

## **DRS Advisory Committee**

### **Deferred Compensation Program Briefing**

April 26, 2013

**Issue:** Can DRS retirees become members of the Washington State Deferred Compensation Program (DCP)?

**Answer:** No. Under federal law, only current governmental employees may establish membership in a plan like DCP, which is qualified under Title 26 USC section 457.

**Analysis:** Federal law has established various retirement and salary deferral plans. Some are for private employees, some for governmental employees, some for both, and some are not employment based. A 457 plan, such as DCP, is established in law as follows:

“Eligible deferred compensation plan” means a plan established and maintained by an eligible employer (a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State) in which only individuals who perform service for the employer may be participants.

Retirees, even retirees from qualifying governmental employers, do not perform service for the employer, and have been ruled as ineligible for *becoming* a participant in a plan. A retiree who was a participant while working can maintain contributions in the plan, can roll over funds from another qualified plan, but cannot contribute to the plan from pension payments or other sources of income.

To change this would require changes to section 457 of federal law. More importantly, this would require a significant change or expansion of federal policy behind the establishment of these plans. A 457 plan offers tax-deferred benefits to employees during their working career, but distributions will be taxed when taken after leaving employment. Law currently requires withdrawal prior to age 70 ½. The design of this and other retirement plans encourages distributions as participants age. Allowing retirees to continue to defer the taxes on these plan payments is contrary to that policy.

What may be an effective way to allow retirees access to DCP? One answer could be to ensure all public employers offer DCP to their employees. That way, prior to leaving employment, retirees could establish an account in the plan, and use DCP to manage their funds from other sources during their retirement years. All public employers in Washington State are eligible to offer this plan, but many local governmental employers do not. Many offer other 457 plans administered by industry vendors, such as ICMA-RC.

If the desire is to allow retirees access to low-fee, high-value funds professionally managed by the State Investment Board, are there other types of plans that could be created to meet that need?

The Economic Opportunity Institute has proposed legislation in the past that would create a publicly operated retirement plan for private employees. The State of California has passed laws creating such a plan, but they are still designing it and must get IRS approval. While these plans seem to target employees of private employers who don't offer viable retirement programs, such as 401Ks, it may be possible to allow participation by non-employees.