

Deferred Compensation: The Basic and Growing Need

Kenneth A. Dayton, JD, CPA
The Newport Group

April 2011

Helping to bridge the retirement planning gap for executives is one of the most significant challenges—and near-term opportunities—plan advisers have today. This is because many executives face a daunting task: making sure they will have sufficient assets to continue funding their lifestyles through retirement age and beyond.

According to the U.S. Department of Health and Human Services, the average life expectancy in 2007 for a 65-year old individual was an additional 18.6 years – to age 83.6. Executives, because of lifestyle choices and more rigorous healthcare treatment, will often live beyond this threshold—into their 90s—as will their spouses.

Furthermore, today's executives often have to care for elderly parents. The cost of long-term health care and nursing homes can exceed \$100,000 annually, and this can be a tremendous responsibility.

Other Challenges

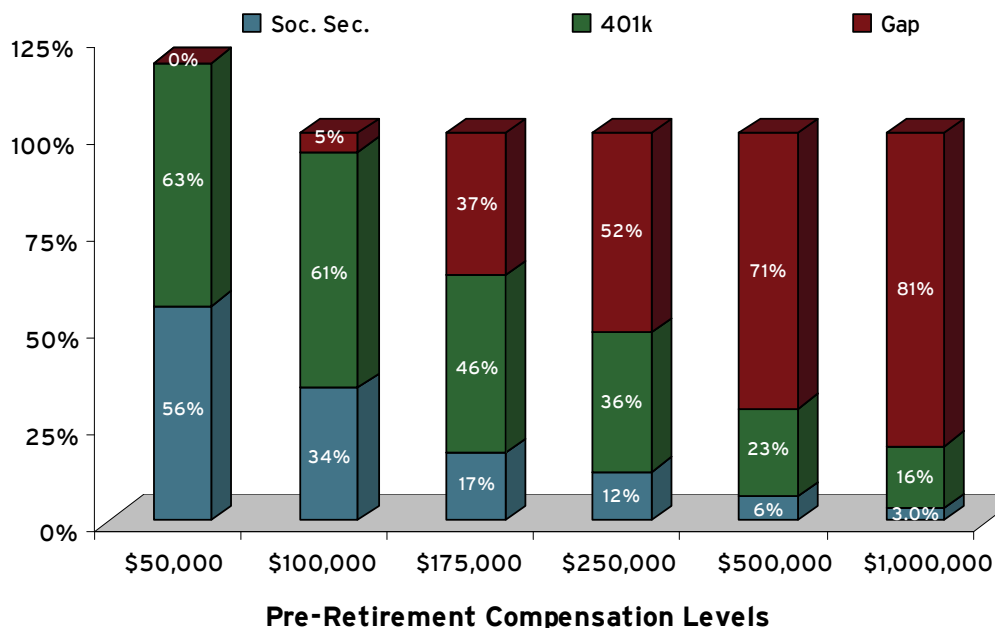
There is a generally accepted standard that an individual will need 70 to 80 percent of current income as retirement income in order to maintain his style of living. While full participation in qualified retirement

plans and Social Security can enable many employees who save aggressively to reach this threshold, the shortfalls can be significant for executives earning more than \$150,000 annually.

In fact, many highly compensated executives can expect to receive 30 percent or less of their average annual compensation from these vehicles, despite significant statutory increases in 401(k) contributions and IRA contributions over the past decade.

Saving For Retirement

Gap Widens for HCE's



Fidelity Research Institute 2007
Social Security Benefit Calculator

Difficult conditions in the financial markets have added to this challenge. Low or even negative stock returns over the past decade have been accompanied by declining interest rates on fixed-income securities.

Pension plans have also been cut and stock options curtailed. And with the historic budget gaps facing the country, there seems to be a growing sense that some Social Security benefits could be cut, with high income earners the first targets.

The Deferred Compensation Bridge

To address executives' retirements needs and to implement programs that will cost-effectively retain and attract high quality executives, many companies offer non-qualified deferred compensation plans. Think of these as an extension on a 401(k) program, with customizable goals for executives.

Plans can be structured so that they only allow executives to defer a portion of salary and/or bonus compensation. And, of course, deferrals enjoy tax-deferred growth.

Some companies set up plans so contributions come exclusively from executives. Others find it advantageous to retain and attract executives by providing a company match, including incentive-based matches, and various vesting schedules.

There are, however, administrative challenges associated with such plans in light of IRS and other regulations. As many executives defer more to a non-qualified deferred compensation plan than a qualified 401(k), proper service as well as administration is imperative. Plan advisers may thus want to form alliances or partnerships with firms that specialize in deferred compensation and fully understand its complexities.

As baby boomers approach retirement, properly structured and administered executive benefit plans will only increase in importance. Advisors who understand how to provide these programs as one of their key retirement planning solutions will find this an effective way to expand their relationships with existing clients and forge new relationships as well.

About the Author

Kenneth A. Dayton, JD, CPA is a Regional Director with The Newport Group, a national provider of customized retirement and executive benefit plans and investment consulting services. Dayton provides client development and project oversight for consulting services in the design, funding, and administration of executive benefits.

THE
NEWPORT
GROUP

From *VISION* to *value*

ABOUT THE NEWPORT GROUP

Founded in 1984, The Newport Group is a leading retirement services and investment and fiduciary consulting firm—specializing in the creative design, funding, and administration of qualified and non-qualified retirement plans. Newport is uniquely positioned to satisfy the distinct financial needs of employers and employees, and has done so for hundreds of the country's largest and best-known companies.

www.newportgroup.com