Agenda Report

TO: CITY COUNCIL **DATE:** JANUARY 13, 2003

FROM: DEFERRED COMPENSATION OVERSIGHT COMMITTEE

SUBJECT: AMENDMENTS TO THE CITY'S DEFERRED COMPENSATION PLAN INSTITUTING VARIOUS OPTIONS FOR PLAN PARTICIPANTS

RECOMMENDATION

It is recommended that the City Council approve the following amendments to the City's Deferred Compensation Plan:

1. Increase the elective deferral and catch-up limits.
2. Allow additional contributions for participants age 50 and over.
3. Allow flexible distributions.
4. Allow in-service transfers for the purchase of defined benefit service credit.
5. Allow rollovers from 403(b) and other 457 Deferred Compensation Plans.

BACKGROUND

The City of Pasadena offers its employees a Deferred Compensation Program. Various federal and state laws, as well as regulations established by the Internal Revenue Service govern the program.

Recent legislation, specifically the federal Tax Relief Reconciliation Act of 2001 (Economic Growth and Tax Relief Reconciliation Act of 2001, i.e., EGTRRA) and the Job Creation and Workers Assistance Act of 2002, have necessitated amendments to the City's Deferred Compensation Plan Document. These amendments address such issues as qualified domestic relations orders, i.e., divorces and the portability of participant assets upon separation from the City.

Additionally, there are a number of optional provisions, which the City may elect to include in its plan. The City's Deferred Compensation Oversight Committee as well as the Plan Administrator have carefully considered these optional provisions, and are recommending that all but one of these options be incorporated into the City's Plan. The following is a brief summary of the recommended changes.

Option 1: Elective Deferral and Catch-up Limits.
Prior to EGTRRA the maximum amount a participant could defer into his/her deferred compensation account was $8,500 per year. EGTRRA allows the maximum regular deferral limit to be $12,000 in 2003, plus $1,000 per year up to $15,000 in 2006, then indexed in $500 increments. Those employees who are within three years of normal retirement age, may make "catch-up" contributions effectively doubling their contribution. By way of example, in 2003, a person within three years of normal retirement age may contribute $12,000 plus an additional $16,000, for a total of $24,000.

Option 2: Additional Contributions for Participants Age 50 and Over.
EGTRRA permits employees who are 50 or older to contribute an additional amount into their deferred compensation account, except during the three-year "catch-up" period mentioned above. The additional amount for 2003 is $2,000, increasing $1,000 per year up to $5,000 in 2006. This additional amount is then indexed in $500 increments based upon the cost of living.

Option 3: Flexible Distributions.
Prior to EGTRRA, plan participants were required to make an irrevocable election at the time of separation from the City as to how and when they want to receive payments from their deferred compensation accounts. Certain minimum distribution rules also apply. Under EGTRRA, participants who have separated from the City may change their elections and are not subject to minimum distribution rules.

Option 4: In-Service Transfers for the Purchase of Defined Benefit (PERS) Service Credit.
EGTRRA permits plan participants to purchase service credit in defined benefit pension plans such as the Public Employees Retirement System (PERS) using deferred compensation assets.

Option 5: Rollovers from Employee-Sponsored Plans and IRAs.
EGTRRA permits the plan to accept rollover contributions from other types of employer-sponsored plans, including 401(a), 401(k), 403(b), 457 plans, and IRAs. It is recommended that the City permit rollovers from 403(b) and 457 plans, but not 401(a)(k) or IRAs. The reason for this is that IRS regulations provide for a 10% penalty on distributions from IRAs and 401(a)(k) plans if the recipient is less than 59 ½ years of age. Consequently, plan participants could unwittingly set themselves up for a penalty by rolling these monies into the City's plan.

Option 6: Loans.
The U.S. Treasury Department is expected to issue regulations in the near future that may permit loans by plan participants. A loan would reduce the value of a participants' account, but would have no other adverse impact if paid back within a certain period of time.

Given that the Treasury has yet to issue these regulations and not knowing the affect such a program might have on the City's Deferred Compensation Program, the Oversight Committee and Plan Administrator believe it would be pre-mature at this time, to amend the City's plan to allow loans. The Committee and City staff will continue to monitor this issue.

FISCAL IMPACT

There is no fiscal impact to the City as a result of this action. The proposed amendments will increase the benefits available to those persons participating in the City's Deferred Compensation Program.

Respectfully submitted,

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Chair, Deferred Compensation
Oversight Committee

Concurrence:

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