

# Nonqualified Deferred Compensation Plans

*Since nonqualified deferred compensation (NQDC) plans can be used to recruit, retain, and reward key employees, as well as provide the opportunity to accrue benefits above qualified retirement plan limits, it is no wonder that many organizations are embracing their value.*



## Meeting the Unique Needs of Plan Sponsors & Key Employees

As the number one deferred compensation plan recordkeeper<sup>1</sup>, The Principal provided services for more than 3,800 nonqualified retirement plans that represented nearly 43,000 participants in 2006. This is approximately a 10 percent increase in the number of plans from 2005 and a 15 percent increase in the number of participants.

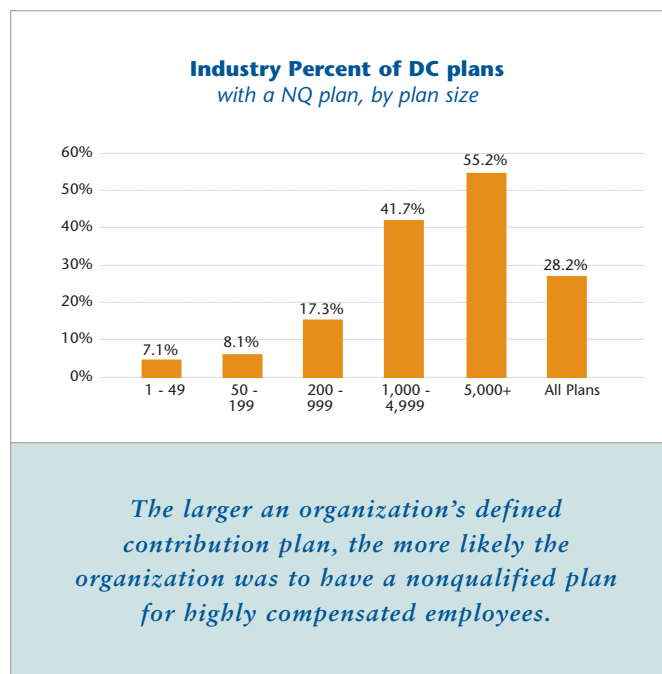
The most common nonqualified plan offered by plan sponsors is the Executive Bonus & Split Dollar plan. While offered by 52 percent of plan sponsors, it only represented 20 percent of participants. The plans offered to a majority of the participants, representing 36 percent of plan sponsors, were nonqualified DB and nonqualified DC plans. The remaining 12 percent of plan sponsors and 26 percent of participants were covered by 457 plans.

In 2006, approximately 85 percent of NQ plans offered were NQDC plans. The next most popular plan was a nonqualified Defined Benefit (NQDB) plan (52 percent).

Nonqualified plans can play an important role in attracting and retaining key employees. This was particularly true for large corporations. Companies with more than 1,000 employees had a significantly higher presence of NQ plans.

<sup>1</sup>Based on number of plans records kept (including 401(k) mirror plans), PLANSPONSOR deferred compensation provider stats, PLANSPONSOR.com, December 2006.

<sup>2</sup>PLANSPONSOR magazine, "NonQualified Deferred Compensation Survey: Purpose Full", January 2007.



Source: Profit Sharing Council of America (PSCA)  
50th Annual Survey of Profit Sharing and 401(k) Plans.

### Fast Fact

*NQDC plans are most commonly offered to help retain key employees and to provide executives with a retirement benefit.*

## THE PENSION PROTECTION ACT

In 2007, legislative changes affecting deferred compensation created the potential for significant change for employers, participants, and plan administrators alike. The Pension Protection Act of 2006 enacted new corporate-owned life insurance (COLI) provisions. COLI is one of the financing methods used by employers within deferred compensation plans.

The bigger impact occurred on April 10, 2007, when the Treasury Department and the Internal Revenue Service (IRS) published its long-awaited final regulations for nonqualified deferred compensation arrangements governed under Internal Revenue Code (IRC) Section 409A. The American Jobs Creation Act of 2004 created the addition of Section 409A of the IRC, which specifically addresses nonqualified deferred compensation plans.

**The good news for employers with existing plans or considering new plans is that many of the attractive key features of nonqualified deferred compensation plans are now codified in Section 409A.** However, it is essential for employers to take action to ensure they are using best practices and taking advantage of transition relief available until the end of 2008.

The Principal suggests employers consider these steps as a result of the legislative changes over the past several years:

- 1 Identify and review plans impacted by Section 409A.
- 2 Avoid material modifications that affect “grandfathering.”
- 3 Conduct a Section 409A “capabilities audit” of plan administrators.
- 4 For public companies: account for key employees.
- 5 For not-for-profit organizations: don’t overlook Section 457(f) plans.
- 6 Establish new deferred compensation plans.

The IRS issued Notice 2007-86 on October 22, 2007, providing transition relief for compliance with Section 409A. Plans with amounts subject to 409A must be fully compliant by January 1, 2009. **As a matter of best practice, in 2008, plan sponsors should consider operating their nonqualified deferred compensation plans consistently with the final regulations.** Employers need to take action to ensure their participants avoid penalties and interest for noncompliance by the employer.

## Fast Facts

---

*NQDC plans were more common in organizations with 1,000 or more employees and in public organizations.*

---

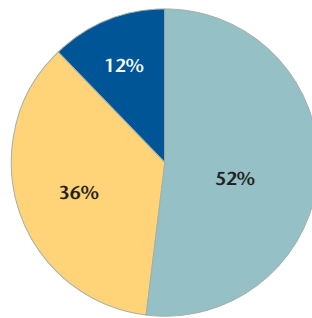
*NQDC plans were more common in the financial and service industries than in the construction and wholesale/retail industries.*

---

*54% of NQDC plans were funded by the company and 37% were not funded by the company.<sup>3</sup>*

*More than half of nonqualified plans were executive bonus and split dollar plans.*

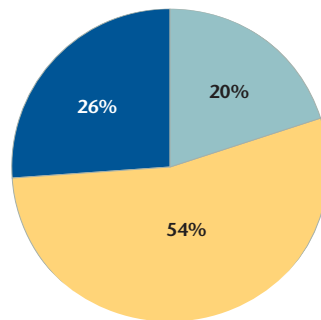
**Nonqualified Plans,  
Percent of Plans**



Executive Bonus & Split Dollar Plans  
NQDC & NQDB  
Executive 457(b) & 457(f)

*The largest number of nonqualified participants were covered under nonqualified defined contribution and nonqualified defined benefit plans.*

**Nonqualified Plans,  
Percent of Participants**



## Fast Fact

*Research showed that NQDC plans were the second most common executive benefit offered, following life insurance for key employees.<sup>3</sup>*

<sup>3</sup>LIMRA International 2006 – The Value of Executive Benefits to Corporate Executives.

