NONQUALIFIED PLANS

Nonqualified benefit plans are plans established for only the top executives or the most highly compensated employees within an organization. They are often used to supplement a qualified plan or provide a stand-alone benefit that serves as an important tool to recruit, retain, or reward highly skilled executives. In general, no limits exist to the amount that can be deferred, and they are designed to avoid most of the provisions of ERISA.

WHY SHOULD YOU PURSUE NONQUALIFIED SALES?

- Top executives desire to defer more than 401(k) plans allow
- Increase your assets under management
- Looks and feels like a 401(k) so it's an easy sell
- No testing or annual reporting requirements

QUICKTIP: Every 401(k) client is a prospect for a nonqualified plan!

KEY POINTS TO A NONQUALIFIED PLAN:

- Unlimited pre-tax deferral of compensation with tax-deferred growth
- Can offer the same investment choices and matching contributions as 401(k)
- Vesting can be the same as or much more flexible than a 401(k)
- Penalty-free pre-retirement distributions (if scheduled at the time of deferral)
- Employer tax deduction at the time of distribution
- Discrimination allowed – participants must only include management or highly compensated employees
- Plan must be "unfunded" (i.e., benefits are not secured)
- Participant balances are just a "promise to pay" – no actual segregated account
- Loan or rollovers are not allowed

EMPLOYER CONSIDERATIONS:

- Employer must accrue a liability on its books
- FICA taxes are due as amounts vest
- Future deduction rather than a current deduction
- Compliance with IRS Code Section 409A
- Recordkeeping costs

FACTS:

79% of nonqualified plans have less than 10 participants.

41% of nonqualified plans have only 1 participant.

Statistics based on the Department of Labor Top Hat filing database

HOW THEY WORK:

- Participants elect to defer current income on a pre-tax basis and choose how and when to be paid upon certain events (e.g., termination, death, disability)
- Participants select funds to value their account based on a menu of funds. The funds selected are only a mechanism to value the "promise to pay" participants. Balances are tracked on a daily basis in a "phantom account" (i.e., book entry).
- To offset the liability created by the "promise to pay," employers can deposit deferrals and employer contributions into company assets (e.g., corporate owned life insurance and/or mutual funds)
- The employer "mirrors" the investments in the corporate asset based on the aggregate of participants' "deemed" investment selections