By Richard S. Sych

Do Retirement Plans Without Limits Make Sense for Your Bank's Executives?

Since the passage of ERISA in 1974, plan sponsors have been trying to balance the delivery of retirement benefits (defined benefit or defined contribution) between qualified and nonqualified plans. A fundamental objective of either a qualified or nonqualified plan is the deferral of taxes.

In exchange for compliance with Internal Revenue Service (IRS) requirements, favorable tax treatment is available to qualified plans. For example:

- contributions are tax deductible for plan sponsor.
- benefits increase on a tax deferred basis.
- participants generally not taxed until they receive benefits.

Since a nonqualified plan is not subject to most of the IRS requirements imposed on qualified plans, it can be designed to target certain individuals to provide them benefits in excess of IRS limitations. Tax treatment is not as favorable as qualified plans or may not exist:

- plan sponsor not entitled to a tax deduction until benefit is actually paid.
- there is no trust fund that fully protects the benefits.

Technically these plans are unfunded but may be supported through certain corporate funding arrangements.

Competition for Talent

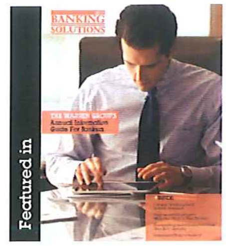
More competition for talent exists today than at any other time in history. Financial organizations are striving to be as efficient as possible. This focus on efficiency also includes the use of benefit dollars. Every benefit dollar needs to be deployed in the most efficient way possible to obtain the maximum impact. An employer not using nonqualified plans will find themselves at a competitive disadvantage to others. As a result, operations and profitability may ultimately suffer. Benefit dollars used effectively allow employers to attract and retain the "A" players that everyone wants on their team.

Nonqualified plans are a popular way to attract and retain not only senior level executives but also middle managers. These plans (either defined benefit or defined contribution) permit the employer to specifically target the use of benefit dollars for certain employees rather than all employees. A well designed plan will attract new talent, drive performance, and motivate and retain "A" players by providing comprehensive benefits.

The Total Picture

Many organizations and employees do as much as possible to mitigate taxes through retirement savings. Qualified plans can be a very effective part of an overall benefit program and can provide an enhanced level of retirement benefits to all employees. However, qualified plans must limit benefits and contributions in accordance with the IRC. For 2012 annual limitations for defined contribution plans are $17,000 for employee deferrals (excluding catch up contributions) and $50,000 for total employee and employer contributions.

There are currently at least two deficit reduction proposals that would limit tax deferred saving to the lesser of 20 percent of compensation



or $20,000 annually (for employee and employer contributions combined!). If Congress adopts proposals that reduce amounts that can be deferred into a defined contribution plan, nonqualified plans will be more widely used and become a very common way to address these issues. In that case, you will see plan participation dramatically increase to include more middle management. Increased participation enables the employer to make sure his key employees are retirement ready.

Retirement Income Replacement

Even without the proposed changes in Congress, one could argue that qualified plans already disadvantage highly compensated employees. To illustrate that, let's look at an example involving two 50 year old employees, a "middle manager" and a "senior executive:"

- The middle manager has a salary of $75,000; the senior executive has a $250,000 salary.
- Each employee defers salary to the maximum amount permitted by law (excluding catch-up).
- Inflation is 3 percent.
- Each has salary increases of 4 percent.
- Employer contributes 5 percent of salary for each.

The chart at right shows the amount of income replaced in retirement for each employee and illustrates two very different results.

The disparity of the benefits delivered to the employees is a direct result of the current deferral limitations. If the proposals in Congress are adopted, it will only increase the disparity and create more of a demand for a nonqualified plan.

In Summary

Continued communications and education regarding a nonqualified plan is critical to its success. Employees need reminders and reinforcement of the many benefits that the plan has to offer.

If you don't have a nonqualified plan already, you should consider working with your benefit consultant, actuary, attorney or accountant to determine if one is right for your organization. Working with a qualified professional is critical to ensuring compliance with all applicable rules and regulations.

Employers facing tight budgets and limited benefit dollars will find that nonqualified plans can be an effective way to maximize the use of those dollars. They will also assist with the deferral of taxes for the individual especially with the large budget deficits in Congress. One can only assume that part of the solution will be increasing income taxes, perhaps including reducing limits on qualified plans. ■

Retirement Income Replacement Comparison

	Middle manager	Senior executive
Age	50	50
Current salary	$75,000	$250,000
Final salary at age 65	$129,876	$432,919
Accumulated 401(k)/403(b) account value at age 65	$630,213	$909,656
Estimated annual annuity	$63,021	$90,966
Retirement income replacement	**49%**	**21%**

Conditions for a Well-Designed Nonqualified Plan

Employer Choices	**Types of nonqualified plans:**
	Defined benefit
	Defined contribution
Employer Goals	Attract and retain talent
	Reward senior management
	Provide benefits in excess of IRC limits
	Supplement core compensation
	Efficient use of benefit dollars
	Deferral of taxes
Employer Flexibility	Identify executives to participate
	No discrimination or other testing
	Choose any additional benefits
	Consider including some welfare benefits
	Can support benefits with "rabbi" trust
Get Help	**Assistance from professionals:**
	Attorney
	Benefits consultant
	Accountant
	Actuary
Identify Key Factors	**Identify which plan design best meets goals:**
	Will plan be an addition or amendment to current plan?
	Determine legal implications
	Avoid unintended modifications
Make a Decision	Select plan design that best meets overall objectives
Communicate	Prepare communication materials and related forms

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