ATTACHMENT C

Deferred Compensation Plan
BOARD REPORT 14-51

Date: November 10, 2014

To: Board of Deferred Compensation Administration

From: Staff

Subject: Deferred Compensation Plan - Automatic Enrollment Program (AEP) Core Provisions

Recommendation:

That the Board of Deferred Compensation Administration (a) approve the recommendation from the Plan Governance & Administrative Issues Committee to adopt the core provisions of an Auto-Enrollment Program for the City's Deferred Compensation Plan as included within this report; and (b) direct staff to work with Board counsel in drafting the necessary Plan Document changes to implement the Auto-Enrollment Program for subsequent Board review and adoption.

Background:

At its December 17, 2013 meeting, the Board considered the development of an Auto-Enrollment Program ("AEP") for the City's Deferred Compensation Plan. An AEP automatically places newly hired employees into an employer's defined contribution savings plan at their beginning eligibility date. The intent of an AEP is to support new employees in achieving retirement income security by facilitating the initial enrollment process.

In the December 2013 staff report, staff indicated that in 2006 the Federal Government had passed the Pension Protection Act (PPA), which includes provisions encouraging employers to facilitate enrollment in 401(k), 403(b) and 457(b) plans. This concept is known as "auto enrollment" and generally involves automatically placing new employees in an employer's optional retirement savings plan at their beginning eligibility date. **Auto enrollment is not "mandatory enrollment" because employees have the ability to opt out of participating at any time**. Rather, the intent of auto enrollment is to facilitate plan participation and the creation of retirement income security by facilitating the initial enrollment process for new employees.

In addition, the PPA encouraged auto enrollment by providing fiduciary safe harbors for employers subject to the Employees Retirement Income Security Act (ERISA). The PPA also established that automatic enrollment programs are not subject to state wage withholding restrictions, except that this exemption was not extended to state and local government employers. Thus, plans administered by governmental agencies must still address the question of State law wage withholding limitations if they are contemplating establishing auto enrollment programs.

Staff informed the Board that the relevant State law language related to wage garnishment could be found in Sections 221 and 224 of the California Labor Code. Section 221 states:

> *"Section 221. It shall be unlawful for any employer to collect or receive from an employee any part of wages theretofore paid by said employer to said employee."*

Section 224 states that the sanction of Section 221 does not apply in three circumstances:

(i) W*hen the employer is required or empowered so to do by state or federal law or*
(ii) W*hen a deduction is expressly authorized in writing by the employee to cover insurance premiums, hospital or medical dues, or other deductions not amounting to a rebate or deduction from the standard wage arrived at by collective bargaining or pursuant to wage agreement or statute, or*
(iii) *When a deduction to cover health and welfare or pension plan contributions is expressly authorized by a collective bargaining or wage agreement.*

The Board Counsel, Assistant City Attorney Curtis S. Kidder, with the assistance of the City's tax counsel, Donald Wellington at Steptoe and Johnson LLP, reviewed Sections 221 and 224 and determined that, although it is not absolutely clear under those statutes, an auto enrollment program could likely be established so long as it is provided for within a collective bargaining agreement.

At this meeting the Board directed its Plan Governance and Administrative Issues Committee to develop recommendations for creating an AEP for the Plan. Prior to the Committee meeting, staff worked with the Plan's recordkeeper (Great-West Financial) and representatives of the City Controller and DWP payroll systems to explore issues and options for development and implementation of an AEP.

Following this research, staff brought recommended AEP provisions to the Plan Governance & Administrative Issues Committee ("Committee") on August 20, 2014. The Committee reviewed and discussed the relevant decision points necessary to design an AEP, and finalized recommendations to the full Board for each program provision. An overview of the proposed AEP provisions are detailed in this report and included in summary form in Attachment I. The Committee's recommendations are now forwarded to the Board for its review and approval.

<u>Discussion:</u>
This report addresses the following key design provisions of the proposed program:

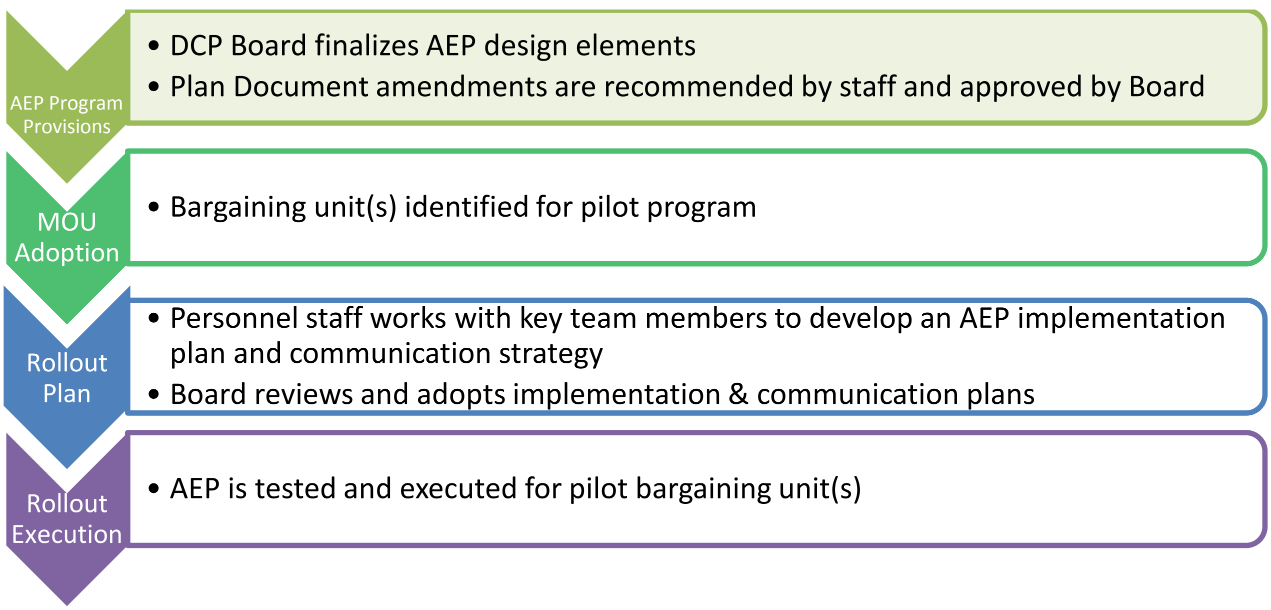
1. Participation and Opt-Out Provision
2. Contribution Amount and Contribution Formula
3. Auto-Escalation
4. Contribution Type (pre-tax versus after-tax)
5. Default Investment

Once the Board adopts these provisions as recommended by the Committee, staff will work with the City Attorney's Office, the Board's consultant (Mercer Investments Consulting) and Great-West to draft the necessary Plan Document modifications that will subsequently be presented to the Board for consideration and final approval.

It will be necessary to to identify a potential bargaining units or units interested in participating in the AEP as a pilot group. A notice was sent to all labor organizations representing City (civilian and sworn) and DWP bargaining units to notify them that AEP program elements were under active consideration by the Board at the November 18, 2014 Board meeting (see Attachment).

Staff has also held discussions with the City Controller's Office, Department of Water and Power Payroll, and Great-West to develop workable protocols for implementing an AEP. Upon creation of the AEP, Personnel Department staff will also work with Great-West and Mercer Consulting to develop a detailed communication campaign and implementation plan for Board adoption.

The following flow chart illustrates the various steps involved in implementing the AEP:



A. MISSION, TARGET POPULATION & CURRENT PARTICIPANT CONTRIBUTION PATTERNS

In discussions with the Committee, staff first addressed the threshold questions regarding the AEP's target population and the fundamental goal of the program. Engaging with these topics helps to frame each program provision relative to the target and goal.

(1) AEP Mission

In the Board's adopted Strategic Plan for 2012-2016, the mission of the Deferred Compensation Plan is defined as providing "active and retired City employees with a supplemental retirement and savings program that offers opportunities for enhancing retirement and financial security." In short, the mission of the Plan is to assist City employees in achieving retirement income security.

An AEP facilitates participation in a defined contribution plan, but for the City's Plan it is important to add greater specificity regarding "to what purpose." As a result, staff has drafted a goal for the AEP intended to incorporate three principles.

First, it refines and adds greater specificity to the mission statement of the Plan as that relates to achieving retirement income security. Second, it provides that the goal should be accomplished in a manner consistent with how City employees are already achieving this objective. And third, it defines certain key terms ("retirement income security" and "lifestyle income") which have been previously discussed with the Board in other contexts (e.g. in the development of the Retirement Income Projection Calculator).

The fundamental goal of the AEP is proposed to be established as follows:

> *To facilitate initial participation in the Deferred Compensation Plan for the purpose of enabling City employees to achieve retirement income security through a combination of their defined benefit and defined contribution plan benefits. Retirement income security is the ability for employees to, upon retirement, replace their "lifestyle income" during their post-retirement years. Lifestyle income is considered to be an employee's gross nominal salary upon retirement less their primary defined benefit, defined contribution and other required salary reductions.*

This goal assumes only the employee's defined benefit and Deferred Compensation Plan account as being sources of post-retirement income. Further, the full (i.e. 100%) lifetime income replacement goal applies to individuals working a full career with the City. Including this goal for the AEP helps establish a framework for the policy provisions included within the AEP.

(2) Target Population

In addition to an AEP goal, it is important to identify the target population for the AEP. Staff recommends that the target population be identified as:

> *Employees who are (a) newly eligible to participate in the Deferred Compensation Plan by virtue of beginning their contributions to one of the City's three primary defined benefit plans <u>and</u> (b) have an MOU or Administrative Code provision allowing for participation in the AEP.*

This definition would exclude rehired employees, employees returning from leave, and transfers (for example, an employee who is hired into a collective bargaining unit that does not provide for the AEP and subsequently transfers to a unit that does provide for AEP). The rationale for limiting the scope of the AEP to this group of individuals is to limit the potential for auto-enrolling individuals who have already made a decision not to enroll, or who have enrolled and made an election to discontinue their deferrals. Those kinds of enrollment errors would be more problematic to reverse under Federal rules. Maintaining the focus on newly hired employees promotes simplicity and reduces the potential for administrative errors.

(3) Contribution Patterns of Current Plan Participants

Staff believes it is important to understand current patterns of participation in the Plan as a guide for structuring the AEP. Initial contribution amounts, escalation, and other features should be grounded in participant behaviors which are achievable and sustainable.

Data regarding these behaviors is available by looking at the contribution patterns of current Plan participants, as indicated in the following current payroll contribution data for the City's Civilian and sworn workforce, a comprehensive sample size of over 22,000 participants. This data is summarized as follows:

Years of Service Range	Average Age	Avg Years of Service	DCP Contribution %	DCP Contribution $ Per Pay Period	Average Annual Salary
0-5	32	3	5%	$ 138	$ 71,879
5-10	39	7	6%	$ 189	$ 83,946
10-15	45	13	6%	$ 229	$ 89,084
15-20	47	18	6%	$ 239	$ 98,979
20-25	52	23	7%	$ 304	$ 103,337
25-30	54	27	8%	$ 344	$ 104,599
30-35	56	32	9%	$ 366	$ 108,485
35+	62	38	10%	$ 449	$ 113,644

This data indicates that, on the aggregate, in their beginning years of service Plan participants contribute to the Plan at a rate of approximately 5% of pay, and very gradually increase that contribution percentage until reaching 9-10% of pay after 30 years. **Staff's modeling of this contribution pattern suggests that it is consistent with achieving a 100% replacement of lifestyle income following 30 years of service**.

B. AEP RECOMMENDED PROVISIONS

(1) Contribution Form: *Percent of Pay*

The Plan Governance Committee recommends that the auto enrollment contribution be structured as a percent of pay rather than flat dollar amount. Although historically the City's Plan has utilized a flat dollar model, the principle and goal of income replacement are much better served by the percent of pay structure because different employees are hired in at different salary levels.

From a recordkeeping perspective, Great-West indicates that creating a percent of pay contribution structure for the AEP will necessarily open a percent of pay option for current participants. This means that all participants will have the option of establishing contribution levels by percent of pay as well as dollar. Although this does create some level of new complexity for Plan participants, staff believes that adding the percent of pay structure will ultimately better serve participants because, as demonstrated by the Plan's Retirement Income Projection Calculation Calculator, it is percentages (of pay and lifestyle income replacement), not dollars, that are the true metrics of participant retirement income security.

(2) Contribution Type: *100% Pre-Tax*

The Plan Governance Committee recommends that the contributions be designated as 100% pre-tax. Staff informed the Committee during its deliberations that staff's preference was for the auto-enrollment program to split participant contributions between pre-tax and after-tax (Roth) dollars because both savings approaches offer unique tax advantages, and because future income and tax rates are inherently unknowable. However, staff indicated that Great-West indicates it presently can only accommodate pre-tax contributions within its auto enrollment recordkeeping structure. Staff has requested that Great-West initiate an internal review of this limitation and move towards creating an after-tax savings option, as plan sponsors are likely to be requesting it as the use of after-tax savings options and auto enrollment continues to grow across the country.

(3) Contribution Structure: *Initial Contribution Percentage of 2% with Auto-Escalation of Additional 0.25% Per Year Ongoing*

The Plan Governance Committee is proposing a 2% initial contribution amount for the first phase of the auto enrollment program. Although current saving patterns indicate Plan participants are enrolling at much higher rates (5% of pay in the aggregate within the first five years of employment), it is probably wiser to begin the program at a more modest contribution level, both to provide the Plan with an opportunity to evaluate participant reaction to this contribution level, and further given the fact that an after-tax savings option is not available at the present time. It is possible that, in a later iteration of the AEP, the initial default amount would be increased (perhaps by adding in an additional after-tax contribution along with the pre-tax contribution).

The table below illustrates the dollar impact of this contribution level on a range of starting salary amounts. The "Starting Deferral Per Pay Period" column provides the total amount of the contribution to the Plan participant's account, while the "Estimated "Net Pay Reduction Per Pay Period" column provides an estimate of the actual net reduction of the employee's paycheck (since a portion of the contribution will be pre-tax). *As an example, an employee with a starting salary of $35,000 would begin with a bi-weekly deferral of $27, and see an estimated net reduction to his/her pay of $22.*

Starting Salary	Percent of Pay	Starting Deferral Per Pay Period	Estimated Net Pay Reduction Per Pay Period
$ 30,000	2%	$ 23	$ 18
$ 35,000	2%	$ 27	$ 22
$ 40,000	2%	$ 31	$ 25

With respect to auto escalation, the Plan Governance Committee recommends that the contribution auto-escalate by 0.25% each year, with no cap. This escalation structure appears to be consistent with current contribution patterns for existing participants, in that (if untouched) it would over the course of a 30-year career bring the employee to a contribution rate of approximately 9.5% of pay, which is approximately where, in the aggregate, long-term employees are presently capping out with their contributions.

The lifestyle income replacement results of this proposed contribution structure are presented below. This particular illustration assumes and includes:

- All new retirement tiers for LACERS, DWP, and LAFPP, along with the immediately preceding tiers for comparative purposes.
- Starting salary of $40,000 with 3% average wage increases over 30 years, ending at a final salary of $94,263.
- A starting 2% auto enrollment contribution amount and assumed 0.25% average increase in deferral.
- Assumed 5% annual rate of return on investment assets.
- Projected replacement of lifestyle income based on the above variables.

SUMMARY	**LACERS TIER 1**	**LACERS TIER 2**	**DWP TIER 1**	**DWP TIER 2**	**PENSIONS TIER 5**	**PENSIONS TIER 6**
Starting DCP Contribution %	2%	2%	2%	2%	2%	2%
Starting PP Deferral in $	$31	$31	$31	$31	$31	$31
DCP Contribution % After 30 Years	9.25%	9.25%	9.25%	9.25%	9.25%	9.25%
Ending PP Deferral in $	$335	$335	$335	$335	$335	$335
Average Deferral	$151	$151	$151	$151	$151	$151
Net Income Replacement %	95%	88%	95%	93%	113%	108%

It should be noted that although this design suggests that sworn personnel would achieve over 100% of lifestyle income replacement after 30 years, sworn personnel are eligible to retire at younger ages and there are sharp differentials in year-to-year percent of pay income replacements for Tier 6 members (4% per year after 25 years of service).

(4) Opt-Out Feature and Permissible Withdrawal Provision

Along with an initial 30-day opt-out period prior to the first deferral, the Pension Protection Act (PPA) contains safe harbor guidelines that permit an employee to withdraw funds in full without penalty within 30-90 days of the first contribution, also called a permissible withdrawal. The Plan Governance Committee recommends that a 90-day permissible withdrawal window provision be included in the City's Plan.

(5) Default Investment

The PPA regulations developed by the Department of Labor offer fiduciary safe harbors for ERISA plans (meaning plans are not liable for investment losses) for default investment selections in what are called Qualified Default Investment Alternative (QDIA) options. The City's Plan is not governed by ERISA, although the regulations can be considered a guideline. The regulations define QDIAs as including Target Date Funds, Balanced Funds, and Managed Accounts. The City's Target Risk funds would be included within the definition of "Balanced Funds." The Plan Governance Committee recommends that participant contributions initially be defaulted into the DCP FDIC-Insured Bank Deposit Account for the first 90 days during the permissible withdrawal window and then subsequently be transferred to the Plan's Moderate Profile Fund. Depositing contributions first into the FDIC-Insured Bank Deposit Account ensures that the participant will not experience any investment loss during the initial 90-day decision-making period. During this 90-day period the Plan would mail out information to participants advising them that, if they take no action, their existing balance and future contributions will be automatically redirected to the Plan's Moderate Profile Fund. The Moderate Profile Fund provides balanced exposure to all major asset classes offered within the Plan, and also balances out risk and return objectives over an extended period of time. As is true for all Plan participants, investment allocations can be changed by a participant at any time.

C. TPA AND PAYROLL SYSTEM REQUIREMENTS/OPERATIONS

As previously indicated, staff has held discussions with Great-West, the City Controller and DWP Payroll in order to identify systems options and requirements that will impact the design of the AEP. In general, all of the design provisions included within this report are consistent with the information provided by these three entities. Of note is the following:

(1) Both payroll systems have indicated that they can produce bi-weekly files identifying those employees who (a) are in MOUs for which auto enrollment has been approved for those members; and (b) are first-time contributors to one of the City's three primary defined benefit plans.

(2) Upon receipt of this listing, Great-West will provide the individuals identified as eligible with Plan information and approximately 30-days notice that, barring action on the employee's part to opt out, an automatic enrollment deferral will begin as of a given date.

(3) Both payroll systems will then provide bi-weekly files indicating the employees and their contribution percentages to be uploaded to the appropriate payroll system.

(4) By creating a percent-of-pay mode for the AEP, the percent of pay will be a new option for establishing or modifying contributions for existing participants.

(5) After contributions begin, the participant will still have 90 days to request a permissible withdrawal from his/her account; this will be treated as a distribution from Great-West (tax-reported on a 1099) and no adjustment of the employee's W-2 wages will be required of the City's payroll systems.

D. RECOMMENDATIONS FOR FURTHER ACTION

Staff recommends that the Board adopt the Committee's recommended core AEP provisions. Once these plan design features have been identified, staff will work with Board counsel, the Plan Administrator, and the City's payroll systems to address any operational issues that may arise in connection with implementing the preferred plan design before developing the proposed final codification of the AEP within the Deferred Compensation Plan "Plan Document." The Plan Document language will then be brought to the Board for approval. Upon adoption, the AEP program would be open to begin the initial pilot group testing phase with an interested bargaining group.

These and other next steps are outlined within a tentative timeline as follows:

<table>
<tr><th>DESCRIPTION</th><th>TIMELINE</th></tr>
<tr><td>Board Review & Approval of AEP Core Provisions</td><td>December 16, 2014</td></tr>
<tr><td>Board Adoption of AEP Plan Document Provisions</td><td>January 20, 2015</td></tr>
<tr><td>Logistics Planning
• Develop implementation and communication plan with Great-West and the two City payroll systems (Controller's Office and DWP Payroll)</td><td rowspan="3">1st-2nd Quarters 2015</td></tr>
<tr><td>Identification of Pilot Bargaining Unit(s)</td></tr>
<tr><td>Board Adoption of Implementation & Communication Plan</td></tr>
<tr><td>Pilot Group Testing & Implementation</td><td>By 3rd Quarter 2015</td></tr>
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Submitted by: ______________________________

Esther Chang

Approved by: ______________________________

Steven Montagna

ATTACHMENT I

PROPOSED AUTO-ENROLLMENT PROGRAM (AEP) DESIGN OVERVIEW

Eligibility	Employees must meet BOTH criteria: 1) Original contributing member to LACERS, LAFPP, or DWP Retirement. 2) Member of bargaining unit, or member of bargaining unit subject to Administrative Code provision, that provides for auto enrollment.
Enrollment and Opt-Out	• Once determined eligible, participant is given a 30-day opt out period prior to the first deferral. • After the first deferral, participant has 90 days to request a permissible withdrawal of funds.
Initial Contribution	Rate: Participants will begin with **2%** of eligible gross pay Type: **100% Pre-tax**
Contribution Escalation	Contribution rate will be increased **0.25% annually**, with no maximum cap.
Default Investment	FDIC-Insured Savings Account during the first 90 days subject to permissible withdrawal opt-out provision; Moderate Profile Fund thereafter.

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October 30, 2014

All City of Los Angeles Employee Labor Organizations

City of Los Angeles Deferred Compensation Plan – Development of Auto Enrollment Option

The purpose of this correspondence is to bring to your attention the development of an **automatic enrollment** ("auto enrollment") program within the City of Los Angeles Deferred Compensation Plan, which will be **optional** for any employee labor organization wishing to participate in the program. The City's Board of Deferred Compensation Administration, which governs the Plan, is in the process of developing this program with a target implementation date of the first quarter of 2015.

The goal of auto enrollment is to facilitate new employee participation into the Deferred Compensation Plan. **Auto enrollment is not "mandatory enrollment" because it will provide employees with the ability to easily "opt out" of participating if they so choose.**

All terms and features of the automatic enrollment option (including the initial contribution amount, default investment option, auto-escalation of contributions, etc.) will be established by the Board within its "Plan Document," the governing document providing for the rules and administrative procedures of the Plan. On **November 18, 2014**, the Board will be considering the proposed features of the auto enrollment program developed by its Plan Governance Committee. If you would like to provide input on these features you are welcome to attend the Board meeting or otherwise share your feedback by contacting our Employee Benefits Division Chief, Steven Montagna, at steven.montagna@lacity.org. Information regarding the Deferred Compensation Plan, Board meetings, and development of the auto enrollment program is available at http://per.lacity.org/DeferredComp/Deferred_Comp_Main%20Page.htm. The report containing the proposal for the auto enrollment program will be posted on this website on or before November 13, 2014.

The automatic enrollment program will be open to any employee bargaining unit electing to participate in it by including that election within the terms of its MOU. If there is no election by a bargaining unit to participate, the members of that bargaining unit will not otherwise be impacted. Upon adoption, bargaining units electing to participate will be phased in based on a schedule approved by the Board. Implementation will occur in stages so that payroll and recordkeeping processes can be closely monitored, tested and refined.

If you have any questions, feel free to contact me at (213) 473-3474 or Mr. Montagna at (213) 978-1621. Thank you very much for your consideration of this matter.

Alex Basquez, Assistant General Manager
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