

GOING OUTSIDE CAN BRING

Non-qualified Plans Into Focus

Non-qualified deferred compensation (NQDC) plans have become popular mechanisms for providing supplemental benefits to an organization's key executives.

Whether performed in-house or outsourced to a third party, plan administration and record keeping are key components of any benefit plan. The question of whether to outsource these tasks to a Third Party Administrator (TPA) is ultimately a question that should be resolved by cost-benefit analysis and/or the availability of in-house expertise. When considering outsourcing, one should take the following into account:

LEGISLATIVE COMPLIANCE

IRC Section 409A and its associated regulations must be followed if plan participants are to avoid significant tax penalties. NQDC plans must be compliant with 409A from both a documentation and operational basis. Plan documentation must also conform to required definitions including the terms "disability" or "unforeseen emergency." Plan documentation and operation also must conform to other items such as timing of deferral elections, permissible payment events, and time and form of payouts.

NQDC plans must be supported by comprehensive legal agreements between the plan sponsor and the participant(s). A TPA can often provide compliant plan

agreements for the client and their legal counsel to review, thus reducing overall client costs and expediting plan implementation.

Ongoing monitoring of timely deferral elections, payouts and general conformity to the 409A-compliant document is critical. Detailed record keeping of all plan transactions will play a substantial role in case of an IRS audit. A qualified TPA should be equipped to monitor and track all plan transactions efficiently and accurately.

REPORTING

Reporting plays an important role in plan administration. Certain information is required to be reported to the IRS on an annual basis, including FICA and split dollar-imputed income for W2 and 1099 purposes. 409A requires additional information disclosure entries with regard to the reporting of deferrals and earnings.

NQDC plan liabilities and assets affect the plan sponsor's financial statements based on Generally Accepted Accounting Principles (GAAP). The Federal Accounting Standards Board (FASB) dictates what must be reported and how to calculate the numbers (FASB 87, FASB 106, FASB 109, TB 85-4, etc.). TPAs often employ financial professionals who enjoy expertise in these specialized accounting areas. Quality record keeping involves calculating detailed and accurate current

period general ledger entries, accounting for plan events and changes in actuarial assumptions, as well as projecting future cash flows and the net effect on earnings.

Plan sponsors informally funding their plan liabilities with Corporate Owned Life Insurance (COLI) or mutual funds, which also require periodic analysis of funding requirements and asset/liability balancing ... a skill not usually found in-house.

FLEXIBLE PLAN FEATURES

As previously mentioned, the ability to design a plan that meets the specific objectives of the plan sponsor and individual participants is one of the reasons NQDC plans are so popular. For example, a NQDC plan designed to look and feel like a 401(k) plan with even more flexibility than a traditional qualified plan could be established. The NQDC plan could permit the deferral of salary, bonus or fees, and allow participants a distinct set of deemed investment options and distribution choices for each deferral source. In addition, each year's deferral could be associated with its own vesting schedule (commonly called "class year vesting," a feature no longer permitted in 401(k) Plans).

NQDC plans continue to be as popular today as they have been in the past. Plan sponsors are encouraged now,



more than ever, to carefully evaluate a variety of factors when making outsourcing decisions. Compliance, complexity, accounting, reporting and cost may often lead plan sponsors to the services of a qualified TPA.

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