Keeping Them Happy
Deferred Compensation for Key Employees
Bill Rapp, Vice President - Consulting Services

SAVING : INVESTING : PLANNING
Designing Deferred Compensation

It’s a 2-sided coin!

Valuable plan tools to accomplish:

- Individual goals
- Institutional goals
  - Attract talent
  - Retain talent
  - Encourage departure (early retirement incentive)
Deferred Compensation: Where is it found?

Employment contracts:

- Source for overall compensation for key employees
- Including any deferred compensation
Optimizing Deferred Compensation

Primary factors to consider:

- Venue – public or private 501(c)(3)
- Dollar limit – ability to achieve individual or institutional goals
- Complexity – cost of set-up, administration, testing, etc.
- Risks –
  - Regulatory compliance
  - Benefits exposure
- Rollover / portability
Designing Deferred Compensation

Key plan tools to consider:

- 403(b)
- 401(a)
- 457(b)
  - Governmental
  - Non-governmental tax-exempt
- 415(m)
- 457(f)
## Summary of 2013 Plan Types and Contribution Limits

<table>
<thead>
<tr>
<th></th>
<th>403(b)</th>
<th>401(a)</th>
<th>457(b) Gov’t</th>
<th>457(b) Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee Elective Deferral</td>
<td>$17,500</td>
<td>None</td>
<td>$17,500</td>
<td>$17,500</td>
</tr>
<tr>
<td>Age 50 catch-up</td>
<td>$5,500</td>
<td>N/A</td>
<td>$5,500</td>
<td>N/A</td>
</tr>
<tr>
<td>Special catch-up</td>
<td>$3,000/year with $15,000 lifetime limit (if eligible and has 15+ years of service)</td>
<td>N/A</td>
<td>$17,500 additional if eligible and within 3 years of plan’s NRA</td>
<td>$17,500 additional if eligible and within 3 years of plan’s NRA</td>
</tr>
<tr>
<td>Overall IRC Section 415(c) Annual Addition Limit</td>
<td>$51,000 (both employee and employer contributions exclusive of age 50 catch-up)</td>
<td>$51,000</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>5 year post-severance employer contribution</td>
<td>Up to $51,000 per year for 5 years</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>
415(m) Governmental Excess Benefit Plan

Used with underlying 403(b) or 401(a) plan
  - With overall limit of $51,000
  - When limits need to be exceeded

Allowable compensation in underlying plan can not exceed $255,000 unless grandfathered ($375,000)
457(f) Ineligible Non-Qualified Deferred Comp Plan

Limits:

- None - on employer’s promised payments
- Generally used for highly compensated
- Substantial Risk of forfeiture
403(b)/401(a) Defined Contribution Plan

**Complexity:** Minimal

- Cost of setup: Minimal
- Cost of administration: Minimal

**Risks:** Minimal

- **Regulatory Compliance:** Minimal
  - Rules are certain & established
- **Benefits Exposure:** Minimal
  - Funds are safe: even through bankruptcy or dissolution

**Rollover / portability:** Yes
457(b) Eligible Deferred Comp Plan

Complexity: Minimal
- Cost of setup: Minimal
- Cost of administration: Minimal

Risks: Depends on Venue
- Regulatory Compliance: Minimal
  - Rules are certain & established
- Benefits Exposure: Varies
  - Governmental - funds are safe even in bankruptcy or dissolution
  - Tax Exempt: Funds subject to claims of general creditors

Rollover / portability: Depends on Venue
- Governmental – YES
- Tax-Exempt - NO
415(m) Governmental Excess Plan

Complexity: Moderate

- Should be set-up by experienced professional

Risks: Moderate

- Regulatory Compliance: Moderate
  - Rules currently unsettled
  - No existing or planned regulations
- Benefits Exposure: Higher
  - Unfunded & subject to claims of employer’s creditors

Rollover / portability: No
457(f) Ineligible Non-Qualified Deferred Comp Plan

Regulatory Risks: Moderate to High
- Rules unsettled
- Regulations in process, may be years off.

Benefits Exposure: Moderate to High
- Unfunded & subject to claims of employer’s creditors
- Must be subject to substantial risk of forfeiture

Rollover / portability: None
Let’s build a deferred compensation package for Don and Karen
Meet Don

Age 55
Football coach at large public university
Highly compensated employee
Institution’s normal retirement age: 60
16 years of service with university
Meet Karen

Age 48
Mid-size private university
Dean of the law school
Key employee:
  ▪ in a select group of management
Institution’s normal retirement age: 65
5 years of service at university
## Deferred Compensation Tools

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Don</th>
<th>Karen</th>
</tr>
</thead>
<tbody>
<tr>
<td>403(b)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>401(a)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>457(b) Governmental</td>
<td>✓</td>
<td>NA</td>
</tr>
<tr>
<td>457(b) Non-governmental</td>
<td>NA</td>
<td>✓</td>
</tr>
<tr>
<td>415(m)</td>
<td>✓</td>
<td>NA</td>
</tr>
<tr>
<td>457(f)</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
Don’s 403(b)

$17,500  Employee elective Deferrals
$  3,000  Potential 15-yr special catch-up
$  5,500  Age 50 catch-up
$26,000  Potential total elective deferrals
$30,500  Employer match or contribution
  ▪ No Testing

$255,000  5-year post separation provision
  ▪ Incentive to stay or leave
Don’s 401(a) Defined Contribution Plan

$51,000 – Employer contribution
  ▪  No testing – public venue
Don’s 457(b) Governmental

$17,500 – Salary deferral &/or employer contribution
- (all contributions subject to FICA)

$ 5,500 – Age 50 catch-up - additional elective deferral

$35,000 – Possible special catch-up amount: Ages 57, 58, & 59 (elected NRA @ 60)
Don’s 415(m) Excess Benefit Plan

Can be used with his 401(a) or 403(b)

- When more than $51,000 is needed to be contributed, in accordance with contract
Designing Don’s Deferred Compensation

Don’s compensation: $1 million/year and participates in State 401(a) Defined Benefit Plan

Employment contract calls for additional $200,000/year to deferred compensation plan

- $51,000 401(a) Employer contribution
- $30,500 403(b) Employer contributions ($56,500 - $26,000)
- $23,000 457(b) Employee/Employer contributions
- $104,500 all of which is safe
- $95,500 in 415(m) plan
- $0 in 457(f) with substantial risk of forfeiture
- $200,000 Total
Karen’s 403(b) plan

$17,500   Employee elective deferrals
$33,500   Employer match or contribution

- Subject to yearly non-discrimination testing
- May or may not prove cost effective (private venue)
- May consider cross-tested (new comparability allocation method)
Karen’s 401(a) Defined Contribution Plan

$51,000 - Employer contribution

- Not available since would not pass yearly non-discrimination testing covering her alone
Karen’s 457(b) Tax-Exempt

$17,500 - salary deferral and/or employer contribution
Karen’s 415(m) Excess Benefit Plan

NONE

- Karen’s institution is non-governmental
Designing Karen’s Deferred Compensation

Karen’s compensation: $250,000/year and participates in University’s 403(b) Plan (8%)

Employment contract calls for additional $50,000/year to deferred compensation plan

- $13,500  Additional 403(b) Employer contributions
- $0  401(a) Employer contribution
- $17,500  457(b) Employer contributions
- $31,000
- $0  in 415(m) plan
- $19,000  in 457(f) with substantial risk of forfeiture
- $50,000  Total
Deferred Compensation Alternative Plan (DCA)

All employees are eligible
Contributions treated as compensation (discretionary bonus), subject to immediate taxation
Tax on earnings deferred until withdrawal*
Generally owned by employee
May be with or without taxes “grossed-up”
All organizations are eligible
Example of DCA with tax “gross-up”

<table>
<thead>
<tr>
<th></th>
<th>(A) Present Salary</th>
<th>(B) Tax Rate</th>
<th>(C) Employee Contribution [(A) x (%)]</th>
<th>(D) Tax on Contribution [(B) x (C)]</th>
<th>(E) Extra Salary to Cover [(D) / {1-(B)}]</th>
<th>(F) Total Salary [(A)+(C)+(E)]</th>
</tr>
</thead>
<tbody>
<tr>
<td>EE #1</td>
<td>$250,000</td>
<td>28%</td>
<td>$ 19,000</td>
<td>$ 5,320</td>
<td>$ 7,388</td>
<td>$ 26,388</td>
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<tr>
<td>EE #2</td>
<td>$ 80,000</td>
<td>15%</td>
<td>$ 8,000 (10%)</td>
<td>$ 1,200</td>
<td>$ 1,412</td>
<td>$ 9,412</td>
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</tbody>
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Questions?
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