

FREQUENTLY ASKED QUESTIONS DEFERRED RETIREMENT OPTION PLAN (DROP)

(REVISED AUGUST 2014)

Q: What is the Deferred Retirement Option Plan (DROP)?

DROP is a program that provides employees access to a lump sum benefit in addition to their monthly retirement benefit when they terminate employment and retire. Employees who became members of the system before January 1, 2012, are eligible to participate once they have 20 years of credited service. Employees who became members of the system on or after January 1, 2012, are not eligible to participate.

Q: How does DROP work?

A member must voluntarily and irrevocably elect to enter into the program with their employer for a period of up to 60 months. During the DROP period, the member remains in the employ of the employer (a member cannot transfer to a non-PSPRS position or change employers while in DROP) as a full-time paid firefighter or full-time paid certified peace officer but no member or employer contributions are made to the system for members who have twenty (20) years of credited service prior to January 1, 2012, therefore no additional years of credited service are accrued on the member's behalf. Members who have twenty (20) years of credited service on or after January 1, 2012, must continue to contribute while in DROP. Effective August 2, 2012, these contributions, along with a possible 2% interest as provided for in 38-844.08 paragraph A.3, will be refunded to the member and included with the DROP payment.

Q: How is DROP calculated?

The member's monthly pension is calculated based upon the years of credited service and average monthly compensation at the beginning of the DROP period. This monthly pension amount is credited to a DROP participation account with interest that is at a rate equal to the assumed earnings rate of return determined by the board of trustees, currently 7.85% for Fiscal Year 2013-2014, except for a member who has less than twenty (20) years of credited service on or after January 1, 2012 and who elects to participate in DROP on or after January 1, 2012, then the amount credited monthly is the amount that represents interest at a rate equal to the average annual return of the System over the period of years established by the board of trustees. This amount cannot exceed the System's assumed investment rate of return but will be at least two percent. The rate for Fiscal Year 2013-2014 is 3.2%. At the end of the DROP period or prior to that time if the member terminates their employment, the monies in the DROP participation account will be either paid to the member in a lump-sum amount or if allowed by the Internal Revenue Service paid in a lump-sum distribution to an eligible retirement plan or individual retirement account.

Q: What if I enter DROP, but continue employment with my employer after my DROP period? Will I receive a higher pension benefit for working longer?

No. You will receive a lump sum payment of only the pension monies that were credited to you in the DROP participation account at the time of your termination of employment. You forfeit all interest earned as a penalty for not fulfilling the DROP requirement. Your pension benefit will not be adjusted. No additional credited service accrues and no employer and employee contributions are paid into the PSPRS.

Q: If I participate in the DROP, do I still earn my regular pay and benefits (seniority, vacation, pay raises, promotions, etc.) like other public safety personnel not in the DROP?

Yes. Your employment status with your employer does not change.

Q: Can my employer force me to take the DROP option?

No. DROP is strictly voluntary on the part of the employee. The employee can also select the length of DROP participation, from one to sixty months. Since this is only an alternate method of benefit accrual, an employer cannot prohibit an employee from entering the DROP.

Q: I am not currently paying into Social Security. Since I am not making pension contributions during the DROP period, will I have to have social security deducted from my regular paycheck during the DROP period?

No. If your employer has previously exempted police officers or firefighters from social security, you are still exempted as a police officer or firefighter since you are still a member of a qualified retirement plan.

Q: What is the rate of interest to be paid the member on their accrued account during the DROP period?

Per A. R. S. § 38-844.05 the interest rate is set at a rate equal to the assumed rate of return determined by the board of trustees, currently 7.85% for Fiscal Year 2013-2014, except for a member who has less than twenty years of credited service on or after January 1, 2012, and who elects to participate in DROP on or after January 1, 2012, then the amount credited monthly is the amount that represents interest at a rate equal to the average annual return of the System over the period of years established by the board of trustees. This amount cannot exceed the System's assumed investment rate of return but will be at least two percent. The rate for Fiscal Year 2013-2014 is 3.2%. The DROP amount will be calculated at the beginning of the DROP period.

Q: What are some tax implications for the individual member?

As a general rule, a lump sum distribution taken directly by the recipient before the age of 50 will result in payment of taxes on that amount at the individual's tax rate plus a 10% penalty tax. If this amount is taken directly by the recipient, the Internal Revenue Service requires us to withhold 20%

of the monies distributed that may or may not cover your tax liability. If you authorize the System to roll over your DROP proceeds directly to an IRA or other qualified retirement plan there are no immediate tax consequences. You would pay taxes on these funds only when you receive a distribution from your IRA or other qualified retirement plan. Keep in mind that tax laws can change, and they are complex. We urge you to seek the advice of a tax professional to determine what is best for you and how you will be affected.

Q: Does the pension escalator (also referred to as benefit increase or cost of living adjustment) still kick in during the DROP period?

No. The rules regarding the benefit increases will apply at the end of the DROP period. Your eligibility for an increase is determined by your status as of July 1. Please review the PS FAQs for more details on eligibility and how the benefit increase is determined.

Q: If you are killed in the line of duty during the DROP period, what is your spouse entitled to receive?

Your spouse will be entitled to receive 100% of your average monthly benefit compensation for the duration of their life, plus any accumulated DROP money. If you are not killed in the line of duty but pass away during the DROP period, your surviving spouse is entitled to receive 80% of the pension that is calculated at the beginning of the DROP period plus the accumulated DROP money.

Q: If you resign employment after the DROP period begins or after the end of the DROP period, can you become reemployed with a different employer as a police officer or firefighter and re-enter the PSPRS?

You can take a job with a different employer as a police officer or firefighter, but you cannot reenter the PSPRS. Your pension would continue to be paid to you, however, effective July 20, 2011, your new employer must start contributing an alternate contribution rate (ACR) to PSPRS on your behalf. No ACR is required for retirees hired prior to July 20, 2011 who contribute to another retirement system.

Q: I have a certified domestic relations order on file with the Board of Trustees. How does this affect my DROP account?

Any split of a member's pension based upon a certified domestic relations order will take place at the end of the DROP period when the lump-sum payment or rollover is made. Thereafter, the split as provided in the order will be applied against the member's monthly pension benefit.

Q: What about a job related disability during the DROP period?

You may apply for a job-related disability under the PSPRS during the DROP period. If you are awarded a job related disability, you must terminate employment. You may not be moved or transferred to a non-PSPRS position and continue employment with your employer. If you wish to

continue employment with your employer in a non-PSPRS position, you must follow the return to work rules outlined in A.R.S. 38-849.E-J & M. Any deviation from these rules may result in suspension of pension benefits.

Q: If I receive discipline (leave without pay) during my DROP period, are my DROP benefits reduced?

No. Disciplinary sanctions have no bearing on the amounts credited to your DROP participation account.

Q: What if I am fired (terminated) while participating in the DROP?

Your DROP period ends with your separation from employment with your employer.

Q: What if I successfully appeal my termination and I am reinstated?

If your termination is reversed and the court orders that you be reinstated, a member's participation in the deferred retirement option plan, minus any benefits previously distributed pursuant to the PSPRS statutes, shall be reinstated for the duration of the original deferred retirement option plan participation period designated by the member on the appropriate deferred retirement option plan participation form.

Q: May I access my DROP funds in an emergency?

No. There are no hardship provisions allowed.

Q: How should I go about analyzing whether I should enter into the DROP?

Generally, if you have attained your maximum salary at your position and do not anticipate any additional salary increases, you may want to consider the DROP. Remember that this is an important financial decision and is irrevocable. It cannot be changed even if your personal or family circumstances change dramatically after you begin DROP. You can run an estimate based on your contributions in your Member's Only account located on the website at www.psprs.com or you can contact your local board to request an estimate based on your salary records. Once you obtain the estimate, you will need to go to the on-line DROP Estimator and enter the monthly benefit amount along with the current DROP interest rate to estimate your DROP payout. You should consult with a financial advisor to determine if DROP would be beneficial to you.

Q: If I have 32 or more years of credited service in the system, am I still eligible for DROP?

Yes.

Q: How do I calculate my DROP lump sum amount?

You can run an estimate based on your contributions in your Member's Only account located on the website at www.psprs.com or you can contact your local board and request an estimate based on

your salary records. Once you obtain the estimate, you will need to go to the on-line DROP Estimator and enter the monthly benefit amount along with the current DROP interest rate to estimate your DROP payout.

Q: How can I access my DROP account information?

You can access your DROP account information in the Member's Only program located on the website at www.psprs.com. It may take approximately 1-3 months from the time your local retirement board submits your DROP application to PSPRS for your DROP account information to be visible in the Member's Only program.

If you have any additional questions, please contact our Retired Members Department at (602) 255-5575, or email to BenefitsGroup@psprs.com.

The information in this document is not an official version of the Arizona Revised Statutes, or applicable laws. If there are any differences or discrepancies, the official versions will prevail.