

This document was prepared by the West Virginia Municipal Pension Oversight Board for Municipalities that have approved a Deferred Retirement Option Plan (DROP) benefit. This document provides guidance that municipalities should consider when administering a DROP. Some of these considerations are mandated by the WV Code and others are necessary to adequately maintain DROP accounts and to pay out DROP participants upon their actual retirement.

According to WV Code §8-22-25a(a), a DROP is a method to encourage retention of a worker beyond normal retirement age by permitting the worker to freeze retirement benefits at a certain time prior to ceasing work, to continue to work for a specified period, and to have retirement benefits which accrue while the employee continues working set aside in an account which the worker will then receive in a lump sum upon finally discontinuing work.

This lump sum, also referred to as an accumulation account or DROP Account Balance, **must be allocated and tracked within a separate accumulation account** under the pension and relief fund in accordance with WV Code §8-22-25a(d)(2). There are three components which should be added to a participant's DROP Account Balance. These are described below in more detail.

1.) Benefit payments

The members' retirement benefit is calculated as of the DROP participation date (i.e., the member's monthly benefit amount is not credited with additional accruals during the DROP participation period). These amounts would be added to the DROP Account Balance on a beginning-of-the-month basis.

Upon entering the DROP, the member's retirement benefit is then eligible to receive cost-of-living adjustments (COLAs) beginning the July 1st after the second anniversary of the DROP entry date and must be granted if the respective plan is eligible to provide them. For example, if a member entered DROP on June 1, 2024, their benefit would be first increased by COLA on July 1, 2026. However, if the member entered DROP exactly on July 1, 2024, the benefit would be first increased by COLA on July 1, 2027.

2.) Employee contributions (if applicable)

Employee contributions may or may not be mandatory during the participant's DROP participant period, depending on how the respective Plan's DROP is written. It is also not mandatory for such contributions to be credited to the DROP Account Balance.

If employee contributions are required to be paid but are not credited to the DROP account, no special accounting of these contributions are required. They are just deposited into the trust for the plan.

3.) Interest (if applicable)

According to §8-22-25a(d)(2), annual interest on any DROP Account Balance must not exceed 3.5%. Note, it is not mandatory for a DROP plan to provide interest on DROP Account Balances. Please review your respective plan's DROP proposal to see if interest is credited.

If your DROP plan includes this provision, the method in which interest is credited is up to plan administrators since it is not explicitly mentioned within the WV Code. Please note, however, that the method should be applied consistently across all plan members. Illustrated below are examples of two different options for the interest calculation:

- A.) Calculate the rate of return of the DROP Account Balance (which is held in a separate accumulation account) on a monthly basis.

To calculate the interest on a monthly basis, you would divide the annual rate by 12 and multiply that rate times the account balance at the end of the month. For example, if the interest rate is 3% per year, the monthly rate will be $3\%/12 = 0.25\%$ per month. If the beginning of the month account balance is \$10,000, the interest for the month will be $\$10,000 \times .0025 = \25 .

If you are crediting the actual return on the funds in a separate account, the return cannot be more than 0.29% for the month ($3.5\%/12$). Any excess return should be moved to the main trust.

- B.) Calculate the rate of return of the DROP Account Balance (which is held in a separate accumulation account) on an annual basis.

If the interest is a fixed amount, you would multiply the beginning of year balance plus $\frac{1}{2}$ of all the monthly payments times the interest rate. For example, if the annual crediting rate is 3% per year, the beginning balance is \$50,000 and the monthly amount into the drop is \$3,000, the interest would be $\$50,000 \times 3\%$ plus $\$36,000 (\$3,000 \times 12) \times 0.5 \times 3\% = \$1,500 + \$540 = \$2,040$.

If the plan credits the actual return, the amount cannot be more than 3.5% interest using the methodology above. Any excess amount above 3.5% should be deposited into the main trust.

Please note, you should also keep a record of a participant's DROP Account Balance **without** interest. According to §8-22-25a(3), a member may voluntarily terminate DROP participation early with 60 days' advance notice. In such a case, the DROP Account Balance is paid with no interest.

Since the WV Code is not prescriptive, consideration must be given to how DROP assets are invested. Additionally, the DROP document should specify the interest rate, if any, used to grant interest on the DROP accounts. If the underlying assets are invested in risk assets (i.e. equities and other growth-oriented assets)

then the plan will have to make up any losses to the accounts as the DROP provisions generally require that the DROP accounts must be credited with actual monthly payments, employee contributions (if allocated to accounts) and stated interest. Therefore, it may be prudent to invest these accounts in less risky, or risk-free, assets.

When reporting data to the actuary for the annual actuarial studies, you need to provide the following information for each DROP participant:

- The date the employee entered DROP
- The amount of the monthly annuity going into the DROP
- The DROP account balance at the valuation date
- The interest credit for the year (or methodology)

If there are any additional questions concerning how to maintain your plan's DROP, please contact Blair Taylor (MPOB@wv.gov). The WV Code which explains DROP requirements can also be found [here](#).

This document was created in consultation between Bolton and the MPOB staff.