Please Note: The material contained in this newsletter regarding financial planning is merely for informational purposes. The Deferred Compensation Plan is not an investment advisor, and is not holding itself out as such. Any references to rate of return and risk are based on past experience and, as such, there is no guarantee of the rate of return you may actually receive. Therefore, you may wish to consult a professional investment advisor before reaching any investment decisions.

nycdcp

The City of New York
Deferred Compensation Plan is a division of the
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Commissioner
Office of Labor Relations

Deferred Comp

UPDATE

The Plan Newsletter for the 457 and 401(k) Plans Quarter Ended December 31, 2005

In this Issue...

New Benefit

2 The Roth 401(k)... Are you ready for some post-tax investing?

New Plan Service

6 Personalized Financial Snapshot (PFS) Software
- Now helps you understand Pre-Tax or After-Tax Roth investing

9 I'm getting ready to retire... What do I have to do?

10 Plan Loans... Can Your Future Afford It?

11 Year-End Reminders

Free!

Interactive software: *"I have been looking for an 'at home financial evaluation' service where my husband and I can plan for the future. Thank you."* - Story page 6

1985 - 2005
20th Anniversary
New York City Deferred Compensation Plan

Coming Soon: The Roth 401(k)!

With the Roth 401(k) Plan, contributions grow tax-free and your withdrawals will not be subject to income tax provided you have attained age 59 1/2 and the assets have been held in your account for at least five years from the first taxable year of your first contribution to the Plan.

Are You Ready For Some Post-Tax Investing?

Financial professionals say that in order to help combat the uncertainty of future taxation levels, investors may benefit from diversifying their investments over different tax categories. To that end, the Deferred Compensation Plan is pleased to announce the addition of the new Roth 401(k) Plan. The Plan anticipates that it will be able to offer participants the Roth 401(k) Plan during the first quarter of 2006.

Unlike the traditional, pre-tax 401(k), the Roth 401(k) Plan allows you to make contributions to your account with AFTER-TAX money. Contributions grow tax-free and your withdrawals (contributions AND EARNINGS) will not be subject to income tax provided you have attained age 59 1/2 and the assets have been held in your account for at least five years from the first taxable year of your first contribution to the Plan. The contribution limit for 2006 will be $15,000 ($20,000 if you are 50 or older) and is coordinated with your traditional 401(k).

You may contribute anywhere from 1.0% - 50.0% of your post-tax income. Keep in mind, however, that since this deduction will occur post-tax, you may see a noticeable difference in your net pay. For example:

Annual Salary	$50,000
Bi-Weekly Salary	$1,924
Annual Contribution to Plan	$15,000
Estimated Tax Rate (Before Retirement)	20%
Estimated Tax Rate (After Retirement)	20%

	Pre-Tax 457/401(k)	*After-Tax Roth 401(k)*
Deferral Percentage	30.0%	30.0%
Pre-Tax Payroll Deduction	$577	$0
Taxes	($270)	($385)
After-Tax Payroll Deduction	$0	$577
Net Pay	$1,077	$962

This example is for illustration purposes only. Changes in future tax rates will affect the potential comparative benefit of plan participation. The decision to contribute to a Roth 401(k) is a personal one and should be made carefully; we suggest you consult with an independent financial advisor to better understand the complexities of taxation in retirement.

How is a Roth 401(k) different from a Roth IRA?

The benefits that can be provided by allowing you to make designated Roth contributions to an employer retirement plan can <u>not</u> be replicated on your own through a Roth IRA.

- High-income individuals (modified AGI of $110,000 for single individuals, $160,000 for married individuals) are prohibited from contributing to Roth IRAs. This restriction does not apply to Roth contributions made to a 401(k) plan.
- Designated Roth contributions to employer-sponsored plans are not subject to the substantially lower contribution limitations that apply to Roth IRAs -- $4,000 in 2006, or $5,000 for people age 50 or older.

Pre-Tax Versus Post-Tax: Which Plan Is Right For Me?

The benefit of pre-tax investing is not only does it reduce your tax liability while you are actively contributing, but if you are in a lower income tax bracket during retirement, you will have paid less taxes on your money when you withdraw your account than if you had paid taxes at the time your earned your compensation.

But what if you are not in a lower income tax bracket during retirement? Although you no longer have a full-time job, you may also have fewer income tax deductions such as mortgage interest and dependent children. Pension benefits, plus Social Security benefits and deferred compensation withdrawals may cause your income to remain the same, if not increase during retirement. Or, you may retire elsewhere, where state and local taxes may be different. All of which can counteract the effects of a lower income.

If you are in a higher income tax bracket during retirement, then the post-tax, Roth 401(k) may be your best bet, assuming you can afford the higher cost of post-tax investing now. Receiving a little less in net pay now, may result in considerable savings later.

Why Not Contribute to Both a Pre-Tax and Post-Tax Plan?

We may be uncertain as to whether or not we will be in a lower tax bracket at retirement or whether or not tax rates will rise. Since you are not limited to one Plan or the other, you may be better off contributing some money to each Plan in order to diversify your tax liability.

Just as you have recognized the need to diversify your portfolio, perhaps you should consider the feasibility of diversifying the tax categories of your investments as well.

You will need to think about these and other factors when considering which plan is right for you. You may wish to consult with an independent financial advisor to better understand the complexities of taxation in retirement.

How to Enroll in the Roth 401(k)

The Plan anticipates that employees will be able to enroll in the Roth 401(k) as of March 2006. Employees can enrolll either by (1) visiting the Plan's Web site at nyc.gov/deferredcomp, (2) via the telephone by accessing KeyTalk® at (212) 306-7760, or (3) by completing an Enrollment Form. If enrolling via the Web site or telephone, you should select the 401(k) Plan and then indicate whether you wish to contribute pre-tax or after-tax (or both) when entering your deferral amount.

Comparing Programs

Because future tax rates are uncertain, your tax rate could be higher in retirement. To diversify against this risk, it may help to hold a combination of regular pre-tax savings (which will benefit you if tax rates fall in retirement) <u>and</u> after-tax Roth 401(k) savings (which will benefit you if tax rates rise).

<table>
<tr><th rowspan="2"></th><th colspan="2">Pre-Tax Deferrals</th><th>After-Tax Deferrals</th></tr>
<tr><th>457 Plan</th><th>401(k) Plan</th><th>Roth 401(k) Plan</th></tr>
<tr><td rowspan="3">Contributions</td><td colspan="2">You may choose to put money in the 457 Plan or the 401(k) Plan, or both, for a combined deferral of $30,000.</td><td></td></tr>
<tr><td></td><td colspan="2">You may choose to put money in the pre-tax 401(k) Plan or in the Roth 401(k) Plan or both. However, the combined deferral cannot exceed $15,000.</td></tr>
<tr><td>➢ 2006 annual limit of $15,000; $20,000 if age 50 or older</td><td>➢ 2006 annual limit of $15,000; $20,000 if age 50 or older</td><td>➢ 2006 annual limit of $15,000 after-tax; $20,000 after-tax if age 50 or older</td></tr>
<tr><td>Income Limitations</td><td>None</td><td>None</td><td>None, the contribution limits and the income limits of Roth IRAs do not apply.</td></tr>
<tr><td>When are you taxed?</td><td colspan="2">Pay Later: Savings and earnings are taxed upon distribution.</td><td>Pay Now: Savings <u>and</u> earnings are tax free upon distribution.</td></tr>
<tr><td rowspan="2">Things to consider when choosing a plan…</td><td>➢ No tax penalty for withdrawals taken before age 59 1/2
➢ Account can be withdrawn without penalty after severance from City service, regardless of age (subject to income taxes)</td><td>➢ Account can be withdrawn after severance from City service but is subject to income taxes and, in most cases, to a 10% penalty for withdrawal before age 59 1/2</td><td rowspan="2">➢ Distributions are tax-free if the account has been held for a minimum of five years since the first contribution and withdrawn after age 59 1/2
➢ If your tax rate will be higher at the time of distribution from the Roth 401(k) than at the time contributions were made, contributing to a Roth 401(k) may be better than contributing on a pre-tax basis. Note: If in the future you will be receiving a City pension, your tax rate at that time is unlikely to be lower.
➢ Estate planning: At severance from City employment, you can roll your Roth 401(k) account into a Roth IRA
- The Roth IRA has no Required Minimum Distributions (RMDs) at age 70 1/2.
- You can delay distributions indefinitely until death, at which time your heirs have the option to receive distributions throughout their lifetime.</td></tr>
<tr><td colspan="2">➢ If your tax rate will be lower at the time of distribution from the 457 or 401(k) than at the time contributions were made, contributing to a tax deferred account may be better than contributing on an after-tax basis.</td></tr>
</table>

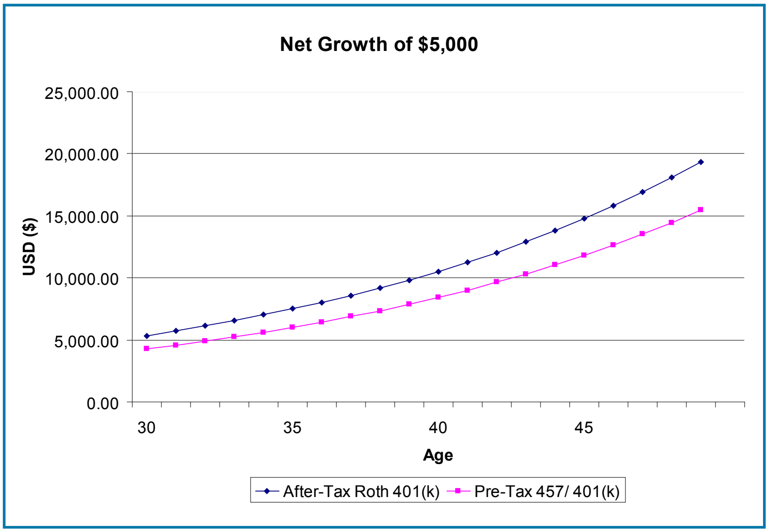
Examples of Investing with Pre-Tax vs. After-Tax Roth Dollars

Leaving aside the issue of what tax bracket you might be in during retirement (refer to table on page 4), you would be better off investing in the Roth 401(k) because you never have to pay taxes on the investment earnings. There is a trade-off however: With the Roth 401(k), you must be willing to take a larger hit in your paycheck up-front for taxes.

The example below illustrates this. The contribution amount to the pre-tax 457/401(k) is the same as to the after-tax Roth 401(k) and the account value in the end is the same. However, after taxes have been satisfied, the difference is significant.

	Pre-Tax Plan	***After-Tax Roth (Same Contribution)***
Gross Salary	$ 50,000	$ 50,000
Pre-Tax 401(k)/457 Contribution	(5,000)	
Taxable Income	45,000	50,000
Taxes @ 20% of taxable income	(9,000)	(10,000)
After-Tax Roth 401(k) Contribution		(5,000)
Net Cash Flow (take home pay)	$ 36,000	$ 35,000
Hypothetical Investment Results		
Account value after 20 Years at 7%	$ 19,348	$ 19,348
Taxes due upon withdrawal	3,870	0
After-tax spendable withdrawal	$ 15,478	$ 19,348

The chart below illustrates how investing in the Roth 401(k) Plan gives better results than pre-tax savings, after taxes at distribution have been paid. With the after-tax Roth 401(k) account, you end up with $19,348 and with the pre-tax 457/401(k) account, you end up with $15,478. However, with the after-tax Roth 401(k) account, you must be willing to accept taking a larger amount out of your paycheck up-front for taxes which results in less take-home pay.



Notes:

1. Pre-Tax 401(k) and 457 plan contributions are tax deferred and taken before federal, state and local taxes are deducted. Withdrawals of contributions and all accumulated growth are considered taxable income.

2. After-tax Roth 401(k) plan contributions are taxed. Contributing the same salary percentage to a Roth 401(k) lowers take home pay and increases after tax retirement assets.

Assumptions used in the above examples: A one-time contribution of $5,000 made at age 30, 20% tax rate throughout, 7% annual growth rate

Personalized Financial Snapshot (PFS) Software

Have You Tried Out the Interactive Software Yet?

Do you wish that you had more information about retirement planning?

Personalized Financial Snapshot (PFS) is a retirement planning software tool which was developed to help participants get started in planning for retirement and devising a plan.

The software will help you:

- estimate your net worth
- estimate your pension benefits
- estimate your family's educational cost
- create a budget of anticipated retirement income and expenses
- create "what if" screens to calculate alternative solutions to retirement savings shortfalls

The Plan is pleased to expand the software to all Deferred Compensation Plan participants. You can access the software from the Plan's website at nyc.gov/deferredcomp. Links are located on the homepage and in the Planning Tools section of the Plan's website.

Here's what a few participants had to say after using PFS:

"EVERY EMPLOYEE SHOULD GO INTO THIS SITE AND TRY IT."

"Wow. This planning tool helped show me how financially unconscious of a person I am. …all of this remains a muddled mystery in my mind. At least now, through each step, I've been shown key pieces of the puzzle that I must learn and evaluate to eventually make some basically informed decisions. Thank you."

"I've tried several printed retirement planners before but never completed them, I was able to do this in under a half hour. Thank you."

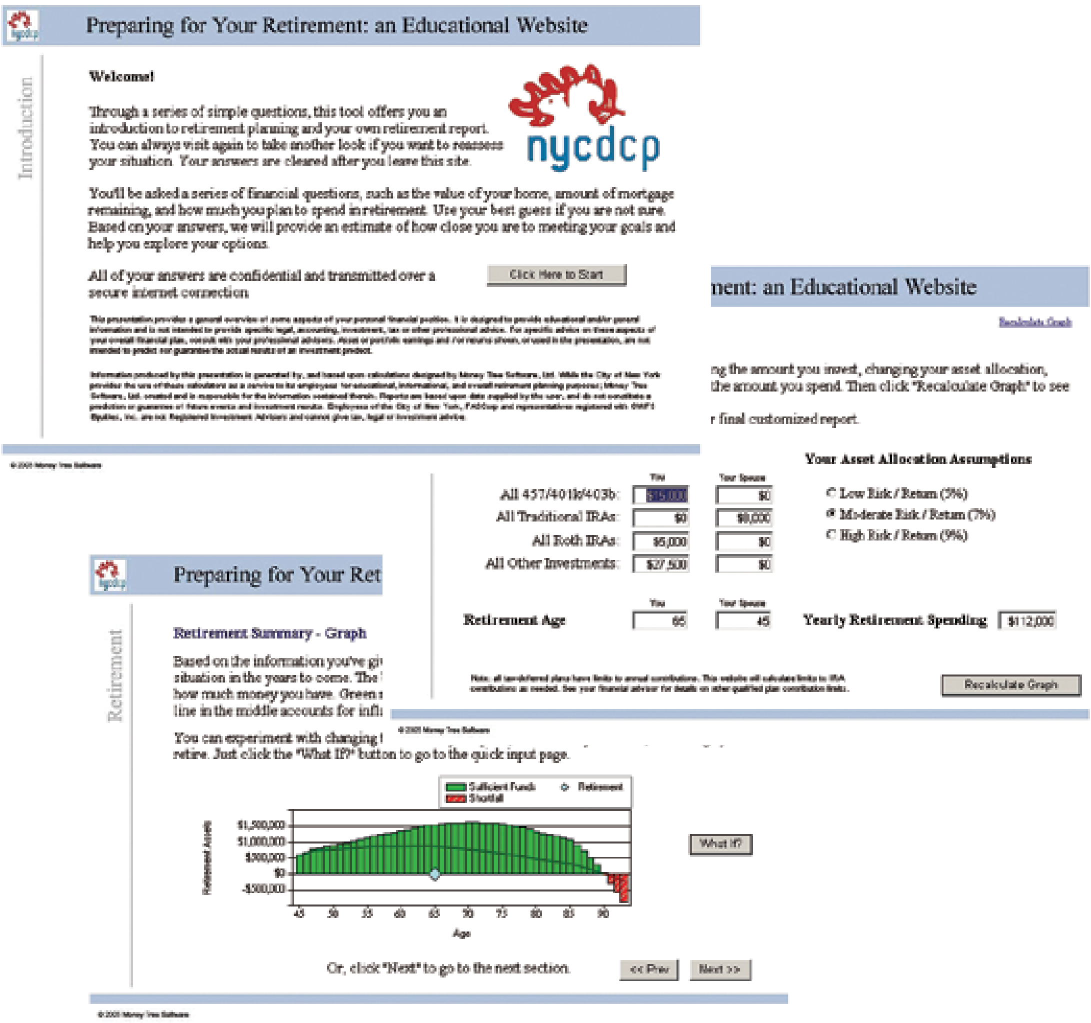
"Because of the chart it gave me a greater outlook on how much I will have to invest each month in order to prepare for retirement."

"Thank you for solving the age-old mystery: No pun intended."

"This is wonderful. I am going to recommend this site to everyone that I work with. This information put you in the KNOW, and knowing is half the battle."

Here’s how the software works

Through a series of simple questions, Personalized Financial Snapshot offers you an introduction to retirement planning and your very own printable retirement report. Based on your answers to simple financial and retirement questions, the program will provide an estimate of how close you are to meeting your goals and help you explore your options.



New Plan Service

Pre versus Post Tax Investing

The Personalized Financial Snapshot (PFS) software has been enhanced to illustrate the differences between traditional pre-tax 457/401(k) investing and after-tax Roth 401(k) investing.

You can access the software from the Plan's website at nyc.gov/deferredcomp. Links are located on the homepage and in the Planning Tools section of the Plan's website.

Understanding the Roth 401(k) Plan

Introduction

Starting in January of 2006, employers will be able to offer their employees a new kind of retirement plan: the Roth 401(k).

As the name implies, the plan combines features of both the traditional 401(k) and the Roth IRA. All of these plans offer a tax-advantaged way to invest for retirement, but do so in different ways.

The Roth 401(k) has a number of features that make it similar to the traditional 457/401(k). It is sponsored by an employer, not an individual. Employers may also offer matching funds. There are no income restrictions (high-income individuals cannot contribute to Roth IRAs). Finally, the contribution limits are the same as for the traditional 401(k), which are much higher that with a Roth IRA. In 2006 you'll be able to put as much as $15,000 into all 401(k) plans.

All of these types of plans (IRAs, 457s and 401(k)s) allow your investment to grow untaxed, but they differ in how the money is taxed when you put it in and take it out. The traditional 457/401(k) gives you a tax break now, but taxes funds when you withdraw them. The Roth 401(k), like the Roth IRA, gives you no tax break now, but you pay no taxes when you withdraw funds.

To learn more details about how the Roth 401(k) compares to the traditional 457/401(k), click the Next button.

Understanding the Roth 401(k) Plan

Introduction

The chart below compares a Pre-Tax 457/401(k) with the After-Tax Roth 401(k). We've broken the comparison into three columns: one which puts money into a traditional plan; one which puts the same amount into a Roth; and one which puts enough money into a Roth to leave you with the same net pay as with the traditional plan. There's a lot going on here, so we've broken explanation into small steps. So click the Next button and we'll begin.

Retirement Plan Comparison	***Pre-Tax 457/401(k)***	***After-Tax Roth 401(k)***	***After-Tax Roth 401(k)***
		Same Contribution	Same Net Pay
Gross Annual Salary	$50,000	$50,000	$50,000
Pre-Tax 401(k) Contribution	**(5,000)**		
Taxable Income	45,000	50,000	50,000
Taxes @ 20%	(9,000)	(10,000)	(10,000)
Salary After Taxes	36,000	40,000	40,000
Post-Tax Roth 401(k) Contribution		**(5,000)**	**(4,000)**
Net Take-Home Pay	**36,000**	**35,000**	**36,000**
Hypothetical Investment Results			
Contribution after 20 Years @ 7%	19,348	19,348	15,478
Taxes due upon withdrawal	(3,870)	0	0
After-tax spendable withdrawal	15,478	19,348	15,478

<< Prev Next >>

I'm getting ready to retire....What do I have to do?

Actually, if you don't need the money, you don't have to do anything at all!

So many participants are under the misconception that once you leave City service, you must make a decision about what to do with your Deferred Compensation Plan account. That used to be the case, but laws have changed and now participants are not required to make any withdrawal decisions unless they are at least age 70 1/2 at severance from City service.

There is another popular misconception about "what you have to do when you leave the City" and we think it may have something to do with our cousins in the private sector. Many private employers require that when an employee leaves the company, they must roll their 401(k) into an IRA. ***Beware the family friend or financial advisor that tells you that you must do this!*** Not only are you not required to roll your account into an IRA, but doing so could prove hazardous to your wealth!

What makes the 457 Plan such a wonderful thing for our younger-than-average retiree is that it does not have any early withdrawal penalties. If you withdraw your 457 account directly from the Plan prior to age 59 1/2, you are liable for taxes, but not for the additional 10% penalty you have with 401(k)'s or IRA's. You could roll over your 457 into an IRA, but here's the sticky part: if you roll your 457 into an IRA, you forfeit the ability to withdraw those assets penalty-free before age 59 1/2...Yikes!

Another thing you must consider is fees. There is no free lunch – you would be paying for that retail IRA and it ain't cheap! Let's assume you have a $30,000 Plan account balance. The annual cost of maintaining your Deferred Compensation Plan account for one year at a total cost of 31 basis points (that includes your $50 administrative fee) would be $93. Now let's look at the median retail cost of 95 basis points for an IRA. The total cost of maintaining your $30,000 IRA account would be $285. That's over 200% more than Deferred Comp...Double Yikes!!

With Deferred Compensation, you are not a single investor, you are part of a group and so you are paying fees at lower, institutional rates than individual investors. This is the same principle as your health insurance; your health insurance premiums are lower because you are part of a group. If you had to purchase health insurance individually, it would be dramatically more expensive.

Summary: Once again, if you are younger than 70 years of age, you are not required to make any distribution decisions upon severance from City service. You can defer distributions until the April 1st after the close of the year in which you reach age 70 1/2 and even then, you are not required to withdraw your account completely, you need only take the minimum required amount as determined by IRS minimum distribution rules.

So relax – and stick around for a while. Continue to enjoy your low-cost Deferred Compensation Plan and the freedom and the flexibility it has to offer.

Remember

Before making any decision to move your money into any new retirement plan or IRA, research the applicable surrender fees, mortality and expense risk fees, administrative fees, as well as the initial investment requirements.

Plan Loans

Loans... Can Your Future Afford It?

Recognizing that participants have been waiting for the ability to take loans from their Deferred Compensation Plan accounts, we would like to take this opportunity to explain why, although it is now an option, it may still not be the best option. Before taking a loan, take a minute to ask yourself the following two simple questions:

Can I afford it?

When taking a loan from the Plan, you are agreeing to make payments via payroll deductions within a specified term. Should your financial circumstance change and you discover that you can no longer afford your payroll deductions; you will not be able to change the term of your loan and may be in a position of defaulting on your loan. We encourage you to run a loan quote prior to submitting your request. Loan quotes can be obtained via the telephone by dialing (212) 306-7760, pressing "1" for KeyTalk® or online at nyc.gov/deferredcomp in the "Account Access" section. You will need your personal identification number (PIN) in order to access this information.

If you should leave City service prior to the end of your loan term, the remaining balance of your loan will be immediately due and payable in full. You cannot continue to make periodic payments once you are no longer on payroll. Depending on the amount of the loan, this can result in an unexpected yet considerable tax consequence.

Can my future afford it?

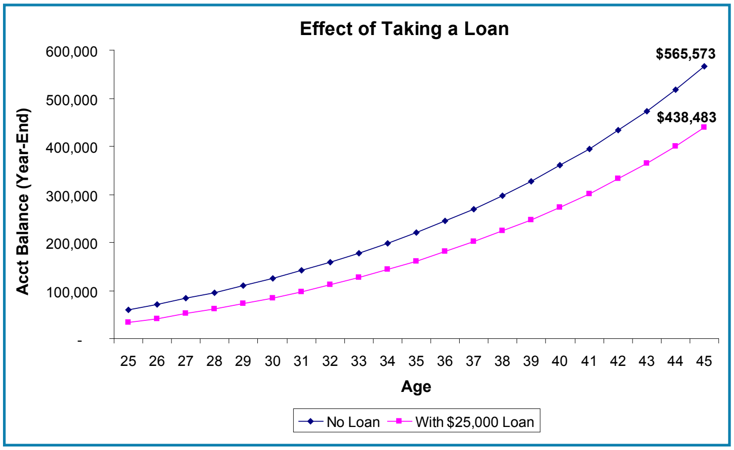
While there are fees associated with taking a loan from the Plan, perhaps the most important thing to consider is that unlike most pension loans, DCP loans immediately reduce your account balance by the amount of the loan. This may cause any future growth of your account to be substantially reduced as a result. That is because although the loan will be paid back with interest, those repayments are made via payroll deduction over time, whereas your loan was a one-time withdrawal. In short, you are taking one potentially giant step backwards on your road to retirement.

One last point to consider: Before loans were available from the Plan, you viewed your Deferred Compensation Plan account as a long-term savings vehicle, to help provide for your future. We encourage you to not lose sight of that fact now.

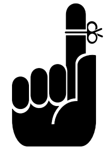
*The following example illustrates how taking a $25,000 loan from your Deferred Compensation Plan account can impact your future account balance over 20 years. According to the example below, taking a $25,000 loan could cost you **$127,090**.*

Assumptions:

Current account balance is $50,000. Loan decreases beginning account balance to $25,000. Regular annual account contributions are $6,000. Annual rate of return is 8%. Borrowing rate is 7%. Annual loan repayment at 7% rate is $5,940 for five years. In order to stay cash flow neutral, participant stops regular contributions for five years.



Year-End Reminders



Maximum annual contribution amount increases to $15,000 in 2006

The maximum annual contribution amount for the 457 and 401(k) Plans will increase from $14,000 to $15,000 effective January 1, 2006. If you are making catch-up contributions to the 457 Plan through Deferral Acceleration for Retirement (DAR), you should be aware that the total, annual maximum contribution for regular deferrals and DAR deferrals combined will be $30,000 in 2006. The maximum annual 457 contribution for participants age 50 or older who are not making DAR contributions will be $20,000 in 2006. 401(k) participants age 50 or older will also have a maximum contribution limit of $20,000. All Deferred Compensation contributions combined must not exceed the 415(c) limit of $44,000 for 2006.

Understanding your Form W-2

- The amount you contributed to the Deferred Compensation Plan in 2005 will be reflected in Box 12 of your 2005 Form W-2. There will be a code "G" before the dollar amount. This letter indicates that the amount represents 457 deferred compensation contributions. The code "D" before the dollar amount represents 401(k) deferred compensation contributions. For income tax filing purposes, your adjusted gross income (reportable income) will be reflected in Box 1. THIS WILL HAVE ALREADY BEEN ADJUSTED BY THE AMOUNT(S) IN BOX 12.
- If you received a distribution payment during 2005, you will receive a 2005 Form 1099-R from Financial Administrative Services Corporation (FASCorp), the Deferred Compensation Plan's recordkeeper.

Expecting a distribution check soon?

Please note that if you make any account transfers immediately prior to the processing of your distribution, this will delay your check or Electronic Fund Transfer (EFT).

Payroll deferral notes

Will you be contributing to the 401(k) Plan and a 403(b) plan in 2006? You must ensure that your contributions to both plans combined do not exceed $15,000 in 2005.

Changing agencies?

If you are changing agencies, you must complete a Change Form telling us the name of the new agency one month in advance of the change in order to avoid a break in your deferred compensation deductions. If you joined the Deferred Compensation Plan in lieu of paying FICA tax and experience a break in deductions due to an agency change, you may no longer meet the criteria for contributing to the Plan in lieu of FICA. You may be required to contribute to both until you requalify.

Changing your address?

Remember, you must inform the Plan if you have a change of address by completing a Change Form indicating your new address. Submit the form directly to the Plan's Administrative Office. Keep in mind, you must also change your beneficiary's address on the Plan's records by using a Change Form and list all beneficiaries when making beneficiary information changes.

How to obtain forms

Change Forms, as well as some of the Deferred Compensation Plan's guides and the DAR Form, are available through fax, mail, the Internet, and the City's Intranet. To obtain a form by mail or fax, call the Plan at (212) 306-7760, press "2" for all other inquiries, and press "1" for the Deferred Compensation Plan main menu. To download a form or guide from the Plan's Web site, go to the site's library section at nyc.gov/deferredcomp. Please do not submit forms entitled "Enrollment/Change Form" as they are no longer in use.

Retiring soon?

If you are retiring, please note that you are not required to make any decisions regarding the distribution of your account immediately at retirement. You are able to postpone withdrawals up until you reach age 70 1/2, at which time you must begin taking your annual minimum required distributions. Call (212) 306-7699 and attend a retirement seminar to learn more about your distribution options.

Flexible Spending Accounts Program and 414(h) Pension Pick-up

- Box 14 of the Form W-2

  Box 14 will contain the entry "IRC 125" which will represent the total pre-tax dollars used for paying health insurance premiums in the Medical Spending Conversion Program (MSC), the pre-tax dollars used for dependent care expenses in the Dependent Care Assistance Program (DeCAP), and medical expenses in the Health Care Flexible Spending Account (HCFSA).

  The entry "IRC 414(H)" pertains to the pre-tax dollars used to pay pension contributions. These two dollar amounts in Box 14, IRC 125 and IRC 414(H), are pre-tax for federal tax purposes, but <u>not</u> for state and city tax purposes. Consequently, they must be added back in the area designated for that purpose on the state tax return at the time you file your state taxes.

- Box 10 of the Form W-2

  If you participate in DeCAP, you will also see the amount set aside for this purpose listed in Box 10. You must also attach Form 2441 Child Dependent Care Expenses to your Form 1040. If you file Form 1040A, you must file a Schedule 2 form, as well. For New York State tax purposes, the DeCAP amount in Box 10 can be ignored since the same amount is included in the IRC 125 amount in Box 14. It is there for federal tax purposes as a record of dollars deferred for dependent care expenses.