The Pension Trust

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Deferred Retirement Option Program (DROP) – Tier 1 Members

Many of you have heard about the Deferred Retirement Option Program, or "**DROP**" feature of the retirement Plan. The DROP is available only to Tier 1 Members of the Plan. If you are a Tier 2 or 3 member you probably want to move on to some other article at this point.

What is the DROP?

DROP is an alternative way to start taking the pension benefit you have earned – and to do so while still working. DROP is designed to be cost-neutral to the retirement system.

How does DROP work?

When you sign up for the DROP -

- Your pension benefit is set as of the start of DROP with your Final Average Salary, Pension Trust Service Credits and Retirement Factor based on your age at that time. You also select the optional form of a survivor benefit to your pension at that time (e.g., 50% or 100% survivor continuance if you pre-decease your spouse).
- You make an irrevocable commitment to stop working in 5 years or less. You can always stop working earlier, so most DROP participants pick 5 years to start.
- Your pension benefit is paid each month into a separate DROP account much like the Deferred Compensation Plan – you choose the investment funds, and you bear the investment risk. You cannot access these funds while you are still in the DROP and working. It is a tax-deferred account.
- You do not accrue any additional pension benefits while in DROP. Your pension amount is "frozen as of that date. Although annual pension COLAs apply to the benefit just like a regular pension. This means that future pay increases while you are in DROP help your take-home pay, but they do not increase your pension.
- Pension contributions cease at the start of DROP. This saves you and your employer substantial amounts of money. Perhaps you can use the extra take-home pay to increase your Deferred Compensation Plan amounts? The DROP payments do not count against your DC Plan maximum amounts under IRS rules.
- When you "Exit DROP" and really retire, your pension benefit starts to be paid directly to you just like a regular retirement. Your DROP account – held by Nationwide, just like the DC Plan – must be taken out in a lump sum or regular payments over no more than 10 years. You can rollover your DROP account to an IRA or to your DC Plan account or you can take it as cash.

The DROP funds are taxable when you take them out as cash or later on when you take them out of your rollover IRA.

Who does DROP makes sense for?

DROP was designed for Tier 1 Members who have many years of service and are nearing the maximum pension benefit cap under their bargaining unit's pension formula (e.g., maximum pension amount of 80% of final pay for SLOCEA units while other units have higher maximum amounts). It allows them to continue to work without paying pension contributions for a benefit that is already at its maximum.

DROP is sometimes used when a participant thinks their pension amount is not at its maximum, "but it's big enough". In these cases, the DROP participant wants to accumulate an extra lump sum of money for when they do retire – perhaps to pay off their mortgage or some other planned need for cash.

What are the downsides of DROP?

Entering DROP freezes your pension benefit (apart from retiree COLAs) so you stop earning a larger pension. DROP also requires an irrevocable commitment to quit in 5 years or less – even if you change your mind.

Often we get inquiries from Tier 1 Members who "heard from someone that DROP is a really great deal and they shouldn't miss it". However, they may not realize that the person who thinks DROP is great has 30 years of service and is near their max pension. A Tier 1 member nearing retirement with less than 20-30 years of service may be better off letting their pension continue to grow until they retire.

The SLOCPT counselors would be glad to run estimates for you of your pension paid now into a DROP account, vs. your pension paid with a few more years of growth to it.

Is the DROP "double-dipping"?

No. Often the DROP is viewed as getting your pension AND getting your pay – which is double-dipping. In the DROP you don't actually receive your pension amount – it goes into an account only accessible to you after full retirement. And your pension is frozen - so it does not grow. In the meantime, your employer gets the benefit of your experience and service for up to 5 years at a cost saving since pension contributions have ceased.

Please call the Pension Trust at 805/781-5465 to discuss DROP.