Annuitization of DROP balances in accordance with HB 3158

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DALLAS
POLICE & FIRE
PENSION SYSTEM

HB 3158 Requirement

- The bill requires that all DROP accounts be annuitized over the account holder's remaining expected life at a rate based upon a Treasury rate or other federal rate.
- The bill specifically tasks the Board with making the rules regarding this annuitization process.
- The bill provides that the annuity for current DROP members should start "as promptly as administratively feasible..." (6.14(e)).

Considerations

The following are specific issues the Board needs to address in order for staff to finalize a DROP Policy.

1. Monthly/Annual Election
2. Interest Rate
3. Interest for the period from September 1 to Annuitization Commencement
4. Mortality Table
5. Payments to Beneficiaries and Alternate Payees
6. Revised Annuity Upon Hardship Payment
7. De minimis Payment

Monthly/Annual Election

- The bill requires giving DROP holders the option of receiving their DROP annuity monthly or annually. Staff is recommending that the initial default election be monthly for the first payment but that notice be given that DROP holders may change that election to annual within 60 days of the date of the first payment.

- As there is no tax benefit in taking the annuity annually versus monthly and because staff believes that most DROP holders will want and elect monthly annuities, staff believes the monthly annuity default election is appropriate.

- Payments are made at the end period selected.

Interest Rate

- The bill requires the interest rate used for the annuitization be "…a rate as reasonably equivalent as practicable to the interest rate on a note issued by the Unites States Department of the Treasury or other federal treasury note with a duration that is reasonably comparable to the annuitization period applied to the account, as determined by the board." (6.14(e-2).

- Staff is recommending the interest rate be based upon the United State Department of Commerce Daily Treasury Yield Curve Rates. These relevant rates are available for 5,7,10,20 and 30 year US Treasury securities. All other years between 5 and 30 years would be calculated using a "straight-line interpolation" of these data points.

Interest Rate - continued

- For a life expectancy that occurs between the years for which rates are established, the rates are linearly interpolated.

- For example, if the 10-year rate is 2.20% and the 20-year rate is 2.60%. There is a difference of 40 basis points over the 10-year period, therefore with each year the rate increases by 4 basis points, i.e., 2.20%, 2.24%, 2.28%, etc.

Interest Rate - continued

- Rates would be set the first business day of each quarter (January, April, July and October) and would be based upon the average of the rates on the 15th day of the preceding three months (or the next day rates are published if the 15th day of any month is a date when rates are not published). The average rate is rounded to two decimals.

Published Rate	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
7/17/2017	1.86	2.12	2.31	2.65	2.89
8/15/2017	1.83	2.09	2.27	2.60	2.84
9/15/2017	1.81	2.04	2.20	2.52	2.77
Average	1.83	2.08	2.26	2.59	2.83

Interest Rate - continued

- US Treasury securities do not have maturities beyond 30 years therefore there are no US Treasury rates past 30 years. Segal and staff are recommending that the 30-year rate be used as the rate in annuitizing any DROP member's balance with a life expectancy of 30 years or longer.

Interest Rate - continued

- In determining the monthly annuity payment, the interest rate that is used is the annual interest rate divided by 12.

- The number of months of the annuity term are determined by multiplying the number of years of life expectancy, rounded to the nearest whole number, by 12.

- Interest on the DROP balance as of 9-1-17 is calculated for the period beginning on the last day of the month the member leaves active service and ends based on the applicable mortality table.

Interest for the period of 9/1/17 to Annuitization Commencement

- The bill provides that the annuity for current DROP members should start "as promptly as administratively feasible..." (6.14(e)).
- The bill also provides that the annuitization of a DROP account "…must reflect the accrual of interest on the amount in the DROP account as of September 1, 2017, over the annuitization period applied to the account under this section (6.14(e-2))."
- It is not clear from the bill if DROP accounts should be bear interest between September 1, 2017 and the date the DROP annuitization commences. Therefore, the Board has the right and duty to interpret the Plan and make a determination.

Interest for the period of 9/1/17 to Annuitization Commencement

- Staff is recommending that all DROP balances, except those of any member on Active Service, bear interest from September 1 to the date the DROP annuitization commences, taking into account their retirement date and any distributions out of DROP during such period. The interest credited would be at the interest rates used for the initial annuitization of these DROP balances.

Mortality Table

- Segal's Recommendation: The mortality table used is the same as the healthy annuitant tables as those used in the 1-1-2017 actuarial valuation, with the exception that for DROP Annuitization and the Joint & Survivor calculation the table is blended 85% male and 15% female.

- The table used in the annuitization is based on the RP-2014 Blue Collar Healthy Annuitant Mortality table, set forward two years for females, and projected generationally using Scale MP-2015.

Mortality Table - continued

- Staff is further recommending that the mortality table be reviewed upon the earlier of (i) the occurrence of any actuarial experience study or (ii) any change in mortality assumptions used in the annual actuarial valuation.

- For purposes of the annuitization, fractional ages which are equal to or greater than 0.5 years will be rounded up, fractional ages less than 0.5 years will be rounded down.

Payments to Beneficiaries and Alternate Payees

- If a holder of a DROP annuity should die prior to the end of the annuitization period, staff is recommending that the holder's designated beneficiary(ies) will continue to receive the same annuity for the period that remained for the deceased DROP annuitant.
- For spouses who through a divorce receive a portion of a DROP annuity that has commenced, staff is recommending that the annuity will be split as provided in the Qualified Domestic Relations Order.
- For spouses who through a divorce receive a portion of a DROP account while the member is still in Active Service, staff is recommending that the DROP annuity for the alternate payee (non-member spouse) not commence until the earlier of (i) the date the member's DROP annuity commences or (ii) the date the alternate payee reaches age 58. The annuity will be based the age of the alternate payee.

Revised Annuity Upon Hardship Payment

- Staff is recommending that upon any DROP hardship payment, the annuity of the DROP holder receiving the payment will be revised.

- The new annuity will be based upon the present value of the remaining annuity at the date of the hardship payment.

- The remaining term for such annuity will be used in calculating the revised annuity payment. The original interest rate will be used in calculating the revised annuity payment.

De minimis Payment

- Section 6.14(f)(2) allows the Board to adopt rules and policies regarding the annuitization of DROP accounts which are "…in the best interest of the pension system."

- Because of the administrative requirements that small amounts will create in the future when the DROP annuitants either pass away or beneficiaries are not able to be located, staff is recommending that accounts less than a certain dollar threshold be paid in total to DROP account holders.

- The de minimis payment will only apply at the time of the initial annuitization and not subsequent annuity revisions or beneficiary events, however this can be revisited by the Board at a later date.

De minimis Payment

- The chart below contains information about smaller retiree, beneficiary and alternate payee DROP balances:

Balances less than or equal to:	# of Accounts	% of Accounts	Total Dollars
$5,000	87	4.2%	$163,276
$10,000	136	6.5%	$521,236
$20,000	218	10.5%	$1,716,233
$30,000	285	13.7%	$3,379,174
$50,000	386	18.5%	$7,372,492

- Staff's recommendation is that the Board set the de minimis amount at $20,000. This amount will eliminate more than 10% of the accounts from being annuitized and managed for potentially 20 to 30 years. The dollar impact to the fund is approximately $1.7 million lump sum payment.

Next Steps

- Staff will develop a DROP Policy based on the direction received from the Board.

- If the policy is approved on November 1st at the Special Board meeting, the goal would be to stop the payments of the Minimum Annual Distribution as of October 31st and commence the annuitization payments on November 30th.

- If the policy is approved at the November Regular Board meeting, the goal would be to stop the payments of the Minimum Annual Distribution as of November 30th and commence the annuitization payments on December 29th.