Non-Governmental 457(b) Plans- Friday Q&A Series

Q.

I have access to a non-governmental 457(b) plan at work. I'd like to save more but someone told me I could lose the money if my employer's sued. Also, can I roll over a non-governmental 457(b) into an IRA? Is this something I should use?

A.

I've seen variations of this question several times recently, and unfortunately, there's no good answer. With respect to retirement plans, it's usually better to be a business owner-whether an independent contractor or a partner, because you can take advantage of much higher maximum contributions-$50K into a SEP-IRA, Solo 401K, or through a "self-match" into a profit-sharing plan/401K. A business owner may also have a cash balance plan and maybe even an HSA on top of that. An employee is lucky to be able to put $17K into a 401K. So often times an employer will offer a 457 in addition to a 401K, or more typically, its governmental cousin the 403B. This allows an employee to sock away $34K instead of just $17K.

Benefits of a 457 Plan

The main benefit of using a 457 plan is you basically get another 401K/403B. You can double your tax deduction and double your savings. Another benefit is that 457 plans are not subject to the Age 59 1/2 rule, meaning you can access the money without penalty as soon as you leave the employer. So they're a great option for someone planning an early retirement. You just withdraw from the 457 first. 457s, like most retirement plans, are good asset protection vehicles since they are generally protected from YOUR creditors.

Governmental vs Non-Governmental 457(b)s

When discussing 457 plans it's important to recognize the difference between a governmental and a non-governmental 457. In a governmental plan, the money is held in trust, i.e. not subject to the employer's creditors. The money can also be rolled over into an IRA upon separation from the employer. Not so with a non-governmental plan. That money technically belongs to the employer, and is thus subject to the employer's creditors. Even when you quit the job, your 457 money can only be withdrawn or transferred to another non-governmental 457 plan. It can't be rolled over into a 401K or IRA.

Tax Savings Vs Risk Of Loss

Most doctors with access to a governmental 457 should be maxing it out. With a non-governmental 457 the right move is a little less clear. You have to balance the tax savings of having another retirement account, especially one you can access before age 59 1/2 without penalty, with the potential risk of loss. Personally, I think the risk of loss due to your employer going bankrupt is pretty low. While I'm sure it's happened, I've never heard of it happening. It certainly isn't common. I don't think I'd be willing to give up a $5-6K per year tax break because of that worry. I'm much more worried about market risk than 457 risk. So I'd go ahead and use the plan. But I'd be sure to max out my 401K and Backdoor Roth IRAs first. And I'd definitely spend that money first in retirement.