Deferred Compensation Plan
BOARD REPORT 11-80

Date: December 14, 2011

To: Board of Deferred Compensation Administration

From: Staff

Subject: Revisions to Plan Document Concerning After-Tax Rollovers, Minimum Distribution Waiver, Distributions for Health Insurance Premiums for Retired Safety Officers, and the Heroes Earnings Assistance and Relief Tax Act of 2008

Recommendation:
That the Board of Deferred Compensation Administration approve staff/Mercer recommended revisions to the Deferred Compensation Plan "Plan Document" in order to incorporate certain mandatory/optional Federal legislative changes.

Background:
Periodically, Federal legislative changes create mandates or opportunities for updating plan documents used by plan sponsors to administer Section 457 plans. The City's consultant, Mercer Investment Consulting ("Mercer"), has advised staff of the following mandates and optional revisions. Staff has reviewed the basis for the changes and is recommending adoption of the following provisions.

I. "Eligible Retirement Plan" Definition

Changes were made to rollover rules by the Pension Protection Act of 2006 (PPA) and the Worker, Retiree and Employer Recovery Act of 2008 (WRERA). Prior to the PPA, after-tax fund rollovers were allowed only to defined contribution plans. With the PPA, after-tax fund rollovers are now permitted to *defined benefit plans* and *Roth individual retirement accounts (IRAs).* Now that the City's Plan has incorporated Roth accounts, incorporating this provision provides participants the opportunity to roll over their after-tax holdings to these additional plan types.

The language being recommended to be added to the Plan Document clarifies and adds to the current definition of an "eligible retirement plan" and adds to the list of eligible retirement plans to which after-tax amounts can be directly rolled over. This applies to distributions of after-tax contributions occurring on or after January 1, 2008.

Federal legislation requires that this benefit be extended to Plan participants, so a Plan amendment incorporating this change must be adopted by December 31, 2011. The recommended language is to be added to Section (II)(q) of the Plan Document, *Definitions – "Eligible Retirement Plan,"* as indicated below:

> Effective for distributions of after-tax contributions (including Designated Roth Contributions) occurring on or after January 1, 2008, 'Eligible Retirement Plan' includes a qualified trust described in IRC § 401(a) maintained by a defined benefit plan or a Roth IRA described in IRC § 408A.

II. Minimum Requirement Distribution Waiver for 2009

A WRERA provision waived minimum required distributions (MRDs) for 2009 in response to the economic downturn at the end of 2008 and resulting financial hardships. Minimum required distribution essentially means that once a participant reaches the age of 70½ (s)he must take distribution from his/her account at a rate creating a reasonable expectation that the account will be exhausted over the participant's life expectancy. The WRERA provision allowed participants subject to MRD in 2009 to waive the distribution if they chose. The Federal government's rationale for enacting this was that it did not want to force distributions (and investment liquidations) during the severe market downturn occurring at that time.

Making this benefit available was required, but plans were given until December 31, 2011 to update their plan documents. As a result, a Plan amendment to comply with this WRERA provision <u>must</u> be adopted by <u>December 31, 2011.</u> The recommended language is to be added, as indicated below, to Section (V)(f) of the Plan Document, *Distribution of Benefits* - *Conformance with Internal Revenue Code (IRC)*:

> Effective January 1, 2009, a Participant or Beneficiary may elect on an individual basis to suspend all or part of the distribution that would otherwise be required by this Section (V)(f) for the 2009 distribution calendar year. Any amount that is distributed to a Participant or Beneficiary for the 2009 distribution year shall be treated as an Eligible Rollover Distribution only if it would be an Eligible Rollover Distribution without regard to the preceding sentence.

III. Distributions for Health Insurance Premiums of Retired Public Safety Officers

Effective for distributions made after December 31, 2006, a participant who is an eligible retired public safety officer may elect to exclude from taxable income up to $3,000 annually for out-of-pocket payments made for health, accident, or long term care insurance premiums. Coverage can be for the retiree or the retiree's spouse and/or dependents. To be eligible, the payment must be paid directly from a retirement account to the provider.

Board member John Mumma brought this issue to the attention of staff and staff conducted further research. Fire & Police Pensions ("Pensions") has already implemented this benefit for its members receiving Pensions-sponsored health care. Given this, it may be rare that a retired public safety officer would have a need to utilize this benefit through the City's Deferred Compensation Plan. However, some potential circumstances that might qualify include retirees paying for non-Pensions sponsored health care, or retirees paying for accident or long-term care insurance that is not deducted from their Pensions retirement check. Staff is working with Great-West to develop a form for individuals to use the Plan for direct payment of eligible insurance premiums.

A Plan amendment incorporating this change is optional but recommended by Mercer and staff. The recommended language would be added to Section V of the Plan Document, *Distribution of Benefits,* as indicated below:

(n) Distributions for Health Insurance Premiums of Retired Public Safety Officers

Effective for distributions made after December 31, 2011, a Participant who is an eligible retired public safety officer (as defined in IRC §402(l)(4)(B)) and who has separated from service as a public safety officer with the Employer, may elect a distribution to be paid by the Plan from the Participant's account directly to an insurer for payment of qualified health insurance premiums (as defined in IRC §402(l)(4)(D)), up to $3,000 per taxable year (or such other limitation prescribed in IRC §402(l)(2)). Such election shall be made in accordance with procedures established by the Plan Administrator(s).

IV. Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART)

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) provides benefits for participants who died on or after January 1, 2007 during qualified military service. This mandatory provision requires that these participants be treated as if they had died in active employment for Plan death benefit purposes. This generally requires that a benefit which would have become vested or increased upon the participant's death as an active employee will be vested or increased upon death while in military service. Though the Plan does not provide for benefits that are specially vested upon a participant's death, Mercer indicates that incorporating it into the Plan Document is nevertheless likely required under HEART.

As a result, a Plan amendment incorporating the mandatory HEART death benefit provision must be adopted by December 31, 2012. The recommended language is to be added, as indicated below, to Section (XI)(d), *Miscellaneous – Qualified Military Service:*

Should a Participant die while performing qualified military service after December 31, 2006, such Participant's Beneficiaries are entitled to receive any additional Plan benefits (other than contributions) that would have been provided had the Participant resumed employment with the City and then terminated employment on account of death.

Conclusion:

For additional clarity, the proposed language changes are provided in "Track Changes" format in the attached revised Plan Document. Once the Board adopts the changes an updated version of the Plan Document will be provided to Board members and posted on the Plan website.

Submitted by: ______________________________
Esther Chang

Reviewed by: ______________________________
Steven Montagna

Approved by: ______________________________
Alejandrina Basquez