Nonqualified Deferred Compensation Plans

Presented by:

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The Principal Financial Group

NONQUALIFIED FOCUS

LESS THAN 2% CLIENT ATTRITION IN 2014

The #1 provider of nonqualified plans[1]

Provide administrative services for over **4,200 clients**

More than 150 **dedicated employees** to NQ operations

Over **20 years** dedicated to serving nonqualified clients and their participants

Serve over **66,000 participants**

[1]Based on the total number of NQDC plans, PLANSPONSOR Deferred Compensation Plan Buyer's Guide, December 2015.

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NONQUALIFIED DEFERRED COMPENSATION SOLUTIONS

	FOR PROFIT	LTIP
DEFINED CONTRIBUTION (DC)	"EXCESS"	"INCENTIVE BONUS"
DEFINED BENEFIT (DB)	DEFINED BENEFIT	

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WHAT IS AN "EXCESS" PLAN?

Nonqualified defined contribution plan

Not subject to qualified plan restrictions due to contribution or compensation limits, or to coverage and discrimination testing

An **"unfunded" contractual agreement** between a Plan Sponsor and a Plan Participant to pay compensation at a future date

A plan **not subject to the fiduciary and most reporting requirements** of ERISA

ELIGIBILITY

GENERAL "TOP HAT" GUIDELINES

"Highly Compensated" – generally $120,000 or more of total compensation

Key management position(s) that have the ability to "influence plan design"

No more than 10% of employees eligible compared to the entire employee group

COMPENSATION

PARTICIPANTS MAY ELECT TO DEFER COMPENSATION

Base salary, Bonus, PBC, 1099 Income, etc.

Restricted stock and stock options (consider earnings period and deferral election timing)

Board of Directors fees

Consideration: Employer may impose maximums on participant elected deferrals for each type of compensation

EARNINGS CREDITING

Mutual fund investments

Interest rate crediting

Company stock

Individual securities?

- Constructive receipt issues
- Can the company buy the asset?

VESTING WHAT ARE THE COMPANY'S OBJECTIVES?

Vesting not governed by qualified plan rules

Graded vesting tied to 401(k)/profit sharing plan

Graded or cliff vesting tied to corporate objectives

"Rolling" vesting for each annual contribution

Different vesting schedules for different levels

Specific vesting for specific contributions

BENEFIT PAYMENT EVENTS

SECTION 409A PERMITTED EVENTS

- Separation from service (including retirement)
- Specific time and form ("in-service")
- Change in control
- Unforeseeable emergency (very rare)
- Disability
- Death

CONSIDERATIONS

- Plan sponsor may choose which events to permit in plan design
- "Intervening events" may override

BENEFIT PAYMENT OPTIONS

Lump sum and installments

Different elections for different events

Different options before and after a "seniority date"

Change in "time and form" rules

Made 12 months before the distribution begins

Minimum 5 year deferral (except for death, disability, unforeseeable emergency)

PRIMARY USES:

401(k) Repair & Retirement Savings

401(k) Repair

Employer can offer the plan to those HCE's capped on qualified plan contributions due to testing restrictions.

- Allows eligible key employees to defer into an NQDC plan
- Any amount restricted by qualified plan non-discrimination testing
- Company contributions follow deferrals as a way to restore a lost match.

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Retirement Savings
Going beyond the 401(k)

Addressing the retirement gap higher earners face

- **Deferral limits can be raised**, or more commonly, eliminated
- **May or may not include** company matching amounts and/or discretionary profit share contributions
- Employer has the **ability to choose which key employees can participate -** discrimination.
  - Plan design may allow ability to create tiers of the Top Hat Group with different deferral limits, employer contributions and vesting schedules

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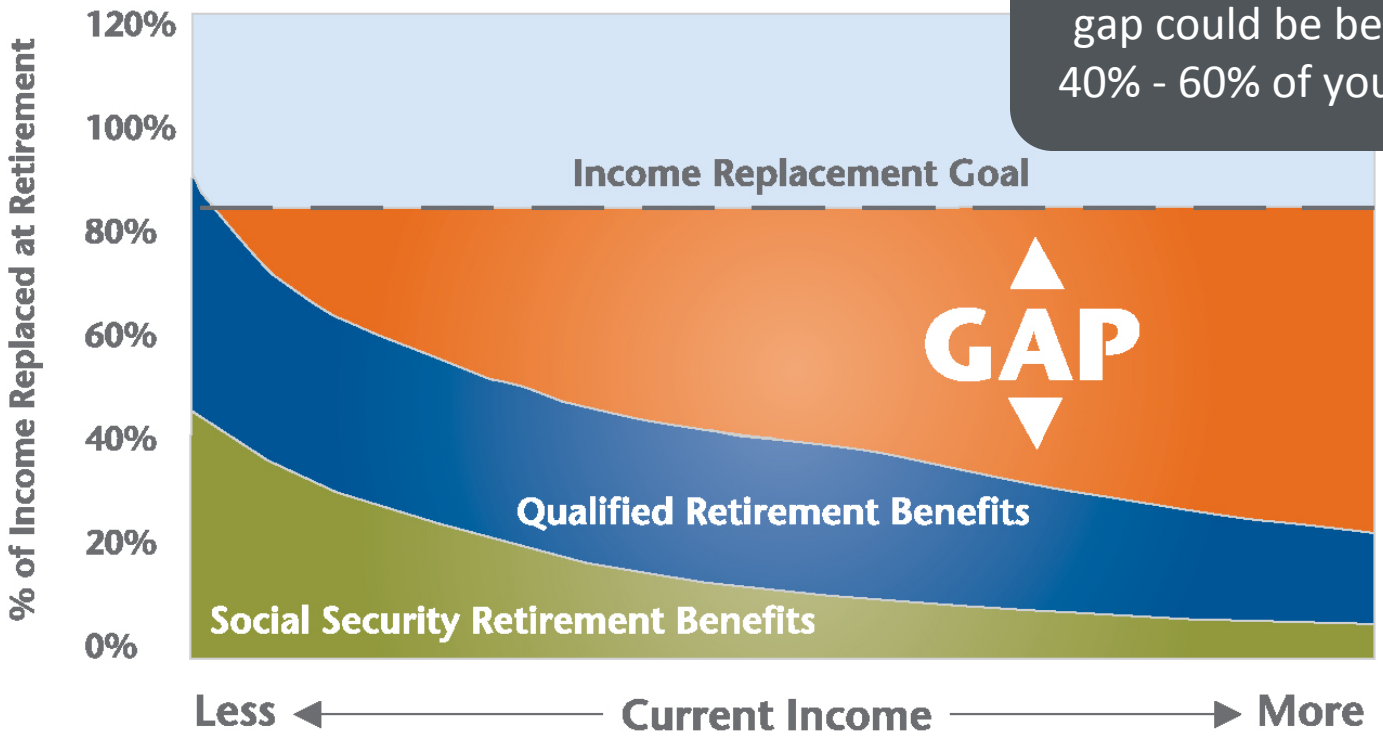
THE RETIREMENT GAP

Your retirement savings gap could be between 40% - 60% of your need



This information is from the Principal Financial Group® Replacement Ratio Calculator with source information from the Annual Statistical Supplements to the Social Security Bulletin (*www.ssa.gov*). It is intended to demonstrate the potential impact of Social Security and 401(k) plan benefits at various income levels. For more information on your individual circumstances, please speak with your financial or tax professional. ©2015 Principal Financial Services, Inc.

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PRE-TAX VS AFTER-TAX

Q:

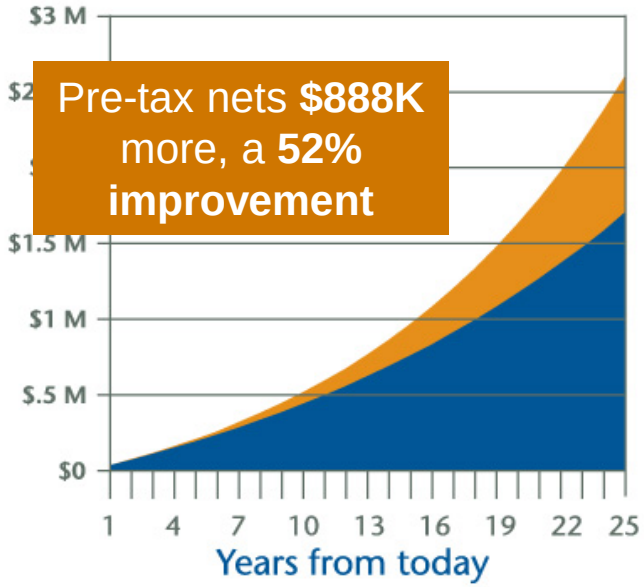
WHY WOULD YOU WANT TO SAVE ON A PRE-TAX BASIS VS AFTER-TAX?

A:

YOU KEEP THE MONEY YOU WOULD HAVE PAID IN TAXES INVESTED, EARNING COMPOUNDED RETURNS.

Your pre-tax deferrals at work

NET ACCOUNT VALUES



Pre-tax nets **$888K** more, a **52% improvement**

Pre-Tax NQ Deferred Comp

Taxable Investment

Assumptions:

35% Marginal Tax Rate

	Pre-tax NQDC	Taxable Investment
Annual deferral amount:	$50,000	$50,000
Net amount invested:	$50,000	$32,500
Earnings rate:	8%	8%
Net investment return:	8%	5.2%
Account balance after 25 years:	$3.948M	$1.678M
Net account value after 25 years:	$2.566M	$1.678M

Net amount invested for Taxable Investment based on assumed 35% federal tax bracket. Lower maximum tax rates on capital gains and dividends would make the return of the taxable investment more favorable, thereby reducing the difference in performance between the options shown. Consider your personal investment horizon and income tax bracket, both current and anticipated, when making an investment decision as these may further impact the results of the comparison. Pre-tax NQDC value based on taking lump sum distribution after 25 years at federal tax rate of 35%.

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TAXES 101

Marginal Tax Rate

How your *last and next* dollar of taxable income are taxed.

Effective Tax Rate

Average rate of taxation for *all* of your dollars.

Total amount of tax dollars
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Total taxable income

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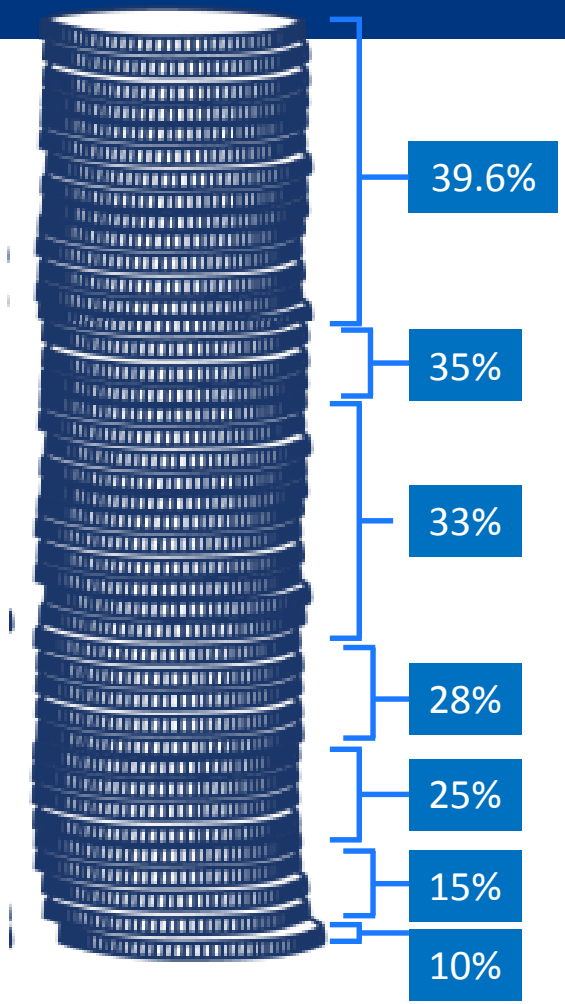
MARGINAL TAX RATES



Deferred comp plan

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MARGINAL TAX RATE VS. EFFECTIVE TAX RATE

Current Income	$200,000
Current Deferral	$50,000
Current Marginal Rate that would have been paid on deferral (Federal)	28%
Retirement Income/ Effective Rate (Federal)	$150,000 / 20%
Improvement	8%

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PRIMARY USES:

Taxation Timing

Taxation Timing

- Participants have the ability to **coordinate their NQDC distributions with distributions from Social Security or other pre-tax retirement plans** such as a 401(k) plan.
  - Often participants will fund their retirement with NQDC distributions first, then receive qualified plan distributions later.
- **Participants can defer distributions** while they're working and their marginal tax rates are potentially high and then take the distribution during retirement when their *effective tax rate* may be lower.
- Income **tax payable in the year money is actually received** by the key employee.

NONQUALIFIED PLAN ACCOUNTS

RETIREMENT ACCOUNT

Save for retirement/net worth

Additional vehicle to build net worth

Payable upon separation from service or other qualifying distribution event

Payable in lump sum or installments – you decide*

IN-SERVICE ACCOUNT(S)

Save for specific event/purchase

Save for college education

Set aside funds with no tax penalties for distributions prior to age 59 ½.

Payable at predetermined date in lump sum or installments – you decide*

*Subject to specific plan provisions

PLAN UTILIZATION

Key Employee Base Income $250,000 Bonus $100,000

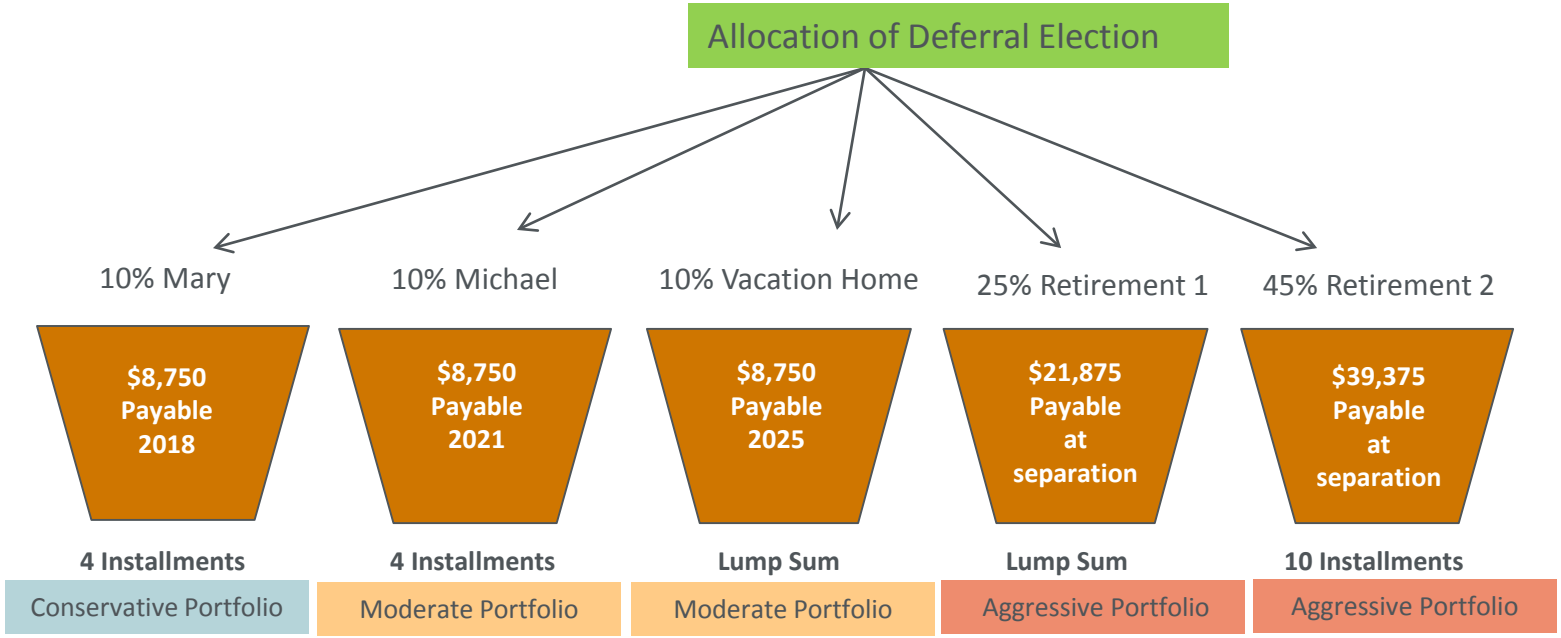
Key Employee elects to defer 15% of base pay and 50% of Bonus

Objectives:

- 2 Kids need College $$
- Planning Second Home
- Secure Retirement

Deferral Amounts:

- Base = $37,500
- Bonus = $50,000
- Total = $87,500



PRIMARY USES:

Compensation Management

Compensation Management

Use discretionary employer contributions based on the particular needs of your organization

RECRUITMENT
Attract key performers to the organization via signing bonuses tied to a fixed period of tenure or business objectives.

RETENTION
Structure bonuses – sometimes referred to as "golden handcuffs" – with vesting schedules to make it appealing for key employees to stay with the organization.

REWARDS
Drive both organizational and personal performance by offering incentive-based contributions to the plan.

RETIREMENT
Restore company match benefits disallowed in qualified plans due to ADP/ACP testing and/or compensation limits.

EMPLOYER CONTRIBUTIONS

FULLY DISCRETIONARY CONTRIBUTIONS

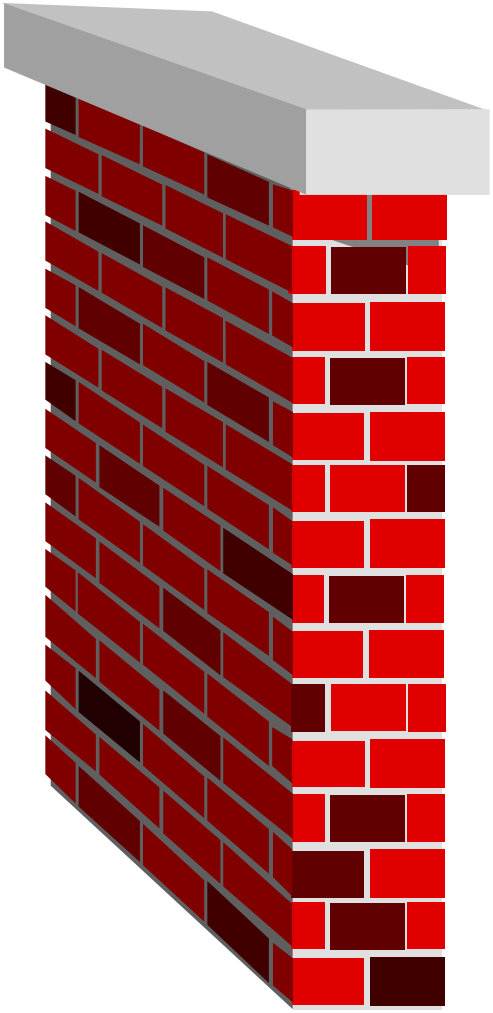
- Make up for missed contributions in qualified plans due to discrimination testing
- Incentive based contributions
- Executive "profit sharing"
- Phantom stock contributions
- Signing and staying bonuses

FINANCING: NONQUALIFIED PLAN OBLIGATIONS

NONQUALIFIED PLAN FINANCING

Corporate Asset

(COLI/Taxable Investments, Securities)



Plan Liability

(Deferred Comp Account)

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PLAN FINANCING OPTIONS

A NONQUALIFIED PLAN IS:

An <u>unfunded</u> and **<u>unsecured</u>** contractual obligation (liability) to pay a future benefit

3 WAYS TO FINANCE:

- Unfinanced
- Taxable Investments
- Variable COLI

BEST APPROACH DEPENDS ON THE COMPANY'S:

- Income tax bracket
- Long-term cost of money
- Earnings assumptions
- Realized vs. unrealized gains and losses on assets
- Cash flow requirements

NQ TEAM

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