



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

MEMORANDUM

**DATE:** November 12, 2020  
**TO:** Business and Governance Committee  
**FROM:** Ted LaSalvia, Controller  
**SUBJECT:** Staff's Recommendation to Approve the 2021 DROP Interest Crediting and DROP Annuity Factor Rates and to Revise Board Rules 6.10 and 6.40

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**Recommendation**

Approve the 2021 DROP account interest crediting rate of 1.0% and the DROP annuity factor of 2.1%, effective January 1, 2021, and revise Board Rules 6.10 and 6.40 accordingly.

**Background**

Board Rules 6.10 and 6.40 provide guidance on the annual calculation of the DROP account interest rate and the DROP annuity factor.

DROP Interest Crediting Rate

The DROP interest crediting rate is calculated as a weighted composite of a 12-month average ending September 30<sup>th</sup> of the current year of:

- 75% of the five-year US Treasury Rate
- 25% of the five-year high quality corporate (HQC) Bond Rate

The DROP interest account crediting rate was 2.5% for calendar year 2020. The recommendation is to decrease the rate to 1.0% effective January 1, 2021.

DROP Annuity Factor

The DROP annuity factor is calculated as a weighted composite of a 12-month average ending September 30<sup>th</sup> of the current year of:

- 40% of the 20-year US Treasury Rate
- 20% of the 20-year HQC Bond Rate
- 40% of the 20-year Pension Benefit Guaranty Corporation (PBGC) Immediate Annuity rate

The DROP annuity factor was 3.1% in calendar year 2020, the recommendation is to decrease the rate to 2.1% effective with retirements on or after January 1, 2021.

Adopted January 12, 2018; amended May 11, 2018 and November 8, 2019.

## **Division 6 - Deferred Retirement Option Plan**

### **Rule 6.00 Crediting Quarterly Interest to DROP Accounts**

Interest shall be credited to DROP participants' accounts and compounded quarterly based on the average daily balance of the DROP account. Interest shall be credited at the end of each quarter effective on September 30th, December 31st, March 31st, and June 30th.

Formerly Rule 12.10, renumbered and amended April 17, 2009; amended November 14, 2014; reviewed May 8, 2015; and reviewed and amended November 9, 2018.

### **Rule 6.10 Amount of Interest Credited to DROP Accounts**

- a. Pursuant to San Diego Municipal Code (“Municipal Code”) section 24.1404(c)(5) and section 1203(c)(5) of the Port and Airport Plans, the amount of interest credited to DROP accounts is determined by the Board.
- b. The Board has adopted the following rates for crediting interest to DROP accounts, SDCERS shall continue to use the most recent interest rate specified below until the Board sets a different rate:

<b>Effective Date</b>	<b>DROP Interest Crediting Rate</b>
January 1, 2020	2.50%
January 1, 2019	2.70%
January 1, 2018	2.00%
January 1, 2017	1.50%
January 1, 2016	1.70%
January 1, 2015	1.80%
January 1, 2013	1.20%
January 1, 2012	1.90%
January 1, 2011	2.30%
January 1, 2010	2.90%
July 1, 2009	3.54%
January 1, 2009	7.75%
January 1, 2008 – April 1, 1997	8.00%

- c. No later than the regularly scheduled November Board meeting of each year, staff shall present updated rates to the Board based upon:
  - 1) The weighted composite of a 12-month average ending September 30th of the current year of:
    - i. 75% of the five-year US Treasury Rate, and
    - ii. 25% of the five-year HQC Bond Rate; or
  - 2) Such other rate or rates as the Board deems reasonable.
- d. Notwithstanding the above or any other Board Rules, the Board may, consistent with the relevant plan documents, change the interest rate at any time.

This Rule is incorporated into (1) Chapter 2, Article 4 of the San Diego Municipal Code, (2) the Amended and Restated San Diego Unified Port District Retirement Plan and Trust, and (3) the Amended and Restated San Diego County Regional Airport Authority Retirement Plan and Trust as part of the Plan document.

Formerly Rule 12.10(a), renumbered and amended April 17, 2009; amended January 22, 2010, January 21, 2011, January 20, 2012, January 18, 2013, September 20, 2013, May 8, 2015, November 13, 2015, November 4, 2016, November 3, 2017, and November 9, 2018.

**Rule 6.20 Payment of DROP Benefits to DROP Participants Who Exit DROP After December 31, 2005**

- a. A Member who exits DROP after December 31, 2005 must elect to receive their DROP account in one of the following benefit forms before their DROP exit date. SDCERS shall make these payments with the normal monthly or weekly payment cycle.
  - 1) Lump Sum: The Member may elect a single lump sum distribution of their entire DROP account, to be paid within 60 days of their exit date. A lump sum distribution may include a rollover to another plan, subject to IRS requirements.
  - 2) Partial Lump Sum and Annuity: The Member may elect a lump sum distribution of a portion of their DROP account with the remainder to be paid in a monthly annuity in accordance with subsection (3).
  - 3) Monthly Payments Over 240 Months or Member's Life Expectancy: The Member may make an irrevocable election to receive their DROP account in substantially equal monthly payments over 240

months or the Member's life expectancy at the time the Member exits DROP, according to the Single Life Table in Treas. Reg. 1.401(a)(9)-9, Q&A-1. This benefit form may not exceed the Member's life expectancy at DROP exit.

- b. Payments under the benefit forms described in subsections (a)(2) or (a)(3) shall be calculated using the annuity factor on the date of the Member's exit from DROP, as determined by Board Rule 6.40.
- c. If the Member chooses an annuity, the Member may at any time during the distribution period elect to end their annuity and receive the remaining principal balance in a single lump sum.
- d. All distributions made to or on behalf of a Member must comply with section 401(a)(9) of the IRC. SDCERS may distribute a Member's DROP account earlier than the Member has elected if necessary to ensure compliance with section 401(a)(9).
- e. If a Member fails to make the election required by subsection (a) of this Rule before the effective date of their exit from DROP, the Member's retirement benefit shall be suspended and not paid until the election has been made. Once the election is made, the retirement allowance shall be paid retroactively to the effective date of their exit from DROP.

Formerly Rule 12.20, renumbered and amended April 17, 2009; reviewed on May 8, 2015; and reviewed and amended November 9, 2018 and March 8, 2019.

**Rule 6.30 Payment of DROP Benefits to DROP Participants Who Exit DROP Before January 1, 2006**

- a. A Member who exits DROP before January 1, 2006 must elect, before December 1, 2005, to receive their DROP account in one of the following benefit forms. The Member must make this election regardless of whether the Member has previously taken distributions or the form of such previous distributions, except as otherwise noted herein. SDCERS shall make these payments on the normal monthly payment cycle.
  - 1) Lump Sum: The Member may elect a single lump sum distribution of their entire DROP account, to be paid at any time before April 1 of the year following the year in which the Member turns 70½ (or, age 72 for a Member who reaches 70 ½ after December 31, 2019). A lump sum distribution may include a rollover to another plan, subject to IRS requirements.
  - 2) Monthly Payments Over 240 Months: The Member may make an irrevocable election to receive their DROP account in equal monthly payments over 240 months.

- 3) Monthly Payments over Member's Life Expectancy: The Member may make an irrevocable election to receive their DROP Account in equal monthly payments of a fixed amount and duration over a period equal to the Member's life expectancy as of January 1, 2006, using the Single Life Table in Treas. Reg. 1.401(a)(9)-9, Q&A-1.
  - 4) Partial Lump Sum at Retirement plus Monthly Payments over Member's Life Expectancy: The Member may make an irrevocable election to receive, effective January 1, 2006, a partial lump sum distribution of a portion of their DROP account, with the remainder of the account paid to the Member in equal monthly payments over a period equal to the Member's life expectancy as of January 1, 2006, using the Single Life Table in Treas. Reg. 1.401(a)(9)-9, Q&A-1.
  - 5) Monthly Payments over a Fixed Period Less than Member's Life Expectancy: The Member may make an irrevocable election to receive their DROP Account in equal monthly payments over a fixed period less than the Member's life expectancy as of January 1, 2006, using the Single Life Table in Treas. Reg. 1.401(a)(9)-9, Q&A-1.
- b. Notwithstanding subsections (a)(1) through (a)(5) of this Rule, the retired Members who selected either the single life annuity or the joint and survivor annuity benefit, which were available under the Municipal Code before June, 2002, shall continue to receive payments under their chosen benefit forms.
  - c. Payments under the benefit forms described in subsections (a)(2) through (a)(5) shall be calculated using an annuity factor of 8%.
  - d. Notwithstanding any language to the contrary in subsection (a) of this Rule, if the Member chooses a benefit form described in subsection (a)(2), (a)(3), (a)(4), or (a)(5), the Member may at any time during the distribution period elect to receive the remaining principal balance in a single lump sum.
  - e. All distributions made to or on behalf of a Member must comply with the final regulations issued under section 401(a)(9) of the IRC. SDCERS may distribute a Member's DROP account earlier than the Member has elected if necessary to ensure compliance with section 401(a)(9).
  - f. A Member who did not make the election required by subsection (a) by December 1, 2005, is deemed to have elected the lump sum option set forth in subsection (a)(1).

Formerly Rule 12.21, renumbered and amended April 17, 2009; reviewed May 8,

2015; and amended November 9, 2018,  
March 8, 2019, and March 13, 2020.

**Rule 6.40 DROP Annuity Factor**

- a. The DROP program began in April 1997. The Board has adopted the following annuity factors to calculate DROP annuities under Board Rule 6.20(b). SDCERS shall continue to use the most recent annuity rate specified below until the Board sets a different rate.

<b>Effective Date</b>	<b>DROP Annuity Rate</b>
January 1, 2020	3.10%
January 1, 2019	3.00%
January 1, 2018	2.80%
January 1, 2017	2.80%
January 1, 2016	3.00%
January 1, 2015	3.60%
January 1, 2014	3.20%
January 1, 2013	3.30%
January 1, 2012	4.40%
January 1, 2011	4.80%
January 1, 2010	5.00%
July 1, 2009	5.00%
January 1, 2009	7.75%
January 1, 2008 – April 1, 1997	8.00%

- b. No later than the regularly scheduled November Board meeting of each year, staff shall present updated rates to the Board based upon:
- 1) The weighted composite of a 12-month average ending September 30th of the current year of:
    - i. 40% of the 20-year US Treasury Rate,
    - ii. 20% of the 20-year High Quality Corporate (HQC) Bond Rate, and
    - iii. 40% of the 20-year Pension Benefit Guaranty Corporation (PBGC) Immediate Annuity rate; or,

- 2) Such other rate or rates as the Board deems reasonable.
- c. Notwithstanding the above or any other Board Rules, the Board may change the annuity rate at any time.

This Rule is incorporated into (1) Chapter 2, Article 4 of the San Diego Municipal Code, (2) the Amended and Restated San Diego Unified Port District Retirement Plan and Trust, and (3) the Amended and Restated San Diego County Regional Airport Authority Retirement Plan and Trust as part of the Plan document.

Formerly Rule 12.20(a), renumbered and amended April 17, 2009; and reviewed and amended January 22, 2010, November 5, 2010, January 21, 2011, January 20, 2012, January 18, 2013, September 20, 2013, January 10, 2014, May 8, 2015, November 13, 2015, November 4, 2016, November 3, 2017, and November 9, 2018.

**Rule 6.50 Election to Extend DROP Period**

- a. If a Member in DROP is eligible to extend their five-year DROP participation period under Municipal Code section 24.1402(b)(8), the Member must file with SDCERS a written election setting forth the Member's decision to extend their DROP participation period. This written election must be filed with SDCERS at least 60 days, but not more than 90 days, before the five-year DROP period ends and must state the date through which the DROP period is extended.
- b. If the written election is not received by SDCERS as required by subsection (a), the Member's participation in DROP shall terminate on the last day of the designated five-year DROP period.

This Rule is incorporated into Chapter 2, Article 4 of the San Diego Municipal Code as part of the Plan document.

Adopted May 9, 2014; reviewed May 8, 2015; and reviewed and amended November 9, 2018.

**Rule 6.60 Member to Enter DROP at Beginning of Pay Period**

- a. A Member must enter DROP on the first day of a pay period so that the Member's DROP contribution includes the entire pay period.
- b. To avoid unintended financial consequences to a Member, this Rule may be waived at the CEO's discretion.