Agenda Report

TO: CITY COUNCIL/DEFERRED COMPENSATION PLAN TRUSTEES **DATE:** APRIL 21, 2008

FROM: DEFERRED COMPENSATION OVERSIGHT COMMITTEE

SUBJECT: AMENDMENTS TO THE CITY'S 457 DEFERRED COMPENSATION PLAN AUTHORIZING PLAN PARTICIPANT LOANS

RECOMMENDATION

It is recommended that the City Council approve an amendment to the City's 457 Deferred Compensation Plan authorizing plan participant loans.

BACKGROUND

The City of Pasadena offers its employees the ability to participate in a Deferred *Compensation Program*. Currently the Plan has approximately 2,500 participants with assets in excess of $154 million. The Plan is overseen by a Deferred Compensation Committee consisting of three elected and two appointed members, with the City Councilmembers serving as the ultimate authority in the role of Plan Trustees. Deferred Compensation Investments are provided through The Hartford.

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, modified the rules governing 457 programs. Among these changes was authorization to allow participant loans against account balances, similar to those allowed in 401k plans. However, the City has not adopted provisions allowing loans nor has the Deferred Compensation Committee previously recommended such.

Currently, plan participants may access their funds prior to retirement only for "unforeseeable emergencies". The IRS defines "unforeseeable emergency" as "a severe financial hardship of the participant or beneficiary resulting from an illness or accident; loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, e.g., as a result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary."

Each year there are approximately 80 requests for hardship withdrawals. Of the total requested, approximately 75% meet the IRS criteria and are approved for dispersal. Persons denied hardship withdrawals may appeal to the Plan Administrator (Director of Finance) or the Oversight Committee. Typically, this amounts to two or three per year. The amount of any hardship withdrawal is considered taxable income by the IRS.

Coinciding with the recent downturn in the housing market and its impact on the availability of credit, has been an increase the number of plan participants requesting hardship withdrawals that do not meet the IRS criteria. It should be noted that hardship withdrawals are permitted in the case of imminent foreclosure or eviction from the participant's or beneficiary's primary residence. However, the general increase in the number of requests has lead the Oversight Committee to reconsider recommending allowing loans in the program. The benefit of a loan over a hardship withdrawal is that there is no tax consequence if paid back within the designated period. Loans allow greater financial flexibility for plan participants whose financial challenges may not rise to the level supporting a financial hardship but are nonetheless important such as the purchase of a home or paying for college. March 13, 2008 the Committee voted to recommend that the City Council/Deferred Compensation Plan Trustees amend the Deferred Compensation Plan Document to authorize plan participant loans.

As proposed a loan would reduce the value of a participant's account, but would have no other adverse impact save for the opportunity cost of not investing, if paid back within a certain period of time. Consistent with IRS regulations, loan amounts could not exceed more than 50 percent of the participants account or $50,000 whichever is less and would carry an interest rate of Prime + 1%. General purpose loans would require repayment within a period of one to five years and a loan for the purpose of purchasing a primary residence would be allowed for up to 20 years.

FISCAL IMPACT

There is no fiscal impact to the City as a result of this action. All administrative expenses will be covered by the Plan Provider, The Hartford.

Respectfully submitted,

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Chair, Deferred Compensation
Oversight Committee

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