

MEMORANDUM

To: House Financial Institutions and Pensions Committee

From: Alan D. Conroy, Executive Director

Date: February 20, 2023

Subject: HB 2196; Deferred Retirement Option Program Expansion

A Deferred Retirement Option Program (DROP) is a plan design feature where a member initiates the calculation of a retirement benefit but opts to defer actual receipt of the benefit for a specified period. During this specified DROP period, the member continues working and the member's benefit is credited to a notional account and made available in a lump sum when the member ultimately leaves employment.

The 2015 Legislature created a pilot Deferred Retirement Option Program (DROP) for KP&F members at the request of the Superintendent of the Kansas Highway Patrol. The policy goal was to aid in retention of staff at the Highway Patrol due to recruitment issues the agency was experiencing. The initial pilot period ran through January 1, 2020, and only the Highway Patrol was included in the pilot group.

In 2019 the Legislature extended the pilot period to January 1, 2025 and added KP&F members at the Kansas Bureau of Investigation to the pilot group.

Current Law

The pilot employers for the DROP include the Kansas Highway Patrol and Kansas Bureau of Investigation. The DROP includes the following plan design features:

- With their employer's approval, members may enter the DROP at normal retirement age.
 - Age 50 with 25 years of service
 - Age 55 with 20 years of service
 - Age 50 with 15 years of service
- Members must select a period of 3-5 years to continue working, during which time their benefit is deposited into a DROP account, which may be credited interest when certain investment thresholds are met. Members can elect to extend their DROP period to a maximum of 5 years.
- Members and employer continue to make regular contributions to KPERS (7.15% for the employee and 22.86% in FY 2024 for State KP&F employers, CY 2023 for Local KP&F employers).



- At ultimate retirement, the member receives the balance of the DROP account, including any interest earned during the DROP period, as a lump sum or a rollover to another qualified account.
- Members who participate in DROP are not eligible to elect a Partial Lump Sum Option at final retirement (10%, 20%, 30%, 40%, or 50% options).
- Members who enter DROP do not earn additional service credit.

DROP Participation

Between July 1, 2015, and December 31, 2022, 67 out of about 550 KP&F members from the Kansas Highway Patrol or Kansas Bureau of Investigation elected to participate in DROP.

Initially, the participation in the DROP was slow as members learned more about the program and how they might be impacted. The amount of participation among the eligible Highway Patrol and KBI members has increased in recent years. Participation by year is summarized below.

Year	Members Electing DROP
2015	0
2016	2
2017	5
2018	6
2019	15
2020	16
2021	17
2022	6

As of 12/31/2022, 18 members have completed their DROP period or opted to leave the DROP and retire.

Potential Costs of a DROP

The individual decisions to participate in a DROP plan are largely behavioral and therefore require several assumptions to complete a cost estimate. The actuarial cost analysis looked at two different scenarios:

1. Members enter DROP when they planned to retire and work additional years.
2. Members enter DROP 3-5 years before their planned retirement date.

When members are assumed to enter the KP&F DROP at their planned retirement age and work additional years there is very little change in the expected costs for the plan. However, if members decided to enter the KP&F DROP 3-5 years before they planned to retire there is an expected increase in the plan costs, which would require an increase in annual KP&F employer contributions.

Expanding the DROP to all KP&F employers increases the potential that retirement behavior will change and impact future employer contribution rates. However, it is not possible to quantify a potential behavioral change. Because these behavioral changes cannot be quantified, an actuarial cost cannot be reliably calculated.

Administrative Costs

Expanding the DROP plan is expected to generate a significant number of questions from the 7,100 KP&F members and 106 employers who would become eligible to participate. In addition, the expansion would require changes to KPERS pension administration system to accommodate the new members.

KPERS anticipates initially hiring two positions to assist with the member and employer transition, one of which would be permanent, and one would be temporary. The total cost to KPERS in FY 2024 is estimated to be \$166,421, including \$20,000 in one-time expenditures for the pension administration system changes, \$70,943 in salary and benefits for a non-FTE temporary position and \$75,478 for 1.0 FTE permanent position.

For your information, I have attached a flyer we provide to KP&F members on DROP. I would be pleased to answer any questions the Committee has regarding the KP&F DROP.

Attachment

DROP BENEFIT

deferred retirement option program

For Eligible Kansas Highway Patrol and Kansas Bureau of Investigation

The Legislature created a program to offer a Deferred Retirement Option Program (DROP) for eligible KP&F members with the **Kansas Highway Patrol** and the **Kansas Bureau of Investigation**.

Instead of retiring, this optional benefit allows eligible members to keep working while their monthly retirement benefit accumulates in a DROP account. They receive their salary and their DROP account grows each month while they work. Members can choose to work another three, four or five years. When they retire, they receive their DROP account balance and begin receiving their monthly retirement benefit.

Steps to the DROP	Example
Member eligible for full retirement	Joe is eligible for full retirement
Member picks a DROP commitment date	Joe picks January 1, 2020
KPERS calculates retirement benefit as of the DROP commitment date	Joe's monthly benefit = \$2,580
Member picks DROP period (3, 4 or 5 years)	Joe chooses to work 3 more years
Member keeps working	Joe keeps working at his KP&F position
Deferred monthly retirement benefit amounts accumulate in a DROP account and may earn interest annually	<p>\$2,580 is added to Joe's DROP account each month</p> <p>Depending on KPERS' investment returns, he may earn interest, too</p>
Member retires at the end of the DROP period, begins receiving monthly benefit payments and receives DROP account balance in a lump-sum payment	<p>Joe retires January 2023 and begins receiving his \$2,580 monthly benefit</p> <p>He receives a lump-sum for \$92,880 plus any interest, the amount that accumulated in his DROP account over the past three years</p>

Who Can Participate?

- ✓ Kansas Highway Patrol troopers, examiners and officers who are eligible for full retirement.
- ✓ Kansas Bureau of Investigation agents who are eligible for full retirement.

What You Need to Know

- You and your employer make regular contributions during the DROP period, but you don't earn additional service credit.
- You can't choose a Partial Lump-Sum Option if you participate in the DROP.
- The election to participate in DROP is irrevocable.
- DROP amounts are subject to federal taxes when you receive them. You can continue deferring taxes by rollover to another plan.
- Your employer must agree to your participation in DROP. And participation does not guarantee continued employment.
- Program ends January 1, 2025 unless legislation is passed to extend it.

Questions?

Email: kpers@kpers.org

Toll Free: 1-888-275-5737

In Topeka: 785-296-6166

kpers.org



Common Questions

When Can I Begin DROP?

You can choose the first day of any month, as long as you are eligible for full retirement.

Submit a DROP application 30 days before the date you want to begin.

What happens if I stop working before the end of the DROP period?

If you don't participate for a minimum of three years, all interest is forfeited. You will still receive the balance in your DROP account.

What if I want to extend the number of years of the DROP period?

You can participate in the DROP program for up to five years. If you chose to participate for three or four years initially, you can extend your participation to the 5-year maximum. Contact the Retirement System for more information.

What if I want to work longer than the DROP period?

If you continue working after five years, no additional interest is credited to your DROP account and your KP&F contributions stop. You may not receive your DROP account balance and monthly retirement benefits until you retire.

How are DROP benefits taxed?

In general, Retirement System benefits are subject to federal tax, but not Kansas state tax. Benefits accumulate tax-deferred in your DROP account. The lump sum can be paid directly to you or rolled over into an eligible retirement plan at the end of the DROP period to defer taxes.

Will I be covered by active member Death and Disability benefits while I work during the DROP period?

- Disability: You will have the same disability benefits as an active KP&F member.
- Death: Your designated beneficiary will receive your accumulated DROP benefits in a lump-sum. Retirement benefits are payable based on the retirement option you selected when applying for DROP participation.

Do I need to name a separate beneficiary for my DROP account?

It is optional. If you do not name a separate beneficiary, your DROP beneficiary will automatically be the same as your retirement beneficiary.

What happens to my sick and annual leave?

- Leave Payout: If you choose a DROP option you are not eligible to receive a payout of unused leave until you fully retire or stop working after DROP.
- Final Average Salary: If you joined KP&F before July 1, 1993, you can include additional compensation such as unused sick and annual leave in your FAS calculation, but not until you fully retire. After your DROP period ends, your FAS is recalculated. If higher, your DROP payments will be adjusted retroactively, with a lump sum credited to your DROP account. There is no interest paid on the lump sum. Your benefit is recalculated with the higher FAS.

What if I change employers during the DROP period?

DROP is only available to KHP and KBI. If you change employers, your DROP is cancelled.

How much interest will my DROP savings earn?

Your DROP account will be credited 3% annual interest in years when the Retirement System's 1-year investment return is 7% or higher. You won't earn interest if investment returns are below 7% for the year.

Is the DROP right for me?

Deciding whether to participate in DROP is an important decision. To help in your decision, you should request estimates from the Retirement System to help you compare the two scenarios:

- ✓ The benefits you would receive under DROP without earning additional service credit.
- ✓ The benefits you would receive if you continued working and earning service credit for the same time period, then retired without participating in DROP.

Retiring With Full Benefits

KP&F Tier I

- Age 55 w/20 years
- Any age w/32 years

KP&F Tier II

- Age 50 w/25 years
- Age 55 w/20 years
- Age 60 w/15 years

Online Account Access

Sign up to manage your retirement online with your KPERS member account.

You will be able to track your DROP balance through your account.

kpers.org