

HOUSING AUTHORITY OF THE CITY OF SAN DIEGO

DATE ISSUED: September 6, 2005

DATE: For the Agenda of September 13, 2005

REPORT NO.: HAR05-010

SUBJECT: Section 457 Deferred Compensation Plan Revision & Authorization

SUMMARY

Issue 1: Should the Housing Authority authorize adoption of selected optional changes to the San Diego Housing Commission (SDHC) Section 457 Deferred Compensation Plan (Plan) for implementation by the President and Chief Executive Officer (President & CEO)?

Recommendation 1: Recommend that the Housing Authority adopt and authorize the President & CEO to implement optional Plan changes as provided for in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 and Final Treasury Regulations for service agreement administrative options to include:

- a) Addition of a “roll-in” provision to the Plan for other employer-sponsored plans or personal traditional IRAs;
- b) Self-Directed Brokerage Account (SDB) through HarrisDirect;
- c) Designation of GreatWest Retirement Services as the IRA Provider for mandatory cash out of small account balances;
- d) Outsourcing of Qualified Domestic Relations Orders (QDRO) processing with a participant service fee.

Issue 2: Should Housing Authority approve the delegation of authority to the Housing Commission and President & CEO for implementation Plan changes?

Recommendation 2: That the Housing Authority authorize the President & CEO to implement all future mandatory legislative compliance revisions to the Plan Document with submission to and approval by the IRS as appropriate, and to the Service Agreement provided that the proposed changes are only to bring the Plan into compliance with IRS requirements; and, that the Housing Authority delegate to the Housing Commission future optional changes to the Plan.

Fiscal Impact: None

Previous Related Action(s): In July 1988, the Housing Commission authorized the President & CEO (current title) to negotiate and implement a voluntary Section 457 Deferred Compensation Plan and execute an investment contract for assets of the Plan. In July 1991, a separate, mandatory Section 457 Deferred Compensation Plan was implemented in lieu of Social Security for non-regular employees providing a 3.75% match of the employee's required contribution. In March 1998, the Housing Authority granted the President & CEO authority to implement administrative and legislative changes pursuant to the Small Business Job Protection Act of 1996. In January 2002, the Housing Authority authorized the President & CEO to implement required and selected optional changes pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001.

On April 8, 2005, the Housing Commission approved the two recommendations contained in this report.

BACKGROUND

Following exclusion of public employers from participating in 401(k) plans, the President & CEO received authorization to negotiate and implement a Section 457 Deferred Compensation Plan with plan assets to be invested similarly to the Defined Contribution Pension Plan established in 1979. In November 1988, a Section 457 Plan was implemented providing employees the opportunity to voluntarily contribute a maximum of one-third of salary up to \$7,500 annually on a tax-deferred basis, with plan assets invested through Great-West Life and Annuity Insurance Company.

In February 1998, the Housing Commission authorized the President & CEO to implement required changes pursuant to the Small Business Job Protection Act of 1996 (the primary purpose of which for the first time was to hold assets in trust for participants and beneficiaries), to provide for automatic future increases in deferral limits for cost of living adjustments (deferral limit increased from \$7,500 to \$8,000), to comply with the Conforming Equitable Distribution Orders for former spouses and dependents, amend the group annuity contract, and implement recommended administrative modifications and optional changes.

In January 2000, the Tax Code increased the annual maximum 457 Plan contribution amount from \$8,000 to \$8,500. This increase and subsequent legislative increases have continued to be implemented by the President & CEO in accordance with authorization previously approved by the Housing Commission. The current maximum contribution amount is \$14,000.

DISCUSSION

Housing Commission pension consultants, including the Epler Company, have reviewed proposed changes to the Plan and to the Service Agreement with Great-West Retirement Services for compliance with EGTRRA of 2001 and for compliance with the Plan's existing qualified status provisions. All of the pension consultants have recommended the proposed optional changes as summarized below:

Recommended service agreement administrative options provide additional confidentiality for employees as well as the option to make personal investment decisions. These changes include:

- a) Addition of a "roll-in" provision to the Plan from other employer-sponsored plans or personal traditional IRAs;
- b) Self-Directed Brokerage Account (SDB) through Harris Direct
- c) Designation of Great West Retirement Services as the IRA provider for mandatory cash out of small account balances of less than \$5,000
- d) Outsourcing of and fee collection for processing of Qualified Domestic Relations Orders (QDRO)

The administration of deferred compensation programs requires compliance with stringent IRS regulations and legislative mandates, and requires complex review and advice from Housing Commission pension and legal advisors. Housing Commission staff and SDHC Pension Investment Committee regularly seek guidance from Pension Consultant and General Counsel to address legislative, fiduciary, and administrative responsibilities on behalf of the Commission prior to proposed change recommendations. The Pension Investment Committee serves in an advisory capacity to the President & CEO and is comprised of financial, administrative, management, and union and non-union represented employees as established by Policy PO000.401. In accordance with Policy, pension and related deferred compensation matters are addressed by the Pension Investment Committee in public forum, in accordance with public notice requirements under the Brown Act.

The 457 Plan requires mandatory participation for all temporary employees and is a voluntary Plan for regular benefited employees. Due to precedence, the Plan changes included in this report are presented for Housing Authority adoption although, by previous 1988 Board action, authorization to negotiate and implement a Section 457 Plan and to execute an investment contract for Plan assets was delegated to the President & CEO. Historically, all staff recommendations have been approved and adopted without modification.

In keeping with Commission focus to streamline processes and improve efficiencies while maintaining Plan integrity and Commission fiduciary responsibilities, it is recommended that all future mandated legislated changes to the 457 Plan Document, with submission to the IRS as appropriate, and to the Service Agreement be delegated to the President & CEO, for adoption

and implementation. The delegation of administrative and optional Plan changes is recommended to be delegated to the Housing Commission to avoid the potential or perception of a conflict of interest, involving the financial or economic interest of any Housing Commission employee in any manner. Delegation of administrative and optional Plan changes to the Housing Commission ensures public review of issues impacting employee and Housing Commission interest.

ALTERNATIVES

1. Do not approve optional changes or selectively approve one or more changes. However, it should be noted that Plan recommendations are made considering the best interest of the Housing Commission and its employees, with Pension Investment Committee input that includes Union representation from S.E.I.U., Local 535.
2. Authorize the President & CEO to implement all mandated and optional administrative changes with notice to the Housing Commission and Housing Authority. While this alternative is an efficient approach for administering and implementing Plan Sponsor changes, it may be perceived negatively as a potential conflict of interest.
3. Instruct staff to make no change in process. Continue to bring forward all mandatory and optional changes. While this alternative permits the Housing Authority to continue oversight of optional Plan changes, it does not comply with prior authorization to negotiate and implement the Plan to the President & CEO.

Respectfully submitted,

Approved by,

C. Terry Whitesides,
Director of Business Services

Elizabeth C. Morris
President & Chief Executive Officer

Attachment 1: Summary of Recommendations

Distribution of these attachments may be limited. Copies available for review during business hours at the Housing Commission offices at 1625 Newton Avenue.

ATTACHMENT 1

SUMMARY OF RECOMMENDATIONS

- a) EGTTTRA permits a 457 Plan to accept “roll-in” contributions from previous employer plans including 401(a), 401(k) and 403(b) plans and personal traditional IRA’s. Adopting this provision requires a Plan amendment to separately account for dollars rolled into the plan for purposes of determining allowable distributions from the rolled-in accounts. Under current IRS regulations, rolled over accounts are subject to the 10% penalty tax for premature (i.e., pre-age 59-1/2) distributions. Assets held in the 457 Plan through employee payroll deduction continue to be limited to in-service distributions under IRS hardship rules and will continue to receive favorable tax treatment for distributions prior to age 59-1/2 under current legislation. This “roll-in” option was not previously recommended in order to minimize employee confusion between the SDHC Pension Plan and the 457 Plan options. With the addition of options permissible under 401(a), 401(k), 403(b), and 457 plans, the adoption of this provision provides maximum flexibility for plan participants and potential for great account growth with choices in either the San Diego Housing Commission Pension Plan 401(a) Plan, or the 457 Deferred Compensation Plan.
- b) The addition of a Self Directed Brokerage Account option similar to that offered under SDHC Pension Plan through Diversified Investment Advisors, Inc., allows employees knowledgeable in investment strategy and interested in actively managing their investment portfolio to do so through HarrisDirect brokerage firm, a properly registered broker-dealer, in accordance with the Securities Exchange Act of 1934. Participants may establish an account with options from eligible investments including mutual funds, and stocks and bonds allowed by the Plan. A copy of administrative provisions and fund options may be requested from the Housing Commission, Human Resources Office or Great West Retirement Services.
- c) The mandatory cash-out of small account balances greater than \$1,000, but less than \$5,000 in the form of a rollover to an IRA to avoid facing a tax consequence on the affected employee was adopted in 2001. New Treasury regulations authorize an IRA Provider can be designated for implementation by January 2006. In order to streamline administration of the process, approval of Great West Retirement Services as the IRA Provider will ensure plan compliance and administrative efficiency with no impact to the employee.
- d) A Qualified Domestic Relations Orders (QDRO) provision under EGTRRA was adopted effective in 2002 to permit the Plan to accept QDROs pursuant to amended IRC Section 414 (p)(11) to transfer all or a portion of a Participant’s account to an

Alternate Payee pursuant to divorce. The Plan provides for immediate payments to Alternate Payees and tax report such distribution to former spouse Alternate Payees.

Outsourcing QDRO services instructs Great West Retirement Services to receive and review all domestic relations orders provided they meet specific requirements for qualifications approved by Great West and SDHC General Counsel and to recover a fee per Order processed of \$250.00 which shall be charged one-half (\$125.00) against the Participant's remaining account. In the event that Alternate Payee is awarded 100% of the Participant's account balance pursuant to the QDRO, the entire processing fee shall be charged to the Alternate Payee's account. If there are not sufficient funds in either party's account to pay that party's respective share of the fee, the difference shall be charged to the account of the other party.