# Deferred Retirement Option Program (DROP)

## Participant Explanation

A Deferred Retirement Option Program (DROP) is a payment option that employers may adopt for the MERS Defined Benefit Plan. If your employer has adopted the DROP provision, and you are eligible to retire, but aren't quite ready to leave the workforce, this option may be for you. The DROP payment option allows you to continue working past your retirement eligibility date for a set, limited period of time (up to five years) while your monthly pension benefit is accumulated in an account during that period. When you do leave employment, the DROP account balance is available for withdrawal or transfer and you will begin to receive your monthly pension benefit.

## How Does a DROP Work?

If you are eligible to retire, without a reduced benefit, you may elect to enter into a DROP. Entering into a DROP is an irrevocable decision, so it's important that you understand how it works.

- Your pension benefit will be calculated using the benefit formula:

| Final Average Compensation | X | Service Credit | X | Benefit Multiplier | = | $ Annual Benefit |
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- Your years of service and final average compensation (FAC) will be finalized at the time you **enter** the DROP and will not be adjusted as you continue to work.
- You will need to elect your payment option (e.g. Straight Life, 100% to Survivor, etc.)
- Based on your employer's elected provision, a percentage of your benefit (between 10% -100%) will begin to be deposited into your DROP account.
- The DROP will last for a set period, which can be 6-60 months. The DROP period will begin on the first day of the month you elect the DROP.
- Depending on the structure elected by your employer, the following may or may not apply:
    - An interest rate of 0% or 3% may be applied to the account balance on December 31 of each year.
    - An annual cost of living adjustment (COLA) may be applied to the monthly amount deposited into the DROP.
- At the end of your elected DROP period, you must terminate your employment.
- The balance of the DROP account will be paid to you as a lump sum or rolled over into a retirement account, and you will begin collecting your full monthly pension benefit according to your elected payment option beginning the month following your retirement.

**Employee Benefit Example:** Bob has worked for 20 years and is eligible to retire, but isn't quite ready to stop working yet. He decides to participate in the DROP offered by his employer and makes the irrevocable decision to elect a DROP period of five years. At that time, his FAC is determined to be $60,000, he has 20 years of service credit and his retirement has a benefit multiplier of 2.0%. Bob elects the straight life payment option, and his retirement benefit is calculated as follows:

| FAC $60,000 | X | Service Credit 20 years | X | Benefit Multiplier 2.0% | = | Annual Benefit **$24,000** ($2,000/mo) |
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The DROP adopted by Bob's employer credits 100% of the pension benefit to the DROP account and a 3% interest rate. The division does not have a COLA. Under the terms of this DROP, Bob continues to work for his employer for five more years, but does not earn any additional service credit. Every month during the five years, his monthly pension benefit of $2,000* will be deposited into a DROP account, to which 3.0% interest will be applied annually. At the end of the five-year DROP period, Bob must retire. His DROP account has a balance of $131,241.84, which is available to him immediately. Bob will receive his first monthly pension check the month following his termination of employment.

** The monthly benefit amount is based on the retirement payment option selected when entering the DROP period, the interest rate and benefit percentage are adopted by the employer.*

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## FAQs

### Will I continue to earn service credit during the DROP period?
Service credit will not accrue during the DROP period (cannot be used for MERS to MERS eligibility).

### Will I still have to make contributions to my retirement plan?
Employee contributions to your retirement plan will continue to be withheld throughout the DROP and will be applied to funding your monthly retirement benefit. (i.e. contributions are not deposited into your DROP account).

### What happens if I leave employment before the end of the DROP period?
If you choose to terminate employment before the end of the DROP period, a 20% penalty will be applied, leaving 80% of the DROP account balance to be paid out immediately. If employment is terminated by your employer, no penalty will be applied and the DROP account balance will be paid out immediately.

### How will the account balance be paid to me at the end of the DROP period?
At the end of the DROP period, you will have 60 days to request either a lump sum payment of the account balance or transfer the balance to a qualifying retirement plan. In the absence of other payment instructions, MERS will issue the full lump sum into a MERS IRA in your name.

### How will my lump sum amount be taxed?
If all or a portion of the lump sum is **rolled over** to another qualified retirement plan or traditional IRA:

- No income taxes will be withheld from the amount that is rolled over; and
- MERS will issue an IRS Form 1099-R showing the amount of the distribution was a rollover (code G).

If all or a portion of the lump sum is **paid directly to you**:

- A minimum 20% federal income tax withholding will automatically apply to the amount paid to you; and
- MERS will issue an IRS Form 1099-R showing the amount paid to you with appropriate distribution code:
  - o Age 59½ or older = “normal distribution” (code 7)
  - o Age 55 or older, but not yet 59½ = “early distribution, exception applies” (code 2)
  - o Below age 55 = “early distribution, no known exceptions” (code 1).
    *Note: Receiving a distribution with this code could result in a 10% early withdrawal penalty. Individuals who think they qualify for an exception to the 10% early withdrawal penalty that MERS is not aware of may claim the exception when filing their tax return.*

### What happens if I become disabled and cannot work until the end of the DROP period?
If you become disabled during the DROP period and are approved for a disability retirement, you will receive the full DROP account balance and begin receiving your previously calculated monthly retirement benefit.

### What happens if I die before the end of the DROP period?
If you die before the end of the DROP period:

- Your DROP **account balance** will be paid to the DROP account beneficiary. (In the event your DROP account beneficiary predeceases you, you can name another beneficiary.)
- Your **monthly retirement benefit** will be paid to your beneficiary(ies) (if applicable) according to the payment option you elected at the beginning of the DROP period.

### What if I still want to work after the DROP period ends?
If you wish to continue working, you will be subject to the retire/rehire rules, including the requirement for a bona fide termination (no formal or informal prearranged return to work) and 60-day separation from employment.

### If my employer offers an annuity withdrawal program (AWP) and the DROP, may I apply for retirement using both provisions?
No, individuals who participate in plans that offer both provisions may only choose one of those provisions when applying for retirement.