Understanding Key Components of NQDC

HOW NONQUALIFIED DEFERRED COMPENSATION PLANS SERVE ORGANIZATIONS

A well-designed NQDC plan can be a powerful tool, positioning your organization to compete for and retain top talent. Strategically developed to address your company's unique needs, your plan can help you motivate employees, simultaneously advancing their objectives *and those of the company*.

TYPES OF DEFERRAL

- Salary
- Bonus
- Long-term incentive
- Commissions
- Restricted stock
- Performance shares
- Director fees

AMOUNT OF DEFERRAL

- A typical plan might permit participants to defer up to 80% of base salary and up to 100% of other pay elements, maximizing savings on a pre-tax basis while leaving sufficient cash to cover deductions such as payroll taxes.

TIMING OF DEFERRALS

- Generally, the election to defer must be submitted before the end of the participant's taxable year and preceding the beginning of the service period for compensation.

EARNINGS ON PARTICIPATION

- NQDC plans may mirror investment funds in a company's 401(k) plan, a customized executive fund selection, managed portfolios, a declared interest rate, or any other measurement fund selected by the plan sponsor.

COMPANY CONTRIBUTIONS

- NQDC plans may be designed to provide a discretionary company contribution, adding significant flexibility for making contributions of varying amounts to participants.

TIMING OF BONUSES

- Election to defer a bonus or other "performance-based compensation" under 409A may be submitted up to 6 months before the end of the measurement period.

DISTRIBUTION AT RETIREMENT

- At retirement NQDC plan participants can typically elect lump sum distributions or annual installments of up to 15 years.Some plans allow separate elections for each plan year.

TYPES OF COMPANY CONTRIBUTIONS

- A matching contribution
- A profit share formula or a cash balance formula
- "Restoring" amounts lost in a qualified plan because of participation in a NQDC plan.
- A target benefit contribution for a specific income replacement at retirement
- A contribution tied to performance, used as a recruitment or retention tool.

SECURITY

- Anticipate a change in the predisposition of management/ board to make payments when due, and a change in control of the company.The use of a rabbi trust may be helpful. Some plan designs include a "change in control" benefit feature with a single or double trigger for distributions.

SPECIFIED DATE DISTRIBUTION

- Fulfill short-term needs during the employment period, such as college costs or a vacation home.
- Distribution may also be elected for a hardship or upon the death or disability of the participant (payment is typically made in a lump sum).

FUNDING

- Selecting an appropriate informal funding technique is a discrete task, separate from plan design.
- The funding vehicle may impact the method chosen for crediting earnings to accounts. Consider: security, asset/liability match, flexibility, after-tax return, and cash flow.

ADMINISTRATION

- Successful plans must be regularly and effectively communicated to participants.
- To eliminate confusion arising from a NQDC plan's inherent flexibility, most organizations use a third-party administrator.

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