# A STUDY OF A DEFERRED RETIREMENT OPTION

## SENATE BILL 1134 (2004)

## OKLAHOMA PUBLIC EMPLOYEES RETIREMENT SYSTEM

December 1, 2004

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# OKLAHOMA PUBLIC EMPLOYEES RETIREMENT SYSTEM

### Study of a Deferred Retirement Option

## I. Introduction

Section 30 of SB 1134 directed OPERS to conduct a study on the possible creation of a "deferred retirement option" for its members. There are many different types of benefit options in the general category of "deferred retired options." Some of the options are more commonly known as DROP's, Back-DROP's and PLOP's.

The OPERS Board of Trustees believes that no benefit enhancements of any kind should be considered until (1) the funded ratio of OPERS drastically improves, and (2) OPERS begins to collect adequate contributions to fund the current benefit structure. OPERS' funded ratio stands at 76.1% at the end of FY 2004. It is only collecting 59% of required contributions which is currently the lowest percentage of all of Oklahoma's state retirement systems. Adopting any benefit enhancement without adequate funding would be inadvisable and fiscally imprudent. In addition, it would be a mistake to make a change in plan design like a DROP unless it is fulfilling a clearly defined public purpose or statewide need. It would be inadvisable to change the plan design simply because "other plans have DROP's."

The Board of Trustees makes the following recommendation:

1. A DROP plan should not be adopted for OPERS. (a) There is no indication that Oklahoma state and local government needs to provide an incentive available to all public employees to work past normal retirement date, (b) The cost of a DROP plan similar to the plans of other state retirement systems will be significant. OPERS' actuary has estimated that a DROP plan similar to those in existence in Oklahoma's other retirement systems will increase the unfunded liability of the System by $206 million, (c) A DROP plan would change current public policy against public employees getting a pension at the same time as drawing a full paycheck, and (d) Experience in other states indicates that DROP plans have been controversial and have led to negative publicity.

2. If the state needs to provide an incentive to certain employees to continue to work past their normal retirement date, a narrowly tailored salary incentive would be a more appropriate and cost-effective way to achieve that goal.

3. While there is no compelling need for any plan design changes in OPERS, if policymakers want public employees to retire with some option for a sizable cash lump-sum, a Partial Lump Sum Option ("PLOP") similar to the one available in the Teachers Retirement System is a design change which can be made actuarially neutral.

This study was based on several pre-existing studies, actuarial reports of other systems, interviews and articles in the mainstream press. A full list of those materials is at Appendix 1. Citations will be made to the corresponding number on that list.

## II. DROP's

Traditional DROP's are now known as "forward" DROP's to differentiate them from the newer "Back-DROP" options. Throughout this report, the term "DROP" used by itself will mean a traditional forward DROP.

DROP's began in Louisiana. All of the early DROP plans were in police and firefighter pension plans. While they are growing in popularity, their use is not widespread in retirement systems composed of regular public employees (App. One, 1. NC Report; 2. Bolton Partners report).

The typical design of a DROP is an option that can be exercised only when a member is eligible for normal retirement. DROP periods in such plans are typically for one to five years in length. When a member chooses a DROP option, the member continues to work for the covered employer. When the DROP period begins, the annuity that the member is eligible to receive goes into an account rather than to the member. Some DROP plans permit the account to earn interest, but others do not. Some DROP plans allow for the employee contributions into the system to cease, but others do not. Some DROP plans require the employer to continue to pay employer contributions or a portion. Some DROP plans permit some of the employee and/or employer contributions to be deposited into the account.

Most DROP plans fix the amount of the annuity to be paid to the member without re-calculation at the end of the DROP period. The member in most plans does not earn additional years of service nor does the member get the benefit of salary increases during the DROP period. Some DROP plans permit the annuity to be credited with COLA's and others do not. Most DROP's require the decision to enter DROP to be irrevocable and also require the member to actually leave employment at the end of the DROP period. Most DROP plans permit the member to retire before the end of the DROP period but sometimes a penalty of some kind is involved.

At the end of the period, most DROP plans permit the member to be paid the lump sum of the account, roll it over into an IRA or similar tax-deferred account, or a combination of the two. Some DROP plans permit the member to purchase an annuity from the System. A handful of Systems permit the funds to stay on deposit for as long as the member wishes. (App. One, 2. Bolton Partners report; 3. Segal report; 4. Ice Miller report).

In Appendix 2 and 3 are examples of how a DROP plan works in practice. Appendix 2 shows a DROP for someone with a final average salary of $30,000 at age 55 with 25 years of service. The example shows that such a person could defer his/her actual retirement date for five (5) years and collect a lump sum of more than $100,000. This person would receive an annuity of $15,000 plus COLA's for a lifetime. That compares with the same person receiving a $20,400 annuity plus COLA's for a lifetime beginning at age 60 without receiving a lump sum. Appendix 3 shows a similar person with a final average salary of $50,000.

## III. Purpose of DROP Plans

The stated purpose of the original DROP plans was to encourage police officers and firefighters to work past their normal retirement date. Interestingly, this purpose runs directly counter to the original intent of "20 and out" retirement designs. Early retirements for public safety officers were enacted to ensure the public was protected by a youthful and vigorous workforce. Another reason for a DROP plan is to simply offer a different option (lump sum) in the retirement plan. Other plans which design their DROP's carefully can reduce the amount of "required contributions" into their plans. (App. One, 3. Segal). There are some DROP's that have been adopted to encourage retirements. By exercising the DROP option, the employee must agree to retire by a certain date.

## IV. Back-DROP's

Back-DROP's have been increasing in popularity in the past few years. In a Back-DROP, any member who has worked past his or her normal retirement date can "retroactively" choose to get the benefits of a DROP account as if he or she had exercised the option earlier. The annuity is calculated as if the member had retired earlier, the annuity payments are credited as if they had been paid into the account, interest is credited as if the member's money had been in the account (if interest is paid at all), and the member can get a lump sum when the member actually retires. About the only thing a member has to lose in waiting to Back-DROP is that he or she must still pay in the employee contributions. In plans which suspend employee contributions of members in a DROP period, the employee would get the benefit of an 8% raise in pay during the DROP period, but will be eligible for a refund of his/her contributions at the end of the period. (App. One, 2. Bolton; 3. Segal).

## V. PLOP's

PLOP's are a partial lump-sum option. Instead of retiring with a level, life-time annuity, a member can opt for a "partial" lump sum and receive an actuarially reduced annuity for life. The lump sum is generally only calculated when the member is ready to retire. Some plans require the member to have reached a certain age or have completed a certain number of years of service to qualify. (App. One, 3. Segal). Appendix 4 shows an example of how a PLOP would operate. The example is based on the existing PLOP option offered by the Oklahoma Teachers' Retirement System. A person who retires at age 60 with a final average salary of $50,000 and 30 years of service would normally receive an annuity of $30,000 for life. Instead that member could receive either a $30,000, $60,000 or $90,000 lump sum upon retirement but with an actuarially reduced annuity of $27,102, $24,204 and $21,306 respectively.

## VI. PLOP's vs. Back-DROP's

PLOP's and Back-DROP's are similar. With both, members typically wait until they are ready to retire before electing the option and receiving the lump sum. The biggest difference is cost to the retirement system. PLOP's are almost always actuarially neutral. Back-DROP's sometimes come with added administrative cost or increased liability to the System. If members are able to get a high, guaranteed rate of interest on their DROP accounts, or if employee contributions previously paid by the members are refunded or a substantial amount of employer contributions are added to the account, Back-DROPS can be very expensive.

There is also the issue of "adverse selection." With forward DROP's a member may be taking some financial risk. They are giving up the right to have a higher salary earned during the DROP period to be used in the calculation of the annuity. They may or may not be taking some investment risk. With a Back-DROP a member can look at what they would get with a DROP or what their annuity would be without DROP, and then make the decision. They will generally take the option that is financially best for them which will probably be financially worse for the System. (App. One, 3. Segal).

## VII. DROP's in Public Employee Retirement Systems

As stated earlier, DROP plans were started in public safety retirement systems. DROP's are not a typical plan option for other public employee retirement systems. There is some evidence that some states are adopting DROP's as a way to retain veteran teachers. (App. One, 2. Bolton).

The North Carolina retirement systems did a comprehensive survey in November 2003 of all 50 states and their public employee retirement systems. The survey showed that only 6 states had a DROP plan for all types of public employees. Three (3) states had enacted DROP's just for teachers. Eight (8) states had PLOP's and one state (Missouri) had enacted a Back-DROP for all of its public employees. Upon closer review of Missouri's "Back-DROP" it appeared to be more of a PLOP since the member earned no interest. (App. One, 1. North Carolina).

## VIII. DROP's in Oklahoma

All three (3) of the State of Oklahoma's "public safety" retirement systems have DROP's and Back-DROP's. The DROP benefits are very attractive to the members. In all three plans the member can enter DROP at his or her normal retirement date. The annual benefit amount is frozen at that time. The annuity payment goes into an account. The member's employee contributions into the System cease. Since all of these systems have an 8% employee contribution, this is the equivalent of an 8% immediate pay raise. The employer continues to pay employer contributions. One-half of these contributions go into the members' account and one-half go to the System. The interest earned on these accounts is very attractive. The lowest rate of interest a member earns is 7.5% which is the actuarial investment assumption of all three of these systems at the present time. The highest the member can earn is 2% below the actual rate of return earned by the System on its assets. All of the systems permit the member to receive the account in a lump sum or roll it over into another tax-deferred account of some kind.

One system (Oklahoma Firefighters) permits its members keep their funds in the account earning a minimum of 7.5% interest after the DROP period ceases and the member actually retires. The members can draw down funds whenever they choose. Under IRS rules, members must begin to get distributions at age 70 ½. As of the end of FY 2004 the Firefighters System had 1,386 members with funds in a DROP account. Only 390 were active members with funds equaling $41 million. There were 996 retirees with fund balances totaling $154.1 million. The total amount in the DROP accounts is $195 million which is 13.2% of the Firefighters' total assets of $1.47 billion at the end of this same period. The Firefighters System has a 3.28% reserve on these account balances to pay the cost of the guaranteed interest component. (Firefighters' FY 2004 actuarial report; See Appendix 5).

Participation in DROP varies quite a bit among Oklahoma's 3 public safety retirement systems. The Police Pension & Retirement System has 284 members in its DROP plan out of 3,895 active (7.3%) and 6,626 total members (4.3%). (Appendix 6). The Firefighter's Pension & Retirement System has 390 "active" DROP participants out of 3,518 active/paid members (11%) and 13,162 total members less volunteers (3%). (Appendix 5). The Oklahoma Law Enforcement Retirement System has the largest participation with 152 DROP participants out of 1,129 actives (13.5%) and 2,326 total members (6.5%). (Appendix 7).

## IX. Tax Issues with DROP's

If a DROP plan is adopted it must be "definitely determinable" to meet IRS requirements. Therefore it must be available for all plan participants. (4. Ice Miller). For instance if the State of Oklahoma wanted to give a DROP option to a limited class of OPERS members to encourage them to work longer, this could not be done consistent with the IRS Code. The State would have to create a new plan for a more limited class of employees. This provision also requires there to be a consistent formula to determine the DROP benefit.

A "defined benefit" plan is defined in §414(j) of the IRS Code. Essentially a defined benefit is any retirement plan that is not a "defined contribution" plan. A defined contribution plan has individual accounts with benefits based on the amounts contributed plus or minus investment gains or losses. Many tax attorneys believe that if a DROP plan earns market rates of return without a fixed rate, index or formula, that a DROP plan could be deemed to be a separate defined contribution plan on top of a defined benefit plan. Such a design would make DROP plans unattractive since such a plan would be subject to §415(c) of the Code which limits a taxpayer to only 25% of compensation per year to be deposited into a DC account.

The IRS Code has certain income limits for retirees under §415(b). Amounts paid from a DROP account must be considered in these limits. Police, fire and EMS personnel have different limits at different ages reflecting their usual earlier retirement eligibility.

In most cases, DROP lump sums may be rolled over into other qualified deferred retirement accounts. If not rolled over, large lump sums can be subject to tax. (App. One, 4. Ice Miller).

## X. Cost Issues

OPERS had its actuary conduct a study of the cost to OPERS of implementing a DROP plan similar to those in other state retirement systems. If a DROP is implemented it would add $206 million to OPERS' unfunded liability. In addition, it would increase annual required contributions from $266 million to $294.2 million for an annual increase of $28.2 million.

Supposedly DROP plans can be created which are actuarially neutral. However, the design of DROP's can certainly add to the cost. One item that will be a direct cost to the System is a high guaranteed return on the funds deposited into a DROP account. Oklahoma's DROP plans call for a <u>minimum</u> return of 7.5%. However, a member can earn up to 2% less than what the System's actual rate of return is. In Appendix 8 is an example of what the cost of a single DROP account earning this guaranteed rate of return would have been if OPERS had a DROP plan in place over the last five (5) years. The example uses an assumption of a member who enters DROP with 25 years of service at a $50,000 final average salary. With the guaranteed rate of return used by Oklahoma's other systems, the member would receive a lump sum of $186,637 at the end of a 5-year DROP period. If the amounts earned what OPERS actually earned, the lump sum would have been $165,259. Such a design would have cost OPERS $21,378 for one account to subsidize the guaranteed rate of return.

Creating and monitoring a DROP plan will add to the cost of administration. There could be significant upfront cost to creating an accounting system with individual accounts and interest accruals. The software cost would certainly be in the thousands of dollars and could easily lead to the need for an additional FTE with a cost of $40,000 to $60,000.

## XI. DROP's in the News

Several DROP plans have been the subject of unflattering articles in the press. An article in the May 17, 2004 edition of Fortune had an article entitled "The $366 Billion Outrage." The article focused on the lucrative City of San Diego retirement system. Those employees have a 2.5% retirement benefit multiplier and an 8% guaranteed interest on their DROP accounts. The Mayor of San Diego was quoted in an article that appeared in the San Diego Daily Transcript on September 13, 2004, as advocating the elimination of the DROP plan in that City and attributed part of its $1.1 billion unfunded liability to the DROP plan.

The City of Houston system was also mentioned in the Fortune article. That plan offered a guaranteed floor of 8.5% interest on DROP balances but with the prospect of getting more if investment earnings go up.

When Milwaukee County instituted Back-DROP's, a surge of payouts led the pension system to ask the county for an "advance" in taxpayer-funded contributions. In June 2004, 85 members retired under the Back-DROP and received a total of $9.5 million. One of these individuals was an assistant hospital manager who received a lump sum of $684,000 plus his $43,000 annuity. Three other retirees received lump sums of $500,000 or more. (Milwaukee Journal-Sentinel, 7/21/04)

The State of South Carolina instituted a "Teacher and Employee Retirement Incentive" (TERI) aimed at teachers and "key employees." It was structured as a forward DROP but the plan wasn't available to all non-teachers. State employers could identify "key employees" to participate. First, a study indicated that the plan increased the unfunded liability of the retirement system by $100 million. Second, the IRS advised the System that if the plan continued it would have to be available to all employees. There were comments and complaints that the program had the effect of keeping non-productive employees on the payroll longer, and by keeping some of the employees around who could otherwise retire, the State was not promoting less-experienced employees who were ready for promotion. (The State, Columbia, S. Car. 3/18/04).

"Governing" magazine recently published an article on DROP plans entitled "*DROP OUTS: A seemingly simple device to keep retirement-age workers on the job is turning into a pension plan debacle.*" The article chronicled many of the high-profile problems with DROP plans around the country. One of the conclusions of the article was, "[w]hatever your view of DROPs, there is one sure thing about them: They are a public relations grenade waiting to explode. When the fire commissioner leaves office with half a million dollars in his pocket, as Philadelphia's Hairston did, the press is sure to get inflamed about it." ("Governing" Sept. 2004, pg. 36).

## XII. Policy Issues

### A. Retirees Continuing on the Payroll

DROP plans are a not so indirect way to pay someone a pension while remaining on the payroll. Even though the employee doesn't actually receive the benefit immediately, the employee has constructive receipt of the retirement payment. In addition, some of Oklahoma's retirement systems sweeten this already attractive plan by paying a high rate of interest and crediting the member's account with one-half of the employer's contributions. Oklahoma's other systems stop collecting the member's employee contributions which gives the employee more take-home pay during the DROP period.

The State of Oklahoma currently limits an OPERS retiree's ability to return to work for another OPERS employer and receive a full pension. Under OPERS statutes, retirees are subject to the same earnings limitations governing Social Security beneficiaries. OPERS members under age 64 can only earn $11,640 per year from an OPERS employer and still keep their OPERS annuity. If they exceed that sum, their OPERS annuity ceases. A member who is 64 and reaching 65 years, 4 months of age can earn up to $31,080 per year. An OPERS retiree who is 65 years, 4 months or older has no earnings limitations. Of course an OPERS retiree can return to work, waive his/her benefit and continue accruing credit in the System also.

Adopting a DROP plan would essentially abandon the current public policy against earning a full pension and a full paycheck at the same time.

B. Incentive for All Public Employees to Work Longer

The original stated purpose for DROP plans was to provide an incentive for firefighters and police officers to work a little longer rather than train new officers. There are anecdotal stories of several experienced employees getting ready to leave state government. The suggestion is that there aren't able public employees ready and eager to take their places. However, we are unaware of any empirical evidence of such a critical shortage of qualified employees that a major retirement design change is necessary to address it. In addition, as has been pointed out previously, the State of Oklahoma cannot offer DROP's to only those experienced, productive employees that it wants to retain. The IRS Code requires benefits to be "definitely determinable." The level of benefits cannot be up to someone's discretion to offer one member or the other. To introduce a DROP plan for all state employees whether the State wants to encourage them to work past normal retirement age, seems unwarranted.

If there is a need for a financial incentive to keep certain employees on the job longer, it would make more sense to tailor a more narrow program to solve this problem. A narrowly tailored program would be less costly and less disruptive. Current state law severely limits and regulates ways that state agencies can raise certain employees pay. Title 74 O.S. §840-2.17 prohibits salary increases for state employees unless done within the requirement of the statute. Some of the permissible ways to raise an employee's salary are promotions, advancing to a new payband in a job family, certain market adjustments, skill-based adjustments, performance-based adjustments, career progression increases, and salary adjustments for employees leaving probationary status. Certainly a new classification could be developed to permit agencies to increase the pay of certain key employees to give them an incentive to stay. Not only would their salaries be raised, but the higher salary would raise their ultimate retirement benefit as well. Such a narrowly tailored program would be more reasonable than a significant change in retirement benefit options for all employees.

C. Atypical Benefit from Private Sector and Taxpayer

Most Oklahoma taxpayers in the private sector have no comparable benefit to a DROP plan. Most people cannot draw a pension from the companies that they work for at the same time they are drawing a paycheck. Just as other states have experienced negative publicity with DROP plans, Oklahoma can expect more of the same if DROP plans become widespread throughout state government.

## XIII. Summary

OPERS does not recommend implementing a DROP for its members. It will be a costly benefit enhancement. There is no demonstrable need for a DROP. Implementing DROP's in other states has been controversial with public employees and public retirement systems being held in a bad light.

# APPENDIX 1

Bibliography

1. "Summary of Public Pension Plans Incorporating Retention Efforts: A State by State Analysis of Retention Efforts within Public Pension Plans" by Connie Mann Bragg, North Carolina Retirement Division (Nov. 2003).

2. "Design and Actuarial Aspects of Deferred Retirement Option Programs" prepared for the Society of Actuaries by Bolton Partners (March 6, 2003).

3. "DROP Update: The Latest Variations on a Popular Theme." Public Sector Letter (Feb. 2004) The Segal Company.

4. Deferred Retirement Option Programs ("DROP's"): Current Issues for Governmental Plans." Ice Miller Donadio & Ryan (Aug. 5, 1999).

# APPENDIX 2

DROP Example 1

OPERS member reaches Rule of 80 at age 55 with 25 years of service. The member has a final average salary of $30,000 and will get $1,000 per year more in salary each year thereafter. The DROP account will receive each annuity payment for 5 years, one-half of the employer contribution and 7.5% simple interest posted annually. A 2% COLA will be credited beginning in year 2.

| Age | Salary | Raise | COLA | Annuity | 1/2 Employer Contribution | Interest Rate | Credited Earnings | DROP Account Balance |
|---|---|---|---|---|---|---|---|---|
| 55 | 30,000 | | | | | | | |
| 56 | 31,000 | 1,000 | 2% | 15,000 | 1,550 | 7.5% | 1,241 | 17,791 |
| 57 | 32,000 | 1,000 | 2% | 15,300 | 1,600 | 7.5% | 2,602 | 37,293 |
| 58 | 33,000 | 1,000 | 2% | 15,606 | 1,650 | 7.5% | 4,091 | 58,640 |
| 59 | 34,000 | 1,000 | 2% | 15,918 | 1,700 | 7.5% | 5,719 | 81,978 |
| 60 | 35,000 | 1,000 | 2% | 16,236 | 1,750 | 7.5% | 7,497 | 107,462 |
| | | | | 78,061 | 8,250 | | 21,151 | |

Without DROP *

| Age | Final Avg Salary | Annuity |
|---|---|---|
| 60 | 34,000 | 20,400 |

* In this example, the person exercising the DROP option would get an annual benefit payment of $16,236 at age 60 compared to $20,400 for someone who didn't take the DROP option.

# APPENDIX 3

DROP Example 2

OPERS member reaches Rule of 80 at age 55 with 25 years of service. The member has a final average salary of $50,000 and will get $1,500 per year more in salary each year thereafter. The DROP account will receive each annuity payment for 5 years, one-half of the employer contribution and 7.5% simple interest posted annually. A 2% COLA will be credited beginning in year 2.

| Age | Salary | Raise | COLA | Annuity | 1/2 Employer Contribution | Interest Rate | Credited Earnings | DROP Account Balance |
|---|---|---|---|---|---|---|---|---|
| 55 | 50,000 | | | | | | | |
| 56 | 51,500 | 1,500 | 2% | 25,000 | 2,575 | 7.5% | 2,068 | 29,643 |
| 57 | 53,000 | 1,500 | 2% | 25,500 | 2,650 | 7.5% | 4,334 | 62,128 |
| 58 | 54,500 | 1,500 | 2% | 26,010 | 2,725 | 7.5% | 6,815 | 97,677 |
| 59 | 56,000 | 1,500 | 2% | 26,530 | 2,800 | 7.5% | 9,526 | 136,533 |
| 60 | 57,500 | 1,500 | 2% | 27,061 | 2,875 | 7.5% | 12,485 | 178,954 |
| | | | | 130,101 | 13,625 | | 35,228 | |

Without DROP *

| Age | Final Avg Salary | Annuity |
|---|---|---|
| 60 | 56,000 | 33,600 |

* In this example, the person exercising the DROP option would get an annual benefit payment of $27,061 at age 60 compared to $33,600 for someone who didn't take the DROP option.

# APPENDIX 4

PLOP Example

For this example, we are using the PLOP option features of the Oklahoma Teachers' Retirement System. Under TRS' plan, a member must have at least 30 years of service. We will use an example of a member with a final average salary of $50,000 at age 55, 60 and 65. The member may elect a 1, 2 or 3 year option which gives the member the equivalent, unreduced benefit for those time periods. The member's benefit is then actuarially reduced for life.

| Age | Final Average Salary | Unreduced Annuity | 1 Year $30,000 Lump Sum | | 2 Year $60,000 Lump Sum | | 3 Year $90,000 Lump Sum | |
|---|---|---|---|---|---|---|---|---|
| | | | Amount | Factor | Amount | Factor | Amount | Factor |
| 55 | $50,000 | $30,000 | $27,273 | 90.91 | $24,546 | 81.82 | $21,819 | 72.73 |
| 60 | $50,000 | $30,000 | $27,102 | 90.34 | $24,204 | 80.68 | $21,306 | 71.02 |
| 65 | $50,000 | $30,000 | $26,850 | 89.50 | $23,697 | 78.99 | $20,547 | 68.49 |

# APPENDIX 5

### Statistics for Oklahoma Firefighters Pension & Retirement System

Actuarial Value of Assets 7/1/04 - $1.4 billion
Actuarial Funded Ratio - 66.0%

| | | | |
|---|---|---|---|
| Active Paid Members | 3,518 | DROP Active Members | 390 |
| Active Volunteer Members | 7,262 | DROP Retired Members | 996 |
| Retired, Disabled & Deferred Ben. | 7,420 | DROP Active Account Balance | $41 million |
| | | DROP Ret'd Acct. Balance | $154.1 million |
| Beneficiaries | 1,834 | | |
| DROP Members | 390 | Annual Annuity payments into DROP accounts | $9.0 million |
| Total | 20,424 | | |

Average Retirement Benefit (paid) - $24,149
Avg. Retmt. Benefit (volunteer) - $1,681
Normal Cost of Benefits
(% of payroll) 31.63%

Sources of Contributions

| | FY 2003 | % | FY 2004 | % |
|---|---|---|---|---|
| Member contributions | $12,373,090 | 14.3 % | $12,964,333 | 34.7 %. |
| Employer contribution | $23,872,222 | 27.6 % | $24,397,011 | 65.3 % |
| Dedicated taxes | $50,206,475 | 58.1 % | $0 | 0 % |
| Total | $86,451,787 | 100 % | $37,361,344 | 100 % |

Contributions as % of payroll

| | FY 2003 ($163,684,035) | FY 2004 ($173,178,595) |
|---|---|---|
| Members | 7.6 % | 7.5 % |
| Employers | 14.5 % | 14.1 % |
| State taxes | 30.7 % | 0 % |

# APPENDIX 6

### Statistics for Oklahoma Police Pension & Retirement System

Actuarial Value of Assets 7/1/04 - $1.4 billion
Actuarial Funded Ratio - 81.1%

| | | | |
|---|---|---|---|
| Active Members | 3,895 | DROP Members | 284 |
| Retired, Disabled | | DROP Account Balance | $30.8 million |
| & Deferred Ben. | 2,015 | Annual Annuity payments | |
| Beneficiaries | 432 | into DROP accounts | $9.0 million |
| DROP Members | 284 | | |
| Total | 6,626 | | |

Average Retirement Benefit - $26,577
Normal Cost of Benefits
(% of payroll) 27.5%

Sources of Contributions

| | FY 2003 | % | FY 2004 | % |
|---|---|---|---|---|
| Member contributions | $12,879,000 | 22.58% | $13,354,000 | 37.1 %. |
| Employer contribution | $23,738,000 | 41.63% | $22,682,000 | 62.9 % |
| Dedicated taxes | $20,400,000 | 35.77% | $0 | 0 % |
| Total | $57,017,000 | 100 % | $36,036,000 | 100 % |

Contributions as % of payroll

| | FY 2003 ($170,507,025) | FY 2004 ($175,559,285) |
|---|---|---|
| Members | 7.5 % | 7.6 % |
| Employers | 13.9 % | 12.9 % |
| State taxes | 12 % | 0 % |

# APPENDIX 7

### Statistics for Oklahoma Law Enforcement Retirement System

Actuarial Value of Assets 7/1/04 - $604.1 million
Actuarial Funded Ratio - 87.6%

| | | | |
|---|---|---|---|
| Active Members | 1,129 | DROP Members | 152 |
| Retired, Disabled & Deferred Ben. | 794 | DROP Account Balance | $14.6 million |
| Beneficiaries | 251 | Annual Annuity payments into DROP accounts | $5.4 million |
| DROP Members | 152 | | |
| Total | 2,326 | | |

Average Retirement Benefit - $35,317
Normal Cost of Benefits
(% of payroll) 40.1%

Sources of Contributions

| | FY 2003 | % | FY 2004 | % |
|---|---|---|---|---|
| Member contributions | $3,858,698 | 15.2 % | $3,752,395 | 21.4 %. |
| Employer contribution | $5,906,894 | 23.3 % | $5,674,166 | 32.4 % |
| Dedicated taxes | $15,579,168 | 61.5 % | $8,100,308 | 46.2 % |

Contributions as % of payroll

| | FY 2003 ($50,282,208) | FY 2004 ($48,871,602) |
|---|---|---|
| Members | 7.6 % | 7.6 % |
| Employers | 11.7 % | 11.6 % |
| State taxes | 31 % | 16.5 % |

## APPENDIX 8

Cost of DROP*

One direct cost of a DROP plan will come with any Plan having a minimum guaranteed rate of return. To show what a DROP can cost in actual market environments, the following example shows what a DROP would have cost the system had it been in existence over the last 5 fiscal years. Assume an OPERS member with a final average salary of $50,000 entered DROP on July 1, 1999. (DROP accounts on the 3 other public safety systems in Oklahoma get 2% below actual returns but not less than 7.5%.)

| Age | Salary | Annuity | 1/2 Employer Contribution | Fiscal Year | OPERS Rate of Return | OPERS Experience | DROP Earnings | DROP Account Balance | OPERS Surplus/(Deficit) |
|---|---|---|---|---|---|---|---|---|---|
| 55 | 50,000 | | | | | | | | |
| 56 | 51,500 | 25,000 | 2,575 | 2000 | 10.0% | 30,333 | 8.0% | 29,781 | 552 |
| 57 | 53,000 | 25,500 | 2,650 | 2001 | -5.9% | 55,032 | 7.5% | 62,276 | (7,244) |
| 58 | 54,500 | 26,010 | 2,725 | 2002 | -5.1% | 79,495 | 7.5% | 97,837 | (18,342) |
| 59 | 56,000 | 26,530 | 2,800 | 2003 | 5.7% | 115,028 | 7.5% | 136,704 | (21,676) |
| 60 | 57,500 | 27,061 | 2,875 | 2004 | 14.0% | 165,259 | 12.0% | 186,637 | (21,378) |

*Even if the other one-half of employer contributions received by the system is used to "subsidize" the guaranteed rate of return, OPERS would still experience a loss in this example.