Retirement Options Act
Frequently Asked Questions (FAQs)

Q1. Why are the cost estimate figures associated with members' selecting Tier 1 (20 year retirement) so high? What factors were used to derive the cost estimates?

A1. To retire after completing 20 years of service, a member would need to elect to transfer into Tier 1. In addition to being able to retire five years (or more) earlier than under Tiers 2 and 3, Tier 1 also has a formula that uses the 12 highest consecutive months of pay for an average salary. Also, it has an uncapped cost-of-living adjustment (which is capped at 3% in Tier 3). A current member who elects to transfer to Tier 1 is actually "buying" participation in that tier for all of his/her years of service back to date of participation in the current Tier. Consequently, the member is not just paying for service under the new Tier from now until retirement.

The most expensive aspect of the cost is early eligibility to receive a pension benefit. Under the Plan, a member who is not yet eligible to retire has earned a benefit that is payable beginning at age 55. Transferring to Tier 1 would entitle the member not only to a higher benefit for reasons described above, but also to begin those payments much earlier than age 55. The additional payments, which include cost-of-living adjustments (COLA's) between the "new" retirement age and age 55, represent a cost to the Plan that has not been funded previously and which now must be paid.

Since the Retirement Options Act requires you to be responsible for funding all costs associated with the transfer, you are also responsible for the cost of all benefits until you reach age 55.

Q2. The EFI Actuarial Report indicates that there are several ways a member can pay for the costs associated with transferring from one retirement tier to another. As noted in the study, such options include: making a lump-sum payment, participating in a payment plan (i.e., making installments), or electing a reduced benefit. Can you further explain the aforementioned options? In addition, has it been determined what the reduced benefit rate will be and will this be a plausible option to be provided under the Act?

A2. A member who elects to transfer to a different tier can pay for that election by:

A. <u>Making a one time payment of the lump-sum amount calculated as required by that election</u>**.** As with purchases of service, the amount would need to be paid by cashier's check, certified check or money order, and would be deposited into the District (DCRB) trust.

B. Making installment payments via payroll deduction over the remaining years to retirement eligibility. The cost of transferring to another tier would be calculated as a flat dollar amount and would be in addition to the retirement contribution of 7% or 8% that the member is already contributing. Included in the additional (flat dollar) payment would be interest of 7.5%, which is the actuarial assumed earnings rate on the assets in the pension trust. This method is similar to making a mortgage payment, a portion of which is attributable to principal and a portion to interest. Also, like a mortgage payment, the fewer the number of years that payments will be made, the larger the payment amount will be.

C. Increased Contributions. This payment method would spread the cost of electing a different tier over the number of years remaining until the member retires. Under this option, it would be assumed that the member would retire as soon as eligible under the chosen tier. These amounts, although the same percentage of pay, would change with changes of pay, and the percentage would need to be adjusted annually to account for changes in the contribution required by the District.

D. Assuming a reduction in retirement benefits. This payment method would permit the member to pay for the new tier by taking a reduced benefit at the point of retirement. The magnitude of the reduction would depend upon the number of years the member retires prior to age 55, and is the actuarial equivalent at 20 years that the retiring member would have been able to receive at age 55. The reduction is typically between 40% and 75%, for retirees between ages 40 and 50. The reduction is less severe the closer the retiree is to age 55. This concept is similar to that used for Social Security benefits where an eligible person chooses to receive his benefit at age 62 rather than at normal retirement age (age 65 to 67). In that system, the early receipt of the benefit serves to reduce the benefit amount to 80% of what it might otherwise have been 3 to 5 years later.

Q3. Considering that members participating in Tier 1 and Tier 2 pay a pre-determined 7% of their salary into the retirement plan, why is it a requirement that a member must "make up the difference" in the District contribution in order to switch from Tier 2 to Tier 1?

A3. The reason that members who choose to transfer to another tier must pay the "difference" is that the MPD Retirement Options Act of 2008 (the "Act") requires that members pay all administrative and program (benefit) costs that result from the change. Since there has been no change in the percentage that members pay toward their retirement benefit, the only difference is in the District's contribution, which is about 80% of the total cost of the benefit.

Q4. How was EFI Actuaries selected to conduct the actuarial study and was any secondary actuarial study conducted by another vendor for a comparison of the findings derived? What factors, if any, were utilized to assure that the figures derived from the actuarial study produced by EFI are indeed accurate?

A4. As a result of a competitive bidding process, EFI Actuaries was selected as the Plan's actuary in 2003. EFI was the first national actuarial firm to dedicate its business exclusively to public sector retirement systems. They have offices in six major U.S. cities.

EFI is very familiar with the provisions of the Plan and they have a data base that includes information related to all plan participants. Consequently, when financial impact studies such as this need to be performed, the interested parties usually select the Plan's actuary to complete the study. This is the same process that is used by other retirement systems.

Since the calculations completed for a financial impact study use not only the actual data related to participants, but also the actuarial assumptions that have been selected by the Board for valuing the assets in the Trust, any actuary selected to do such a study would have to use the same data and assumptions. Therefore, calculations performed by any other actuary should result in similar answers and conclusions.

Q5. Can prior years of service with DC Government be calculated toward the total years of service with the MPD? If so, in what ways will this impact the estimated payment costs of a member electing to transition into Tier 1 (20-year retirement)?

A5. The eligibility rules under the Plan have not changed. Upon transferring from one Tier to another, all police service you have completed up to the point of transfer is used toward eligibility to retire. (Civilian service is not used to determine eligibility to retire, even if you complete a purchase of service). For Tier 1, a member must have 20 years of police service to be eligible to retire. For Tier 2, a member must have 25 years of service and be at least 50 years old to be eligible to retire. For Tier 3, a member must have 25 years of service to be eligible to retire. For example, if you have 18 years of police service and you want to transfer from Tier 2 to Tier 1, in order to retire at 20 years you cannot use a purchase of service to fulfill the two years needed to retire. In this case, you would need to work two additional years of departmental service.

Q6. Will members electing to transfer into Tier 1 (20-year retirement) still be eligible for longevity payments?

A6. The concept of longevity pay has not been changed by the Act. It applies to the completion of 25 years of creditable service. Consequently, any member who has fewer than 25 years of creditable service, no matter what tier they are in, will not be eligible for longevity pay.

Q7. If a member elects to receive a reduced benefit as part of participating in Tier 1 (20-year retirement), will there be any costs associated with this? If so, how can this be, considering the member is taking a reduced benefit?

A7. As stated in the question, the benefit reduction is the payment for the transfer to the new Tier, consequently, there is no additional cost for the transfer. The only other cost may be an administrative cost to determine the amount of the reduction.

Q8. What is the projected percentage amount that a new member coming into the Department and electing Tier 1 will have to pay? How was this percentage derived?

A8. Currently, all newly hired officers participate in the Plan under Tier 3, which requires an employee contribution of 8% of pay. Using the existing actuarial assumptions and the earnings the Plan assets have achieved over the past few years, the District's contributions to the Plan have been between 28% and 38% of pay. Under these same circumstances, should a newly hired member elect to participate in Tier 1 rather than Tier 3, his/her contributions would be around 27% rather than the 8% required for Tier 3. It should also be noted that any change in actuarial assumptions or earnings on Plan assets (which is going to be the case in the near term, given current market conditions) would affect the expected District contribution amount, and changes in the District contribution percentages could change from year-to-year.

Q9. Can you explain the process that existing members who participate in Tiers 2 and 3 would need to follow to get their calculation of what it will cost them to switch into Tier 1? Also, is there a cost associated with receiving a calculation and, if so, why?

A9. First, there is a cost associated with the calculations because the Act requires that administrative costs be paid by members who choose to change tiers. EFI has indicated that estimates will cost approximately $300 per request. Since there is a cost, MPD provided data (generic salary, service and ages) to DCRB and EFI calculated amounts for a number of different scenarios that should be close to those of many members who may be considering changing tiers. These sample calculations should be a good benchmark in allowing members to determine the probable cost of changing tiers. If, using those sample calculations, a member finds that the cost of changing tiers is more than they want to pay, they will avoid having to pay for a calculation specific to their situation. However, if there isn't a sample calculation either like or close to the member's situation, then the member will need to ask for a calculation that uses his/her own data. There will be a form available to members for requesting a personal calculation and a process in place to accommodate such requests.

Q10. What is the benefit multiplier for a member electing to participate in Tier 1?

A10. The multiplier for Tier 1 is: 2.5% for the first 20 years of Department service, 3.0% for Department service after 20 years, and 2.5% for non-Department service.

Q11. What is the average period for final pay for a member who participates under Tier 1?

A11. Average salary under the Tier 1 formula is the highest 12 consecutive months of base pay.

Q12. What are the provisions for the retiree COLA for a member who participates under Tier 1?

A12. Members who participate in and retire under Tier 1 receive cost-of-living adjustments (COLAs) that are based on the Consumer Price Index (CPI) applicable to the previous calendar year (which is usually announced in October of each year). Although Tier 2 retirees receive the same COLA as Tier 1, members who participate in and retire under Tier 3 are capped at 3%.

Q13. What retirement tier will a new hire be placed into?

A13. Just as now, new hires would begin their participation in the Plan in Tier 3.

Q14. Can a member go from Retirement Tier 2 to Retirement Tier 3? If so, are there any costs associated with this change?

A14. A member can choose to transfer from Tier 2 to Tier 3. Whether there is a cost depends upon the individual situation. Where such a change would result in a member being able to retire earlier than in the current tier (e.g., earlier than age 50), there would be a cost.