

New Choices for DROP Participants Over Age 70

During the January Board of Trustees meeting, the Board approved a new policy regarding DROP accounts that provides more flexibility for many participants. HMEPS Financial Counselor Steve Waas explains the policy change:

Q: What is the change?

A: Under the old procedure, retirees with DROP accounts could only keep their money in DROP after reaching age 70½ if they adhered to a specific withdrawal schedule. Under the new policy, retirees have more flexibility. They can keep their money in DROP, and still have access to the funds through Partial Distributions just as they could before age 70½. While participants have to agree to an automatic Required Minimum Distribution each year, they retain the ability to withdraw more.

Q: Why did the pension systems have restrictions in the first place?

A: It stems from IRS regulations. DROP is a tax deferred account, meaning generally that the dollars in DROP have never been taxed. The IRS wants to make sure that it eventually collects taxes on this money. This is why they invented the RMD. Basically, if you are retired, you must begin taking money out of DROP – and therefore pay taxes on it beginning in the year you turn 70½. You don't have to take all of it, only a portion needs to be withdrawn. The precise amount is explained in detail in IRS Publication 590.

The problem is that administering and monitoring these distributions for a large number of people is a complex process. The pension plan has not been set up to implement such a process, until now.

Q: Why the change?

A: First, many retirees have requested it. These retirees have had their DROP accounts for many years and are comfortable with how it works. They simply didn't want to make a big change. Second, we believe we've designed a system for giving these participants the flexibility they want, but without adding a costly administrative burden on the pension system.

Q: How will this work?

A: Beginning in 2011, HMEPS will automatically distribute an RMD for all retirees with DROP accounts who have an RMD

due that year. We plan to make these distributions in January. This will be based on the age and marital status information that HMEPS has on file. Ultimately, the participant is responsible for ensuring that the correct RMD is distributed each year.

Q: What about those who have RMDs due in 2010?

A: Any retiree with a DROP account, and who was born between July 1, 1939 and June 30, 1940, will have their 70½ birthday in the year 2010. This means that a 2010 distribution is required. Over the course of this year, I will be trying to contact those people to make arrangements for the 2010 RMD and subsequent distributions. To any of those people reading this, please feel free to contact me to get this process going.

Also this year, I will be trying to contact retirees who have DROP accounts and who were born between July 1, 1940 and June 30, 1941 – they will have their 70½ birthday in the year 2011. They don't need to take a distribution this year, but we want to have all the arrangements in place for next year's required distribution.

Q: What if the retiree wants to take out more than the RMD?

A: The participant will still be free to take out additional partial distributions, following the same process they did prior to reaching age 70½.

Q: Since participants can receive partial DROP distributions only once every 90 days, does this mean that a participant will have to wait 90 days after an RMD before taking another partial distribution?

A: No. The RMD will not count against the participant in terms of the 90-day restriction. In other words, the participant can request a partial distribution in addition to, or immediately after the automatic RMD, rather than waiting 90 days.

Q: Is it a good idea for participants to leave funds in DROP after age 70½?

A: This is a personal decision. I frequently meet with participants to discuss the pros and cons of various options. Anyone wanting to receive such counseling can reach me at 713-595-0140.

What Is the DROP?

The Deferred Retirement Option Plan (DROP) is an optional retirement method for HMEPS members who have reached their normal retirement eligibility (age and years of credited service) but do not want to retire. It is an alternative method of accumulating and receiving a pension benefit from HMEPS. The decision to participate in the DROP is a personal one that each member should make only after careful consideration of his or her individual financial needs and goals. For more information, call the HMEPS office at (713) 595-0100.