PRE-MEETING OVERVIEW

# NONQUALIFIED DEFERRED COMPENSATION PROGRAMS

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*Perhaps the least understood type of employer-sponsored plan — and the most varied in design — are nonqualified deferred compensation plans.*

## Key points to know before your meeting:

- These plans vary considerably in design from employer to employer and there can be a wide variation in what different employers offer.
- Eligibility to participate may differ based on compensation level or rank. Highly compensated and executive-level employees may be eligible to participate in more than one type of deferred compensation arrangement.
- It's important to have a complete understanding of the plan's structure, how to integrate it with other company-sponsored plans and compensation arrangements, and the risk factors involved.
- Deferred compensation plans are elective or supplemental and may "mirror" a qualified plan or stand alone.
  - An **elective plan** allows an employee to defer the receipt of their scheduled compensation such as base salary, bonus and commissions or even stock from vesting restricted stock grants.
  - A **supplemental plan** enables an employer to retain and reward key employees with promises of payment at a future date for remaining an employee of record for a period of time and, in some instances, for meeting certain performance objectives.

Whether elective or supplemental, deferred compensation plans usually allow the participant to elect, at enrollment, when the proceeds will be distributed (at a certain date, reaching a certain age, or at separation or retirement), and how it should be distributed (as a lump-sum or in installments commonly over five to fifteen years). If a distribution election is not made, the default is a lump-sum distribution when the triggering event occurs.

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## Questions to review before your meeting

**Q: What makes me eligible to participate in a deferred compensation plan?**

A: Highly compensated employees and people who consistently maximize qualified contributions may be eligible. Mature, publicly held companies are more likely to offer these plans. If you qualify, your employer may automatically enroll you in a plan (supplemental), or you may be required to elect to participate each year (elective).

**Q: How do I know if I can make distribution elections?**

A: Participation in an elective plan requires active enrollment each year — often in late fall, coinciding with health and other benefit enrollment periods. You will be asked to elect deferral percentages and a distribution decision for each enrollment year. Supplemental plans generally provide a notice of participation where you can choose when and how to distribute. If nothing is selected, the default distribution is often a lump-sum at separation or at a scheduled distribution date.

**Q: How can a deferred compensation plan help me in managing taxes and savings objectives?**

A: Elective plans enable you to defer income above what a qualified plan permits. They're used for tax management by lowering current income and/or to save income for your future needs. You can time distribution elections on elective and supplemental plans for a child's college tuition expenses, a second home purchase or to create a multi-year retirement income stream. How quickly you receive the income (lump-sum vs. installment) could affect your income tax burden in the future.

Note: *10-year installment distribution shifts the state income tax from where you earned the income to where you reside when you receive it. This should be a consideration if you plan to move to a lower tax state.*

**Q: What risk-factors are associated with a nonqualified deferred compensation plan?**

A: A plan is "nonqualified" when it does not meet the requirements for the legal protections of the Employee Retirement Income Security Act (ERISA). The tax-deferred treatment happens because the employee does not have constructive receipt of the funds — and until a receipt, there is a risk of forfeiture. If the employee separates before their promised compensation vests, the compensation is forfeited. If the company declares bankruptcy, the employee becomes a general creditor of the company with no guarantee of receiving employee-deferred or employer-promised compensation.

**Q: Are there ways to mitigate the risk factors associated with a nonqualified deferred compensation plan?**

A: There are ways to reduce risk with plans that offer more flexible designs. You can pick a closer time frame (distribute in 5 years rather than at retirement 15 years in the future) if a plan permits the election of a distribution date. As you near the distribution date you can revaluate your situation, goals and the health of the company and decide if you wish to defer again or receive the scheduled distribution — but only if the plan allows redeferral of prior distribution elections.

Note: *By law, the decision to change a distribution date must be made 12 months prior to that date and the new distribution date must be extended out at least five years from the prior date.*

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## Checklist to complete before your meeting

Before you meet with your financial advisor, please gather:

- [ ] The plan document(s) for the plan(s) in which you can participate or in which you are participating
- [ ] A plan enrollment document or brochure
- [ ] The most recent statement from your deferred compensation plan(s), if any
- [ ] Your current and former employers' benefits administrator contact information so you and your financial advisor can confirm the details

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