

State Association of County Retirement Systems

Deferred Retirement Option Program Proposal

Prepared by SACRS DROP Committee

November 3, 2000



Actuaries you can understand

Table of Contents

BOARD SUMMARY	2
A. Background	2
B. Guiding Principles	4
C. Basic Design	5
D. Forward DROP	10
E. Actuarial Equivalent DROP	18
DETAILED OUTLINE	20

Section

1 Board Summary

A. Background

Since the first Deferred Retirement Option Program, commonly referred to as DROP, was implemented in 1982 by the City of Baton Rouge - Parish of East Baton Rouge Employees' Retirement System in Louisiana, DROP has become the most talked about retirement plan feature at conferences and retirement board meetings across the United States.

Its main attraction is simple; a large lump sum payment. Under DROP, a retiring member get a large one-time payment, while still being eligible to collect the retirement annuity normally paid to plan members. In the past, members who wanted to receive a large payment up front had to forfeit their monthly retirement payments. Under DROP, they can get both the up-front money to spend and still have the monthly income protection for themselves and their spouse. And spend it they do. Retirees have used these payments to take vacations, pay off their mortgages, buy recreation vehicles, or start a businesses, as well as putting the money to other uses too numerous to mention.

DROPs made their way to California in the late 1990's. The cities of Fresno and San Diego implemented DROPs for their retirement plans. Since 1997, the California Public Retirement Journal has published no fewer than four articles focusing on DROPs. In this year alone, the State Legislature reviewed multiple DROP proposals for both the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS).

In the past, SACRS viewed DROP from a distance. DROP has been the topic of concurrent presentations at a number of the semi-annual conferences and the topic of heated discussion at many of the trustee break out sessions.

In March 2000, the SACRS Executive Committee and the SACRS Legislative Committee jointly sponsored a well-attended symposium on DROP. The group attending the workshop was not sure whether they wished to see DROP added to the 37 Act, but had some definite opinions on some parameters that would need to be in place for any DROP that did get passed. At the top of the list were a requirement of universal coverage (DROP would have to cover every active member in a plan, not just a single tier or classification of employees), and a need for the program to be cost neutral.

The growing interest led to a resolution at the May 2000 SACRS business meeting to prepare a detailed DROP proposal to bring back to the November 2000 meeting for discussion and possible action. During the past summer, the SACRS Executive

Committee formed an ad-hoc DROP Committee to work through the issues and outline proposed legislation. The committee consisted of six members:

- **Terry Slattery, Committee Chair**, Retirement Administrator, San Bernardino County Employees' Retirement Association
- **Brian Hast**, Trustee, Contra Costa County Employees' Retirement Association
- **Skip Murphy**, Trustee, San Diego County Employees' Retirement Association
- **David Prince**, Trustee, Imperial County Employees' Retirement Association
- **Patricia Wiegert**, Retirement Administrator, Contra Costa County Employees' Retirement Association
- **Ira Summer**, Public Pension Professionals

This is the report of that committee.

B. Guiding Principles

Designing a DROP to fit into the 37 Act was a fascinating challenge for the DROP Committee. Since their initial appearance, DROPs have evolved into hundreds of variations. The myths surrounding DROPs have likewise developed over time. A common myth, for example, indicates that all DROPs are cost neutral. Unfortunately, that is not necessarily the case.

The DROP Committee worked to separate the fact from the fiction. We were guided in developing our proposal by three major factors:

- **37 Act Structure** – Operating within the 37 Act means that retirement systems are limited by the restrictions set into law by the State Legislature and signed by the Governor. Historically, the State Legislature has adopted well-defined design parameters, and has been resistant to providing individual counties with large-scale flexibility in designing plan provisions. For our proposal to have a reasonable likelihood of passing through the Legislature, we needed to develop strict guidelines into which the DROP would fit.
- **Local Differences** – Our proposed DROP would potentially be available to 20 county retirement systems covering more than 30 different benefit structures (and potentially many more). Each of these systems had a different set of contribution rates, actuarial assumptions and funded positions. These differences underlined the need for flexibility in our DROP design.
- **The Will of SACRS** – The DROP Committee focused our design proposal using input received from the attendees of the March 2000 DROP Symposium and the corresponding concurrent session at the May 2000 Conference. This input was used as a general indication of the interests of the group as a whole. It was not used as a formal vote of the body. When we believed there existed a significant minority opinion, we allowed for that flexibility in our proposal.

These factors led us to what we refer to as a Box with Dials Design. The basic structure of the DROP will be fixed by law. This is the box. Some design aspects can be set at varying levels by the county or retirement board. These are the dials.

We have included an outline of the proposed DROP design later in this report. The next three sections provide overviews of the proposed base design and the local customization options we propose to include.

C. Basic Design

The DROP would be placed in a new section of the County Employees Retirement Law of 1937 (37 Act). This section would describe guidelines that all 37 Act DROPs would follow. These include:

Implementation

DROP implementation in a county would require approval by majority vote of that county's Board of Supervisors. We have included several safeguards to provide a meaningful benefit for members while limiting the employer's risk:

- **Initial Actuarial Analysis** – DROP would include a requirement that it is Cost Neutral. The retirement system would be required to have an actuary prepare an analysis showing that the DROP is expected to be Cost Neutral.
- **Cost Neutrality** – We have proposed a definition of Cost Neutrality for the purpose of implementing DROP. It includes specific measures, tolerances levels of change, and guidelines for assumption changes. Although we use the phrase cost neutral, these definitions can more accurately be described as not having a significant negative impact on the members, the employer or the retirement system.
 - *Measures* – No single measure was able to fully represent the combination of impacts possible from implementing DROP. The DROP Committee found three measures that appear to handle to complexities expected to arise:
 - Employer Contributions (Contr) – The dollar amount of contributions to be paid by the employer in the coming year is the first thing most people think of when they speaking of cost. This becomes a threshold measure. If the contribution increases significantly, it will be difficult to convince those paying the contribution that the change was cost neutral. This measure is not sufficient by itself, though. Its focus is too short term in nature. We are seeing this with some of the changes affecting CalPERS agencies. Some well-funded agencies are making significant benefit improvement while having their contribution rates remain \$0. Improvements of this type did not fit into our definition of cost neutral.
 - Actuarial Accrued Liability (AAL) – A significant change in the funded position of the plan is also at odds with most people's understanding of cost neutrality. The funded percentage is the ratio of the plan's assets to its AAL. Since the assets will not be

affected by implementing DROP, the AAL becomes the logical second measure of cost neutrality.

- Present Value of Benefits (PVB) – The most theoretically appropriate measure of long-term cost neutrality, from an actuarial perspective, is the present value of benefits. While the other values can change with changes in assumptions or funding methodology, the PVB tells you whether a benefit change will increase or decrease plan costs over the long term.
- *Tolerances* – It is highly unusual for the value of one set of benefits to exactly equal the value of another set of benefits, to the penny, no matter how equivalent those benefits are. Realizing this, most people consider very minor changes in value to be effectively equivalent. That “very minor change” is what we refer to as a tolerance level. If the change in the measure falls within the tolerance level it is considered equivalent.

The general tolerance level will be a change of 3% between the measure without DROP and the same measure at the same time with DROP being implemented. PVB will not be allowed to move (either up or down) by more than 3%. AAL and Contr will be limited so that neither of these increases by more than 3%. The DROP Committee believed that a decrease in the AAL or Contr would not be harmful and could be tolerated in this context.

- *Guidelines* – To maintain the integrity and long-term viability of DROP, it was essential that the required actuarial cost analyses be perceived as fair and accurate. This would not happen, for example, if the addition of DROP would be shown not to increase cost due to a concurrent increase in the valuation interest rate up to 12%. While we do not believe that anyone would try to pass off a change of that nature as cost neutral, we believed it necessary to develop guidelines for assumption and method changes to eliminate the perception of such an event taking place.

In determining the impact of adding DROP to a retirement system, the actuary can only show changes based on items that can be expected to change due to the implementation of the DROP. In addition to the change in benefit provisions, these could include elements such as expected retirement age or the likelihood of termination or disability for those near retirement age. It would not include unrelated items such as the investment return on fund assets or the life expectancy of currently retired members.

- *Funding methodology* – Some retirement systems with DROPs currently treat DROP enrollees as retired members in determining employer contribution rates (their compensation is not used to determine normal cost and contributions are not spread over their compensation). Other

retirement systems treat DROP enrollees just like active employees. The decision regarding how the retirement system would be funded was left to each local Retirement Board.

- **Expiration and Review** – DROP approval would include both a beginning date (the date that the first member is allowed to enter into DROP) and an expiration date (the last day that a member is allowed to enter into DROP). Each DROP will expire no more than 10 years after it has begun. Within one year of the expiration of the DROP provisions, the retirement system will perform another actuarial analysis to estimate the cost impact of the DROP. The Board of Supervisors would be allowed to renew the DROP provisions as many, or as few, times as it wanted to.

Eligibility

The attendees of both the March Symposium and the May Conference voiced a strong preference that DROP eligibility should NOT be limited by classification (General / Safety). If a program is established, both groups should be in.

DROP can be implemented in a county only if all classifications and tiers of active members are included. DROP eligibility may be limited using age or service criteria if that is needed to maintain cost neutrality. For example, a DROP could be designed which only allows members to elect to enter DROP when they have between 20 and 30 years of credited service.

While we were working on our proposal, the Governor vetoed a DROP proposal for CalPERS with the following message:

I am returning Senate Bill 1312 without my signature.

This bill would establish a Deferred Retirement Option Program (DROP) for State and school members of the California Public Employees' Retirement System (CalPERS) and as an option to local contracting agencies of CalPERS. This bill would result in increased retirement costs to the State and school employers, and for contracting local agency employers opting for the DROP.

This bill is overly broad. These benefits, if at all, should accrue only to Safety personnel.

Sincerely,

GRAY DAVIS

We are optimistic that this objection would not apply to a cost neutral DROP negotiated at the local level.

Types of DROP

At both the March Symposium and the May Conference, the group voiced a strong opposition to a Backwards DROP design. Based on this consensus, no Backwards DROP is included in this proposal. The attendees of the March Symposium appeared to prefer the Actuarial Equivalent DROP structure over the others, but were willing to allow a Forward DROP design. The attendees of the May Conference session preferred the Forward DROP design to the Actuarial Equivalent DROP structure. Both a Forward DROP and an Actuarial Equivalent DROP structure are included in this proposal. Their benefit structures are discussed in the following two sections. The enrollment requirement would differ depending on the type of DROP implemented.

Nature of DROP Enrollment

Generally, in a Forward DROP, the decision to enroll would be irrevocable with minor exceptions for significant life events outside the control of the member. For example, if the member were to become disabled during the DROP Period, or the member's spouse were to die, the member should be allowed to undo the DROP election and receive a benefit under the regular plan provisions for all service.

Mandatory retirement would be part of the price for enrolling in DROP. In other words, at the end of the DROP Period, the member would be required to terminate employment and begin collecting service retirement. Other requirements for enrolling in DROP include attendance at a mandatory education session and signing legal waiver forms. These waivers include:

- **ADEA Waiver** – The member agrees not to sue for age discrimination.
- **Disability Waiver** – The member agrees not to apply for disability based on a condition related to any event that occurred prior to the DROP Period. The waiver would not apply to the heart, cancer and bloodborne disease presumptions, which will be in effect until retirement. At retirement, the member will waive their rights under the heart, cancer and bloodborne disease presumptions when they receive the lump sum benefit under DROP.
- **Domestic Relations Orders** – The exact details of this waiver will vary by county.

For all employment purposes other than the calculation of the member's retirement benefit, a member electing to enroll in DROP will be treated as an active employee. These include areas such as eligibility for other benefit programs, seniority, use of vacation and sick leave or pay increases.

Ancillary Events

Sometimes tragic events outside the control of the member happen during the DROP Period. In the interest of fairness, the DROP Committee included provisions for opting out of DROP under the most tragic of these circumstances. These events include:

- **Disability during DROP Period** – If the member becomes disabled during the DROP Period the member will have a choice between electing a service retirement with DROP or taking a disability benefit calculated as if the DROP election had never taken place.
- **Spousal Death during DROP Period** – If the member had a spouse at the time of electing into DROP and that spouse dies during the DROP Period, the member can undo the DROP election within 90 days of the death of the spouse.

Employee Contributions

Since we were including in the DROP provisions the possibility that the member would opt out of DROP before retirement (see above subsection entitled Ancillary Events), the DROP Committee decided to require Member contributions to continue during the DROP Period just as they would during that time if the member had not opted into DROP.

D. Forward DROP

The simpler of the two proposed DROP types is the Forward DROP. This is the original DROP format and the one that most people think of when they speak of DROP. If a member elects into a Forward DROP, his benefit is calculated as if he had retired on that date. Instead of retiring, though, the member continues to work for a fixed period of time, called a DROP Period. During the DROP Period, the member accrues an account balance within the retirement system. At the end of the DROP Period, the member retires and receives the DROP account balance along with the monthly retirement annuity calculated earlier.

That is a general description of a Forward DROP. The outline includes two types of provisions for the proposed SACRS DROP: Common Guidelines that all Forward DROPs would be subject to, and Variable Features that each county would be able to use to customize to meet the goal of cost neutrality based on their own goals, benefit provisions, future expectations and assumptions.

Common Guidelines

- **Definition of dates** – There are two critical dates that need to be thought of separately under a Forward DROP.
 - *DROP Election Date* – This is the effective date that the member enters into DROP. It is the beginning of the DROP Period. The member continues to work after the DROP Election Date.
 - *Retirement Date* – This is the date that the member actually stops working and begins to receive monthly payments from the retirement system. It is the end of the DROP Period. The member no longer works for the county after the Retirement Date.
- **Calculation of Monthly Retirement Benefit** – The calculation of the monthly service retirement benefit will be the same for all county systems operating under the DROP provisions. It will involve a two-step process: calculation of the monthly amount to be added to the DROP Account, followed by the calculation of the monthly amount to be paid to the member. While these amounts are similar, there will be some subtle differences.
 - *Initial Monthly Benefit Amount* – This amount will be calculated as if the member retired and elected an unmodified allowance on the DROP Election Date.
 - Plan Provisions – Those provisions in effect at the DROP Election Date.

- Age Factor – Calculated using the age of the member at the DROP Election Date.
- Credited Service – Calculated through the DROP Election Date. It does not include any additional time for unused vacation or sick leave.
- Compensation – Calculated through the DROP Election Date. It will *not* include any adjustment for unused sick leave or vacation or any other amounts that might be payable at termination.
- *Final Monthly Benefit Amount* – This amount will be the same as the Initial Monthly Benefit Amount, except for the following adjustments:
 - Compensation Adjustments – The compensation used in the final benefit amount will be calculated as of the DROP Election Date, but will take into account any unused sick leave, vacation pay or other amounts that were available at the DROP Election Date, are still available at the Retirement Date and are includable in the definition of Compensation Earnable by the specific retirement system.
 - Cost of Living Adjustments – The benefit shall be adjusted for Cost-of-Living Adjustments that would have been provided to members who retired at the DROP Election Date.
 - Optional Form Adjustment – The retiring member may elect an optional benefit form, such as a life annuity with 100% continuance to spouse, which is available to other members retiring at the Retirement Date. The adjustment is done using the age of the member (and beneficiary, if applicable) at the Retirement Date.

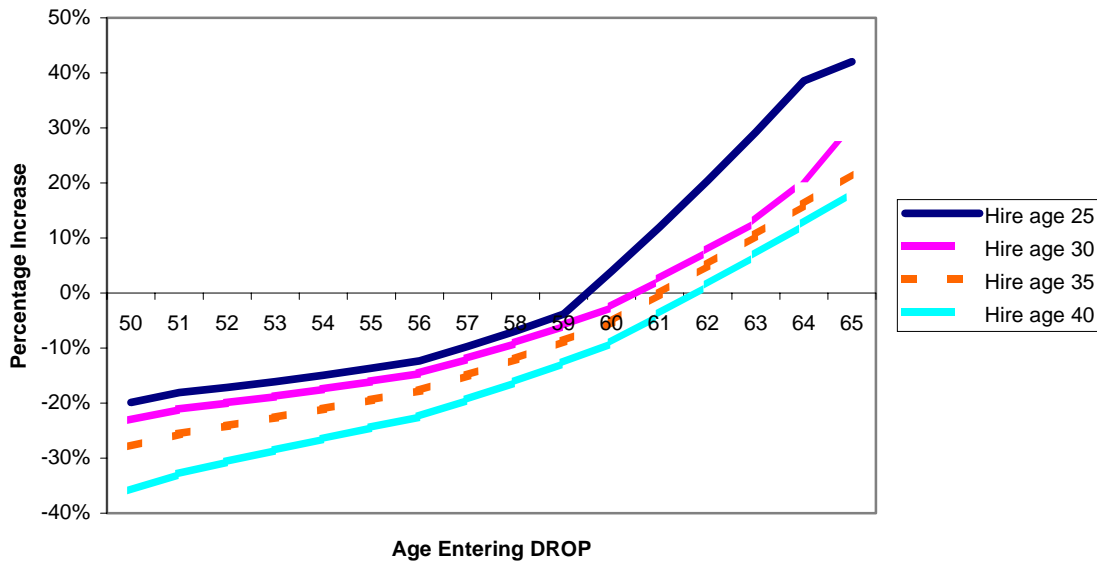
Variable Features

Not all DROP designs are cost neutral in all situations. For some benefit formulas a specific DROP design can be considered a benefit improvement, while for other benefit designs the same DROP design would be considered a benefit decrease. The value of a particular DROP design can vary not only between benefit structures, but also will depend on when a member was hired, when she is considering entering into the DROP, how long she plans on staying in the DROP, the salary increases she expects to receive during the DROP Period, and whether she is willing to work longer due to the existence of the DROP.

The following graphs illustrate the relative increase (or decrease) in the value of a member's benefit achieved by electing into DROP. For the purposes of this illustration we have used the 31676.11 age factors and assumed a 2% automatic cost-of-living adjustment (COLA). The DROP in the illustration has a 5-year DROP

Period providing 8% interest on the account balance. The graph shows how the value varies by retirement age and by age at hire.

Graph 1
Impact of Age at Hire and Retirement
31676.11
2% COLA



As the above graph shows, with the same plan provisions and the same DROP, some members will increase their benefit value by 40% or more by entering into DROP while others would decrease the value of the benefit they receive from the retirement system by almost 40%. Graph 1 illustrates two trends that affect every set of plan provisions within the 37 Act.

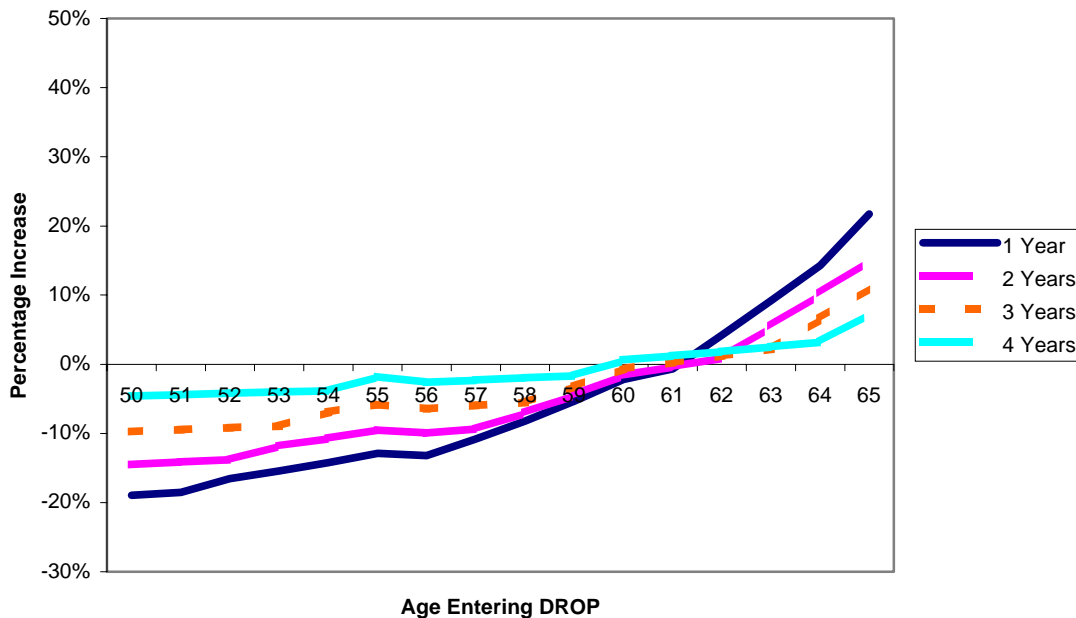
- **Impact of Retirement Age** – For members at the earliest retirement ages, entering DROP is generally not to their financial advantage. Electing in at that time would cause members to miss out on up to 40% of the value of their benefit. This is due to the combination of the increase in the plan’s age factors, along with relative increases in credited service and expected pay levels. When the age factors flatten out (at the higher retirement ages), the member gets less of a benefit increase by remaining in the retirement plan. At those ages, DROP becomes more valuable.
- **Impact of Hire Age** – Members hired at earlier ages get relatively more value from DROP than those hired at later ages. For those with long service before becoming eligible for DROP, an additional year of service will only increase their benefit by a small percentage. The relative increases for those with less service can be significantly greater.

The above graph has been prepared assuming that a member electing DROP is not changing his retirement behavior. In other words, if the member planned on retiring

at age 60, he would elect into DROP at age 55, stay five years and still retire at age 60.

This is not always what happens. Some DROPs have been able to encourage members to work for a number of additional years. Graph 2 illustrates a third element that can have a significant impact on the cost of the DROP.

Graph 2
Impact of Deferring Retirement
31676.11
2% COLA



- **Impact of Deferring Retirement** – Forward DROPs are generally designed to come up with benefits that are similar to those a member would get by retiring and putting the monthly benefit check into a savings account. As the graph above shows, when the DROP causes a member to defer retirement for a number of years, the DROP becomes closer to being cost neutral.

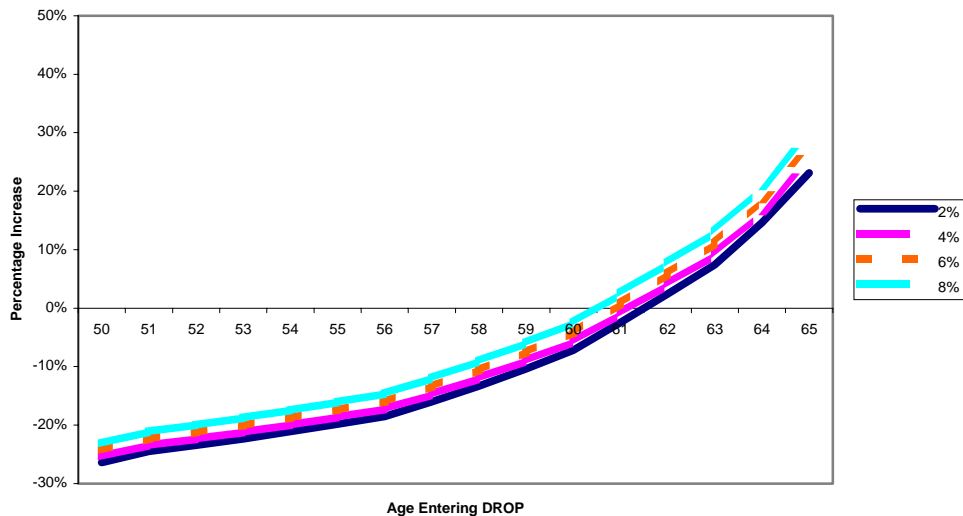
Each county has a different combination of ages at hire and expected ages of retirement. The existence of a DROP will have differing impacts across the state depending on how it is designed and communicated. There does not exist a single Forward DROP design that will provide an attractive benefit to active members and remain cost neutral for all potential plan designs within the 37 Act. The DROP Committee, recognizing this, left some flexibility in three key areas:

- **DROP Account Balance** – There are four elements that potentially go toward increasing the lump sum available to the member at actual retirement: the monthly retirement benefit, employee contributions, employer contributions and

interest crediting. The proposed design allows individual counties to adjust the last three of these elements to fine-tune the DROP cost.

- *Interest Crediting* – The greater the interest rate credited to the DROP Account, the larger the benefit the member will receive when retiring under DROP. While this is often a heated element in the negotiation of DROP features, it does not significantly impact the overall cost of the DROP, as shown in Graph 3. This is mostly due to the short time that the DROP Account accrues interest prior to retirement.

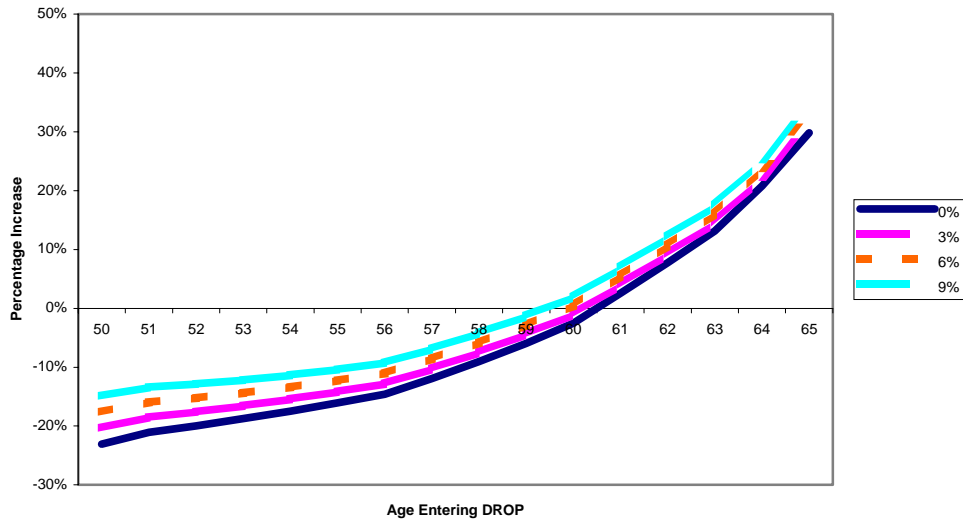
Graph 3
Impact of Interest Crediting
31676.11
2% COLA



The proposed outline includes four approaches for setting the interest crediting rate:

1. No interest
 2. The same rate credited to employee contribution balances
 3. A fixed annual percentage rate
 4. A rate determined semi-annually by the retirement board
- *Member or Employer Contributions* – When additional amounts are credited to the DROP Account, whether associated with Member Contributions or Employer Contributions, the greater the benefit to the member under DROP. Graph 4 shows how varying levels of contributions impact the relative value of benefits under DROP.

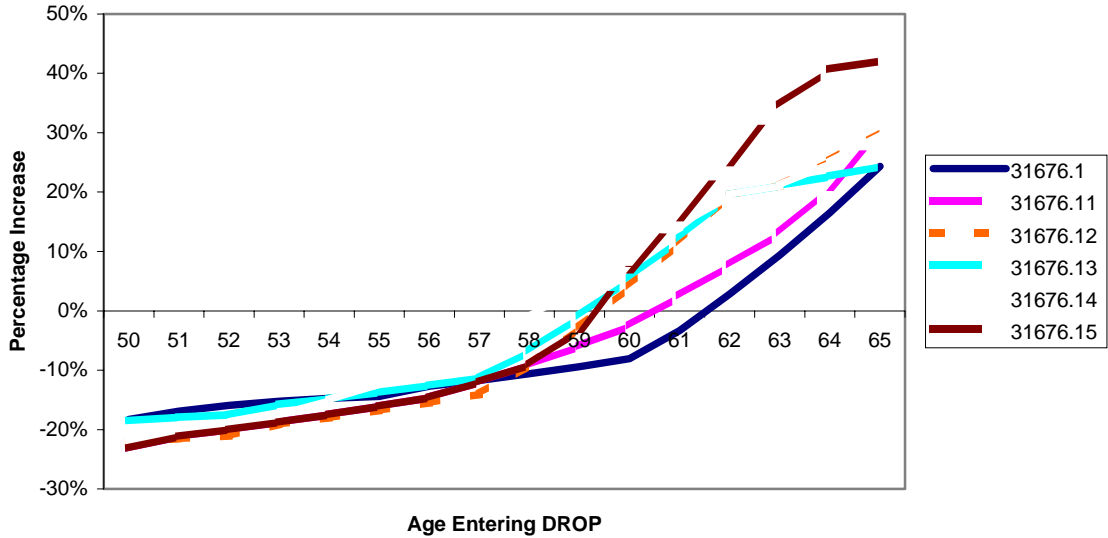
Graph 4
Impact of Additional Contributions
31676.11
2% COLA



The proposed outline allows each county to decide whether to include Member or Employer Contributions in the DROP Account.

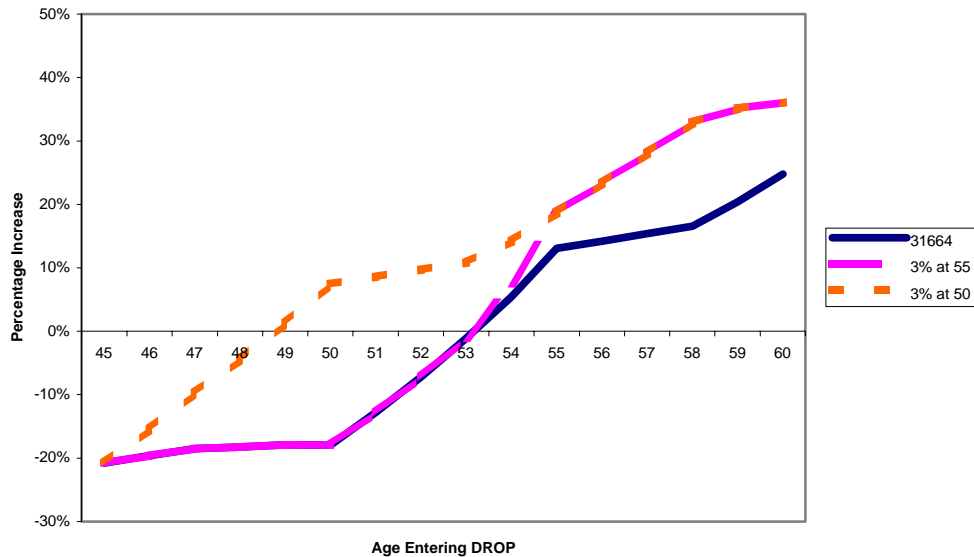
- **DROP Eligibility** – A second element included for customizing the cost of DROP is through limiting eligibility in the program to members who meet specific age and / or service requirements. The above graphs illustrate over and over that some members will be able to increase the value of their benefit significantly through DROP, while others may lose value. As a general rule, those who are likely to lose significant value through the election are probably less likely to enter into DROP. The job of the DROP designers is to select a design that will be selected by a combination of members that will, on average, not change the value of their benefit significantly. If the DROP changes retirement patterns, this may be sufficient. If not, the county may need to limit eligibility to those meeting certain age and service requirements in order to create a cost neutral DROP.
- **Separate provisions by benefit structure** – Although the DROP Committee would like to encourage counties to provide the same DROP benefits to all plan members, these benefits will not be cost neutral for all members. The graphs below show changes in the value of benefits through DROP for varying sets of 37 Act service retirement factors for General and Safety

Graph 5
Impact of Plan Provisions
General Members



For each potential DROP Entry Age from 50 through 70, the above graph shows the increase in value that the member would receive by selecting to enter DROP, rather than staying in the regular part of the retirement plan. Although the patterns are similar to what we have seen before, the relative gains and losses vary by section due to the differences in age factors.

Graph 6
Impact of Plan Provisions
Safety Members



Graph 6 above shows similar results for Safety members. We have included the new benefit provisions providing 3% at 50 and 3% at 55. The new benefit levels allow members to reach the 100% of pay limit sooner, thereby creating more ages when the member increases the value of his benefit by entering into DROP.

E. Actuarial Equivalent DROP

The second proposed DROP type is the Actuarial Equivalent DROP. The Actuarial Equivalent DROP is not considered by some to be a DROP at all, because it is not intended to defer retirement. It is sometimes referred to as a partial lump sum option. An option of this nature was added to CalSTRS in the recently ended legislative session. It was referred to, in that instance, as simply a Retirement Option Program.

Under an Actuarial Equivalent DROP, the member can select a portion of his monthly lifetime benefit at retirement. That monthly benefit is converted into an equivalent single sum amount. Because this is done on an actuarially equivalent basis, these programs are largely cost neutral.

The two key elements to an Actuarial Equivalent DROP that we will discuss in more detail deal with how much of a benefit the member can take and how the lump sum is calculated.

- **Benefit Limitations** – One of the concerns related to Actuarial Equivalent DROPs is that a member must reduce his monthly retirement benefit in order to receive the lump sum. Members, enticed by the opportunity to receive a large amount of cash in a single payment, may not realize how much income they will need to live for the remainder of their lives. Some Actuarial Equivalent DROPs, including the one recently approved for CalSTRS, deal with this by limiting the benefit reduction the member is allowed to select. Although no limitation on the lump sum is required, the proposed DROP outline would give each county three approaches to limiting the lump sum paid:
 - *Employee contributions with interest* – This would be similar to the PAW (Partial Annuity Withdrawal) suggested in an article in the Public Retirement Journal.
 - *20% of Monthly Retirement Benefit* – This approach would provide a relative reduction in the benefit that could be elected by members. The member would not be allowed to reduce his benefit by more than 20% under the Actuarial Equivalent DROP.
 - *50% of Compensation* – Under this approach, the member would not be allowed to reduce his monthly retirement benefit below a level equal to 50% of his final average compensation. This would provide a sustenance level for the lifetime of the member.
- **Calculation of Lump Sum** – In general, the lump sum would be calculated using the actuarial equivalence factors adopted by the retirement board in the most recent actuarial valuation. The lump sum would include the value of the monthly retirement income paid for the life of the member and any automatic COLA

payments anticipated. It would not include the value of ancillary benefits (such as disability benefits), death benefits or survivor continuances.

Section

2 Detailed Outline

New Section of 37 Act

- Will be separate from the rest of the 37 Act, and able to apply without regard to other provisions adopted by the individual county.
- Must be adopted by Board of Supervisors in order to become effective (details of adoptions discussed below).
- Most requirements will be written into the law.
- Some flexibility will be available by selecting among a small number of available options.

Adoption and Renewal Procedures

These are the requirements to adopt DROP provisions or renew the DROP provisions at the end of their expiration. They include:

- Clear statement of subsections adopted. For a Forward DROP this should include the maximum length of DROP Period, which may be no more than 5 years.
- The DROP Effective Date and the DROP Expiration Date for the adopted provisions.
 - Expiration Date - No fewer than four (4) years, nor longer than ten (10) years after effective date of DROP.
 - Actuarial Analysis of cost impact must be performed at expiration of DROP (or within one year of expiration of DROP).
 - Those who have retired under DROP, or whose DROP Period has commenced prior to the Expiration Date will remain in DROP under the same provisions as they accepted upon entering DROP. If a DROP with alternate provisions replaces the expiring DROP, the Retirement System may allow a member in the DROP period to elect to transfer to the new DROP provisions.

- Majority approval by Board of Supervisors.
- Actuarial Analysis prior to approval projecting the cost impact of adding the DROP provisions. The analysis must include a finding that adding the DROP provisions will be Cost Neutral.
- Provision Renewal
 - Successor provisions can be renewed within one year of the expiration date of the expiring provisions.
 - Successor provisions must follow these rules as if they were the initial adoption of DROP.

Effect on compensation, employment-related benefits and post-employment benefits

- Other than for purposes of calculating the retirement benefit, a member electing DROP will be treated as an active employee.
- Enrollment in DROP is not a guarantee of employment.
- Eligibility for post-employment benefits will be based on all service with employer, without regard to when the member elected into DROP or whether the member elected into DROP.
- Spousal eligibility, for purposes of post-employment benefits, including survivor benefits under the retirement program, will be based on marital status and duration as of the Retirement Date.

Overall Requirements – Those that affect all adopting systems

Waivers and Enrollment Requirements

- **For all DROPs:**
 - Each retirement system will determine its own method of informing DROP applicants.
 - Applicant will sign form, signifying understanding of required areas.
 - Content of form will include, but not be limited to:
 - DROP Benefits

- How determined
- Projection of benefit with and without entering DROP
- Potential advantages
- Potential disadvantages
- Not a guarantee of employment
- Need to seek advice from tax and investment professionals
- ADEA Waiver
- Disability Waiver
 - Applicant will waive right to apply for disability after receiving DROP balance
 - Applicant will waive right to apply for disability during DROP Period on the basis of event occurring prior to the beginning of the DROP Period.
 - The heart, cancer and bloodborne disease presumptions will still be applicable during the DROP Period, but not after the member has accepted the DROP balance.
- Domestic Relations Order Update / Waiver
 - Details will vary by County. It will, in part, depend on whether the Retirement System is working under the new DRO provisions in the 37 Act.
- **For Forward DROPs:**
 - Timing of application – Application must be received in the retirement office prior to the beginning of the DROP Period.
 - Timing of enrollment
 - Beginning of DROP Period
 - Length of DROP Period
 - Agreement to retire at end of DROP period
 - Naming Beneficiary
 - DROP Account – Can be different than for monthly benefit

- Spousal recognition – The spouse understands that the benefit that will be received after the death of the member will be reduced because of this election.
 - Monthly benefit – Election becomes irrevocable at time of actual retirement
- **For Actuarial Equivalent DROPs:**
 - Timing of application – Application must be received in the retirement office prior to retirement.
 - Lump Sum and Reduction amounts – These must show on the application and be initialed by the applicant
 - Spousal recognition – The spouse understands that the benefit that will be received after the death of the member will be reduced because of this election.

Eligibility Parameters

- **Allowable parameters**
 - Age
 - Service
 - Minimums and Maximums allowed
 - Combinations / Sums allowed
 - Must be at least as strict as Service Retirement eligibility
- **Parameters not allowed**
 - Collective bargaining group
 - Classification (general / safety)
 - Tier

Ancillary events

- **Death during DROP Period**
 - Same benefit as paid under Death while eligible rules based on frozen service retirement benefit

- DROP balance paid to specified beneficiary
- **Disability during DROP Period**
 - Must be due to event occurring during DROP Period. Employee will waive their right to apply for a disability retirement based on an event that occurred prior to the DROP Period.
 - To be a valid claim for a service connected disability, the disability application must cite an event that occurs during the DROP period as the proximate cause.
 - If an applicant goes out on 4850 time, their DROP application will be automatically rescinded, and will be treated as if it never happened. They will be allowed to apply for entry into DROP after returning to regular employment status.
 - There will be exceptions to this rule to allow for the heart, cancer and bloodborne disease presumptions in the law.
 - Member can choose between:
 - Disability benefit calculated as if the member had never elected into DROP.
 - The member will receive a disability benefit based on the member's service and compensation at disability.
 - The member will not be eligible to receive a lump sum DROP account payment.
 - If the member returns to active service from disability, he will be eligible to elect into DROP at that time.
 - Service retirement benefit including DROP.
 - This would be the benefit that the member would receive if he actually retired from DROP at the date of disability.
 - The monthly benefit would be the frozen benefit determined at the beginning of the DROP Period with appropriate adjustments.
 - The member would receive the accumulated DROP Account at that time.

- **Spousal death during DROP Period**

- Short period (90 calendar days) after death of spouse during which member can revoke election into DROP.

Reciprocity

- For reciprocity with other retirement systems, retirement from both systems must be concurrent.
- Reciprocal service can be used to become eligible to enter DROP.
- Reciprocal benefits earned from other systems do not enter into DROP in any way.
- A member must currently be employed with the County whose retirement system he is in to enter into DROP.
- If the final compensation from the reciprocal agency is greater than the final compensation that would otherwise be used in the DROP calculation, the higher final compensation from the reciprocal agency should be used in the DROP calculation.
- For the purpose of determining whether final compensation from the current retirement system is to be used in the calculation of the service retirement the member will receive from a reciprocal retirement system, the DROP Retirement Date will be considered the retirement date for determining whether retirement within the two systems are concurrent. The compensation used in the determination of the monthly benefit to be paid to the member after retirement will be the compensation sent to the reciprocal retirement system.

Forward DROP

- **Monthly Retirement Benefit**

- How calculated
 - Compensation – Calculated as if member retired and began receiving benefit at beginning of DROP Period
 - Age Factor - Calculated as if member retired and began receiving benefit at beginning of DROP Period
 - Service - Calculated as if member retired and began receiving benefit at beginning of DROP Period
 - Sick Leave and Vacation Time

- It will not be calculated as part of the monthly benefit that goes into the DROP account.
- The member will be allowed to use vacation time and sick leave during the DROP Period in the same manner as if the member were not in DROP.
- At the end of the DROP Period (when the member actually retires), the frozen benefit that will be paid to the member will be adjusted to reflect pay adjustment or service adjustments due to sick leave or vacation time or similar pay elements normally included by the retirement system. This will NOT change the amount of the DROP Balance in any way.
 - Benefit Provisions - Calculated as if member retired and began receiving benefit at beginning of DROP Period
- When payable – at actual retirement (end of DROP Period)
- How payable
 - Same forms as available for regular service retirements
 - Benefit form adjustments (such as conversion to 100% Joint & Survivor form) will be calculated using ages (for member and beneficiary) at actual commencement (not at enrollment into DROP)

Actuarial Equivalent DROP

- **Monthly Retirement Benefit**

- How calculated = Base Benefit - Reduction
 - Base Benefit – Same as under Service Retirement without DROP
 - Reduction – Present value of lump sum amount received.
- When payable – at actual retirement
- How payable
 - Same forms as available for regular service retirements

- **Lump Sum Amount**
 - How Calculated
 - Actuarial Equivalence – Valuation assumptions
 - Values included
 - Life annuity to member
 - Automatic COLAs
 - Value excludes
 - Ancillary benefits
 - Death benefits
 - Survivor continuance
 - When payable – at actual retirement
 - Payment Form
 - Single Sum payment
 - Must be paid immediately at the time of retirement
 - Can be rolled over into a qualified tax-deferred account

Menu for Customization

Forward DROP

- **Can create different formula for different groups based on:**
 - Benefit Formula Tier
 - Classification (General / Safety)
- The DROP provisions available to the member will be based on the member's Tier and Classification at the time of entry into DROP (the beginning of the DROP Period).

- **Account Balance**

- Additions

- Monthly Benefit – Full amount (calculation will not include service or pay increases due to sick leave or vacation time)
- Employee Contributions
 - None
 - All
- Employer Contributions
 - None
 - Lesser of Normal Cost percentage and Actual contribution percentage
- Interest
 - None
 - Same as employee contribution accounts
 - Fixed Annual Percentage (for example, 4% per year)
 - Determined semi-annually by retirement board

- When payable – at actual retirement (end of DROP Period)

- Payment Form

- Single Sum payment
 - Must be paid immediately
 - Can be rolled over into a qualified tax-deferred account
- Convert to equal monthly payments for expected life of member
- Other actuarially equivalent forms adopted by the Board of Retirement

Actuarial Equivalent DROP

- **Lump Sum Amount**

- Limitations – Maximum Lump Sum
 - Employee contributions with interest
 - Value of 20% of monthly retirement benefit
 - Cannot drop retirement benefit below 50% of final compensation

Funding

- Employer Contributions
 - Funding methodology must be consistent across retirement system (i.e., same methodology for safety as for general and for all tiers).
 - Retirement Board shall retain control over the methodology employed in determining funding of retirement system (consistent with Proposition 162).
 - Retirement Board may determine that benefits are funded over the period prior to entering DROP. This would mean that no contributions would be requested on payroll of members in DROP.
 - Retirement Board may determine that benefits are funded over the full working period of the member (extending through the DROP Period). This would mean that contributions would be requested on payroll of members in DROP.
- Member Contributions will continue during the DROP Period as if the member had not enrolled in DROP.

Definitions (this list is not exhaustive):

Here are listed some terms that will need to be defined in the legislation. The explanations included below with these terms are not intended to be legal definitions. This list may not contain all the terms that will need to be defined.

- **Actuarial Accrued Liability (AAL)** – The portion of the PVB attributable to service before the valuation date. Please note that this is not the same as the value of benefits earned prior to the valuation date. Under some funding methods, each projected benefit (based on past and future service) is allocated between past and future service for funding purposes. Therefore a change in a benefit payable in the future will affect this measure. This is the measure upon which a plan's funded percentage is usually calculated.
- **Actuarial Equivalent DROP**
- **Cost Neutrality** – Cost Neutrality has been defined for the purposes of this section. It includes specific measures, tolerances levels of change, and guidelines for assumption changes. Although we use the phrase cost neutral, these definitions can more accurately be described as not having a significant negative impact on the members, the employer or the retirement system.

- *Measures* – Cost neutrality will be monitored using three measures: Present Value of Benefits (PVB), Actuarial Accrued Liability (AAL) and Employer Contribution (Contr).
 - *Tolerances* – The general tolerance level will be a change of 3% between the measure without DROP and the same measure at the same time with DROP being implemented. PVB will not be allowed to move (either up or down) by more than 3%. AAL and Contr will be limited so that neither of these increases by more than 3%.
 - *Guidelines* – In determining the impact of adding DROP to a retirement system, the actuary can only show changes based on items that can be expected to change due to the implementation of the DROP. In addition to the change in benefit provisions, these could include elements such as expected retirement age or the likelihood of termination or disability for those near retirement age. It would not include unrelated items such as the investment return on fund assets or the life expectancy of currently retired members.
 - *Funding methodology* – Some retirement systems with DROPs currently treat DROP enrollees as retired members in determining employer contribution rates (their compensation is not used to determine normal cost and contributions are not spread over their compensation). Other retirement systems treat DROP enrollees just like active employees. The decision regarding how the retirement system would be funded was left to each local Retirement Board.
- **DROP Account Balance**
 - **DROP Entry Date** - This is the effective date that the member enters into DROP. It is the beginning of the DROP Period. The member continues to work after the DROP Election Date.
 - **DROP Period**
 - **DROP Effective Date**
 - **DROP Expiration Date**
 - **Expected Contribution (Contr)** – This is the dollar amount that the employer is asked to contribute in the coming year under the funding methodology adopted by the Retirement Board. The contribution rate is a function of both the plan's NC and its AAL.
 - **Forward DROP**

- **Normal Cost (NC)** – This is the portion of the PVB attributable to the current year of service. Please note that this is not the same as the value of benefits earned during the year. Under some funding methods, each projected benefit (based on past and future service) is allocated between past and future service for funding purposes. Therefore a change in a benefit payable in the future will affect this measure.
- **Present Value of Future Employer-Provided Benefits (PVB)** – The value, as of the valuation date, of all benefits expected to be paid to current members of the retirement system.
- **Retirement Date** - This is the date that the member actually stops working and begins to receive monthly payments from the retirement system. It is the end of the DROP Period. The member no longer works for the county after the Retirement Date.