

# Insight



A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

## IRS LIMITS FOR THE 2013 PLAN YEAR

To help you better prepare for the upcoming year, below is a summary of the 2013 salary deferral contributions you can make to your State of Illinois Deferred Compensation Plan (457 Plan):

- The IRS annual salary deferral dollar limit for before-tax contributions is \$17,500.
- For participants who will be age 50 and older, the age 50 catch-up provision allows you to defer up to \$23,000 in before-tax contributions. (This includes the \$17,500 maximum before-tax contribution allowed by the IRS plus an additional \$5,500.)
- The 457 special catch-up provision is \$35,000. (This provision can only be elected during the three years (consecutive) prior to, but not including, the year the participant attains normal retirement age, as defined by the 457 Plan.)

1099-Rs for 2012 distributions will be mailed by January 31, 2013.

## REQUIRED MINIMUM DISTRIBUTIONS

If you turn age 70½ in 2013 and have left state service, you must receive your 2013 required minimum distribution (RMD) by April 1, 2014. To calculate your RMD, divide your account balance as of December 31, 2012, by 27.4 if you turn age 70 or 26.5 if you turn age 71 in 2013. This is the minimum amount that you must withdraw from your account.

Each year thereafter (including 2014), you must receive your RMD for that year by December 31.

## PLAN LOANS NOW AVAILABLE

In an effort to make the 457 Plan in line with industry best practice and to provide participants in the 457 Plan with additional access to their retirement savings, effective January 2, 2013, ISBI has approved allowing employees with a balance in the 457 Plan to take a loan from their accounts. This service will be available after January 2, 2013, on the website at [rps.troweprice.com](http://rps.troweprice.com) or through a T. Rowe Price representative. Only one loan from any state-run retirement plan is permitted at a time, and employees will be asked to self-certify that they have no other outstanding loans prior to initiating a loan from the 457 Plan. (Participants will also be



## INVESTMENT CHANGES IN EFFECT JANUARY 2, 2013

These enhancements will result in lower fees for the State of Illinois Deferred Compensation Plan.

### *Three common trust funds have been added to the investment option lineup:*

- Northern Trust Collective S&P 400 Index Fund
- Northern Trust Collective Russell 2000 Index Fund
- Northern Trust Collective MSCI ACWI ex-US Index Fund

### *Three existing investment options have changed their investment structure from mutual fund to separate account and one investment option is changing its share class:*

- Ariel Fund (separate account) 0.57%
- LSV Value Equity Fund (separate account) 0.30%
- Northern Small Cap Value Fund (separate account) 0.60%
- Vanguard Total Bond Market Index Fund (VBMPX) 0.05%

These changes present a great opportunity for you to review your portfolio and confirm that your account is properly allocated and diversified. Having an appropriate mix of stocks, bonds, and short-term investments in your portfolio can help balance your investment goals against investment risks. Please take a careful look at your investment elections and balances to determine if you need to make any changes. For instant access to investment information and interactive financial planning tools, visit the website at [rps.troweprice.com](http://rps.troweprice.com).

Call 1-888-457-5770 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

asked to provide their highest outstanding loan balance in the last 12 months.) Therefore, if you are a university employee or otherwise eligible to participate in a 403(b) plan and you have an outstanding loan in that 403(b) plan, you may not take a loan from the 457 Plan.

**For your benefit, please review these important features of the new loan provision:**

- A loan may be taken for any purpose; however, prospective borrowers should seek independent tax advice prior to taking out a loan.
- Prior to submitting hardship distribution requests, participants are required to either apply for a loan or certify that taking a loan would create a severe financial hardship.
- There is a loan initiation fee of \$75.
- The minimum loan amount you may borrow is \$1,000.
- The maximum you may borrow is the lesser of 50% of your vested account balance OR \$50,000 minus your highest outstanding loan balance (a total of all of your Plan loans, including 403(b) plans) from the preceding 12 months.
- Loans are available to actively working, retired, and/or separated-from-service employees, but they may not be taken from certain sources in your account (e.g., installment, divorce settlement, etc). If you have a question about an available source in your account, please speak to a T. Rowe Price representative.
- Participants on a leave of absence are eligible to take loans.
- You may not have more than one loan at any time from any state-run retirement plan (including 403(b) plans).
- The interest rate on a loan remains fixed throughout the life of the loan; loan refinancing is prohibited.
- Loans must be taken for at least one year up to five years; failure to pay off the loan within the time period prescribed by the terms of the loan may result in certain tax ramifications.
- Loan repayments will be made via ACH from your bank account, and all loan payments will be debited from your account on the first day of every month.
- To initiate a loan, visit the website at [rps.troweprice.com](http://rps.troweprice.com). Click on My Account > Transactions > Take a loan (see screen shot below). You may also contact T. Rowe Price at 1-888-457-5770.



Plan loans allow you to access money in your Plan account for a financial emergency or a major purchase before you retire. However, there are drawbacks. When you borrow from your retirement account, you borrow from your future. Before you

apply for a loan, it's wise to consider the impact a loan can have on your retirement savings account:

- **Your account may earn less.** When you repay your loan, the amount of interest you pay may be less than you would have earned by keeping your money in the Plan. As a result, your retirement nest egg may be less than you had hoped.
- **You may save less.** Making loan payments each pay period may stress your budget and force you to cut back on your retirement Plan contributions.
- **You might have to pay taxes twice.** You pay interest on your loan with after-tax money. Later, when you retire and withdraw your money, the interest you've paid is taxed again.

**A \$10,000 loan now could cost you much more in retirement**

Let's look at the possible effect of borrowing from your retirement savings. In this example, we'll use average numbers from the 457 Plan. If you want to see an example closer to your situation, use the interactive Plan Loan Calculator located on the website at [rps.troweprice.com](http://rps.troweprice.com). Select the Tools tab and click on Calculators. Look for the link "Should I borrow from my retirement plan?"

**In this example:**

*You are age 40, or 25 years from retirement age. You contribute \$1,600 a year (or \$133/month) to your retirement account and now have an account balance of just \$25,000. You're thinking about taking a \$10,000 Plan loan from your account. You'll repay the loan over the next five years at an interest rate of 4.25%. Your monthly loan payment would be \$185. Total interest paid over five years would be \$1,118.*

Your Options:	Estimated Plan Account Balance at Retirement:
(1) You decide not to borrow from your retirement savings .....	\$251,145
(2) You take a \$10,000 Plan loan but continue making monthly contributions to your account while also making monthly loan payments .....	\$238,792
(3) You take a \$10,000 and stop monthly contributions to your account for five years while you make monthly loan payments .....	\$200,240

*Results assume a 7% annual investment return. However, this example is for illustrative purposes only and is not meant to represent the performance of any of your Plan's investment options.*

**The bottom line: Keep contributing to your Plan**

When you borrow from your retirement account, you borrow from tomorrow. Should you decide to take a Plan loan, it's wise to continue saving each month while you repay your loan. If you are repaying a loan and have suspended your contributions, you can start contributing again. To start contributing again, contact CMS at 1-800-442-1300.

## INCOME TAX INFORMATION

### Currently Deferring Participants

If you are actively deferring into the Plan, your taxable income was reduced thanks to your participation in the Deferred Compensation Plan. You will only report the wages shown in Box 1 of your W-2 statement on your income tax form. Your wages reported in Box 1 show your gross wages reduced by the total amount of your 2012 deferrals and any other tax-deferred and tax-exempt deductions.

Your W-2 statement will reflect contributions to the Deferred Compensation Plan (457). If the “Deferred Compensation” box in the lower right-hand corner of the W-2 is marked “X,” it means you contributed to the Deferred Compensation Plan in 2012; the amount of your deferral is indicated in Box 12 with a “G” coding. Remember, you do not report your deferred compensation anywhere on your income tax form.

### For participants who took a distribution in 2012

If you received a payment from your account during the 2012 tax year, you will receive a separate 1099-R from our recordkeeper, T. Rowe Price, by January 31, 2013. Box 2a of your 1099-R will list the taxable amount of your distribution(s) you received during 2012 and should be entered on line 16b of your Form 1040. Box 7 of your 1099-R shows the distribution code for the type of distribution received. A code of “7” in this box indicates a normal distribution for a participant age 59½ or over. If you were under age 59½, box 7 will be coded with a “2” to indicate that your 457 Plan distributions are not subject to the 10% additional tax on early distributions.

For federal income tax purposes, your deferred compensation, plus any earnings, is taxable as ordinary income when it is distributed. Deferred compensation distributions are reported along with other earnings on line 7 of your income tax Form 1040. Deferred compensation distributions are not subject to State of Illinois income tax. Report the distribution in the “federally taxed retirement and Social Security” subtraction section, line 5 of your Illinois return.

## TELEPHONE NUMBERS

### Deferred Compensation

Plan Rules/Options Information

800-442-1300/217-782-7006

TDD/TTY: 800-526-0844

Internet: <http://www.state.il.us/cms/employee/defcom>

### Recordkeeper

T. Rowe Price Retirement Plan Services, Inc.

Account Value Information and Investment Changes:

888-457-5770 or TDD/TTY: 800-521-0325

Internet Access: 800-541-3022

Internet: <http://rps.troweprice.com>

## TEST YOUR KNOWLEDGE OF BENEFICIARY DESIGNATIONS

### 1. A BENEFICIARY DESIGNATION IS:

- A. The person or entity you choose to receive your account after your death.
- B. An organization named to provide financial assistance.
- C. Your favorite charity.

### 2. YOU SHOULD REVIEW YOUR BENEFICIARY DESIGNATION REGULARLY:

- A. True.
- B. False.
- C. It depends on your plan.

### 3. A SPOUSE IS USUALLY A GOOD CHOICE TO BE A PRIMARY BENEFICIARY BECAUSE OF:

- A. Insurance.
- B. Taxes.
- C. Mortgage deductions.

## ANSWERS

**1. A.** You can name a person or persons, or charities and trusts, to receive your account. Your assets pass directly to the person or entity you designate and avoid the legal process associated with a will. Children under the age of majority—age 18 or 21, depending on your state’s law—cannot actually own the assets.

**2. A.** It’s important to review your beneficiary designation when major changes in your work or personal life occur—preferably before they occur. Beneficiary designations override bequests made in your will. Even if you update your will after marriage, for example, the person named as beneficiary—perhaps your former spouse—will, in most instances, inherit your retirement account unless you remove him or her.

**3. B.** Naming your spouse as the beneficiary of your retirement plan assets can provide flexibility for delaying distributions that are subject to income tax. In addition to rolling over your workplace plan to his or her IRA, a surviving spouse can generally decide to treat your IRA as his or her own. This can give your beneficiary more tax and planning options.

## DON'T PUT OFF NAMING OR UPDATING YOUR BENEFICIARY

It’s always been important to name a beneficiary.

By selecting someone, you’re ensuring that your assets will be distributed as you intend in the event of your death. To make sure our records reflect your current wishes, visit the plan forms section on [rps.troweprice.com](http://rps.troweprice.com) to print out a beneficiary form.

## WHAT DOES BEING ON THE “WATCH LIST” MEAN?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the 457 Plan.

### Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

- 1. Performance**—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
- 2. Risk**—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
- 3. Risk-Adjusted Returns**—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
- 4. Portfolio Construction/Style Drift**—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
- 5. Operations**—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely. There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

## WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

### Current Watch List Summary

**The following fund is on the watch list as of 12/31/2012:**

**Ariel Fund**—The fund remains on watch list status due to longer-term underperformance. From a performance perspective, returns lagged in 2011 due to stock selection in the financial sector as well as an overweight to consumer names. However, the same names that lagged in the prior year, positively contributed to performance in 2012. The fund ranks in the 16th percentile of the peer group for the year-to-date period through September 30, 2012. Over the past several years, the fund's performance was strong in 2009, ranking in the 5th percentile of its peer group, as well as ranking favorably in the fourth quarter of 2010. The risk scores, however, are significantly higher than the peer group and the overall five year return ranks in the 86th percentile of its peer group. Effective January 2, 2013, participants seeking a similar investment strategy also have access to the Northern Trust Collective S&P 400 Index Fund which is a mid-cap equity index fund that attempts to replicate the performance of the S&P 400 Index.

