

Deferred Compensation Plan PLAN GOVERNANCE & ADMINISTRATIVE ISSUES COMMITTEE REPORT 14-01

Date: August 8, 2014

To: Plan Governance & Administrative Issues Committee

From: Staff

Subject: Deferred Compensation Plan Automatic Enrollment Program Elements

*Board of Deferred
Compensation Administration
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Recommendation:

That the Plan Governance and Administrative Issues Committee:

1. Consider staff's report on Auto Enrollment Program provisions and staff recommendations for establishing an Auto Enrollment program within the Deferred Compensation Plan; and
2. Adopt recommendations to the Board of Deferred Compensation Administration for Auto Enrollment Program provisions for the City's Deferred Compensation Plan.

Discussion:

A. BACKGROUND

At its December 17, 2013 meeting, the Board requested that its Plan Governance and Administrative Issues Committee develop recommendations for creating an Auto Enrollment Program (AEP). An AEP involves automatically placing newly hired employees into an employer's defined contribution 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. 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 order to establish an AEP for the City's Plan the Board would have to develop and adopt following key design provisions of the proposed program:

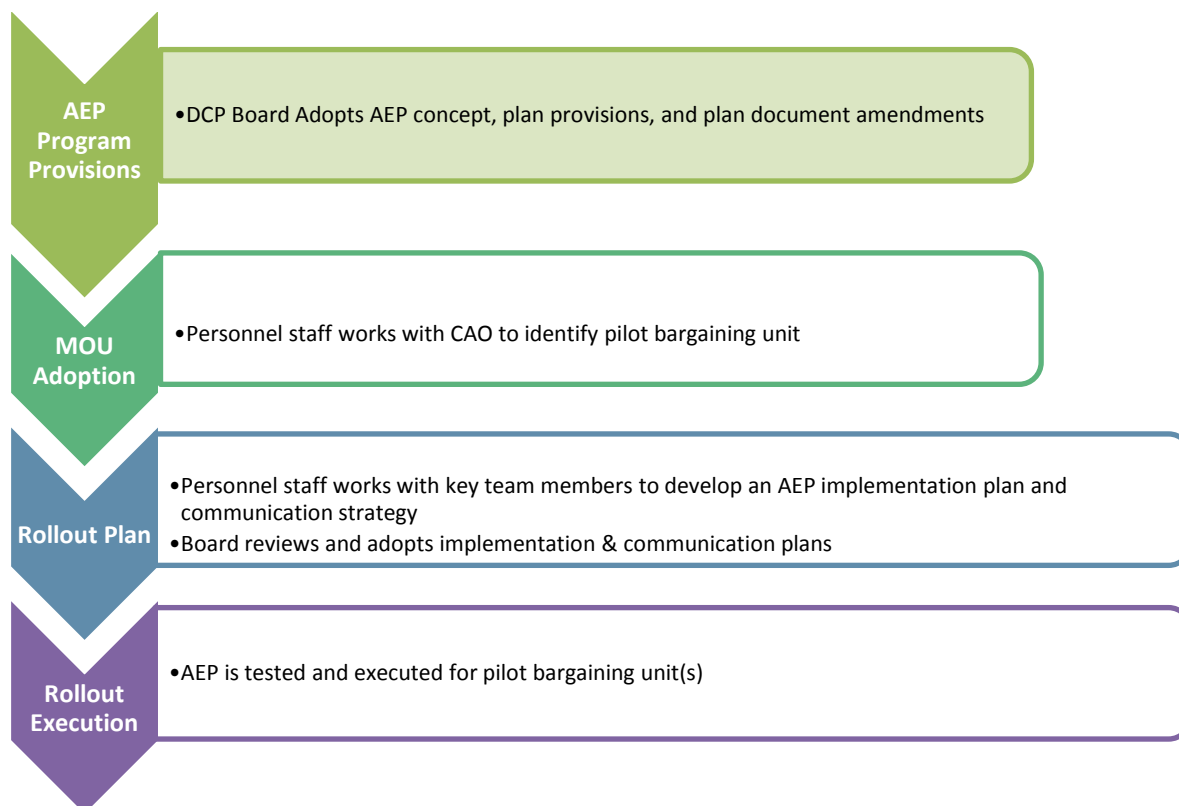
1. Participation and Opt-Out Provision
2. Contribution Amount and Contribution Formula
3. Auto-Escalation
4. Contribution Type (pre-tax versus after-tax)
5. Default Investment

During the December 17, 2013 Board meeting, staff advised the Board that participation in the AEP would require collective bargaining agreement provisions for represented employees and a City ordinance for non-represented employees. The development of the AEP should consist of one program that would apply to all participants. In this report, staff has reviewed and discussed the relevant decision points necessary to design an auto enrollment program, and prepared an analysis and recommendations for each program provision. An overview of the proposed AEP provisions are also included in Attachment I.

Committee recommendations on AEP provisions will be forwarded to the Board for consideration. Once the Board adopts these provisions, staff will work with the City Attorney's Office, the Board's consultant (Mercer Investment Consulting) and third-party-administrator (Great-West Financial) to draft the necessary Plan Document modifications which will subsequently be presented to the Board for consideration and final approval.

The Personnel Department has initiated discussions with the City Administrative Office (CAO) to identify a potential bargaining unit interested in being an AEP pilot group. 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:



B. MISSION, TARGET POPULATION & CURRENT PARTICIPANT CONTRIBUTION PATTERS

Before addressing specific addressing program provisions staff believes it is important for the Board to establish its target population and the goal of the program. Doing so will make it easier 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 staff believes it is important to add greater specificity regarding "to what purpose." As a result, staff has drafted a goal for the AEP which is 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).

Staff recommends that the goal of the AEP 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 and in a manner consistent with how City employees presently achieve this objective. 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 ongoing 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. Adopting a goal for the AEP will create a useful framework for addressing the policy decisions that will be used in the final adopted 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 and (b) have an MOU or Administrative Code provision allowing for auto enrollment.

This definition sets forth two conditions to be auto-enrolled into the Plan: original contributing member to one of the City's three primary defined benefit plans, and belonging to a collective bargaining unit or subject to an Administrative Code provision that provides for auto enrollment. This 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

As noted in the draft goal of the AEP, 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 patterns 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.

(C) AEP RECOMMENDED PROVISIONS

(1) Contribution Form: Percent of Pay

Staff 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 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 our 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.

(a) Contribution Type: 100% Pre-Tax – Ideally staff would be recommending that the auto enrollment program 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, Great-West indicates that presently it 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 grows across the country.

(b) Contribution Structure: Initial Contribution Percentage of 2% with Auto-Escalation of Additional 0.25% Per Year Ongoing - Staff 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 (and 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 \$40,000*

would begin with a bi-weekly deferral of \$27, and see a 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, staff 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 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 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 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% after 30 years, sworn personnel are eligible to retire at younger ages and there are sharp differentials in percent of pay income replacements for Tier 6 members (4% per year after 25 years of service).

- (c) Opt-Out Feature** – Pension Protection Act contains safe harbor guidelines permit an employee to opt out of the program within 30-90 days of the first contribution, and to withdraw funds in full without penalty. Staff recommends that a 90-day opt-out provision be included in the City’s Plan.
- (d) Default Investment** – 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 presumably be included within the definition of “Balanced Funds.” Staff recommends that participant contributions initially be defaulted into the DCP FDIC-Insured Bank Deposit Account for the first 90 days, and then subsequently 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.

C. TPA AND PAYROLL SYSTEM REQUIREMENTS/OPERATIONS

As previously indicated, staff has held discussions with Great-West, 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 above 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 opt out and receive a distribution of 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 Plan Governance and Administrative Issues Committee adopt recommended AEP provisions for consideration by the full Board.

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." These and other next steps are outlined below:

DESCRIPTION	TIMELINE
Board Review & Approval of AEP	October 21, 2014
Governance Documents Review (to allow for AEP) <ul style="list-style-type: none"> Review language necessary for Plan Document and/or Administrative Code (by ordinance) 	By beginning of 2015
Logistics Planning <ul style="list-style-type: none"> Develop implementation and communication plan with Great-West and the two City payroll systems (Controller's Office and DWP Payroll) 	
Identification of Pilot Bargaining Unit(s) <ul style="list-style-type: none"> Discussions to be held with CAO and interested unions 	
Board Review of Implementation & Communication Plan	
Pilot Group Testing	1 st or 2 nd quarter 2015
AEP Implementation for all Participating Bargaining Units	TBD

Submitted by: _____
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Approved by: _____
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PROPOSED AUTO ENROLLMENT PROGRAM (AEP) DESIGN OVERVIEW

Eligibility	<p>Employees must meet BOTH criteria:</p> <ol style="list-style-type: none"> 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	<ul style="list-style-type: none"> • 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	<p>Rate: Participants will begin with 2% of eligible gross pay Type: Pre-tax only for initial implementation</p> <p><i>An employee with a \$30,000 annual salary will start with a \$23 pre-tax deduction per paycheck (actual net reduction of pay: \$18).</i></p>
Contribution Escalation	<p>Contribution rate will be increased 0.25% every year thereafter, with no maximum cap.</p> <p><i>After 30 years, an employee would be contributing 9.5%. Current Plan participants with 30+ years of service are on average contributing 9-10%.</i></p> <p><i>Note: Once an employee actively changes their pre-tax contribution amount, they will be taken off of the auto enrollment/escalation track.</i></p>
Default Investment	<p>Moderate Profile Fund</p> <p><i>Participants will be defaulted into the FDIC-Insured Savings Account during the first 90 days to protect their balance should they decide to take a permissible withdrawal.</i></p>