FISCAL REVIEW SECTION – LEGISLATIVE REFERENCE BUREAU

EXECUTIVE SUMMARY: 2005 Budget Summary Deferred Compensation Plan

1. The 2005 Deferred Compensation Plan's Proposed Budget increases approximately 8.0% from the 2004 Adopted Budget. The increase is associated with an approximately $93,000 increase for Professional Services. The 2005 Executive Budget includes $971,212 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 fiduciary insurance (Pages 2 and 3)

2. The 2005 Proposed Budget includes $75,000 for the Plan's Contingent Fund. The same amount was included in the 2004 Adopted Budget. As of September 1, 2004, the Contingent Fund had not been used. (Page 3)

3. As of December 31, 2003, there were a total of 7,526 participants in the Plan. Approximately 65% of current eligible employees participate in the Plan. At year-end, there were 5,170 participants actively deferring into the Plan. The average monthly cash deferral per participant during the first quarter of 2004 was $559.43. (Page 4)

4. The value of the entire plan, as of December 31, 2003, was approximately $417.9 million. As of June 30,2004, the Plan's valuation was $432.9 million. By August 30, 2004, the Plan's valuation had decreased to approximately $381.3 million. (Page 4)

5. For 2004, Plan participants are able to defer salary up to $13,000 of their salary. (Pages 4 and 5)

6. To better serve the participants of the Plan, effective May 1, 2004, the Plan has extended their "live" phone telephone hours. The new hours are 8am to 5:30pm. (Page 6)

DEPARTMENTAL BUDGET SUMMARY: DEFERRED COMPENSATION PLAN

Expense Category	2003 Actual	2004 Budget	% Change	2005 Proposed	% Change
Total Expenditures	$ 927,388	$ 1,168,982	26%	$ 1,261,029	8%
Capital	$ -	$ -	0%	$ -	0%
Positions	2	2	0%	2	0%

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

<u>Historical Information</u>

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.

2005 Proposed Budget

1. The 2005 Deferred Compensation Plan's Proposed Budget increases approximately 8.0% from the 2004 Adopted Budget. The increase is associated with an approximately $93,000 increase for Professional Services. The 2005 Executive Budget includes $971,212 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 fiduciary insurance.

   - **Third Party Administrator (TPA) ($525,462)** – This is a $41,929 increase from the $483,533 included in the 2004 Adopted Budget. The increase is due to the Cost of Living Adjustment and a $15,000 annual increase (after the 3rd year of the contract) included in the TPA contract with National Retirement Solution (NRS) and a charge for the trades made by NRS. The contract became effective January 15, 2000 and expires in 2006.

   - **Stable Value Account Manager ($96,000)** – This is an $8,300 increase from the $87,700 included in the 2004 Adopted Budget for management fees of the Stable Value Account (STV) option. The increase is due to an increase in the account's valuation. The 5-year contract with Morley Capital Management Inc. expires on June 30, 2005.

   - **Active Managed Equity Account Manager ($90,000)** – This is a $7,500 increase from the $82,500 included in the 2004 Budget for the Managed Equity Account Manager. The increase is due to an increase in the account's valuation. 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 ends on March 31, 2005.

   - **Equity Advisor ($56,000)** – This is a $10,000 increase from the $46,000 that was included in the 2004 Budget for the Equity Advisor. The increase is due to the cost of the Equity Plan Advisor to put together an Asset Allocation Model. These fees represent expenditures paid to Lipper Advisory Services for services related to investment analysis for six of the plan options and advice for five of the plan options. The 5-year agreement with Lipper Advisory Services ends on March 31, 2005.

   Other Professional Services line item expenditures include:

   - **Insurance** ($80,000) – This $30,000 increase from the amount provided in the 2004 Adopted Budget reflects the increasing cost of insurance for Deferred Compensation Plans.

- **Plan Custodian** ($30,000) - The Plan utilizes a Plan Custodian (Bank) to administer the distribution of benefits, as required by law. This is a $10,000 decrease from the amount provided in the 2004 Budget and reflects a negotiated decrease in the Plan's Custodian contract.

- **Audit** ($40,750) – This amount is $2,500 higher than the amount provided in the 2004 and reflects the increased cost of the new audit contract. The City Comptroller is an ex-offico 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 2004 Proposed Budget is $500 less than $20,500 provided in the 2003 Budget.

Other Line Items

1. General Office ($7,200) -This is $500 more than the amount included in the 2004 Budget and reflects additional postage required to mail updates of the Asset Allocation Portfolio booklet to the Plan's participants.

2. Reimbursements of Other Departments ($30,000) - This is $5,000 less than the amount that was included in the 2004 Adopted Budget. The decrease reflects the historical expenditures of the Plan. This account represents expenditures related to reimbursements for services provided by the City Attorney, Treasurer, and Comptroller.

3. Contingent Fund ($75,000) - The same amount was included in the 2004 Adopted Budget. As of September 30, 2004, the Contingent Fund had not been used. The Deferred Compensation Plan budget is offset by revenue collected from member fees. Because government accounting regulations do not allow the City to "net budget" if the Plan under-estimates its costs, the Contingent Fund is the only source of additional revenue. The purpose of the DCP Contingent Fund is to provide contingent expenditure authority that can be repaid by participant charges.

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 2004. The Plan is currently finalizing an asset allocation option that utilizes the Plan's present investment options.

2. As of December 31, 2003, there were a total of 7,526 participants in the Plan. Approximately 65% of current eligible employees participate in the Plan. At year-end, there were 5,170 participants actively deferring into the Plan. The average monthly cash deferral per-participant during the first quarter of 2004 was $559.43.

3. The table below shows the number of participants, valuation performance for each of the plan's options as of June 30, 2004.

Option Name	# of Participants	Valuation (in millions)	2004 Performance (As of 6/30/04)
Stable Value	4,362	$151.7	2.12%
Income Account	1,679	$21.0	1.21%
Active Account	4,499	$134.4	4.99%
Passive U.S. Account	4,099	$81.8	3.83%
Passive International Account	3,114	$22.0	4.15%
Social/Balance	1,619	$13.4	2.20%
Self Directed	97	$6.6	N/A
AUL (old)	136	$1.8	N/.A

4. The value of the entire plan, as of December 31, 2003, was approximately $417.9 million. As of June 30, 2004, the Plan's valuation was $432.9 million. By As of August 30, 2004, the Plan's valuation had decreased to approximately $417.3 million.

5. The total Plan's 2005 proposed costs ($1,261,092) represent less than 1/3 of one percent (0.30%) of the Plan's present valuation.

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 2004, Plan participants are able to defer salary up to $13,000 of their salary.

The (EGTRRA) also provided enhancements to the catch-up provisions for plan participants. The "traditional" catch-up provision allows participants who are within 3 years of the normal retirement age and have not deferred the full deferral amount over the years they have been in the plan to exceed the annual maximum contribution. Beginning in 2002, the catch-up provision increased to twice the maximum deferral amount in effect the year the provision is being used. For example, in the 2004 the catch-up provision that applies to participants within three years of normal retirement age will be $26,000 – twice the $13,000 maximum contribution.

In addition to the traditional catch-up provision, the Tax Relief Act provides a catch-up provision for plan participants 50 or older. In 2004, plan participants, age 50 or older who have not have not deferred the full deferral amount over the years they have been in the plan, may make an additional $3,000 contribution to the $13,000 maximum contribution. The additional contribution increases by $1,000 each year until 2006 when it becomes indexed to the rate of inflation at $500 increments. Plan participants can only use one of the catch-up provisions.

In 2002, the Tax Relief Act provided a tax credit for low to moderate-income plan participants. The table below 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 2003, The Third Party Administrator (TPA) attended all 31 new employee orientations. In addition, the TPA visits every department that gives permission to give presentations. During 2003, the TPA enrolled 417 new participants.

In addition to the marketing efforts made by the TPA, the Plan has enhanced its educational curriculum for 2004. The new educational curriculum has a user friendly application orientation in a variety of formats and is referred to as "Join It, Learn It, Live It." The "Join It" course material is for workshops, small group interactions and one-on-one sessions and has been developed to help the Plan reach eligible employees. The "Learn It" course material is designed to help employees design a successful investment plan for their deferred compensation assets. The "Live It" course material is designed to help plan participants identify the best way to use their accumulated retirement account balance during their retirement years.

To better serve the participants of the Plan, effective May 1, 2004, the Plan has extended their "live" phone telephone hours. The new hours are 8am to 5:30pm.

The Retirement Income Management Team is now available to answer retirement planning questions. The team has a variety of tools available to assist plan participants:

1. Determine a participant's retirement income needs
2. Evaluate a participant's current financial picture
3. Identify other retirement assets
4. Evaluate combining all assets into one account
5. Choose the distribution option that is right for a participant
6. Manage a participant's funds throughout retirement

Departmental Revenues

2003 Actual	2004 Budget	% Change	2005 Proposed	% Change
$927,570	$1,168,982	26.0%	$ 1,261,029	8%

The 2004 Proposed Budget estimates revenues of $1,168,982. These revenues consist primarily of fees that are assessed against participant accounts. Participants are charged an annual flat fee of $20 per account in January of each year, and the remainder of the revenue is generated through monthly assessments to accounts based on account values. When the Deferred Compensation Plan spends less than its budgeted amount and more revenues are collected than are actually needed, the "excess" revenues are carried over to the next budget year and fees are reduced accordingly.

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