



PREPARING NQDC PLAN PARTICIPANTS FOR STRATEGIC BENEFIT DISTRIBUTION DECISION-MAKING

Companies use nonqualified deferred compensation plans (NQDC) as a tool to help attract, retain, and reward top talent. NQDC plans provide executives and key employees, as plan participants, with the opportunity to defer pre-tax income for future distribution, allowing them to save beyond the limits imposed on qualified plans, such as 401(k) plans. However, one of the most critical and often overlooked aspects of these plans involves the election of benefit distributions and the need for participant education.

OVERVIEW

NQDC plans lack some of the safeguards of qualified retirement plans, and they are governed by complex tax rules under Internal Revenue Code Section 409A. Making decisions strategically, relevant to each plan participant's situation, is essential for achieving optimal results.

By making education, resources, and personalized support available to the employees participating in NQDC plans, plan sponsors can help guide participants through their critical decision-making process.

Understanding Challenges NQDC Plan Participants Experience

Plan participants must choose the “form” of their benefit payment, which refers to whether their benefits will be paid in a lump sum or installments, and the “timing” of the payment(s), which can be at retirement, upon separation of service, or on a fixed date. Selections must be made years in advance, and can potentially be made without clarity on future financial needs, tax implications, or employment changes.

Questions that NQDC plan participants may ask include:

- How should I estimate my future income and potential tax bracket?
- How do I plan both for long-term financial goals and the unexpected, and allow sufficient liquidity to cover these needs?
- What are the potential penalties for changing my elections, and what triggers penalties?
- How can I determine how much I should be contributing and when I want to receive my benefits in the face of market volatility and job instability?

The Plan Sponsor's Strategic Role in Supporting Employee Needs

As the plan sponsor, an employer that equips plan participants with guidance and information helps them make informed decisions and align their strategy to support their individual goals and objectives.

Ways Plan Sponsors Can Support NQDC Plan Participants

1

EDUCATION AND AWARENESS

Making informed decisions requires that the plan participant understand how plans work. Plan sponsors may choose to provide participants with readily accessible, straightforward educational materials that describe how NQDC distribution elections function.

These materials should explain or provide:

- IRC 409A requirements
- The irrevocable nature of elections
- Tax treatment of distributions and how timing affects the individual's tax liability
- Differences between installment and lump sum options
- Examples that show how different election strategies can impact outcomes

Guidance can be provided through webinars, live Q&A meetings, or personalized financial planning sessions to help reinforce the plan participants' understanding and give them support. A company's executive benefits advisor or consultant may provide some of these materials or facilitate connections to other tax, legal, or plan design professionals to help support the education process.

2 **DECISION MODELING TOOLS**

Plan sponsors should consider providing financial calculators or modeling software that enable participants to visualize different benefit distribution scenarios.

These tools can help participants understand:

- How a lump-sum payment may affect marginal tax rates
- How installment distributions align with retirement spending needs
- Projected investment growth based on deferred balances

Many participants benefit from seeing side-by-side comparisons tailored to age, income, projected retirement date, and account balance.

3 **ACCESS TO FINANCIAL PROFESSIONALS**

Companies can support the success of their NQDC plan participants by encouraging or subsidizing access to financial advisors who understand NQDC planning. This personalized guidance can help participants evaluate:

- Optimal distribution timing based on tax efficiency
- Integration of NQDC distributions with other retirement plans and assets
- Estate planning considerations and beneficiary designations

A company also might develop a vetted list of professionals familiar with the company's plan to ensure consistent quality of advice.

4 TIMING REMINDERS AND COMMUNICATION

Strategic decisions require strategic timing. Plan sponsors can help their participants stay aware of timing and deadlines by:

- Sending reminders well in advance of election deadlines
- Offering calendar tools for tracking key dates
- Providing timelines that outline when decisions become irrevocable

Proactive communication reduces last-minute decisions and encourages thoughtful planning.

5 ONGOING EDUCATION AS CAREERS EVOLVE

Participants' lives change, and so should their financial strategies. Even though initial elections are irrevocable, plan sponsors can help participants make more strategic decisions by:

- Revisiting plan options during annual reviews or promotions
- Offering refresher courses when employees reach milestone ages or career stages
- Sharing anonymous case studies of retired participants to highlight long-term impacts

Building a culture of financial literacy ensures NQDC plans remain aligned with evolving goals.

Promoting Compliance and Confidence

By supporting participants through the benefit distribution election process, plan sponsors also promote regulatory compliance. Mistakes in election timing or form can result in substantial penalties under Section 409A, including immediate taxation and an additional 20% penalty. A well-informed participant is less likely to make such errors.

When employees feel supported in their decision-making, they are more likely to grow in confidence in the company and its leadership. An alliance between the plan sponsor and the plan participant helps foster loyalty, boosts satisfaction with executive compensation packages, and strengthens the employer brand.

CONCLUSION

Making strategic decisions about NQDC plan distributions involves more than minimizing tax liability. When employers are committed to equipping their teams with the knowledge and tools they need for thoughtful decision-making, they help employees shape their financial futures.

Companies, as plan sponsors, can go beyond compliance and create a meaningful, lasting and loyalty-inspiring impact by guiding plan participants with clarity, care, and precision.

To learn more about how executive benefit strategies can benefit your organization and its employees, contact executivebenefitsolutions@onedigital.com

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