Current Practices in Non-Qualified Deferred Compensation

2017 EDITION
Contents

Executive Summary 3
A Global View 4
The Current Environment 5
Survey Findings 6
Methodology 8

Goals and Satisfaction 9

Non-Qualified Deferred Compensation Plans 12
Offering 13
Company Contributions 14
Eligibility 16
Eligible Compensation 18
Investments 20
Distributions 24

Informal Funding 29

Plan Administration 36

Survey Demographics 39
Executive Summary
A Global View

Non-qualified deferred compensation plans (NQDC plans) remain a crucial tool for plan sponsors to attract, motivate and retain qualified and talented professionals—while at the same time helping these employees save for a more secure retirement.

An attractive retirement program is a critical element of workforce management, creating opportunities for an employer’s rising talent. Employers need to be diligent in working with their consultants and administrators in order to keep their deferred compensation plans current and relevant in today’s marketplace, as these plans are a key component of a competitive compensation package.

Achieving Objectives

Since these plans are so popular and widespread in corporate America, it is incumbent on plan sponsors to ensure they achieve both employee benefit and corporate financial objectives. Properly designed, these programs will balance the interests of a company’s stakeholders, including its owners/shareholders and current and future management.

As a leader in the design, implementation, and administration of these plans, Newport Group is pleased to present the 2017 edition of our survey report on Current Practices in Non-Qualified Deferred Compensation. This survey provides current and comprehensive information on voluntary non-qualified deferred compensation plans, including plan prevalence, plan eligibility requirements, company contributions, distribution and payment options, funding vehicles and plan administration.

Insight and Analysis

This data was compiled and analyzed by Newport Group’s in-house staff of plan consultants, who have supplemented it with valuable insight and marketplace analysis to assist plan sponsors and their advisors in understanding specific survey findings. The results are designed to help plan sponsors review and enhance their plans to meet their company’s specific objectives.

We hope you find Current Practices in Non-Qualified Deferred Compensation useful and thought-provoking as you evaluate your own company’s compensation and benefits programs.
The Current Environment

Two significant retirement industry trends have impacted deferred compensation plans over the past several years:

- The declining use of defined benefit pension plans has led to an increase in the use of NQDC features that allow the plan to effectively replace lost pension benefits.
- There has been increasing interest in incorporating company stock deferral into NQDC plans. This reflects greater use of restricted stock and a move away from stock options, and the recognition that NQDC can improve the tax and cost efficiency of restricted stock or stock unit plans. In addition, many plan sponsors continue to allow deferred compensation to be tied to company stock.

The past 15 years have also seen legislative and regulatory activity which has had a significant impact on these plans. Much of this activity (notably IRC §409A and the 2006 Pension Protection Act, which included COLI best practices provisions) has been helpful in clarifying the deferred compensation landscape for plan sponsors and advisors.

Current events indicate that the regulatory and legislative environment could change again. Additionally, changes in tax law could also impact deferred compensation plans. Some potential changes in legislative, regulatory and tax areas include the following:

- Dodd-Frank—which previously stimulated the use of deferred compensation plans to provide incentive compensation for key employees of banks and financial institutions—could see significant change.
- Individual income tax rates may come down, although any currently proposed changes are unlikely to significantly impact the attractiveness of deferred compensation to key employees.
- Corporate tax rates will likely decrease, which will factor into financial accounting and funding considerations.
- General rules on compensation, securities, or investing may change, potentially impacting how companies and key employees view deferred compensation or the funding of these plans.

This constantly changing landscape requires employers, executive benefit consultants and plan administrators to carefully manage the plan design, administration and compliance risk of their NQDC plans. However, change also creates opportunities. If plan sponsors and their advisors are proactive, they can ensure the plans they implement remain a powerful competitive tool.
Survey Findings

A Key Part of Compensation Programs

The following are some findings of the 2017 survey:

• 92% of respondents indicated they have an NQDC plan—an increase from our previous survey, which indicated plan prevalence for 78% of companies. It should be noted that 78% represented a low point in the temporary decline of plan prevalence which began with the financial stresses in 2008. We discuss these findings in more detail in our Marketplace Insights on page 11.

• 93% responded that it is important to them to have an NQDC plan which is competitive with their peer companies.

• 89% responded that an important goal for an NQDC plan is to allow key employees to accumulate assets for their financial planning needs. This goal also likely speaks to the increased use of in-service scheduled distributions—74% of plan respondents allow them.

• 88% of respondents indicated that an important goal for the NQDC plan was to retain key employees.

About the Companies Using these Plans

The larger the company, the more likely it is to offer an NQDC plan. Once companies reach $1 billion of annual revenue, they are usually competing for a certain level of key employee talent, and need to have a competitive plan.

Publicly traded companies slightly lag non-public companies in offering NQDC plans. Of the publicly traded respondents, 91% have an NQDC plan, while 96% of not-publicly traded respondents have one. This higher percentage may be a result of key employees in these companies not being offered an opportunity to participate in the company’s equity growth. The NQDC plan is an attractive tax-efficient alternative.

Finally, the use of stock in deferral plans is still somewhat low (19%) but trending upward. Many companies ask Newport Group and their advisors about the efficiencies of deferring stock—both in terms of tax-deferral and in meeting stock ownership guidelines. We believe stock will continue to grow in importance in these plans.

Given the high degree of use of NQDC plans at this point, companies that do not have a plan (or are not fully utilizing their existing plan) are likely falling behind the curve with respect to having an attractive and competitive compensation program.
Informal Funding

The survey results indicate a decline in the percentage of companies funding their plans. In this survey, 54% of respondents indicated that they informally fund their NQDC plan, while in the past that percentage has been around 70% to 75%.

However, our experience at Newport Group doesn’t fully support this response. Some key factors require additional consideration.

One, the rate of NQDC plan growth has been significant following the recovery that began in 2008. Our experience is not that companies are funding less frequently, but that an increase in the number of plans has occurred faster than the increase in funding. As these plans mature and grow, and as plan liabilities become more significant, we have seen that companies will set aside assets to informally fund their plans. We expect that to impact numbers going forward.

Two, in the past few years our non-qualified consulting team has seen an uptick in the focus and review of plan funding options by sponsors. During the 2008 financial downturn, companies with unfunded NQDC plans didn’t always have earmarked assets (i.e. rabbi trusts) to make required benefit distributions. As a strong recovery has continued through 2017, participant and plan balances have grown substantially, so plan financing is a material concern—and this concern is being addressed regularly by corporate financial teams.

Plan Administration

As a result of IRC §409A, and the increasing size of participant balances, plan sponsors have become increasingly aware of, and concerned about, the risk associated with improper NQDC plan administration. At the same time, plan sponsors and participants increasingly prefer to minimize paper statements and enroll, manage and administer plan-related activity online. Most plans today offer online access, and provide asset allocation features similar to what is available to their 401(k) plans.

Due to all of the above factors, most companies look to outsource plan administration to mitigate their IRC §409A risk, and to obtain key reporting features and participant financial tools that would be too difficult and costly to administer internally. Virtually no respondents (a mere 3%) administer their plan completely on their own.
EXECUTIVE SUMMARY

Summary

Since the implementation of IRC §409A in 2004–2005, legislation, regulation, and the market have worked to codify the significant use of NQDC arrangements as a means of attracting, compensating, and retaining key employees and helping them prepare for a secure retirement.

Our 2017 survey strongly affirms that these plans are now fundamental to the compensation and workforce management programs of many of the largest US companies. The trends we have observed during the past few years are further confirmed by this survey.

Further, our experience with existing NQDC clients illustrates to us that plan sponsors are increasingly looking for ways to strategically utilize non-qualified plans to more effectively align corporate objectives and results. Making the plan design fit company goals, controlling plan costs, and outsourcing administration to mitigate risks and add plan features—these are all trends that have continued over the last several years.

Methodology

Our 2017 survey questionnaire contained over 40 questions about NQDC programs, their funding and administration. This survey was sent to Fortune 1000 human resources and financial professionals at organizations nationwide. In an effort to make this survey as focused as possible, we limited it to voluntary NQDC plans.

Data collection was administered via a secure web-based data submission tool. Results are based on the answers to our questionnaire provided by 113 firms; these answers were analyzed for consistency and prepared for presentation by Newport Group’s professional compensation consultants and non-qualified plan consultants. All individually submitted data is kept strictly confidential, and only aggregate results are reported so as not to disclose any individually reported information.
Goals and Satisfaction
Goals and Satisfaction

How important are each of the following goals for your deferred compensation program?

(Please rank selections in order of importance, with 6 being the least important and 1 the most important.)

<table>
<thead>
<tr>
<th>Goal</th>
<th>6</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>To have a compensation program that is competitive with peer companies</td>
<td>1%</td>
<td>6%</td>
<td>10%</td>
<td>26%</td>
<td>21%</td>
<td>37%</td>
<td>1</td>
</tr>
<tr>
<td>To allow key employees to accumulate assets for their financial planning needs</td>
<td>3%</td>
<td>8%</td>
<td>17%</td>
<td>8%</td>
<td>27%</td>
<td>38%</td>
<td>2</td>
</tr>
<tr>
<td>To retain key employees</td>
<td>2%</td>
<td>10%</td>
<td>25%</td>
<td>20%</td>
<td>23%</td>
<td>21%</td>
<td>3</td>
</tr>
<tr>
<td>To compensate key employees in a more tax efficient manner</td>
<td>6%</td>
<td>33%</td>
<td>15%</td>
<td>18%</td>
<td>16%</td>
<td>12%</td>
<td>4</td>
</tr>
<tr>
<td>To attract key employees</td>
<td>5%</td>
<td>28%</td>
<td>24%</td>
<td>23%</td>
<td>16%</td>
<td>5%</td>
<td>5</td>
</tr>
<tr>
<td>To increase stock ownership of the firm by eligible key employees</td>
<td>78%</td>
<td>9%</td>
<td>6%</td>
<td>3%</td>
<td>2%</td>
<td>1%</td>
<td>6</td>
</tr>
</tbody>
</table>

Based on the goals that you stated, how effective has your deferred compensation plan been in accomplishing these goals?

(Please rank selections in order of importance, with 6 being the least important and 1 the most important.)

<table>
<thead>
<tr>
<th>Goal</th>
<th>6</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>To allow key employees to accumulate assets for their financial planning needs</td>
<td>2%</td>
<td>8%</td>
<td>8%</td>
<td>13%</td>
<td>32%</td>
<td>36%</td>
<td>1</td>
</tr>
<tr>
<td>To have a compensation program that is competitive with peer companies</td>
<td>1%</td>
<td>4%</td>
<td>14%</td>
<td>25%</td>
<td>21%</td>
<td>34%</td>
<td>2</td>
</tr>
<tr>
<td>To compensate key employees in a more tax efficient manner</td>
<td>3%</td>
<td>26%</td>
<td>11%</td>
<td>21%</td>
<td>25%</td>
<td>12%</td>
<td>3</td>
</tr>
<tr>
<td>To retain key employees</td>
<td>2%</td>
<td>19%</td>
<td>28%</td>
<td>14%</td>
<td>17%</td>
<td>19%</td>
<td>4</td>
</tr>
<tr>
<td>To attract key employees</td>
<td>7%</td>
<td>32%</td>
<td>25%</td>
<td>18%</td>
<td>13%</td>
<td>4%</td>
<td>5</td>
</tr>
<tr>
<td>To increase stock ownership of the firm by eligible key employees</td>
<td>78%</td>
<td>3%</td>
<td>7%</td>
<td>7%</td>
<td>2%</td>
<td>2%</td>
<td>6</td>
</tr>
</tbody>
</table>

Survey Findings

Survey results show that the most important goals for employers are to help key employees accumulate assets, as well as to make sure their compensation plans are competitive—and that these plans are effective in both areas.

Marketplace Insights

The fact that “attracting key employees” didn’t score higher may indicate that there is a market perception that a key employee terminating will cause a large NQDC payout—and a taxable event—thereby creating the incorrect perception that the plans are more of a retention vehicle than a vehicle to recruit key employees. Attracting key employees who have an NQDC balance at a competing company can be accomplished by allowing those associates to defer a large percentage of their upcoming salary and bonus, for multiple years if necessary, while they live off their prior NQDC distribution. This distribution/deferral combination creates an effective “virtual rollover” from one plan to another.
Goals and Satisfaction

How satisfied do you think participants are with the following aspects of your deferred compensation plan?

(Please rank selections in order of importance, with 6 being the least important and 1 the most important.)

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuable component of participants’ overall benefit package</td>
<td>1</td>
</tr>
<tr>
<td>Impact on participants’ retirement preparedness</td>
<td>2</td>
</tr>
<tr>
<td>Impact on participants’ tax planning</td>
<td>3</td>
</tr>
<tr>
<td>Investment choices</td>
<td>4</td>
</tr>
<tr>
<td>Website experience delivered by service provider</td>
<td>5</td>
</tr>
<tr>
<td>Their understanding of the plan</td>
<td>6</td>
</tr>
<tr>
<td>Plan education and materials</td>
<td>7</td>
</tr>
</tbody>
</table>

Survey Findings
Sponsors identified three areas in which participants are most satisfied with their NQDC plans (1–3 response):

• Valuable component of participants’ overall benefit package (72%)
• Impact on participants’ retirement preparedness (67%)
• Impact on participants’ tax planning (57%)

Of course many other elements of the plan are important to provide a fully satisfactory experience for plan participants.

Marketplace Insights
Companies have recognized that despite having more resources, many employees still do not adequately plan for retirement and/or are unable to save enough due to qualified plan limits. However, simply making an NQDC plan available to participants is not enough. Plan education, enrollment materials and the general understanding of the plan could be improved, given the lower scores for these areas.

Similarly, we would speculate that part of the reason for only a moderate participant satisfaction with investment choices is that education around these choices and the understanding of them could also be enhanced. We strongly recommend that plan sponsors work with their advisors and plan administrators to review and update their overall retirement plan communication and education programs.
Non-Qualified Deferred Compensation Plans
Offering

Do you offer a non-qualified deferred compensation plan?

Survey Findings
2017 survey data shows that 92% of all survey participants offer a non-qualified deferred compensation plan.

Marketplace Insights
The use of deferred compensation appears to have rebounded after a temporary decline of plan prevalence that began with the financial stresses in 2008. Plan prevalence was at a low point of 78% in our most recent non-qualified plan survey in 2014/2015. This reflected the fact that companies facing financial difficulties tended not to add new benefits, while paying out and terminating existing plans in some cases. Additionally, a downward trend in salaries and bonuses was reflected in deferrals as well. This year’s results confirm a steady increase in plan prevalence as the economy has continued to recover.
Company Contributions

What types of company contributions do you provide?

- **Make-Up (23%)**: Ensure that between the 401(k) actual match and a “make-up” in the deferral plan, the maximum total match is made available.
- **Excess (34%)**: Provide contributions beyond the qualified plan regulatory limits. For example, if the 401(k) provides a 4% match, the deferred compensation plan would continue to provide that match beyond the regulatory limits—although there could be a plan-defined limit.
- **Discretionary (12%)**: These contributions are used in place of SERPs since we have seen the number of SERPs decline.
- **None (27%)**: Companies also appear to be focused on increasing deferral plan participation, as evidenced by over 40% offering either excess contributions (34%) or a match at a percentage other than the 401(k) (7%).
- **Match Other Than 401(k) Formula (7%)**: Companies are recognizing the importance of these plans for their own long-term competitiveness, but also to help their best talent prepare for retirement.

Survey Findings

There was a significant increase in the number of companies providing a company contribution over the last survey. 73% responded that they provide a contribution, whereas in the last survey only 50% indicated they did.

- 23% of companies offer make-up contributions, which ensure that between the 401(k) actual match and a “make-up” in the deferral plan, the maximum total match is made available.
- 34% of companies offer excess contributions. These contributions provide for contributions beyond the qualified plan regulatory limits. For example, if the 401(k) provides a 4% match, the deferred compensation plan would continue to provide that match beyond the regulatory limits—although there could be a plan-defined limit.

Marketplace Insights

Based on our extensive experience with clients, the increase in company contributions is largely due to the fact that these contributions are being used in place of SERP benefits since we have seen the number of SERPs decline. Companies also appear to be focused on increasing deferral plan participation, as evidenced by over 40% offering either excess contributions (34%) or a match at a percentage other than the 401(k) (7%). Once again, companies are recognizing the importance of these plans for their own long-term competitiveness, but also to help their best talent prepare for retirement.
Company Contributions

*How is the company contribution vested?*

- **Immediately 100% Vested**: 54%
- **Vested at Retirement**: 3%
- **Cliff Vesting After X Years**: 17%
- **Graded Vesting Over X Years**: 22%
- **Age+ Service Vesting**: 8%
- **Other**: 13%

Survey Findings
Over half (54%) of company contributions vest immediately, although cliff vesting and graded vesting are both very popular.

Marketplace Insights
Generally, cliff vesting and graded vesting are used to mimic the vesting provisions under the qualified plan. The high incidence of "immediately 100% vested" indicates that the contribution is viewed as belonging to the employee, or restoring to the employee something that was lost.
Eligibility

How do you determine who is eligible to participate in your NQDC plan?

Survey Findings
Over half (51%) of plan sponsors determine eligibility based on either job grade (29%) or position (22%). Basing eligibility on salary or compensation accounts for another 31%.

Marketplace Insights
Generally, most plan sponsors use a minimum range of $125,000–$150,000 as the low end of the total compensation level. In addition, the maximum number of eligible participants in an NQDC plan is typically held at no more than 10%–15%.

Periodically we see benefit plan committees exclude sales positions from the NQDC eligible group due to concerns about year-to-year volatility in compensation/commissions. However, there are methods to mitigate these concerns and allow these valuable employees to participate. One option is to allow them to elect to defer a certain percentage of commission that they receive above a floor dollar amount (e.g., 25% of commission in excess of $50,000).
Eligibility

*What is the approximate minimum total compensation among those eligible for the plan?*

Survey Findings

90% of respondents indicate that eligible employees earn at least $120,000, while 60% indicate eligible employees earn at least $150,000 dollars annually.

Marketplace Insights

Although there is no regulatory reason or requirement, there has been an increasing tendency for companies to follow the highly compensated employee (HCE) limit with respect to their deferred compensation plans ($120,000 in 2017). Only 10% of plan sponsors have an annual compensation eligibility level below that amount.
Eligible Compensation

*Has your 401(k) plan discrimination testing ever resulted in refunds to highly compensated employees?*

![Survey Findings](image)

Almost one-third of 401(k) plan sponsors surveyed state that their discrimination testing has resulted in refunds to highly compensated employees.

**Marketplace Insights**

As qualified plan discrimination testing has continued to impact an increasing number of employees, more employers have added deferred compensation plans to provide an alternative company-sponsored retirement savings program.

Note that a contemporary NQDC plan can include an election feature that allows for an automatic increase in a participant's annual deferral equal to the amount of the qualified plan refund.
Eligible Compensation

*What types of compensation may participants elect to defer?*

Survey Findings
Companies generally allow for base salary and annual bonus deferrals (93% each) with all other types of compensation “deferrable” approximately 20% to 35% of the time. We note the increase in stock deferrals, from 6% in our previous survey to 19% in 2017.

Marketplace Insights
Salary and bonus are the typical forms of compensation which may be deferred, and generally are universal in their inclusion among compensation that can be deferred. As public companies have moved away from stock options and because many closely held private companies do not offer stock to their senior management, we have seen an increase in the past few years of plan sponsors creating long-term incentive plans and allowing them as a deferral source in their NQDC plans.

For those plan sponsors who have a restricted stock program, RSU deferrals have seen significant growth as companies realize deferred compensation is an excellent way to increase participation in the stock, and also making it easier for key employees to meet stock ownership guidelines.
**Investments**

*Are your NQDC plan investment options the same as those offered in the 401(k)?*

---

**Survey Findings**
66% of respondents report they use different investment options in their deferral plan as compared to their 401(k) plan, while 34% use their 401(k) menu in their NQDC plan.

**Marketplace Insights**
Companies generally offer their key employees different investment menus for three reasons:

- Key employees may have a different set of investment planning needs than the broader employee base.
- Although the plans are similar, not all 401(k) investments are clearly appropriate for deferred compensation plans. For example, target date funds and stable value funds have specific uses in 401(k) plans that are not always applicable or available in NQDC plans.
- Using two different menus allows participants to better diversify their retirement plan investments among a wider range of fund companies.
**Investments**

*Please specify the number of investment options the plan offers.*

- **20 or more**: 24%
- **10-19**: 55%
- **1-9**: 20%

**Survey Findings**

55% of respondents who use mutual funds as a crediting rate offer 10-19 investment options, down slightly from the prior survey (67%). 20% report fewer than 10 funds, up from 11% in the last survey. Those with 20 or more funds have remained about the same, 24% this year versus 22% in the prior survey.

**Marketplace Insights**

Like 401(k) plans, NQDC plans offer a variety of funds that represent major asset classes, thereby supporting the participant’s ability to use asset allocation in a manner consistent with their risk tolerance and time horizon.

It is possible that the continued trend to provide participants enhanced investment education and asset allocation tools has also led some companies to simplify the investment menu through a decrease in the number of funds, or by having a plan that uses a single fixed rate option only.

However, many companies have adopted pre-constructed model portfolios, which provide participants the means to manage their portfolios to a target “risk” (where the equity/fixed income allocations correspond to a participant’s appetite for risk) or a target “date” (where the equity/fixed income allocations correspond to a participant’s age/retirement date). Providing model portfolios allows participants the ability to have a professionally managed asset allocation based on their risk tolerance, which simplifies participant investment decisions and enhances investment returns over time.
Investments

*Please specify the types of investment options the plan offers.*

Survey Findings

Mutual funds, life insurance (COLI) funds or other market related investment funds are the most common participant investment options (89%), and these findings are virtually unchanged from our previous survey (90%). Fixed rate indices also remain very attractive (44%), down slightly from 60%. Company stock increased to 34% from 21% last year.

Marketplace Insights

A range of funds (similar to a 401(k) menu) is by far the most popular approach to investment menu construction for NQDC plans. Fixed rate option alternatives have been particularly popular after the 2008 financial downturn and in this interest rate environment. Although these investment alternatives remain very popular, we’ve also seen an increased use in company stock.

The high use of market-based investment menus and increased use of company stock both reflect the performance of the stock market over the past few years. The increased use of company stock also fits with the increased ability to defer stock-based compensation.
**Institutions**

*Please specify all of the fixed rate options in the plan.*

Survey Findings

The survey results found that U.S. Government Treasury rates and a company declared rate are the most common fixed rate options offered today.

Marketplace Insights

Treasury rates are well understood and easily determined, which contributes to their popularity. As a market-based rate, Treasuries generally avoid any tax for excess interest under the Social Security/FICA rules, and they also typically avoid any additional disclosure under proxy compensation disclosure regulations.

While a company declared rate (or fixed rate option as it is also known) may not be as easily determined, it does have the advantage of giving the company significant control over the cost of the plan, and it can be financed using a tax-managed COLI strategy.

Moody's has some of these same advantages: it can be viewed as a market-based rate, thereby avoiding excess interest Social Security taxes and proxy disclosure. Moody's rate plans are not as they once were when they were tied to the plan financing vehicle. As a fairly stable rate, the cost is predictable and easily managed.

Prime rates are well known, but potentially volatile and therefore somewhat less attractive. While the applicable federal rate works well with respect to regulatory issues, it's not as well known and is typically not used very often.
Distributions

*Does the NQDC plan use a “class year” structure or an “account-based” structure?*

![Pie chart showing distribution of class-year and account-based structures.](image)

**Survey Findings**

Account-based plans are designed to focus on the participant-selected specified distribution dates (including in-service distributions and retirement, death, termination, etc.). The account-based structure continues to be slightly more popular (54%) than class-year structures (40%), where a distribution election is made for each year of deferral.

**Marketplace Insights**

Although class-year structures may offer the highest degree of distribution flexibility, account-based structures deliver virtually the same distribution flexibility. Account-based plans are generally viewed as simpler for participants to understand and manage.
Distributions

Under which of the following circumstances may participants receive distributions from the NQDC plan?

Survey Findings

Since the implementation of IRC §409A, the rules around timing and events for NQDC distributions have been formally defined. During the past several years, plan sponsors have worked on which events to allow in their NQDC plans. Termination—including retirement—continues to be the most important distribution trigger with a specified date being a very important feature as well. The key ways that participants take distributions have not changed dramatically since our previous survey.

Marketplace Insights

Distribution options provide an opportunity for plan sponsors to coordinate their NQDC plans with other benefit programs in designing a total compensation program.

Some design features to consider are these:

• Will the plan allow in-service distributions? (Note that most do.)
• Will retirement or disability be treated as a separate incident, or as a form of termination?
• Will the plan have a single or double trigger for a change in control event?
• Will the plan allow for domestic relations orders?
Distributions

How may participants take distributions from the NQDC plan?

Survey Findings
Lump sums and installments continue to be the most popular forms of distribution (71% each). A partial lump sum in the first year of distribution with ongoing annual installments thereafter is another popular form of distribution.

Marketplace Insights
 Retirement distribution elections typically provide greater flexibility and allow longer duration installment payments than other events (termination, in-service payment, change in control, etc.). The longer duration afforded to retirement distributions (as opposed to a single lump sum payment for a termination or shorter-duration scheduled in-service distributions) may also enhance retention and allow key employees to optimize their retirement cash flows.
Distributions

What is the maximum period over which participants may take their payments from the NQDC plan?

Survey Findings
85% of plans allow distributions of ten years or greater. Only 13% require distributions of fewer than 10 years. Life annuities continue to be rare.

Marketplace Insights
Given the federal rules on source state taxes, the allowable length of distributions is not surprising—those rules say that a “source” state may not tax retirement distributions if they are paid out over 10 or more years. These federal tax rules, which allow relocated retirees to take advantage of states with lower income tax rates, make it surprising that any plans still have a maximum distribution of fewer than 10 years.
Distributions

*Are participants allowed to change their existing payment schedules?*

![Pie chart showing 80% Yes and 20% No]

**Survey Findings**

A large majority of companies (80%) allow participants to change their distribution schedules as long as they are within the parameters allowed by IRC §409A (i.e. at least 12 months in advance of distribution date and a minimum five year re-deferral).

**Marketplace Insights**

IRC §409A clarified the rules on changing distribution elections. Today, most plan sponsors allow for distribution modification within their NQDC plan. This flexibility helps plan participants modify their retirement planning as their situations change over time. While this feature is advantageous to participants, it is important to consider the plan administrator’s systems and distribution modification procedures in order to avoid potential IRC §409A violations.
Informal Funding
Informal Funding

**Does your company currently fund non-qualified plan liabilities?**

![Pie chart showing 54% Yes and 46% No](image)

**Survey Findings**

54% of companies informally fund their deferred compensation plans. The advantages of setting aside assets include managing expense volatility, asset/liability management, providing participants some security, and having assets potentially available for the ultimate payment of benefits under the plan.

**Marketplace Insights**

This funding percentage is down from previous levels, but these statistics may be an anomaly. Some key factors require additional consideration:

- The rate of the number of plans over the past few years has been significant following the recovery from 2008. It may not be that companies are funding less, but rather that the increase in the number of plans has occurred faster than the increase in funding. As plans mature and grow, and NQDC plan liabilities become more significant, our expectation based on experience is that companies will look to finance their unfunded plans.

- Since 2008, we have found that companies are very focused on funding. During the financial downturn, unfunded plans didn’t have dedicated trust assets to make benefit payments that resulted from layoffs. As the market recovered, plan sizes and plan costs have increased. For those plans that remain unfunded, there can be significant market exposure and finance/treasury departments should be reviewing their NQDC cash flow management strategy.
Informal Funding

What type of assets has the company set aside?

Survey Findings
Corporate-owned life insurance (COLI) and mutual funds continue to be the most common assets set aside to informally fund NQDC plans.

Marketplace Insights
The asset selection involves an in-depth analysis of each company's specific needs and financial situation. While COLI may be the best overall tax-management and asset/liability management tool, other factors may contribute to different funding decisions. Companies should consult with their benefit plan or investment advisors to help them evaluate their current and future circumstances.
Informal Funding

What is the primary reason you do not informally fund your liabilities?

Survey Findings
Respondents indicated that the primary reason for not funding their NQDC plans is “corporate philosophy” (52%), a result in line with our previous survey at 48%.

Marketplace Insights
Many companies which have not previously funded their NQDC plans are expressing interest in doing so due to the performance of the stock market over the past few years, and the growing nature of the liability for income statement and cash flow management purposes.

Additionally, the “other” category is significantly greater: 29% versus 10% in our prior survey. We speculate this is due to new plans coming on board with relatively small liabilities post-financial recovery, and those companies haven’t yet revisited how or when they want to fund their plan.
Informal Funding

*Does your company use a grantor trust to segregate any of the informal funding assets?*

Survey Findings
Grantor trusts (including rabbi trusts) are the most common form of benefit security used by NQDC plans, and are very common—with over two-thirds (70%) utilization among plan sponsors.

Marketplace Insights
Rabbi trusts are the funding vehicle of choice because they are a cost-effective and well-tested means to provide plan participants with benefit protection against a change-of-heart or change-in-control by management. The IRS has provided their views on the use of rabbi trusts in various rulings including Revenue Procedure 92-64, in which they modeled a specific grantor trust as a rabbi trust. While rabbi trusts do not protect against insolvency, they may mitigate the insolvency risks in a bankruptcy filing.

Additionally, most other benefit security techniques have potential flaws or design issues. Secular trusts are similar in some ways to rabbi trusts, but they protect the key employee’s benefits against company-sponsor insolvency. However, the participant’s single biggest NQDC advantage of income tax deferral is lost.

One viable benefit security alternative is an after-tax plan. The primary method of constructing this type of plan uses life insurance policies owned directly by the participant, thereby eliminating the plan sponsor credit risk. While these plans offer tax-deferred growth, the deferrals are made with after-tax dollars, similar to a Roth 401(k). After-tax plans are generally effective in situations where typical deferral plans may not work as well, such as non-profit companies, partnerships, S-corps, or companies with a high insolvency or litigation risk.
Informal Funding

*Does your company offer any type of death benefit to plan participants?*

![Pie chart showing 40% Yes and 60% No](image)

**Survey Findings**
Fewer than half of companies surveyed offer a death benefit to participants as part of their informal funding strategy.

**Marketplace Insights**
Plan sponsors sometimes offer an additional pre-retirement death benefit feature within the NQDC plan. This benefit can be a flat dollar amount (e.g. $500,000) or tied to a multiple of salary. This death benefit can be provided to NQDC participants at (essentially) no additional company cost if COLI funding is used, and it can be another way to harmonize the NQDC plan with other company benefits.
Informal Funding

What percentage of the pre-tax liability is informally funded?

Survey Findings
Well over half (57%) of companies fund their entire pre-tax NQDC plan liability.

Marketplace Insights
Most companies choose to fund 100% of the liability, while others try to manage the cash flows of the plan in the first few years by targeting a smaller funding percentage. There are many reasons why companies fully fund their plan liability, but key is that full funding creates better overall cost management; generates income to offset plan costs for P&L purposes; provides a source of cash for future benefit payments; and creates additional benefit security.
Plan Administration
Plan Administration

*How is the day-to-day administration handled?*

An overwhelming majority of companies (97%) outsource some or all of their day-to-day NQDC plan administration.

**Survey Findings**
An overwhelming majority of companies (97%) outsource some or all of their day-to-day NQDC plan administration.

**Marketplace Insights**
Under IRC §409A, the risks associated with NQDC plan administration have become a concern to plan sponsors. Companies may be liable to their key employees for any tax penalties (and potential 20% excise tax) and interest owed in the event of an IRC §409A violation.

In addition, outsourcing to a dedicated, knowledgeable NQDC administrator also brings online and participant communication feature and resources that may be otherwise difficult to create by self-administered plans. Generally, plan outsourcing provides more information access for participants, and also leverages both HR and Finance so that they spend their time performing only the most important required tasks with respect to the NQDC plan. As mentioned earlier in the survey, plan education and communication is critical to a participant’s experience and the plan’s success.

Among the key advantages that are often most easily gained through outsourcing are:

- NQDC-specific participant website
- NQDC multi-disciplined client service team
- Consulting/legal support
- IRC §409A risk mitigation/support
- Corporate financial reporting
- Investment consulting
- Customized NQ communications and education
- Participant telephone service center—specializing in NQ plans
- Mobile access
Plan Administration

*Please rate your degree of satisfaction with your plan administration.*

Survey Findings
Generally, companies appear to be satisfied with most aspects of their out-sourced plan administration. Although satisfied, plan sponsors appear to be the least satisfied with:

- Participant communication and education
- Plan sponsor website experience
- Participant website experience
- Non-qualified plan legislation and tax monitoring

Marketplace Insights
Plan sponsors have been highly focused on effectively communicating their plans during the past few years and this year is no exception. Increasing satisfaction in participant communication and education continues to be an important opportunity. Helping participants define their financial objectives and illustrating to them how the NQDC plan can be leveraged to assist them in meeting their goals are both key to improving satisfaction and increasing participation rates.
Survey Demographics
Survey Demographics

*Current Practices in Non-Qualified Deferred Compensation* summarizes data from 113 public and private companies.

**Respondent Company Size by Revenue**

- **Over $30 Billion**: 13%
- **$20 Billion to $30 Billion**: 3%
- **$10 Billion to $20 Billion**: 17%
- **$5 Billion to $10 Billion**: 18%
- **$2.5 Billion to $5 Billion**: 23%
- **$1 Billion to $2.5 Billion**: 19%
- **$250 Million to $1 Billion**: 4%
- **Under $250 Million**: 5%

93% have annual revenues of over $1 billion.

**Respondent Company Size by Full-Time Employees**

- **Above 10,000**: 50%
- **5001 to 10,000**: 20%
- **2501 to 5,000**: 17%
- **1001 to 2,500**: 9%
- **501 to 1,000**: 3%
- **Under 500**: 1%

96% have over 1,000 employees, while 70% have at least 5,000 employees.
Survey Demographics

Respondent Companies by Public vs. Private

78% of respondents are public companies.

Participant Companies by Industry

Within this year’s respondents, a diverse range of industries are represented. Five industries represented 60% of the respondents:

- Retail – 14%
- Financial Services – 13%
- Manufacturing-Industrial – 11%
- Manufacturing-Consumer Products – 11%
- Insurance/Reinsurance – 11%
For More Information

Contact information
For questions about the data and analysis in this survey report, or about Newport Group’s retirement plan services and financial solutions, please contact:

Mike Shannon, Senior Vice President
407-531-5677
mike.shannon@newportgroup.com

Kevin Bachler, Vice President
312-488-6711
kevin.bachler@newportgroup.com
About Newport Group

Headquartered in Walnut Creek, California, Newport Group is a leading independent retirement services firm that helps employers—and the advisors who serve them—prepare employees for a more financially secure retirement.

The company has more than $75 billion in retirement assets under administration and more than $150 billion in corporate retirement and insurance assets. Newport Group maintains investment objectivity, fee transparency and a commitment to flexible, responsive service. Staffed by an exceptional team of more than 1,000 retirement, insurance and consulting professionals, the company provides retirement solutions tailored to the needs of employers of every size, from small businesses to the Fortune 1000.