

# Proposed Amendments to the Denver Revised Municipal Code



# Proposed Amendments

- 1) Reduce Rate of Interest Accrual on DROP/DROP II Accounts
- 2) Clarify Application of Internal Revenue Code Section 401(a)(17)

# Reduce Rate of Interest Accrual on DROP/DROP II Accounts

## DERP's Deferred Retirement Option Program (DROP) Overview

- **DROP Programs Are A Common Component of Many Governmental Defined Benefit Pension Plans**

Under a typical DROP program, a member who is eligible for retirement retires, but does not separate from service with the employer. In lieu of receiving retirement benefits directly (and being taxed on them), benefits are credited to a DROP account the member has access to upon separation from service. From 2001 to 2003, certain DERP members were eligible to participate in DERP's DROP and DROP II programs.

- **DERP's DROP Programs Are Codified In the Denver Revised Municipal Code**

- **Members Earn Credited Interest**

- DROP I members earn interest at DERP's assumed rate of return (ARR), currently 7.25%.
- DROP II members are credited interest at the DERP's actual rate of return with a floor of 3% and a ceiling of the ARR.

- **Approximately 450 DERP Retirees Have DROP or DROP II Accounts.**

These accounts have been in existence for nearly 20 years. They collectively hold about \$120 million, and the amount of interest DERP credits to these accounts annually is nearly \$9 million which comes from the DERP trust assets used for paying all retiree benefits.



# DROP Overview, cont.

- **DERP's DROP Programs Ended In 2003**

However, there has never been a change to the rate of interest credited to DROP or DROP II accounts.

- **Governmental Plans Have Lowered the Rate of Interest**

Across the country, governmental plans have been lowering the rate of interest credited to DROP accounts to reflect the increasingly low interest rate market environment.

- **DERP's DROP Program Has a Risk-free Interest Rate of 7.25%**

Risk-free interest rates of 7.25% are virtually unheard of in 2021.

## Proposal

- Credit interest on DROP and DROP II accounts prospectively at a rate set annually by the Retirement Board, with a minimum rate of 1%, not to exceed 3%.

This will not change DROP account balances. It only changes the rate at which interest is credited to those accounts prospectively.



# Clarify Application of Internal Revenue Code Section 401(a)(17)

## Current

- **Compensation limit** – Section 401(a)(17) of the Internal Revenue Code limits the amount of compensation that can be used by a qualified defined benefit retirement plan to calculate a benefit.
- **Benefit calculation limit** - The DRMC incorporates the 401(a)(17) limit for benefit calculation purposes through DRMC Sec. 18-404(5). The limit for 2021 is \$290,000.00.
- **Contributions** – The DRMC does not clearly incorporate the 401(a)(17) limit for the purposes of determining contributions (employee and employer).

## Proposed

- Amend the definition of compensation so the 401(a)(17) limit is clearly applicable for **all** purposes.

