



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Alex Gurza

SUBJECT: SEE BELOW

DATE: August 6, 2012

Approved

Date 8/14/12

SUBJECT: ORDINANCE TO AMEND VARIOUS SECTIONS OF CHAPTERS 3.48 AND 3.50 OF THE SAN JOSE MUNICIPAL CODE TO COMPLY WITH THE HEROES EARNINGS ASSISTANCE RELIEF TAX ACT; INCORPORATE THE ROTH 457 OPTION IN THE DEFERRED COMPENSATION PLAN; AND ELIMINATE THE 30-DAY ELECTION REQUIREMENT AND ALLOW BENEFITS TO CONTINUE TO BE HELD UNDER THE CITY'S DEFERRED COMPENSATION PLAN AFTER A SEVERANCE EVENT

RECOMMENDATION

Approve an Ordinance to:

- (a) Amend Chapters 3.48 and 3.50 of Title 3 of the San José Municipal Code ("SJMC") to incorporate the federal Heroes Earnings Assistance Relief Tax Act ("HEART Act") provisions into the City's 457 Deferred Compensation Plan and PTC Plan ("Plans");
- (b) Amend Chapter 3.48 of Title 3 of the SJMC to incorporate the Roth 457 option into the City's 457 Deferred Compensation Plan ("Deferred Compensation Plan");
- (c) Amend Chapter 3.48 of Title 3 of the SJMC to eliminate the 30-day election requirement and allow benefits to continue to be held under the Deferred Compensation Plan after a severance event.

OUTCOME

Approval of the recommendation will:

- (a) Ensure that the Plans are compliant with the HEART Act;
- (b) Provide a new option for employees to save for retirement in their Deferred Compensation Plan account; and

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- (c) Allow benefits to continue to be held under the Deferred Compensation Plan after a severance event and ensure compliance with the requirements under Internal Revenue Code Section 401(a)(31).

BACKGROUND

HEART Act

The federal HEART Act made several changes to governmental 457(b) deferred compensation plans. The HEART Act impacts the City's Plans, which reside under SJMC Chapters 3.48 and 3.50, respectively. The deadline for amending the Plans for compliance under the HEART Act is December 31, 2012. While the Plans were not required to be amended to adopt the HEART Act changes until December 31, 2012, all mandated administrative requirements have already been implemented by the Plan Administrator, ING, in conformance with the HEART Act.

Roth 457 Option

On September 27, 2010, the Small Business Jobs Act of 2010 (HR 5297) was signed into law. This Act includes a provision that allows governmental 457(b) deferred compensation plans to offer a Roth 457 option to participants effective January 1, 2011 or thereafter. In addition, given recent legislative changes and the popularity of Roth in other defined contribution plans, the Roth 457 option is expected to become an inherent feature within 457(b) plans.

Elimination of 30-day Election Requirement and Allow Benefits to Continue to be Held Under the Plan

In March 2012, the Deferred Compensation Advisory Committee ("Committee") reviewed and discussed strategies on helping participants plan for retirement based on current environmental factors. As a result of this discussion, and in an effort to retain all contributions as long as possible to reduce the overall expenses on funds for participants, the Committee approved the recommendation regarding eliminating the requirement for participants to make an election decision within 30 days after a severance event.

Pursuant to the current Section 3.48.130 of Title 3 of the SJMC, participants that separate need to elect the method of payment and settlement options no later than 30 days after their severance event. There is no Internal Revenue Code requirement that a participant must elect the method of payment within 30 days after a severance event. Additionally, the current Section 3.48.130 of the SJMC provides that if the participant does not make an election after the severance event, a lump sum distribution will be made, and that does not comply with the requirements under Internal Revenue Code Section 401(a)(31), which requires a participant's consent to distributions over \$1,000.

ANALYSIS

In order to have the Plans reflect the HEART Act requirements and have the Deferred Compensation Plan incorporate the Roth 457 feature, eliminate the 30-day election requirement

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and allow the benefits to continue to be held under the City's Plan, the City must amend various sections of Chapters 3.48 and 3.50 of the SJMC as follows:

The HEART Act

The federal HEART Act provides additional tax and pension benefits to individuals who are absent from work due to duty in the uniformed military service. Some provisions of the HEART Act are mandatory, while others are optional.

Mandatory Provisions

The HEART Act requires a change to the definition of "Includible Compensation" in the Plans. "Includible compensation" must include differential wage payments to participants on active duty. These are payments that are made to a participant by the City while the participant is serving in qualified military service. Chapter 3.48.030 (E) in the Deferred Compensation Plan and Chapter 3.50.030 (D) in the PTC Plan have been amended to include this requirement.

The HEART Act also requires that the time a participant serves in the uniformed service shall be deemed to constitute service with the City upon reemployment. In addition, the Plans must provide that contributions, benefits and service credit with respect to qualified military service will be provided in accordance with the provisions of Internal Revenue Code Section 414(u). Internal Revenue Code Section 414(u) permits qualified participants to make additional elective deferrals under the Plans after the participant returns from qualified military service. Chapter 3.48.050 (E) of the Deferred Compensation Plan and Chapter 3.50.050 (B) of the PTC Plan have been amended to include these requirements.

Finally, the HEART Act requires that if a participant dies during military service, the Plans must provide survivor benefits as if the participant had resumed employment and then had a severance event on account of death. Chapter 3.48.134 (E) of the Deferred Compensation Plan and Chapter 3.50.150 (E) of the PTC Plan have been amended to include this requirement.

Optional Provision

There is one provision under the HEART Act that is optional to include in the Plans. Under the HEART Act, a plan may treat active military service as a severance from employment for purposes of receiving a distribution from a plan. If a participant elects to receive a distribution from a plan as a result of this provision, the participant is prevented from making deferrals to the plan during the six-month period beginning on the date of the distribution.

The Human Resources Department recommends adopting this optional provision because it provides the participant the option to access funds for unforeseen or unplanned expenses while the participant is on military leave. Chapter 3.48.130 (G) of the Deferred Compensation Plan and Chapter 3.50.120 (G) of the PTC Plan have been amended to include this optional provision, which will be effective January 1, 2013.

Roth 457 Feature

Under the new Roth 457 provisions, which would take effect on or after January 1, 2013, participants now have an additional option of contributing after-tax dollars to a Roth 457 feature. The Roth 457 feature will allow participants to make after-tax contributions into the Deferred Compensation Plan that would be subject to income tax in the year in which contributions are made, but investment earnings on those contributions within the Deferred Compensation Plan would be tax-free if, when withdrawn, the distribution meets certain IRS criteria.

This option would be in addition to participants' current ability to contribute pre-tax dollars into the Deferred Compensation Plan. Any after-tax Roth contributions would be included in the usual Plan annual deferred contribution limits. For example, the 2012 annual contribution limit of \$17,000 would apply to both pre-tax contributions and Roth 457 after-tax contributions. Participants would be allowed to choose to contribute with pre-tax dollars only, with Roth 457 after-tax dollars only, or a combination of both.

Proposed Amendments to Incorporate Roth 457 Option to Chapter 3.48 of Title 3 of the SJMC

Below is a list of proposed amendments to incorporate the Roth 457 feature in the Deferred Compensation Plan.

1. Chapter 3.48.040 (F) of the Deferred Compensation Plan has been amended to provide that on or after January 1, 2013 an employee may specify that any portion of compensation deferred may be classified as Roth deferrals. This will also apply to any deferrals made by rehired military personnel.
2. Chapter 3.48.040 (G) of the Deferred Compensation Plan has been amended to provide that if the maximum deferral limit is exceeded for any taxable year, an employee may designate how the distribution of excess deferrals shall be determined. If no designation made, the Roth deferrals shall be distributed first.
3. Chapter 3.48.055 (A)(4) of the Deferred Compensation Plan has been amended to provide that an employee may directly transfer to this plan Roth elective deferrals from another governmental 457 plan.
4. Chapter 3.48.058 (A)(5) of the Deferred Compensation Plan has been amended to provide that an employee may directly rollover to this plan Roth elective deferrals from another eligible retirement plan.
5. Chapter 3.48.130 (H) of the Deferred Compensation Plan has been amended to provide that after a severance event (except death), a participant may elect to convert non Roth elective deferrals to Roth elective deferrals which will continue to be held under the plan until a distribution is requested.
6. Chapter 3.48.131 (D) of the Deferred Compensation Plan has been amended to define "qualified distribution" in determining which portion of a Roth elective deferral account is not taxable.

7. Chapter 3.48.131 (E) of the Deferred Compensation Plan has been amended to provide that on or after January 1, 2013, if a Roth elective deferral is made by an employee under Section 3.48.040.D for a year of qualified military service pursuant to Internal Revenue Code section 414(u) that is before the year in which the Roth elective deferral is actually made, the employee may identify the year of qualified military service to which the Roth elective deferral applies for the purpose of determining the five-taxable-year period described in Section 3.48.131.C. In the absence of such designation, the Roth elective deferral shall be treated as relating to the first year of qualified military service for which the employee could have made Roth elective deferrals under the plan, or if later, January 1, 2013.
8. Chapter 3.48.135 of the Deferred Compensation Plan has been amended to provide that if a participant obtains a withdrawal for an unforeseeable emergency, the participant's Roth deferral account and Roth rollover account shall be distributed first.
9. Chapter 3.48.140 (J) of the Deferred Compensation Plan has been amended to provide that loans are not available from a participant's Roth elective deferral account or Roth rollover account, but Roth accounts may be taken into account in determining the maximum loan that a participant may obtain.

Elimination of 30-day Election Requirement and Allow Benefits to Continue to be Held Under the Plan

Chapter 3.48.130 of the Deferred Compensation Plan currently provides that a participant may elect the method of payment and the settlement options for distribution in the event of retirement, disability or other severance event, except death, no later than thirty days after such severance event. There is no Internal Revenue Code requirement that a participant must elect the method of payment within 30 days after severance. Moreover, the current Chapter 3.48.130 does not comply with Internal Revenue Code Section 401(a)(31), which requires that a participant consent to distributions over \$1,000. If a participant's account is greater than \$1,000 and the participant does not request or consent to a distribution upon severance from employment, the participant's account cannot be subject to a mandatory lump-sum distribution. Amounts of \$1,000 or less, however, are exempt from this rule and may be subject to a lump-sum distribution.

The Committee proposes to amend the Deferred Compensation Plan to eliminate the 30-day election requirement and the mandatory payout distributions regardless of participant consent, and to provide that if no election of method of payment is made, the benefits will continue to be held in the Plan until the participant makes an election. Chapters 3.48.130, 3.48.132, 3.48.133, and 3.48.134 of the Deferred Compensation Plan have been amended accordingly to remove the 30-day election and mandatory distribution provisions and to allow benefits to continue to be held in the Plan.

Review by Collective Bargaining Units

Because some of the proposed changes to the Plans are optional, the Office of Employee Relations notified each of the City's collective bargaining units on July 31, 2012, about the Committee's recommendations to add the following:

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- (1) The optional provision under the HEART Act in Chapter 3.148.130 of the Deferred Compensation Plan and Chapter 3.50.120 of the PTC Plan;
- (2) The Roth 457 option to the Deferred Compensation Plan; and
- (3) The elimination of the 30-day election requirement regarding mandatory payout distributions and allowing the benefits to continue to be held in the Deferred Compensation Plan if no election is made.

As of the date of this memo, the Office of Employee Relations has not received any responses to the notification provided.

EVALUATION AND FOLLOW-UP

An Ordinance amending the SJMC will:

- (a) Allow compliance with the HEART Act;
- (b) Provide a new option for employees to save for retirement in their Deferred Compensation Plan account; and
- (c) Allow benefits to continue to be held under the Deferred Compensation Plan after a severance event and ensure compliance with the requirements under Internal Revenue Code Section 401(a)(31).

No additional City Council action is expected for these amendments.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item does not meet any of the criteria above.

This recommendation was reviewed and unanimously supported by the Deferred Compensation Advisory Committee.

This memorandum and associated ordinances will be posted to the City's website for the August 28, 2012 City Council Agenda.

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COORDINATION

This memorandum has been coordinated with the Office of the City Attorney and the Office of Employee Relations.

COST SUMMARY/IMPLICATIONS

There are no anticipated cost implications to the City or the Plan participants for the implementation of the recommended changes to the Plans.

CEQA

Not a Project, File No. PP10-066(e) Services that involve no physical changes to the environment.



ALEX GURZA
Deputy City Manager

For questions please contact Mike Sung at (408) 975-1453.