

FISCAL REVIEW SECTION – LEGISLATIVE REFERENCE BUREAU

EXECUTIVE SUMMARY: 2006 Budget Summary Deferred Compensation Plan

1. The 2006 Deferred Compensation Plan's Proposed Budget increases approximately 11.3% from the 2005 Adopted Budget. The increase is associated with a \$200,000 increase for Professional Services. The 2006 Executive Budget includes \$1,094,212 for Professional Services, primarily related to services such as the third party administrator, equity option advisor fees, record keeping, and other account maintenance activities. The major reasons for the increase are consumer price increases included in some of the Plan's contracts, account valuation increases for the Plan's advisors and an increase in the cost of insurance and an increase in the cost in the Plan's RFP audit to cover an expanded scope. (Pages 1 and 2)
2. As of December 31, 2004, there were a total of 7,670 participants in the Plan. Approximately 70% of current eligible employees participate in the Plan. At year-end, there were 5,223 participants actively deferring into the Plan and 2,447 retired plan members. The average monthly cash deferral per-participant during the first quarter of 2005 was \$528.00. (Page 3)
3. The value of the entire plan, as of December 31, 2004, was approximately \$468.2 million. As of June 30, 2005, the Plan's valuation was \$475.9 million. As of August 30, 2005, the Plan's valuation had increased to approximately \$490.5 million. (Page 4)
4. For 2005, Plan participants are able to defer salary up to \$14,000 of their salary. (Page 4)

DEPARTMENTAL BUDGET SUMMARY: DEFERRED COMPENSATION PLAN

Expense Category	2004 Actual	2005 Budget	% Change	2006 Proposed	% Change
Total Expenditures	\$ 900,978	\$ 1,261,029	40%	\$ 1,403,719	11%
Capital	\$ -	\$ -	0%	\$ -	0%
Positions	2	2	0%	2	0%

The administrative costs of the Deferred Compensation Plan are offset by charges to Plan participants. **This budget has no tax levy impact.**

Historical Information

1. The City's Deferred Compensation Plan (DCP) started in October 1974 and is available to all City employees. The plan is administered by a nine member Deferred Compensation Board consisting of the Mayor, Chair of the Finance and Personnel Committee, City Attorney, City Comptroller, City Treasurer, Employee Relations Director, and three appointed plan participants. Mayoral appointments to the Board consist of one management and one non-management employee. The Common Council President appoints one non-management employee. The Board is responsible for all discretionary decisions in the administration of the plan. An Executive Director, who makes policy recommendations regarding investment portfolio management, plan marketing, and participant education strategies, assists the Board.
2. The Deferred Compensation Plan, which was previously staffed by positions located in the Comptroller's Office, became a separately identified budget control unit in 1996.
3. In late 1996, the Federal Government approved the Small Business Protection Act. The legislation improved the relative value of s. 457 plans with respect to other qualified defined contribution plans (i.e., 401 k) and similar tax-deferred arrangements. The legislation required plan assets to be held in trust separate from the employer's assets for the exclusive benefit of the plan's participants and their beneficiaries.
4. In 1998, the Common Council approved a charter ordinance that shifted the Plan's 5 assets to a separate trust account on January 1, 1999, as required by the Small Business Protection Act. This shift protects the assets of individual members from being subject to bankruptcy or other legal action. The Plan currently utilizes a Plan Custodian (Bank) to administer the distribution of benefits, as is required by the law.

2006 Proposed Budget

1. The 2006 Deferred Compensation Plan's Proposed Budget increases approximately 11.3% from the 2005 Adopted Budget. The increase is associated with a \$200,000 increase for Professional Services. The 2006

Executive Budget includes \$1,094,212 for Professional Services, primarily related to services such as the third party administrator, equity option advisor fees, record keeping, and other account maintenance activities. The major reasons for the increase are consumer price increases included in some of the Plan's contracts, account valuation increases for the Plan's advisors and an increase in the cost of insurance and an increase in the cost in the Plan's RFP audit to cover an expanded scope.

- **Third Party Administrator (TPA) (\$577,101)** – This is a \$51,639 increase from the \$525,426 included in the 2005 Adopted Budget. The increase is based on an increase for marketing and monitoring the asset allocation plan model and a cost of living adjustment included in the TPA contract with National Retirement Solution (NRS). The contract became effective January 15, 2000 and expires in 2006. The Plan and NRS have agreed to renew the contract under the terms of the current contract for 3 years with 2 one-year options.
- **Stable Value Account Manager (\$92,889)** – This is a \$3,111 decrease from the \$96,000 included in the 2005 Adopted Budget for management fees of the Stable Value Account (STV) option. The decrease is due to a decrease in the account's valuation. The 5-year contract with Gartmore Morley Capital Management Inc. expired on June 30, 2005. The Plan and Gartmore Capital Management agreed renew the contract under the same terms as the current contract for 5 years.
- **Active Managed Equity Account Manager (\$56,000)** – This is the same amount that was included in 2005 Budget for the Managed Equity Account Manager. Lipper Advisory Services has full discretion to purchase and sell mutual funds in the Actively Managed Account, subject however to goals and guidelines that are from time to time approved by the Board. The contract with Lipper Advisory Services ended on March 31, 2005. The Plan & Lipper Advisory Services have agreed to a new 5-year contract at same cost. Under the new contract the Plan pay the premiums for a \$4 million Errors and Omission Insurance Policy.

Other Professional Services line item expenditures include:

- **Insurance (\$98,000)** – This \$18,000 increase from the amount provided in the 2005 Budget reflects the Plan's payment of insurance premiums for Active Managed Equity Account Manger's Errors and Omission Insurance Policy.
- **Plan Custodian (\$30,000)** - The Plan utilizes a Plan Custodian (Bank) to administer the distribution of benefits, as required by law. The same amount was provided in the 2005 Budget.

- **Audit (\$95,000)** – This amount is \$54,250 higher than the amount provided in the 2005 and reflects an expansion in the scope of the RFP audit contract. The City Comptroller is an ex-officio member of the DCP Board, which is why an independent audit is required.
- **Travel (\$20,000)** -This funding allows all nine Board members and the Executive Director the opportunity to attend an educational seminar or conference. The passage of the Small Business Protection Act of 1996 requires plan assets to be held in trust for the exclusive benefit of the participant or their beneficiary effective January 1999. Because of this change, the Deferred Compensation Board has had an increase in their fiduciary responsibility. The \$20,000 included in the 2006 Proposed Budget is the same amount that was provided for in 2005 Budget.

Plan Valuation and Participation

1. The Plan currently offers seven investment options. These options include a stable value fund, an active equity fund, a U.S. passive equity fund, an international passive equity fund, an income (bond) fund, and a balanced socially responsible fund. A fund-of-funds investment approach is utilized, whereby participant selection of an option actually results in investment among multiple funds with similar goals. In March of 2002, the Deferred Compensation Board added a seventh investment option; a Charles Schwab & Co. administered Personal Administered Retirement Account. The self-directed account provides participants with greater investment flexibility and options.

The Plan has not offered any new investment options in 2005. The Plan is continuing to review an alternative investment options that would be included as an option in the Actively Managed Account.

2. As of December 31, 2004, there were a total of 7,670 participants in the Plan. Approximately 70% of current eligible employees participate in the Plan. At year-end, there were 5,223 participants actively deferring into the Plan and 2,447 retired plan members. The average monthly cash deferral per-participant during the first quarter of 2005 was \$528.00.
3. The table on page 4 shows the number of participants and valuation performance for each of the plan's options as of June 30, 2005.

Option Name	# of Participants	Valuation (in millions)	2004 Performance (As of 6/30/04)
Stable Value	4,833	\$160.9	4.1%
Income Account	1,919	\$ 23.9	7.4%
Active Account	4,706	\$148.8	14.7%
Passive U.S. Account	4,179	\$87.8	12.4%
Passive International Account	3,322	\$29.3	20.6%
Social/Balance	1,759	\$15.3	8.5%
Self Directed	113	\$8.2	N/A
AUL (old)	129	\$1.7	N/A

4. The value of the entire plan, as of December 31, 2004, was approximately \$468.2 million. As of June 30, 2005, the Plan's valuation was \$475.9 million. As of August 30, 2005, the Plan's valuation had increased to approximately \$490.5 million.
5. The total Plan's 2005 proposed costs (\$1,261,092) represent less than 1/3 of one percent (0.29%) of the Plan's present valuation. A study conducted by R.V. Kuhns & Associates of the Plan's peer group of deferred compensation fees showed the Plan's expenses were below the average cost of 0.50% basis points listed in the Deloitte Consulting 2004 Annual 401(k) Benchmarking Survey.

s. 457 Legislative Impacts

The Economic Growth and Tax Reduction Reconciliation Act (EGTRRA) of 2001 benefited Deferred Compensation participants. Under the Act the maximum contribution a Plan participant can make increases by \$1,000 each year from 2003 to 2006. After 2006, the maximum increase is indexed to the rate of inflation at \$500 increments. For 2005, Plan participants are able to defer salary up to \$14,000 of their salary.

The (EGTRRA) also provided enhancements to the catch-up provisions for plan participants who are 50 years or older and who may be eligible to use a catch-up provision allowing an extra \$4,000 contribution per year for a maximum contribution of \$18,000 in 2005. In 2006, the maximum catch-up limit is \$5000, for a total maximum contribution of \$20,000.

Instead of the age-50 catch-up provision, there is a limited catch-up provision, which can be used for any or all of the last three years prior to normal retirement age. Under this catch-up provision, a participant may be able to contribute twice the normal limit.

The 2002 Tax Relief Act provided a tax credit for low to moderate-income plan participants. The table on page 5 shows the amount of the credit and the income limits. The credit applies to the first \$2,000 a participant contributes to the Plan. The tax credit provision expires in 2006.

Credit	Single Return	Head of Household	Joint Return
50%	0 - \$15,000	0-\$22,500	0 - \$30,000
20%	\$15,000 - \$16,250	\$22,501- \$24,375	\$30,000 - \$32,250
10%	\$16,250 – \$25,000	\$24,376 - \$37,500	\$32,250- \$50,000

The EGTRRA also provides portability to Plan participants. Dollars from a traditional IRA, 401(k) and a 403(b) can be rolled into the Plan and amounts distributed from the Plan can roll into a traditional IRA, 401(k) and a 403(b) plan. (Dollars rolled out of the Plan are subject to tax rules of the receiving plan.)

Plan Marketing

In 2006, the plan will use the following marketing methods to increase participation in the Plan and increase deferrals by using the following marketing methods:

- Quarterly Newsletter
- Department visits on one-on-one meetings
- Payroll stuffers and target mailings
- Presentations at new employee orientations
- Target mailing and payroll stuffers to employees not in plan

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