Current Trends in Deferred Compensation

A Focus on Employee Retention and Asset Management

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What we'll cover today:

- Retain key employees by helping them save more
- Incentivize key employees
- Informally funding of plans
- Opportunities in the market

But first… Why this conversation matters?

Views from the Employer

Concern about **recruiting** and **retaining**

17% increase from last year

76%

Attracting **key employees**

60%

Losing key employees to **competitors**

Recruiting and **retention**

62% view the plan as a valuable **recruiting** tool.

72% view the plan as a valuable **retention** tool.

* 2023 Principal® Trends in Nonqualified Deferred Compensation (NQDC) report is an online survey of 125 NQDC plan sponsors and 1,089 NQDC plan participants between June 5-23, and September 5-25, 2023.

91% of all Fortune 1000 companies provide a Non-Qualified Deferred Compensation Plan to their key employees[1].

1) Results from Lockton’s 2023 Executive Benefits Study

Views from the Employee

Participants consider a deferred comp plan **important in**

61% Deciding to take a **new job**

53% Deciding to **stay** with a current employer

80% **Preparing for retirement.** Plan is important in reaching their financial goals in retirement.

Main reasons for participating in a deferred comp plan

60% Save for retirement

22% Reduce current taxable income

12% Employer contributions participants would miss

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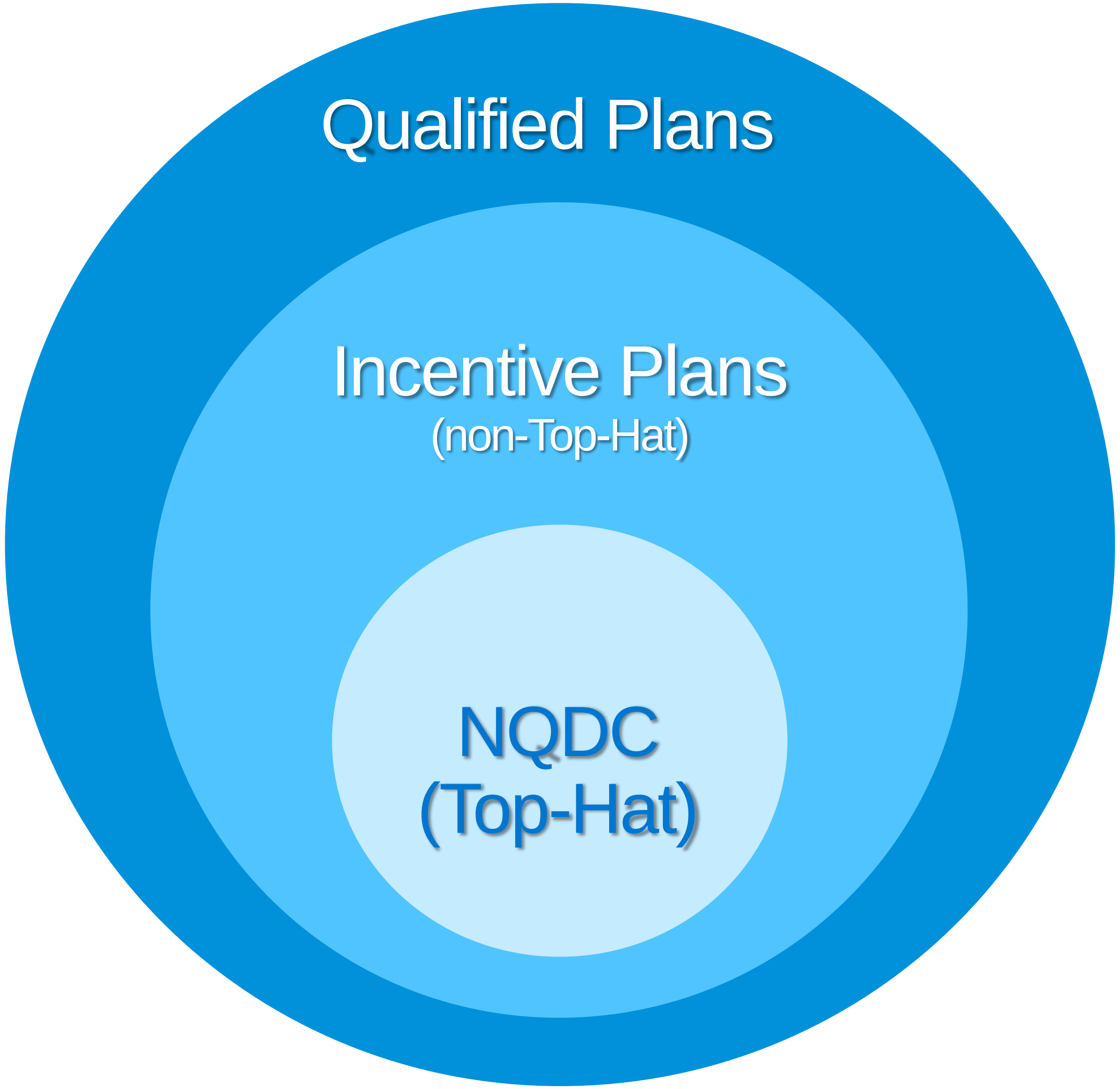
Eligibility:

A narrow focus



What is a nonqualified deferred compensation plan?

An employer-sponsored benefit for key employees

- Participants may be able to defer a portion of compensation into the plan before income taxes.

- You promise to distribute that money, plus any earnings and additional employer contributions, to them in the future.

How it works

Decide

Delay compensation / Receive award

Reduce taxable income

Invest

Pre-tax growth potential

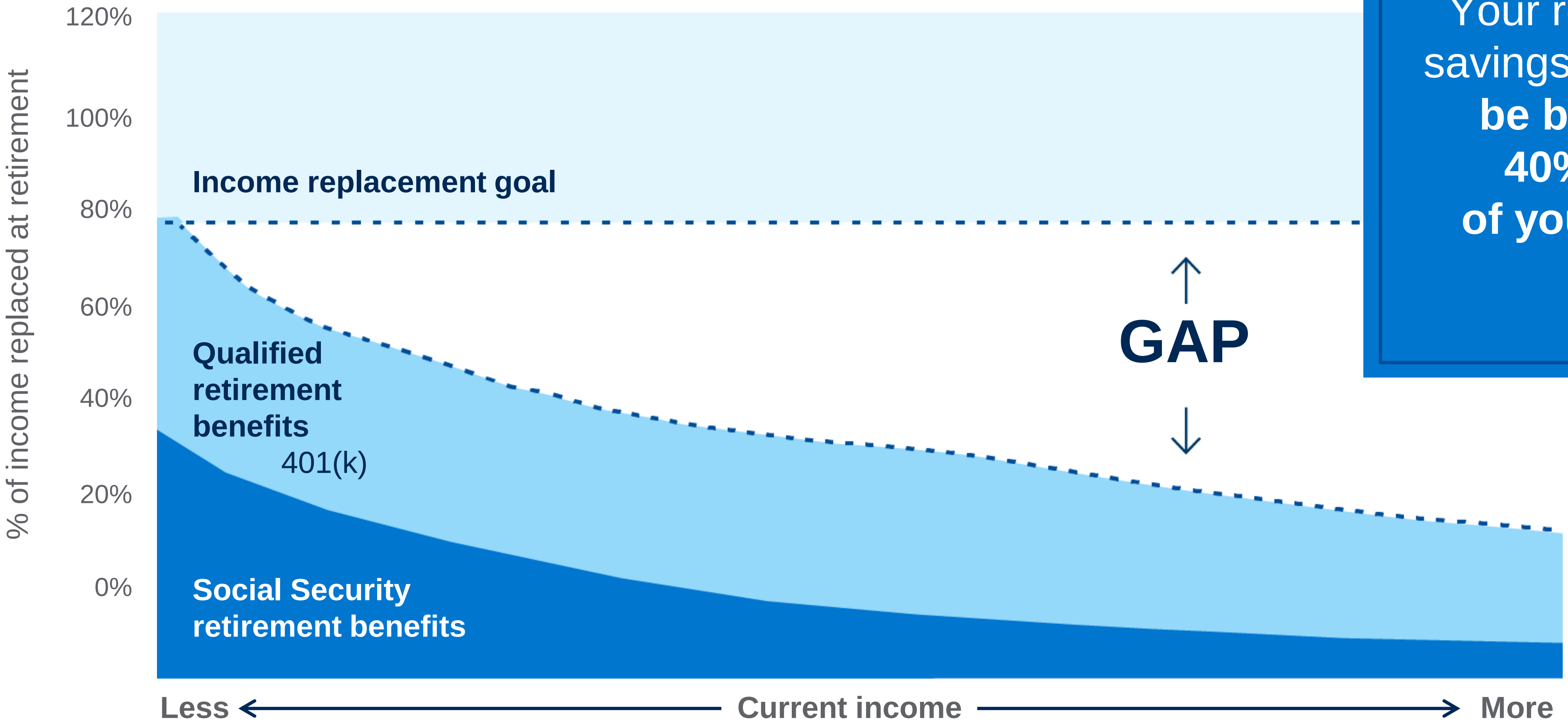
Select your own strategy

Enjoy

Receive compensation plus earnings

Taxed as ordinary income

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.

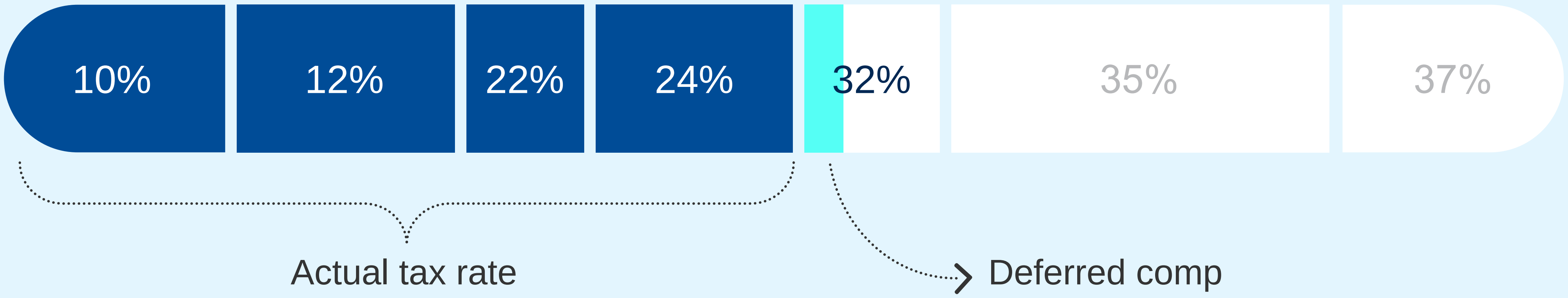
Manage **taxes**

With a NQDC plan, **you can defer your highest tax bracket income** to help lower your actual tax rate.

Helping you save on taxes today

Marginal tax brackets

Total income: $206,000



Actual tax rate
(effective)

Salary taxed: $197,300

Deferred comp
plan deferral

Salary deferred: $8,700

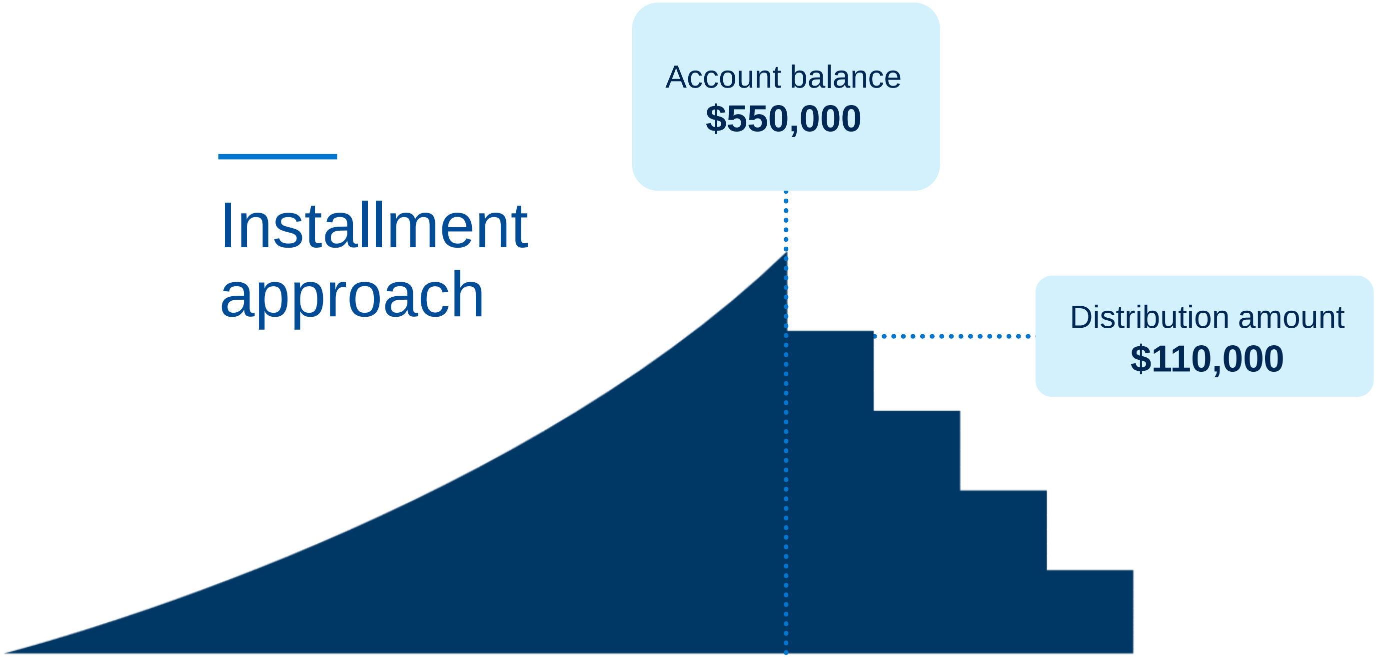
2025 tax year.

Installments can help give you a tax advantage

Either pay taxes on the entire $550,000 in one year, or spread that $550,000 out over 5 years, decreasing the amount of taxes you owe over time.

Lump sum approach

Installment approach



Recruit, retain, reward, and retire key employees

Compensation management

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

Recruit

Attract top talent via signing bonuses tied to tenure or performance.

Reward

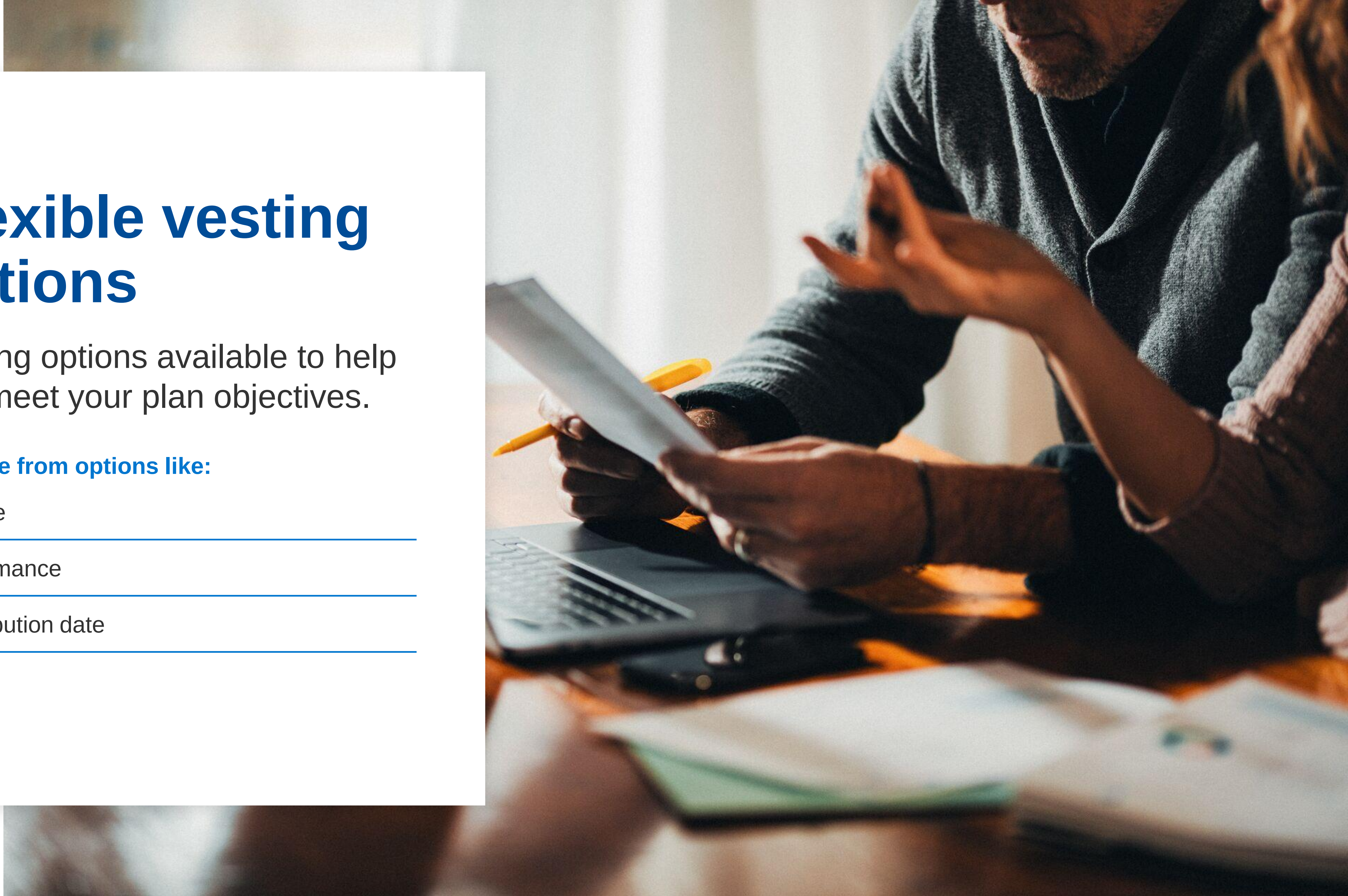
Drive both organizational and personal performance with incentive-based contributions to the plan.

Retain

Influence tenure with structured bonuses that use vesting schedules.

Retire

Restore company match benefits you’re unable to make in qualified plans due to testing or compensation limits.



Flexible vesting options

Vesting options available to help you meet your plan objectives.

Choose from options like:

- Service
- Performance
- Contribution date
- Rolling

Using NQ to 'Fix' The 401(k) Refund / Testing Problem

Use NQ to Recategorize Participants as non-HCEs

-

Targeted Education

Use NQ to Improve 401(k) Design Flexibility

-

Match Stretching

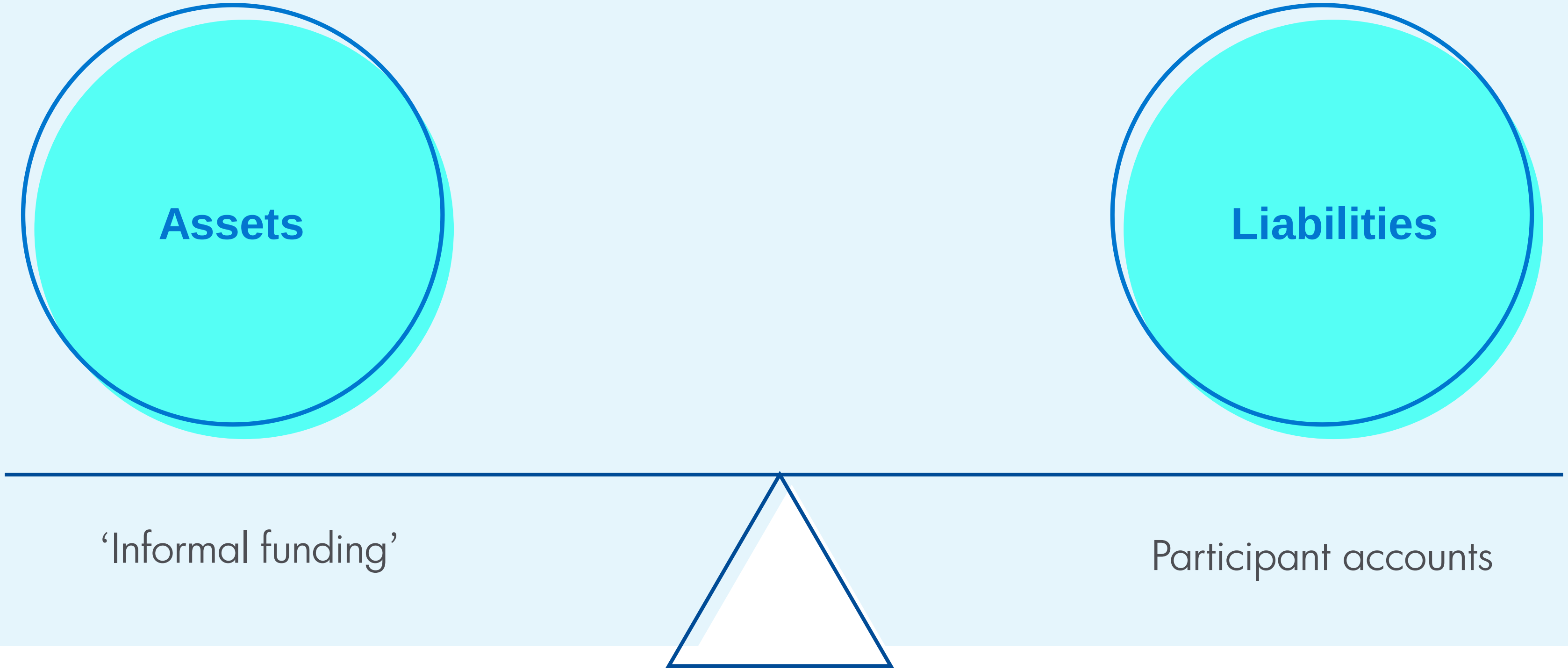
Use NQ to Recapture any 401(k) Refunds

-

Retirement Maximization

NQDC plan financing and investment options

Asset / Liability Management



Asset **rebalancing**

Plan financing approach

Project

Project the plan liability to determine short-term liability needs and long-term cash flow needs.

Compare

Compare the financing strategies with various funding assets.

Determine

Determine the **optimal strategy** and funding assets.

Monitor

Provide **ongoing monitoring** of the strategy and adjust as needed.

How to choose the best financing approach?

Depends on your organization's:

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

How does an organization pay for it?

Company cash

No specific plan assets are set aside. Instead, benefits are paid through company's cash flow.

Taxable investments

The company invests in mutual funds and/or individual securities.

Corporate-owned life insurance (COLI)

The company purchases a policy to pay future obligations.

Combo (COLI & taxable investments)

Dual financing with taxable investments and COLI is a popular method to leverage short-term plan distributions, with the benefits of COLI for distributions with a longer horizon.

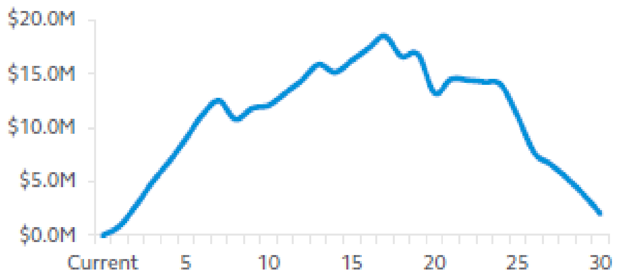
Custom Plan Projection & Funding Analysis

Liability

As people retire you will pay benefits to plan participants. The amount you pay each year will depend on the size of the accounts and the length of time the account is paid out.

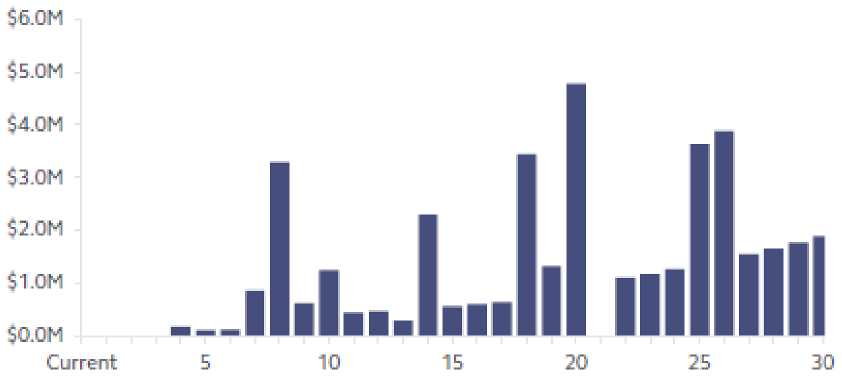
By combining each participant's account you can see your plan's total liability over time. This will give you an idea of the possible size of the benefits for your participants.

Plan balance by year



Here are the results of the projection

Benefits paid by year



Asset

	As demonstrated	Benchmark
Financing		
Total cash need	**$55,069,499**	**$55,069,499**
Reimbursement from tax benefits	15,970,155	15,970,155
Reimbursement from mutual funds	8,392,743	39,099,345
Reimbursement from life insurance withdrawals	30,706,602	0
Total sources of cash	**$55,069,499**	**$55,069,499**

100% **Benefits** financed from invested assets and tax benefits vs. 100% **Benefits** financed from invested assets and tax benefits

	As demonstrated	Benchmark
Performance		
Total cash flow	$20,278,453	($4,601,179)
NPV of total cash flow	$949,541	($5,230,424)

6.18% **Internal Rate of Return** on assets after taxes vs. 5.03% **Internal Rate of Return** on assets after taxes

Grantor trust & tax implications

GRANTOR TRUST

An irrevocable trust where an organization sets aside funds to pay participant distributions.

Offers measure of protection to participants from change of heart from current or future management. No benefit protection in the case of sponsor insolvency.

TAX IMPLICATIONS

Assets are owned by the company, not the grantor trust.

Earnings are taxed at the company's tax rate.

Assets in a grantor trust are subject to creditors at all times.

89% of plans set funds aside to cover future obligations.
Of those that do, 80% put it in a Grantor trust.*

*2023 PSCA Nonqualified Plan Survey

What’s next?

How can a plan sponsor evaluate if deferred comp is right for their business?

- Are key employees concerned about saving enough for retirement on a tax-advantaged basis?
- Do their retirement plans restrict the ability to offer different benefits for their most profitable employees?
- Are their compensation plans motivating the behavior they want from their top executives?
- Are they concerned about turn-over of key people?

Opportunities in the new plan market

Keys to success:
Identify pain points and provide solutions

- Plan sponsor in need of “401(k) repair”
- Employer needing better control of compensation
- HCEs needing to save more than permitted in qualified plans
- Employer wanting to restore lost qualified plan benefits

Opportunities in the existing plan market

Keys to success:
Identify pain points and provide solutions

- Plan sponsor who's dissatisfied with current service provider
- "Best practices" design update – deferred comp plans more than 3 years old
- Participants who don't value current deferred comp plan
- Ineffective or inefficient deferred comp plan financing

Financial professional action plans

REVIEW EXISTING CLIENTS/LOOK FOR OPPORTUNITIES

For profit C corp, S corp, or LLCs (non-owners of "pass throughs")	Higher-than-average attrition at executive level vs others in its industry
Firm size is greater than 100 employees, in business 5+ years	Having trouble recruiting, retaining, and rewarding key performers
Business size is stable or growing	HCE contributions limited in the 401(k) plan
10+ HCEs earning more than $150,000	Consistent 401(k) refunds due to failed plan non-discrimination testing

Thank you!

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