

Deferred Compensation Plan BOARD REPORT 13-03

Date: January 2, 2013
To: Board of Deferred Compensation Administration
From: Staff
Subject: Self-Directed Brokerage Option – Pre-Tax and After-Tax Account Separation

*Board of Deferred
Compensation Administration
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Recommendation:

That the Board of Deferred Compensation Administration receive and file the following information regarding separating pre- and after-tax amounts in the Plan's Self-Directed Brokerage Option (SDBO) with Charles Schwab.

Discussion:

In December 2012 Great-West indicated to staff that it was preparing to implement functionality to establish separate pre-tax and after-tax accounts within the Self-Directed Brokerage Option (SDBO). Presently there is no functionality that exists to track pre-tax and after-tax amounts separately within the SDBO, which is administered by Charles Schwab ("Schwab"). This means that the "translation" of account balances into pre- and after-tax dollars happens based on a proration formula as the Great-West recordkeeping system and Schwab exchange balance information on a daily basis. Separating the after-tax balance into a second SDBO account will allow after-tax earnings to be tracked separately.

According to Great-West, tracking the accounts separately is something that is required by Federal regulation. Translating of SDBO amounts using the formulaic approach is not the optimal way to track pre- and after-tax dollars, which is why Great-West has been working on implementing a more sophisticated approach which would essentially involve creating separate pre- and after-tax accounts with Schwab.

This change should be experienced by most SDBO participants as an enhancement. First, it will allow them to invest pre-tax and after-tax dollars more strategically (a feature several SDBO participants have been requesting) by, for example, directing after-tax dollars into investments with higher anticipated growth potential and pre-tax dollars into slower-growing investments. Second, it will provide participants with the ability to make "like-kind" transfers of SDBO investment holdings to external providers should they elect, after-termination, to roll funds out of the Plan.

Great-West is planning to implement the new functionality in two phases. Phase 1 will apply to new SDBO accounts only, requiring that participants make an election regarding establishing either a pre-tax, after-tax, or both types of accounts within the SDBO. Phase 2 will involve separating accounts of current SDBO investors with after-tax balances into separate pre- and after-tax accounts. There are presently 109 participants who have after-tax dollars in their SDBO accounts.

Phase 1 will be implemented January 21, 2013. Phase 2 will be implemented in approximately the second quarter of 2013, with a precise date to be established jointly by Great-West and staff.

An article regarding this change will be included in the Plan's January 2013 quarterly newsletter, and will simultaneously be posted on the Plan's website. Once Phase 1 is implemented, new SDBO participants with after-tax dollars will be provided information regarding the pre-tax/after-tax election at the time of enrolling in the SDBO.

Prior to implementing Phase 2, a special communication will be provided to affected participants outlining the upcoming changes and providing them with instructions for setting up their new accounts. Great-West has developed a process to first transfer cash equal to the participant's after-tax SDBO balance to the new after-tax SDBO account. If there is insufficient cash to complete this transaction, a participant will have an opportunity to sell other assets in his/her SBDO account to create enough cash equal to the after-tax SBDO balance. Otherwise, shares of securities will be transferred to the after-tax SDBO account in the following order: (1) mutual funds, in alphabetical order by fund name; and (2) settled stocks and exchange traded funds (ETFs), in alphabetical order.

Going forward, participants that have both types of SDBO accounts who are transferring balances back to the Plan's core investment menu will select which account they want to transfer into or out of by clicking on the appropriate link.

There will be no additional recordkeeping fee for the second SDBO account; however, each SDB account will incur its own transaction costs.

Submitted by _____
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