Prudential/PLANSPONSOR

2018

EXECUTIVE BENEFIT SURVEY

Summary of Results

Prudential

THE TOP 10 REASONS WHY NONQUALIFIED DEFERRED COMPENSATION PLANS ARE POPULAR

Many breathed a sigh of relief when the Tax Cuts and Jobs Act ultimately removed a provision that would have placed significant restrictions on nonqualified deferred compensation plans (NQDCPs) to the point of effectively eliminating their tax-advantaged benefits. After all, NQDCPs have long been known to add value by serving as an effective retention tool, making up for qualified plan restrictions, and rewarding outstanding performance that contributes to companies' and executives' bottom lines. With traditional pensions and defined benefit plans waning in prevalence year after year, the appeal of company-sponsored vehicles that offer enhanced deferral opportunities remains strong in 2018, according to the results of the Prudential-PLANSPONSOR annual executive benefits survey, now in its twelfth year. In fact, the rate of companies offering NQDCPs continues to rise. Ninety-three percent of survey respondents affirmed their enduring popularity, up from last year's 85% and the previous year's 77%, and here are the top 10 reasons why:

NQDCPs have long been known to add value and 93% percent of survey respondents affirmed their enduring popularity in 2018

- **No Statutory Contribution Limits.** Plan participants potentially can defer up 100% of their compensation on a pre-tax basis; there are statutory limits to 401(k) plan contributions ($18,500 for 2018; $24,500 for those age 50 and older).
- **Pre-Tax Deferrals.** All contributions to these plans and any earnings thereon generally are not subject to income taxes until distributed.
- **Help Reduce the Impact of High Tax Rates.** Deferrals reduce participants' taxable income, which can help them avoid top tax rates on ordinary income, capital gains and dividends, and Medicare tax. The ability to choose/change the timing and method of future distribution payments to assist with tax planning is another benefit.
- **Flexible Payout Options.** NQDCP participants do not have to wait until retirement or termination of employment to take money out of these plans. Penalty-free withdrawals are generally available while employed or after termination; the participant does not have to be age 59½, as with a 401(k) plan.
- **Investment Flexibility.** NQDCPs can offer participants investment crediting options that are similar to 401(k) plans; in addition, most plans allow participants to select different investment allocations by plan year, which can correspond to the distribution dates.
- **Help Close the Retirement Savings Gap.** At higher income levels, qualified tax-advantaged deferral opportunities and Social Security benefits are limited. An NQDCP can help its participants plan for specific financial goals by serving as an additional source of income in retirement.

- **Customizable to Company Objectives.** Because NQDCPs are exempt from most ERISA requirements, plan sponsors have the freedom to set eligibility criteria, include vesting schedules to strengthen retention, incorporate company stock to closely align participant and shareholder interests, match participant deferrals, or make additional contributions to specific participants.
- **Cost Effective.** With an NQDCP, companies can provide a valued benefit to a select group without having to increase the compensation participants would otherwise be paid.
- **Manage Bottom-Line Impact.** Informally funding an NQDCP's growing liabilities can help support the promise to pay future benefits and minimize income statement volatility. Plan sponsors can determine the informal funding strategy that best suits their specific situation.
- **Recruit, Retain and Motivate Key Employees.** Because of the flexibility and customization that is possible with NQDCPs, they can help differentiate a company's benefits offering from its competitors while also serving to reward and encourage high-performing individuals.

93% offer NQDCPs

44% participation rate

44% Provide company match

58%

Participation rates were higher for plans offering company match

WHY OFFER NQDCP?

- ✔ 78% as a retirement savings vehicle
- ✔ 73% to attract and retain executive talent
- ✔ 72% to restore deferral opportunity limited by qualified plan restrictions

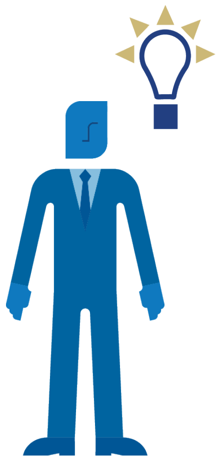
56% informally fund their NQDCP

HOW?

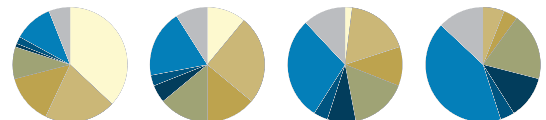
1. COLI–45%
2. Taxable securities–46%

MOST IMPORTANT ATTRIBUTE FOR NQDCP PROVIDER

1. Quality of service team
2. Online user experience
3. Consultative in NQDCP and 409A



47% offer managed or model portfolios



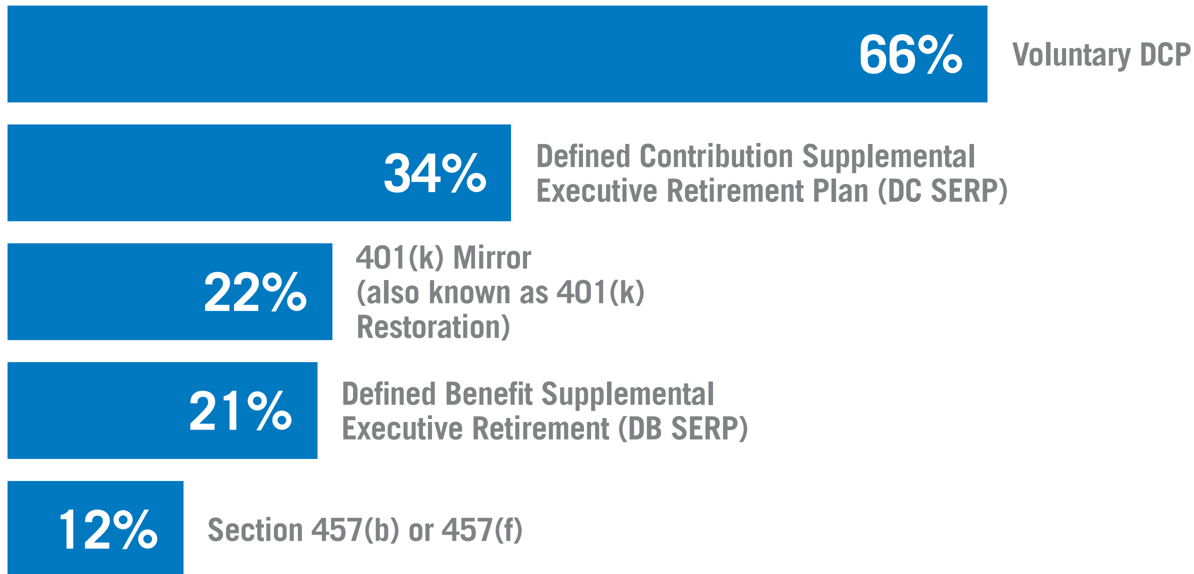
As in previous years, **more than half of respondents favored providing participants between 11 and 20 choices.**

RESPONDENT DEMOGRAPHICS/RESEARCH OVERVIEW

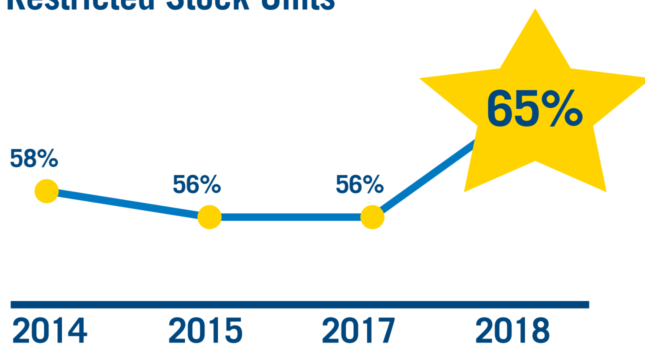
A total of 245 usable responses were collected from survey participants—a cross section of the employer market in terms of revenue, public vs. private and tax-paying status. Overall, respondents continue to represent a wide range of industries, and most are large, public, tax-paying C-Corps.

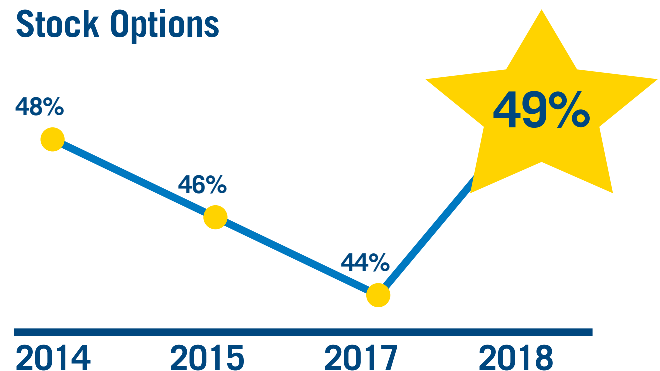
		% of Total
Annual Sales Revenue	<$1B	35%
	$1B+	65%
Public vs. Private	Public	56%
	Private	44%
Tax-Paying Status	Tax-Paying	88%
	Non Tax-Paying	12%

With large, publicly traded companies maintaining prominence in the respondent pool, the rate offering NQDCPs continues to rise. Ninety-three percent offer NQDCPs, up from last year's 85% and the previous year's 77%. Among larger companies and publicly traded companies, prevalence is higher at 98%. The trend is similar with publicly traded vs. private companies, offered by 95.1% and 73.5%, respectively. Of the various types of nonqualified plans being offered, voluntary DCPs continue to top the ranks at 66%—same as last year—followed by DC SERPs, 401(k) Mirror and DB SERPs.



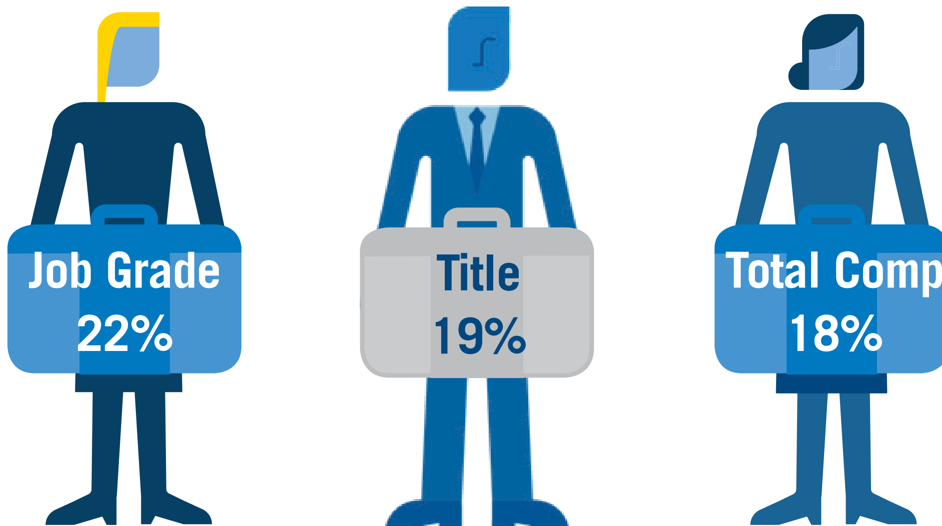
Ultimately, employers continue to regard NQDCPs as a highly valued recruitment and retention tool that provides their top talent with a powerful performance incentive and financial benefit that enables them to reach retirement and other financial planning goals. Only a few (23%) companies overall offer other types of executive benefits, and prefer the use of Restricted Stock Units (65%) and stock options (49%)—up from last year's 56% and 44%, respectively—to tie executive compensation to company performance.



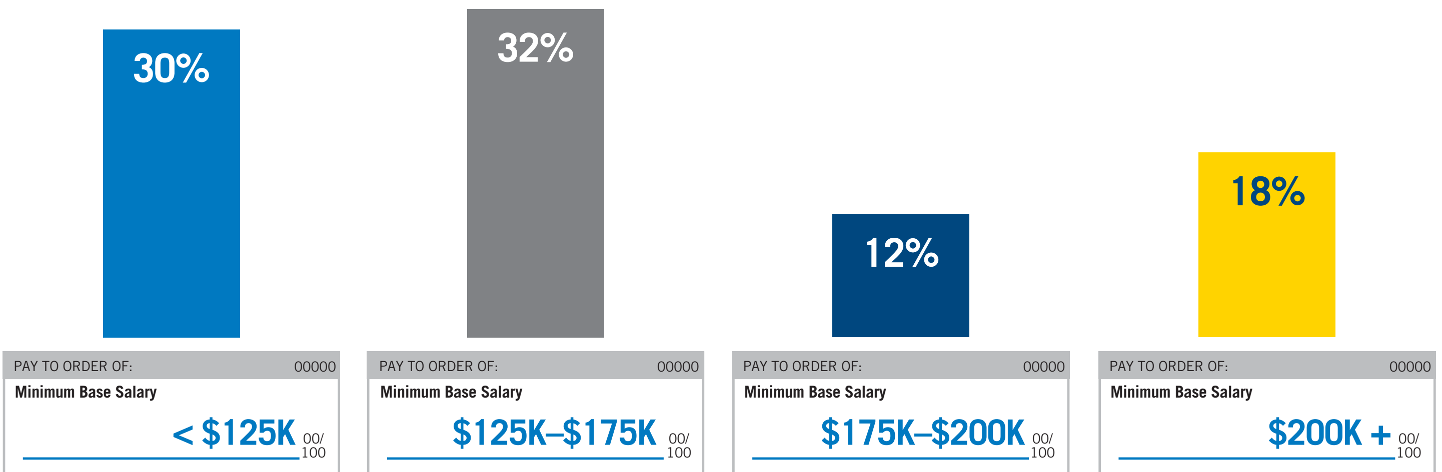


CRITERIA FOR ELIGIBILITY

Similar to prior years, there is no single, primary criteria for defining eligibility. Job grade (22%), title (19%) and total compensation (18%) were the most prominent determining factors in 2018; however, non-monetary descriptors (title, job grade) rose to the top overall (42%), followed by monetary measures of eligibility (34%) and almost a quarter (23%) designed their criteria using a combination of monetary and non-monetary elements.



30% of all respondents cited base salary requirements below $124,999, and a notable **32%** required a minimum between $125,000 and $174,999. The highest minimum annual salary threshold of $200,000 and above was applicable to only **18%** of respondents this year, down from **25%** last year.



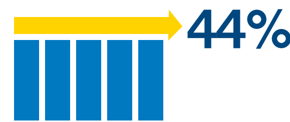
IMPROVEMENTS TO NQDCP

Although **81%** of respondents don't plan on making any changes to their NQDCPs, of those that are, most cited adding or enhancing features:

A notable 31% of respondents plan to either offer or enhance the company match—a key incentive for plan participation, as noted in year-over-year survey results—or increase the number of eligible employees given additional opportunities to meet financial planning goals and reduce their taxable income.

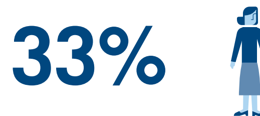
PARTICIPATION

Once again, average participation rates were effectively flat, reflecting little change over the last few years.



Participation rates continue to be higher in plans offering matching contributions.

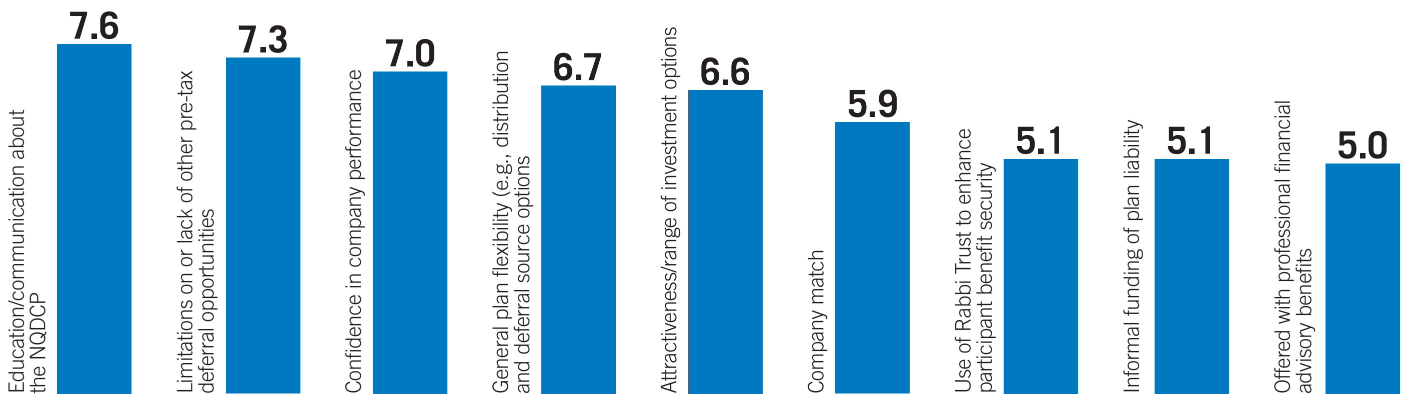
Plans NOT offering a company match had a much lower participation rate.



As in 2017, whether a plan was informally funded (46%) or not (42%) made little impact on participation rates.

PARTICIPATION (continued)

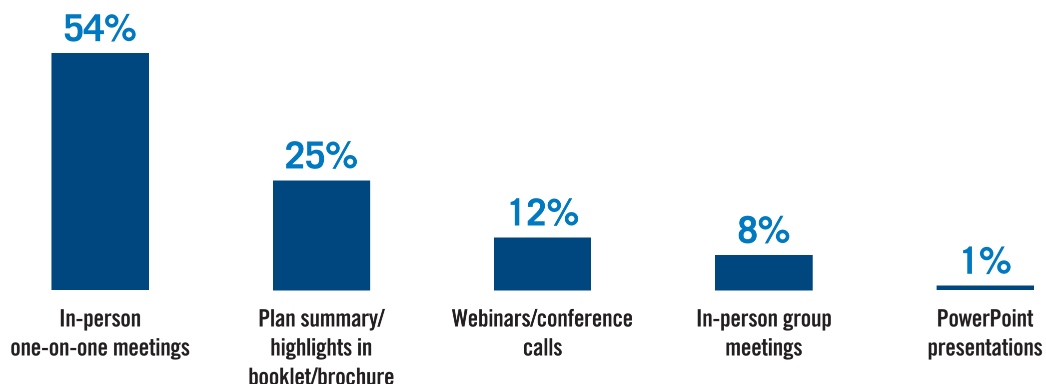
And what do plan sponsors think is most important to eligible employees in making the decision whether or not to participate? **Education/communication** tops the rankings once again, followed by limitations on or lack of other pre-tax deferral opportunities and confidence in company performance. It's worth noting that while middle of the road overall, the importance of a company match as a driving factor tends to be strongest among larger companies and tax-paying companies, and is the most important factor among companies that offer a match.



COMMUNICATION METHODS

A personal touch appears to go a long way in terms of communicating to the eligible population about the features and benefits of NQDCPs. Over half (54%) of companies indicate an in-person, one-on-one meeting is the best method to drive plan participation and engagement. Booklets or brochures— while a format that can provide a great deal of detailed information—came in a far second (25%), and webinars/conference calls an even more distant third (12%).

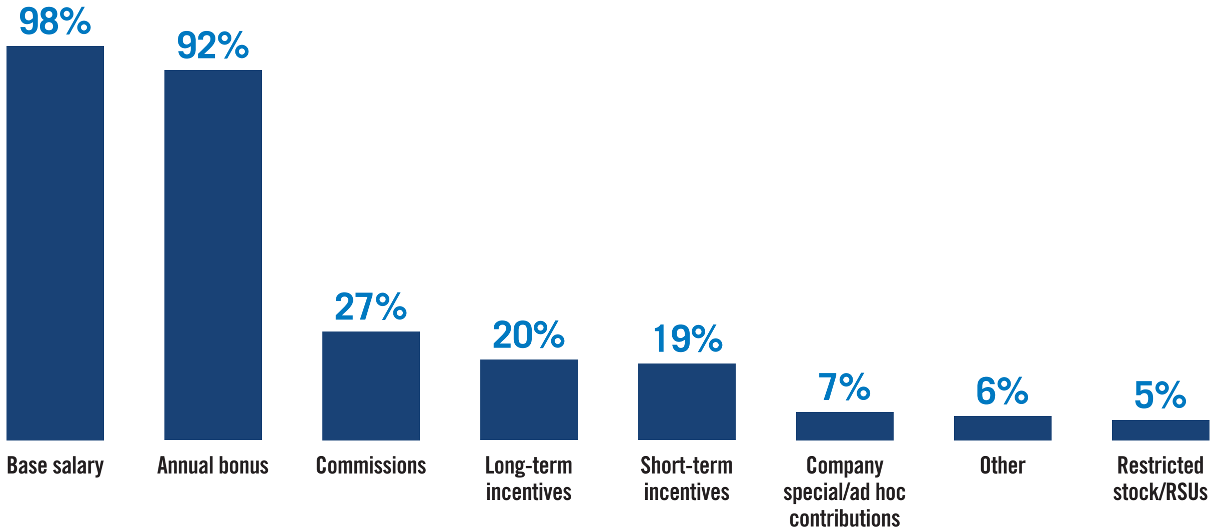
Most Effective Communication Methods



DEFERRAL SOURCES

Nine in ten companies allow for deferrals, especially large **(95%)** and public companies **(94%)**. Consistent with previous years, nearly all companies allow for base salary deferral (98%) and bonus deferral (92%), and about one in five allow for short-term (19%) and long-term (20%) incentives.

Sources of Deferrable Compensation Allowed in NQDCP

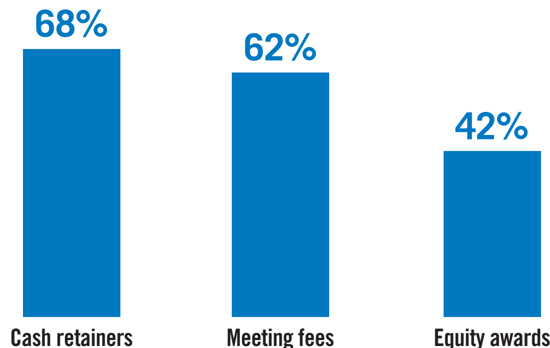


BOARD OF DIRECTORS (BOD) PLANS

Overall, **28%** of respondents offer a separate nonqualified plan for their Board of Directors, up 6 points from last year's 22%. Consistent with last year, large companies (31%), public companies (36%) and tax-paying organizations (32%) are more likely to offer a separate plan for their BODs.

Once again, the top two deferrable compensation types for BODs are cash retainers (68%) and meeting fees (62%)—but both are down by 8 points and 6 points, respectively, versus 2017. Equity awards are allowed by 42% of employers with separate plans for BODs—up 15 points from last year's 27%, again pointing to a shift in tying executive benefits to company performance.

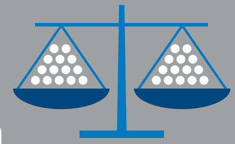
Types of Deferrable Compensation Allowed in the Board of Directors Plan



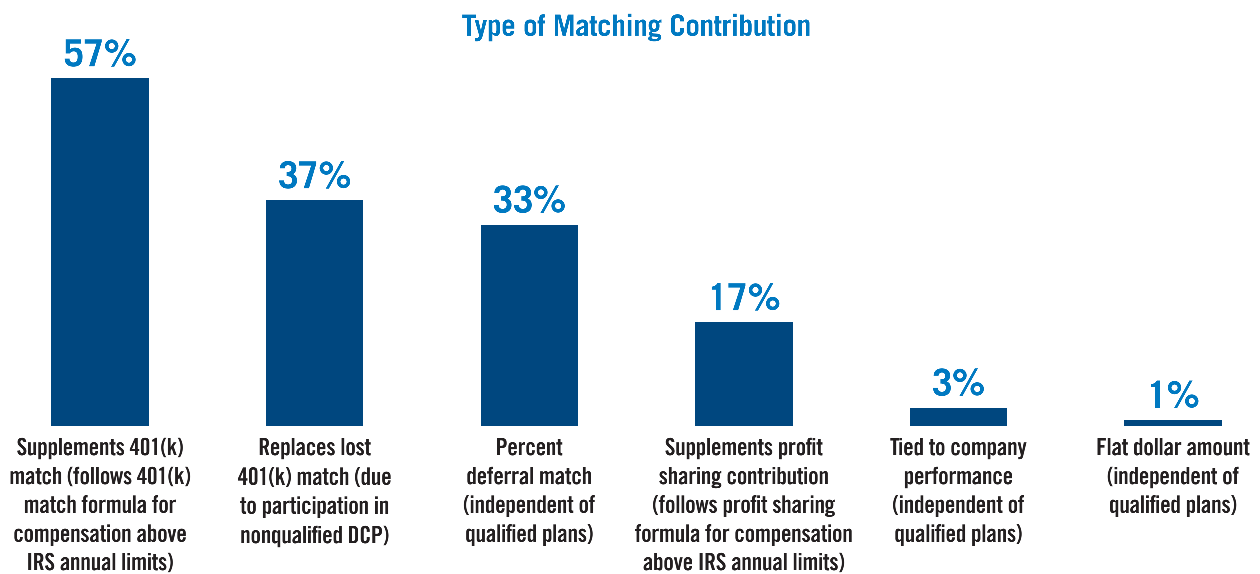
COMPANY MATCHING CONTRIBUTIONS

Less than half (44%) of companies offer a match. As in previous years, matching tends to be more prevalent among larger companies (50%), public companies (50%) and tax-paying organizations (47%).

44%
offer a company match



Supplementing the 401(k) match (57%) remains the most widely used match type, followed by replacing a lost 401(k) match and percent deferral match (33%).



VESTING REQUIREMENTS

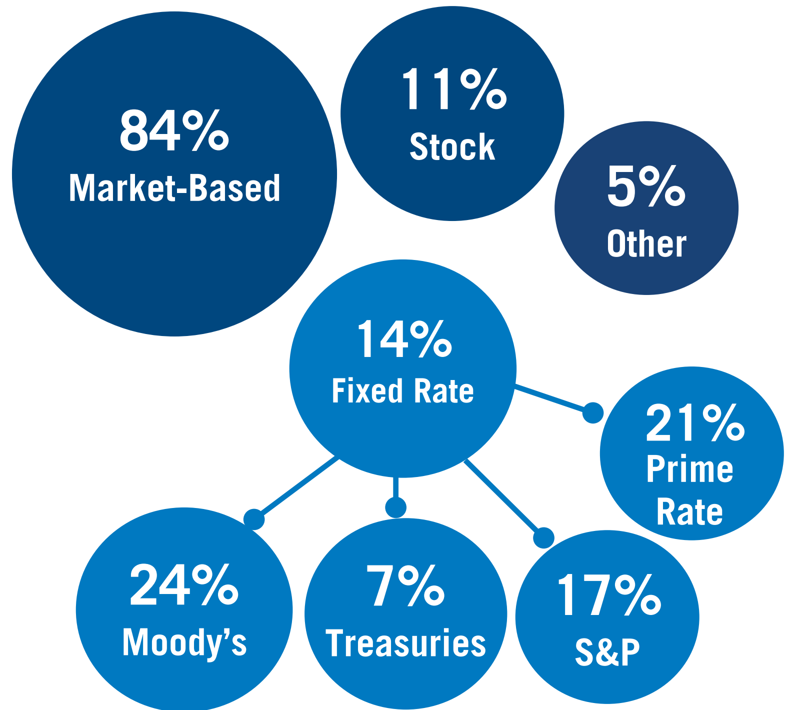
Immediate vesting (49%) is the most common vesting type—up 6 points from last year. This is followed by "same as 401(k)" (30%), which is down by 9 points, and years of service (21%), which remains flat.

PARTICIPANT INVESTMENT CREDITING OPTIONS

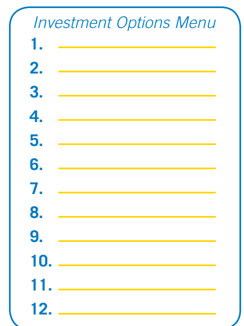
Same as last year, market-based investment crediting options (84%) are by far the most common design for NQDCP fund menus. A fixed rate plan design is offered by only 14% of plan sponsors, and company stock/performance units are less popular, at 11%.

Among those that offer fixed rate, the most common types are Moody's, Prime Rate and S&P.

Year over year results show that most plan sponsors (74% in 2018)—opt to make 20 or fewer investment crediting options available to their participants, with over half (51%) preferring to have 11–20.

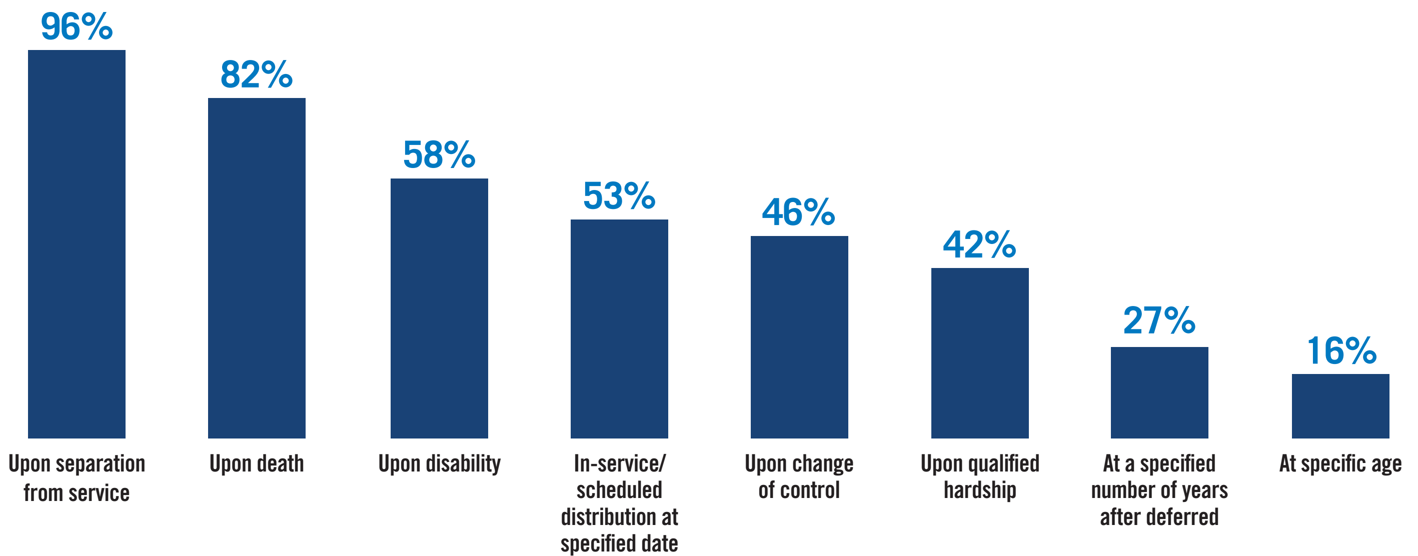


Similar to last year, about half **(47%)** offer pre-mixed portfolios as part of their plan's deemed investment menus, a trend more popular among public companies **(53%)**, and the majority continue to prefer actively managed portfolio **(53%)** over model **(47%)**, although managed portfolio use is down seven points from last year. These portfolios, designed for a range of risk profiles and allocation strategies, are a diverse mix of automatically rebalanced deemed investments either built from the standard menu offered ("model") or professionally constructed and monitored and may include other deemed investments not otherwise available inside the plan. Either way, these portfolios—typically ranging from "conservative" to "aggressive"—offer participants a way of simplifying their allocation decisions by aligning with their tolerance for risk and particular time horizon.

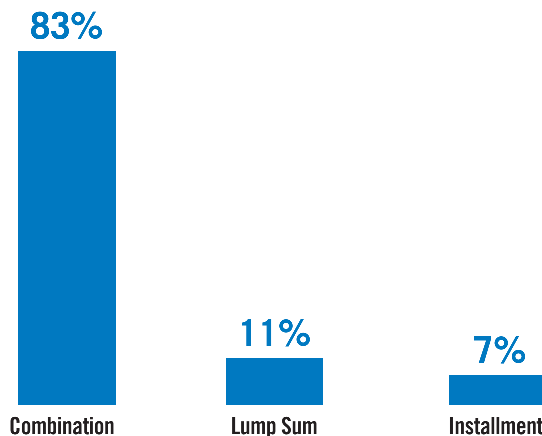


BENEFIT DISTRIBUTIONS AND EVENTS

Flexible options for scheduling and receiving plan payments are a key benefit and differentiator of nonqualified plans, and the vast majority of plan sponsors offer their eligible participants a range of distribution election choices that are permitted under 409A. As in previous years, separation from service was the most common distribution election offered by survey respondents (96%), followed by death (82%), disability (58%) and scheduled in-service (53%), which is down by 13 points.



Consistent with previous years, 83% offer both lump sum and installment distributions, and very few offer lump sum only (11%) or installment only (7%).



INFORMAL FUNDING

The number of respondents setting aside assets to informally fund NQDCP liabilities held steady at over half of plans (56%), and tends to be more common among larger (59%), public (60%) and tax-paying (58%) companies. Taxable securities (46%), corporate-owned life insurance (COLI) (45%), and cash (32%) are the top informal funding vehicles. COLI decreased by 10 points as compared to last year, while taxable securities increased by 11 points.

Managing asset-to-liability ratios (49%) continues to be the primary reason for financing the benefit liability, and consistent with last year, informal funding remains largely based on a pre-tax basis (84%).

WHY?

1. **Manage asset/liability ratio–49%**
2. **Mitigate P&L impact–26%**
3. **Improve employee benefit security–24%**

HOW?

1. **Taxable securities–46%**
2. **COLI–45%**
3. **Cash–32%**

56% of companies informally fund their NQDCP

HOW DETERMINED?

1. **Based on pre-tax liabilities = 84%**
2. **Based on after-tax liabilities = 16%**

- **53% have a security vehicle for their NQDCP**
- **98% of security vehicles utilized are Rabbi Trusts**

WHY DON'T COMPANIES INFORMALLY FUND?

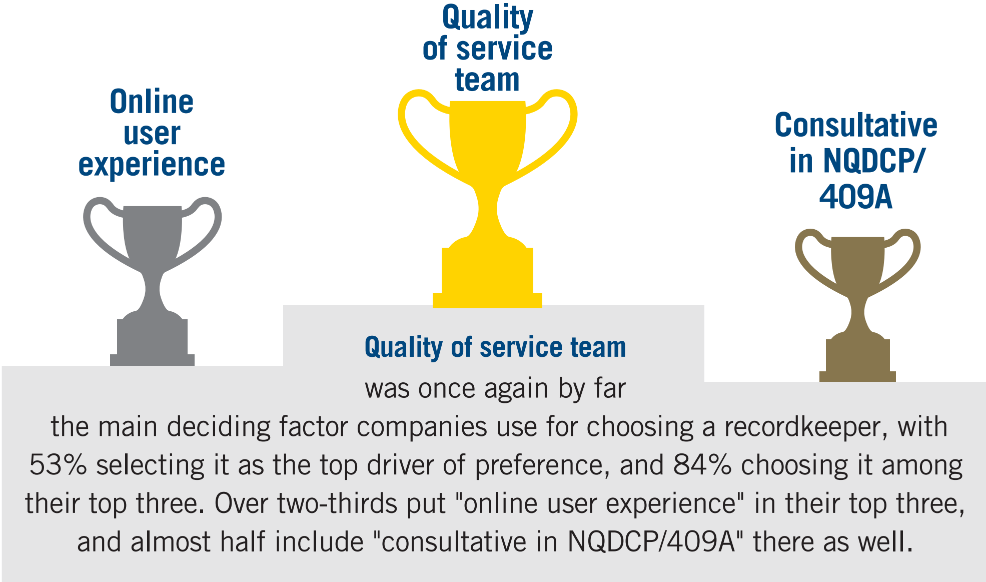
- **Don't know (47%)**
- **Corporate philosophy of "pay as you go" (33%)**
- **Plan liability was so small as to be immaterial (13%)**

While the "pay-as-you-go" (33%) philosophy continues to be the main reason survey respondents cite for not informally funding, almost half (47%) of companies are unclear on their reasons. When companies do set aside assets for future distribution with the intention of having available cash to pay benefits as they come due, they can help secure the incentive value of the plan to attract and retain key executives, and preserve the value of the benefit as a financial planning tool.

RECORDKEEPING AND SERVICE PROVIDERS

Unchanged from last year, NQDCP recordkeeping remains largely outsourced to third parties, with 74% using third parties exclusively, and another 20% utilizing a combination of in-house and third-party providers. The consistently high rate year over year of engaging outside providers may be due to the need for specific and comprehensive nonqualified capabilities from a technological, consultative and legislative/regulatory perspective that could be too challenging to provide in house.

74% of companies rely exclusively on a third-party recordkeeper



Quality of service team was once again by far the main deciding factor companies use for choosing a recordkeeper, with 53% selecting it as the top driver of preference, and 84% choosing it among their top three. Over two-thirds put "online user experience" in their top three, and almost half include "consultative in NQDCP/409A" there as well.

BUNDLING BENEFITS

Almost two-thirds of companies (62%) bundle their NQDCPs and qualified plans with the same recordkeeper, up seven points from last year. Those who offer 457(b) or 457(f) plans and DC SERPs are more likely to say they bundle with the same recordkeeper.

For NQDCPs that mirror the 401(k) and are simpler in design, having the 401(k) recordkeeper handle both plans may make sense from the perspective of dealing with a single vendor relationship, a single website and cost containment.

For NQDCPs that require more system flexibility to accommodate complex features (such as those for multiple distribution options, pre- vs. post-409A rules or different vesting schedules) or have extensive or ad hoc reporting needs, a provider with robust technology, consultative expertise and a dedicated service team would be an ideal choice.

62%
use the same recordkeeper for NQDCPs and qualified plans

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