DEFERRED COMPENSATION

RESEARCH AND ANALYSIS SECTION - LEGISLATIVE REFERENCE BUREAU

EXECUTIVE SUMMARY: 2011 PROPOSED BUDGET

HEARING DATE: OCTOBER 6, 2010

1. **Total Expenditures:** The 2011 Proposed Budget for Deferred Compensation is $1,481,961, a decrease of $76,826 (-4.9%) from $1,558,787 in the 2010 Budget. An increase in salary and fringe benefit costs of $21,134 was off-set by a decrease in operating expenditures of $97,960.

2. **Operating Expenditures:** Operating expenditures in the 2011 Proposed Budget are $1,481,961, down $97,960 (-7.5%) from the 2010 Budget amount of $1,558,787. The reduction in operating expenditures was due to both adjustments made to the budget by the Executive Director based on past actual expenses and successful contract negotiations with Plan providers that have resulted in more favorable professional service fees.

3. **Special Funds:** The Plan has a Contingent Fund of $75,000 that is the same as in 2010. The purpose of the fund is to provide contingent expenditure authority that can be repaid by participant charges.

4. **Revenues:** All expenditures are recovered through charges for service to Plan participants. Therefore, estimated total revenues for 2011 are $1,481,961, the amount of total expenditures. **The Deferred Compensation department budget has no tax levy impact.**

5. **Plan Valuation:** The value of the entire Plan increased from $478.3 million at year's end in 2008 to $578 million at year's end in 2009. As of June 30, 2010 the valuation was down to $565.5 million. This rise and fall of assets reflects the volatile market conditions.

6. **Plan Participation:** As of June 30, 2010, there were a total of 7,757 participants in the Plan; 4,973 were active participants. The number of participants increased by 473 over last year, but the number of active participants decreased by 125. The decrease in participants reflects the aging of City employees and the number of retirements occurring.

7. **Asset Preservation:** As of June 30, 2010, 42% of the Plan's participants were 50 years of age or older, holding 63% of the Plan's assets. As participants retire and begin to withdraw funds and fewer City employees contribute to the Plan, the asset balance is challenged. This impact of an aging population is especially at issue during a period of volatile market performance as is the case now.

8. **Hardship Withdrawals:** The Plan saw a large increase in hardship withdrawals in 2009, many due to foreclosures and evictions. However, the number, while still high in 2010, appears to be leveling off.

Expense Category	2009 Actual	2010 Budget	% Change	2011 Proposed	% Change
Total Expenses	$1,114,302	$1,558,787	39.9%	$1,481,961	-4.9%
Operating	$919,290	$1,306,025	42.1%	$1,208,065	-7.5%
Capital	$0	$0	0%	$0	0%
O&M Positions	2	2	0%	2	0%
FTE's (all)	2	2	0%	2	0%

The City of Milwaukee Deferred Compensation Plan allows all City employees to invest a portion of their income before federal and state taxes are withheld. The Plan is administered by a 9-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 3 appointed members. An Executive Director, who makes policy recommendations regarding investment portfolio management, Plan marketing and participant education strategies, assists the Board. A Program Assistant II provides support services to the Executive Director and Board.

<u>2011 Proposed Budget</u>

The total 2011 Proposed Budget is $1,481,961, a decrease of $76,826 (-4.9%) from $1,558,787 in the 2010 Budget.

Personnel Expenditures

Personnel costs increase $21,134, or 11.9%, in the 2011 Proposed Budget. Net salaries and wages increase 1.3% while fringe benefits increase 37.7%. The increase in fringe benefit cost was accentuated by the use of a higher, and more accurate, rate than was used in 2010. Personnel cost increases were offset by a decrease in operating expenditures.

Operating Expenditures

Operating expenditures in the 2011 Proposed Budget are $1,481,961, down $97,960 (-7.5%) from the 2010 Budget amount of $1,558,787. The reduction in operating expenditures was due in part to adjustments made to the budget by the Executive Director based on past actual expenses. For example, Nationwide Retirement Solutions, the Plan's third party administrator, has taken on much of the costs associated with the production and distribution of marketing materials. In addition, successful contract negotiations with Plan providers have resulted in more favorable professional service fees. (These savings are exhibited in the high percentage increase in expenditures from 2009 Actual to 2010 Budget in the table above.)

Special Funds

The Plan has a Contingent Fund of $75,000 that is the same as in 2010. The purpose of the fund is to provide contingent expenditure authority that can be repaid by participant charges. 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 underestimates its costs, the Contingent Fund is the only source of additional revenue. If no additional funding (over budget) is required, members will not be charged any additional fee.

Revenues

All expenditures are recovered through charges for service to Plan participants. Therefore, estimated total revenues for 2011 are $1,481,961, the amount of total expenditures. **The Deferred Compensation department budget has no tax levy impact.**

Plan Overview

The Plan currently offers 7 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 actively managed income fund, a balanced socially responsible fund and a personal choice retirement account. A fund-of-funds investment approach is utilized, whereby participant selection of an option actually results in investment among multiple funds with similar goals. The 7th option is a Charles Schwab & Co.-administered Personal Choice Retirement Account (PCRA). The self-directed account provides participants with greater investment flexibility and options.

Plan Valuation and Performance

The value of the entire Plan increased from $478.3 million at year's end in 2008 to $578 million at year's end in 2009. As of June 30, 2010, the valuation was down to $565.5 million. This rise and fall of assets reflect the volatile market conditions as exhibited in the account performance in the following table.

Plan Performance

	2008	2009	2010 (YTD)
Stable Value	+4.3%	+3.0%	+1.3%
Actively Managed Income Account	-8.1%	+17.4%	+3.7%
Actively Managed Account	-40.6%	+35.2%	-1.0%
Passively Managed U.S. Account	-37.3%	+29.3%	-5.4%
Passively Managed International Account	-44%	+38.7%	-5.7%
Socially Conscious Account	-24.3%	+21.2%	-11.5%

The Plan's average net expense ratio of 0.52 basis points remained well below the peer group's average of 0.72 basis points listed in the Deloitte Consulting 2009 Annual 401(k) Benchmarking Survey.

Plan Participation

As of June 30, 2010, there were a total of 7,757 participants in the Plan; 4,973 were active participants. The number of participants increased by 473 over the last year, but the number of active participants fell by 125. The decrease in participants reflects the aging of City employees and the number of retirements occurring.

The average monthly cash deferral per-participant at year end 2009 was $486. That was a decrease from the year before of only $3 per month. The goal for 2011 is $500. The participation rate of current eligible employees is approximately 73%, up from 67% one year ago.

The following table shows the number of participants and valuation for each of the Plan's options.

	Number of Participants (as of 6/30/10)	2009 Valuation (in millions)
Stable Value	4,742	$220.3
Actively Managed Income Account	2,396	$36.9
Actively Managed Account	5,276	$147.7
Passively Managed U.S. Account	3,900	$79.2
Passively Managed International Account	3,708	$56.4
Socially Conscious Account	1,821	$17.4
Schwab PCRA	252	$18.4
American United Life (old, no new investments allowed)	93	$1.5

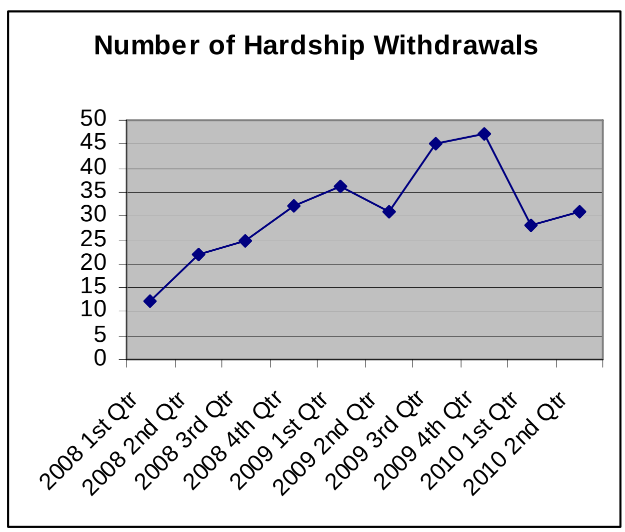
Asset Preservation

Asset preservation and growth is a primary goal of the Plan. Because of the Plan's asset size, participants save money by investing in institutional class mutual funds which are offered at reduced costs. In addition, the Plan's fees will decline over time as a percentage of the account balance because the Plan's account balances are growing faster than the Plan's fee increases.

As of June 30, 2010, 42% of the Plan's participants were 50 years of age or older, holding 63% of the Plan's assets. As participants retire and begin to withdraw funds and fewer City employees contribute to the Plan, the asset balance is challenged. This impact of an aging population is especially at issue during periods of volatile market performance as is the case now. (ERS reports that the number of employees taking advantage of the recent retirement incentives is high. In July there were 76 retirements, in August there were 85. The average had been 40 per month.)

Hardship Withdrawals

The Plan saw a large increase in hardship withdrawals in 2009, many due to foreclosures and evictions. The trend in hardship withdrawals can be found in the following chart.



Hardship withdrawals are regulated by section 457 of the Internal Revenue Code. To receive a hardship withdrawal, the participant must demonstrate one of the following:

1. A sudden and unexpected illness or accident of the participant, the spouse of a participant or of a dependent of the participant.
2. Loss of a participant's property due to casualty that are not covered by insurance.
3. Foreclosure of a primary residence.
4. Another similar extraordinary and unforeseeable circumstance as a result of events beyond the control of the participant.

Plan Marketing

In 2011, representatives from the Plan will continue to attend new employee orientations and meet with employees of departments granting permission to the Plan to give presentations. The Plan will be using PeopleSoft queries to identify and reach the employees that are not enrolled in the Plan. In addition, employees who have separated from employment or are nearing retirement will be identified. An attempt will be made to decrease their plan withdrawals.

To further address the growing number of retirees, the Plan will be diversifying retiree investment options by designing a Retiree Model Portfolio and possibly introducing a custom Retiree Insurance Product which lessens tax consequences and allows them to pass more of their retirement savings on to their heirs.

The Plan is also offering participants, at the least on a quarterly basis, the customized workshops of "Countdown To Your Retirement" and "3 Steps to Plan Your Retirement Income." The "Countdown To Your Retirement" workshop is tailored to meet the needs of those participants that are one to 10 years away from retirement and the "3 Steps to Plan Your Retirement Income" is tailored to meet the needs of those participants that are within one year of retirement.

Issues to Consider

1. As of June 30, 2010, 42% of the Plan's participants were 50 years of age or older, holding 63% of the Plan's assets. The long-term viability of the Plan in light of the aging of the participant population needs to be examined.

2. There is a volatile market and tight economy. Ways of increasing Plan participation in such an adverse economic environment needs to be investigated.