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Retirement Planning

Problem

Qualified plans, such as a 401(k) or a 403(b) have strict IRS requirements, which severely limit the amount or level of benefits available to highly compensated employees. These restrictions make it difficult for executives to create an effective financial / retirement plan with adequate financial resources.

Solution

Offering a nonqualified plan is an attractive, flexible benefit solution to supplement and complement existing qualified plans. Nonqualified plans do not have restrictions on the amount or level of benefits allowed, making these plans appealing to key executives. These plans address specific needs, such as:

- Retention and attraction
- Reverse discrimination
- Personal savings

Nonqualified plans are mainly limited by an employer's lack of information and experience with nonqualified plans. Employers who are not familiar with nonqualified plans should seek expert advice to understand available nonqualified plan solutions.

Nonqualified Plan Solutions for Retirement Planning

There are a number of nonqualified plan solutions and each plan may be highly customized and unique. The most common nonqualified plan solutions fall into three key areas. In this edition we will focus on the following two types:

- Nonqualified Deferred Compensation Plans (NQDC Plans)
- Supplemental Executive Retirement Plans (SERPs)

Nonqualified Deferred Compensation Plans (NQDC)

A Nonqualified Deferred Compensation Plan has many of the same benefits as a 401(k), but without many of the same restrictions.

Benefit to Employers

- Attraction and retention
- Customize plans to fit the goals and objectives of the employer and its executives
- Provide supplementary benefits to executives who are already receiving maximum benefits allowed under qualified plan limits
- Benefits are tax-deductible when paid to executive or beneficiary

Benefit to Executives

- Defer more pre-tax compensation
- Reduce current tax liability
- More flexible allocation options
- Excellent financial planning tool – withdrawals are permitted before age 59 ½

By having the ability to defer almost unlimited amounts of base salary and bonus income into NQDC plans, executives are no longer limited in their ability to save for retirement or execute other financial planning needs. For any executive who wants to take full charge of their financial or retirement planning needs, NQDC plans often serve as the best solution.

Supplemental Executive Retirement Plans (SERP)

SERPS are typically funded entirely with employer contributions. Generally, the intent of most SERPS is to *restore* pension benefits that would otherwise be lost due to government limits imposed on qualified pension plans.

Benefit to Employer

- Exempt from most qualified plan discrimination rules & funding limits
- Control contribution and benefit amounts, pay out options and vesting
- Benefits are tax-deductible when paid to executive or beneficiary
- Attraction and retention

Benefit to Executives

- Additional retirement income at no cost to executive
- Employer contributions are pre-tax

Plan Design Considerations for Nonqualified Plans

There are *absolute* provisions for nonqualified plans to help the executive properly plan for retirement. While no two plans are exactly the same, they will share a similar structure and usually include the following provisions:

- Eligibility requirements
- Deferral election - amount of compensation to be withheld from the participant's paycheck
- Deferral duration - making deferrals of specific amounts over a stated time period. Deferral elections are usually made every calendar year for the subsequent calendar year
- Employer match - may be offered, and often is dependent on other performance goals such as company profitability or revenue growth
- Distribution options – the form and timing of a payout - much more flexible than qualified plan distribution options

The flexibility of nonqualified plans coupled with clearly-defined provisions creates a powerful combination to aid financial planning and retirement planning.

A discussion of retirement planning with nonqualified plans is not complete without also taking into account the role of funding, communication and administration. Simply implementing a nonqualified plan is not a complete solution. It should be implemented at the lowest cost to the employer while offering enhanced communication and administration features to assist in the financial planning and retirement planning process.

Funding, Communication and Administration

Informal Funding of a nonqualified plan is important because it helps the organization underwrite the liability it creates (due to the benefit obligations payable to participants).

To maximize participant benefits, the employer should seek the lowest cost-funding alternative. Employers primarily use two types of funding mechanisms.

- Corporate-Owned Life Insurance (COLI)
- Mutual Funds

Frequently, the most effective approach is a combination of both funding sources and is often driven by the corporate tax rate, discount factor, particular census information and plan design.

Communication is an important element of the retirement planning process. To have an effective communication strategy, communication documents need to be written in a language that the company's executives will understand. The more a company can educate its eligible executives about their nonqualified plan features, the greater the participation and benefit to an executive's retirement strategy.

Administration of a nonqualified plan is critical to the long-term success of the plan. Many recordkeeping systems are not intended to service nonqualified plans; yet they are often used to administer them.

Only a specialized nonqualified plan recordkeeping system is capable of providing the flexibility needed to accommodate these unique plan designs. Nolan Financial continually emphasizes the need to utilize a nonqualified recordkeeping system so that the unique advantages of nonqualified plans can be fully captured.

Summary

Planning for retirement requires a deliberate and carefully devised game plan. Limitations of qualified plans present many challenges to highly compensated executives, most of which can be addressed with nonqualified plans. A properly designed nonqualified plan—whether an NQDC plan or a SERP—can offer most of the retirement planning tools that executives may need.

As a greater percentage of the American population moves towards retirement, nonqualified plans will become more valuable for retirement planning. Retirement planning opportunities under traditional qualified plans continue to be squeezed, especially for highly compensated executives. Implementing nonqualified plans will help empower executives to plan and to save for retirement. Nonqualified plans are not meant to offer hope, but real solutions.

Nolan Financial has designed and implemented nonqualified plans for all types of organizations, including for-profit and non-profit. If you have any questions or interest in regards to designing, funding or administering a nonqualified plan, please contact:

Michael E. Nolan
President and CEO
Nolan Financial
Phone: 301-907-9500
Email - nolanm@nolanfinancial.com

William A. Craig
Senior V.P. Business Development
Nolan Financial
Phone: 866-810-6442
Email - craigw@nolanfinancial.com