



**The National Association of Government Defined  
Contribution Administrators, Inc. (NAGDCA)**

*presents*

**2010 NAGDCAST #3:**

**The Roth 457 is Here: Now What?**

# Program Introduction

Dean Weltman

Plan Compliance Officer

New York City Deferred Compensation Plan

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**THANK YOU!**

# Today's Speakers

**Pamela Hess,**

Director of Retirement Research, Aon Hewitt

**Rick Rodgers,**

Principal, Insight Employee Benefit Communications

**Dean Weltman,**

Plan Compliance Officer, New York City, NY

# Understanding the Roth 457 Deferred Compensation Plan

Rick Rodgers, AIF® | Principal  
InSight Employee Benefit Communications, Inc.

# Your 457 Elective Deferral

- 2011 Contribution limits
  - ◆ Normal Limit: \$16,500
  - ◆ Age 50 Catch Up: \$5,500
  - ◆ Special Catch Up: Additional \$33,000 (conditional)
- Your pre-tax contribution is always 100% vested
- Generally, change your contribution any time
- Contributions

# Introducing Roth 457 Contributions

- Roth contributions allow you to save on an After-tax basis
- No current-year tax deduction for Roth contributions
- Tax-free earnings based upon certain provisions
- 2011 contribution limits same as traditional
- Limits Apply to Total of All Employee Contributions, Whether Pre-Tax, Roth, or a Combination
- Use tax benefits provided by the Internal Revenue Code to benefit growth of your retirement savings

# Roth Distributions

- Tax-Free Withdrawals of Your Contributions and Any Earnings
  - At Least Age 59½
  - Made First Roth Contribution at Least Five Years Prior to Withdrawal
  - Permanent Disability
  - Death

# No Crystal Ball

- Assumptions
  - Current marginal tax rates
  - Applicable tax rate in retirement
  - Assumed and actual investment return
- Government Tax Policy
- Your Income
- Family Status
- Ability to use different sources as a tax tool



# Tax Benefits

	<b>Contributions</b>	<b>Earnings</b>
Traditional 457(b) Elective Employee Contributions	Tax-deferred	Tax-deferred
Roth 457(b) Elective Employee Contributions	After-tax	Tax-free
Matching Employer Contributions	Tax-deferred	Tax-deferred

# Your Pre-Tax Savings

	Pre-tax	After-tax
Annual gross salary	\$45,000	\$45,000
Semi-monthly gross salary	\$1,875	\$1,875
Pre-tax employee contribution (6%)	\$112.50	\$0
<b>Taxable pay</b>	<b>\$1,762.50</b>	<b>\$1,875</b>
FICA and Medicare (7.65%)	\$143.44	\$143.44
Federal income tax*	\$139.90	\$156.77
Net (take-home) pay	\$1,479.16	\$1,514.79
After-tax personal savings account (6%)	\$0	\$112.50
<b>Net pay after savings</b>	<b>\$1,479.16</b>	<b>\$1,462.29</b>
Total income taxes paid	\$139.90	\$156.77
<b>Difference</b>	<b>\$16.87</b>	

\* Federal income tax withholding based upon a married taxpayer claiming 2 withholding allowances. Pre-tax employee contributions also reduce applicable state income tax liability (not included in illustration above).

# Other Considerations

- Rollovers
- Conversions
- Employer Matching Contributions

# ***From Tax Deferred to Tax Favored***

## **A Plan Perspective About Roth: The New York City Deferred Compensation Plan**

Dean Weltman, Plan Compliance Officer

New York City Deferred Compensation Plan



# Agenda

- What is NYC DCP?
- DCP History
- Roth Legislation (401(k) and 457)
- Roth After-Tax Program
- Addition of Roth 401(k)
  - Administrative Changes
    - Recordkeeper
    - Payroll
  - Communication Changes
    - Plan mechanics materials
    - Education materials
    - Website
- Deemed IRA

# Array of Retirement Programs

## New York City Tax-Favored Programs

### Deferred Compensation Plan

### NYCE IRA

457

401(k)

Traditional  
NYCE IRA

Roth  
NYCE IRA

Pre-Tax

Roth

Pre-Tax

Roth

Employee  
& Retiree

Spousal

Employee  
& Retiree

Spousal

# NYC DCP History

- The New York City Deferred Compensation Plan (DCP) was created in 1985 to provide a supplemental retirement program for NYC employees.
  - 1986 – 457 Plan began
  - 2002 – 401(k) Plan began
  - **2006** – **Roth 401(k)** initiated
  - 2007 – Traditional and **Roth NYCE IRA** created
- Number of participants: 140,000+
- Total assets: \$9+ Billion

# Roth Legislation (401(k) and 457)

- Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) established after-tax Roth programs for defined contribution plans.
  - Section 402A of the IRS code is added providing the ability for employees to make elective deferrals as Roth contributions to 401(k) and 403(b) plans
- The Small Business Jobs and Credit Act of 2010
  - Section 402A is amended to include 457 plans and to provide a method for in-plan taxable rollovers from pre-tax to Roth programs

# Roth After-tax Program

- Contributions:
  - Roth Contributions are not tax deductible;
  - Elective deferrals by employees to pre-tax and Roth programs must be aggregated together and cannot exceed the maximum deferral for the year; \$16,500 for 2011 (\$22,000 if age 50 or older)
  - No income limit on Roth Program contributions
- Distributions:
  - “Qualified Distributions” from a Roth program are income tax-free (earnings are never taxed)
    - Qualified Distribution is defined as:
      - Made on or after age 59½
      - After 5 consecutive taxable year period beginning with the 1<sup>st</sup> taxable year for which the individual made a contribution to a Roth program
    - 10% Early Withdrawal Penalty
    - Employees are subject to Required Minimum Distributions from their Roth account upon reaching age 70½

# Roth After-tax Program

- Rollovers:
  - Rollovers permitted to other Roth Programs
    - Count the "age" of the old Roth account toward the five-year requirement for the new account.
  - Rollovers to Roth IRA
    - No RMD for Roth IRA
    - Non-qualified distributions: the years of participation in the Roth 401(k) account don't count toward the five-year requirement to take tax-free distributions from a Roth IRA.
    - Qualified distributions: the entire amount of the rollover becomes basis in your Roth IRA.
  - No incoming rollover permitted from Roth IRA

# Roth After-tax Program

- Loans:
  - Roth Program is not available for loan from the 401(k) Plan and the account balance is not included in determining the amount available for loan
- Hardships:
  - Roth Program is not available for hardship distribution

# Recordkeeper

The Plan's recordkeeper must establish a separate account for Roth contributions and earnings for each employee

- Separate deferral rate for Roth contributions
  - Single investment allocation for 401(k) Plan
- Separate distribution requirements
  - Same beneficiaries for pre-tax and Roth 401(k) Plan
- Report Roth distributions on 1099 form

# Payroll

Add Roth contributions to payroll deduction hierarchy

- Payroll deductions to the Roth 401(k) program are based upon the gross paycheck.
  - Deferral amount selected is the amount contributed
- Must coordinate between pre-tax and Roth contributions as not to exceed annual maximum.
- Must report Roth contributions on yearly W-2 form

# Roth Communications

The addition of the Roth 401(k) Plan brought many new challenges

- DCP is no longer a tax-deferred program, now we are a tax-favored program
- We have two independent programs:
  - Written information materials
    - Full review and update of SPD, distribution and beneficiary guides
  - Written educational materials
    - Explanation of the differences and benefits of Roth contributions
  - Website
    - Develop and implement tools to assist participants to determine:
      - If Roth is right for them
      - How much should they contribute and how it will effect their take home pay
  - Financial Planning Seminars
    - Holistic view and what role Roth plays
      - Tax planning
      - Estate Planning

# The Final Piece of the Puzzle:

## Establish a deemed Traditional and Roth IRA

- You now have both pieces that your employees need to save for retirement.
- **The goal now:** Keep the money in the Plan and help employees consolidate all their retirement assets in one place
- The Solution is a deemed IRA:
  - Participants utilize same low cost investment options
  - Consolidation of Plan assets in the deemed IRA
  - Ability to rollover or convert outside assets to deemed IRA
  - Establish a spousal IRA
  - Continue to save for retirement after separation from service
  - Avoid RMD with the deemed Roth IRA – leave to beneficiaries income tax-free – great for estate planning
  - Create a “stretch” IRA
  - No mandatory withholdings

# The Role of Roth in Defined Contribution Plans

Pamela Hess, Director of Retirement Research

Aon Hewitt

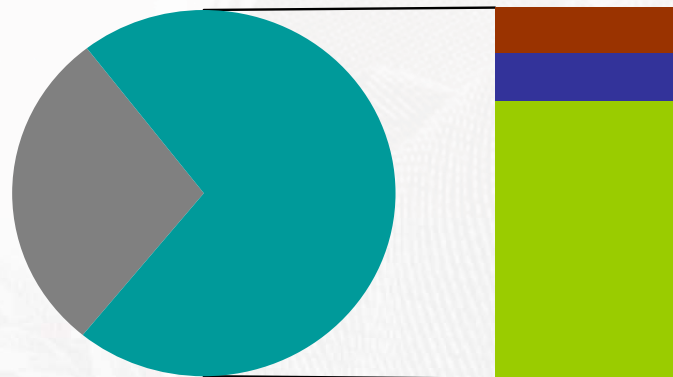
December 8, 2010

# Roth Adoption in Private Sector

- Currently offered by over one-third of 401(k) plans
- Increasingly being adopted, expect over half of 401(k) plans by 2012
- For those sponsors that have not yet added it, the lack of evidence of significant employee usage is reported as the primary obstacle

## Current State

Already Have 34%  
Don't Have 66%



## Future Direction

Very Likely 14%  
Somewhat Likely 24%  
Unlikely 61%

Source: Aon Hewitt 2011 Hot Topics in Retirement Survey (preliminary)

# Roth Employee Usage

## **Recent Report “The Role of Roth in Defined Contribution Plans”:**

- More than twenty 401(k) plans were examined, including some first adopters in 2006 and 2007
- Analysis evaluates usage of 504,000 participants eligible to use Roth

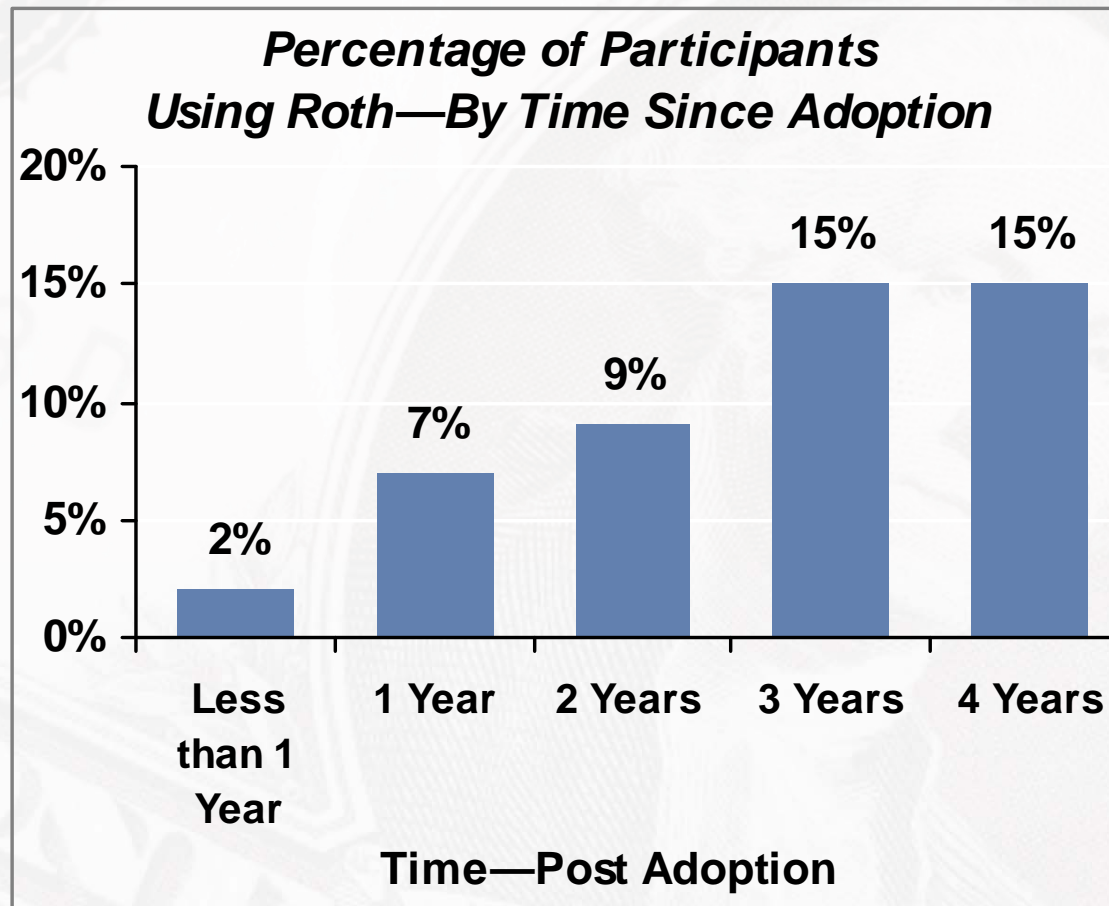
## **Overall Participant Usage**

- 7.4% of all active participants elected Roth, where available
- Usage varied by company—from 4% to 22%
- New hires more apt to use Roth—13% of new enrollees
- The average Roth deferral was 6.8% of pay, with a total contribution rate at 10.8%

*Source: The Role of Roth in Defined Contribution Plans, 2010*

# Roth Usage Over Time

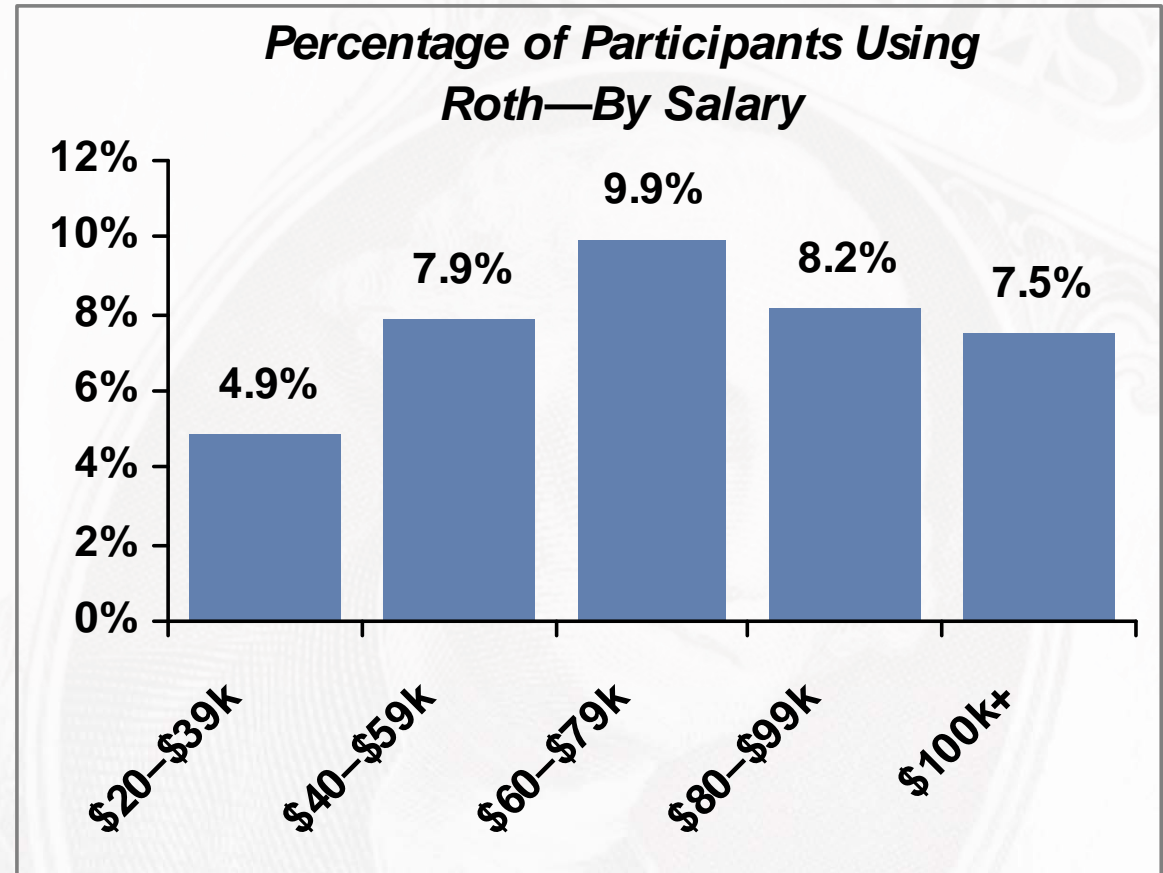
Post implementation, participant usage appears to grow through years one and two, then stabilizes at three to four years.



Source: *The Role of Roth in Defined Contribution Plans, 2010*

# Roth Usage by Demographics

- Younger participants heavier users
- Considerable adoption seen at all income levels above \$40,000
  - Highest usage between \$60,000 and \$80,000 pay levels

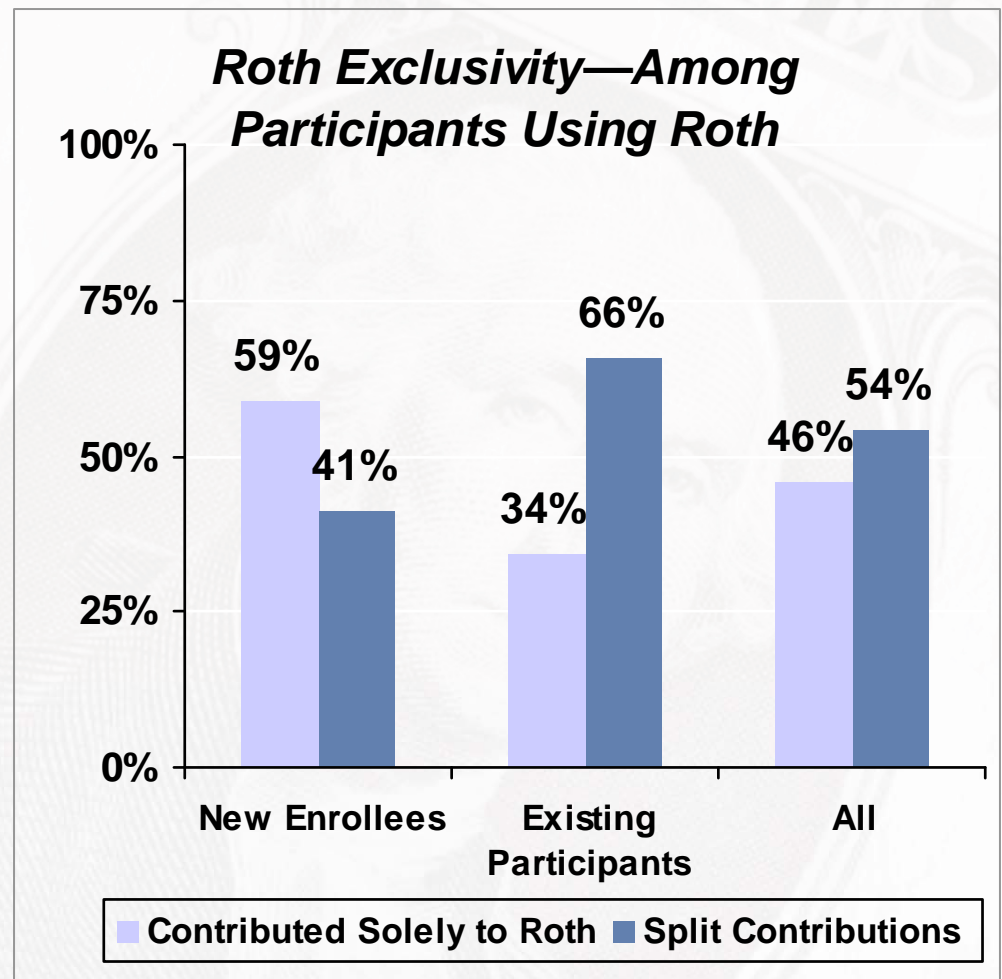


Source: *The Role of Roth in Defined Contribution Plans, 2010*

# Roth and Before-Tax Savings Behavior

54% of the Roth contributors also contributed to before-tax.

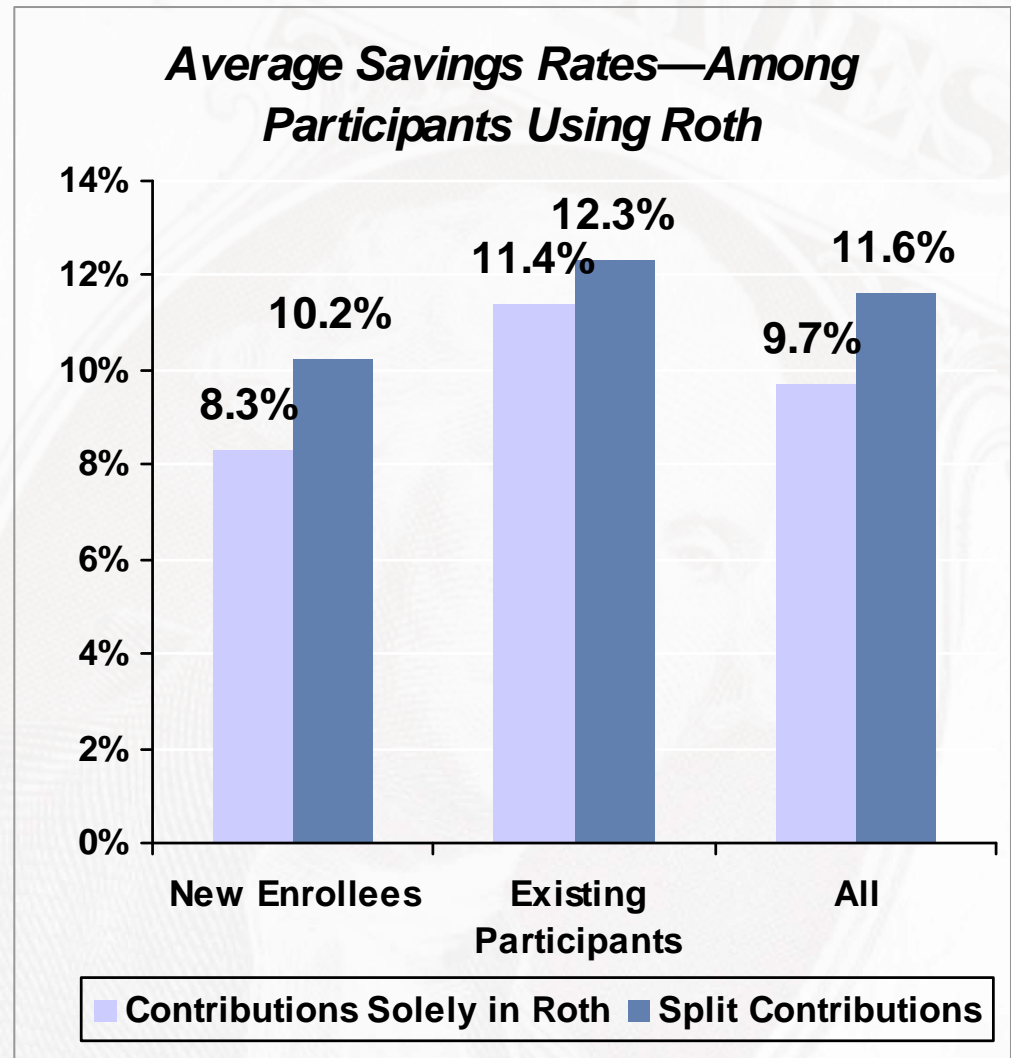
- New enrollees are more likely to make distinct decisions
- Existing participants more likely to split before-tax and Roth contributions
- Younger participants are also more likely to invest exclusively in a Roth



Source: *The Role of Roth in Defined Contribution Plans, 2010*

# Contribution Rate—Details

- The total contribution rate of the Roth contributors was relatively higher than non-users
- Those who split their contributions also had a higher contribution rate than those who invested solely into Roth



Source: *The Role of Roth in Defined Contribution Plans, 2010*

# Roth Lessons and Outlook

Roth feature has proved beneficial to a meaningful segment of plan participants

Likely to become inherent feature in 401(k) and 457(b) marketplace

To make Roth successful:

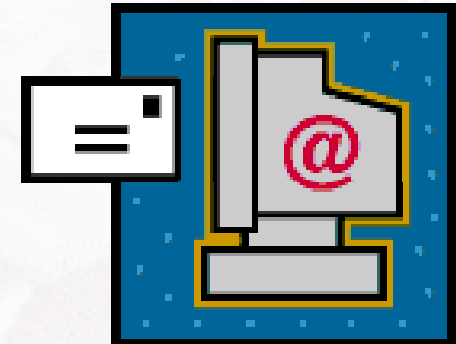
- Communicate using multiple channels
- Educate employees about Roth contributions
- Provide modeling tools to help employees make educated savings decisions

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# Questions From Audience



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today's event.