WELLS FARGO

Institutional Retirement and Trust

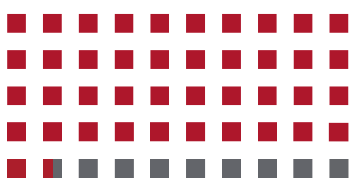
March 2018

Nonqualified Plan Benchmarking Survey

2018 Highlights from a survey of executive benefit clients

Nonqualified plans remain a valued means of attracting, retaining, and rewarding key personnel in our 2018 study of executive benefits clients. Plan types, matching, and eligibility requirements were relatively steady since our last study in 2014, and few firms were planning major changes in the coming year. Yet while they demonstrate significant stability, these plans faced new uncertainties in the guise of potential tax reform and a narrowing focus on cost and efficiency. And while the future looked toward adjustments rather than radical change, best practices have begun to emerge.

83% use executive deferred compensation plans, nearly twice as popular as the next plan type



85% thought tax reform would impact nonqualified deferred compensation (NQDC) plans

Firms look to advisors in key plan decisions

59% use third-party investment advisors or recordkeepers

Thirty-seven percent of firms had **100% participation** among eligible employees. Their secrets?

79% offer employer-only contributions, **71%** use an outside firm for recordkeeping or in combination with an internal resource, **68%** vest on a schedule, and **63%** use title eligibility.

Top concerns

Accounting accuracy, regulatory expertise, fees

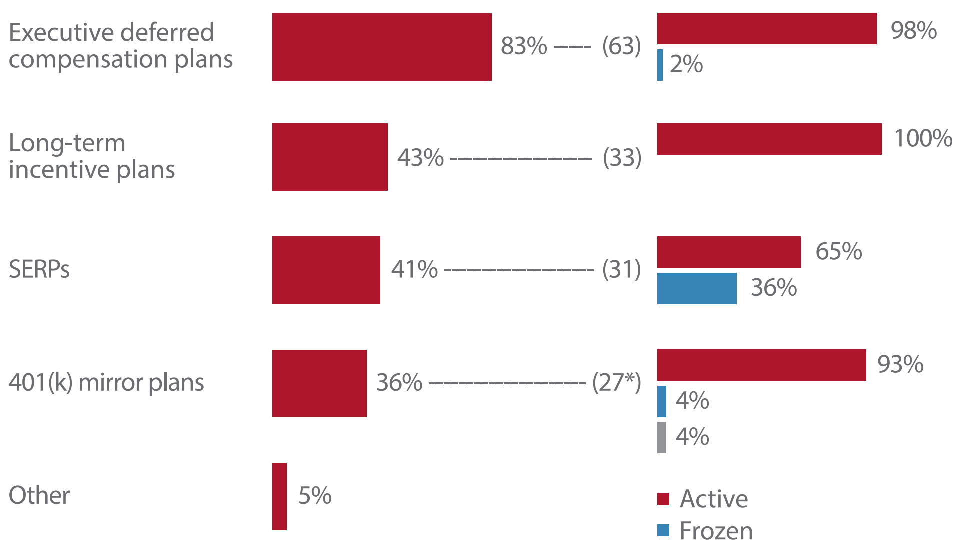
Plan types

Deferred compensation plans lead the mix

A third of SERPs were frozen

Wells Fargo Institutional Retirement and Trust contacted more than 75 executive benefit clients in late 2017 as part of its efforts to keep abreast of industry trends and insights. As expected, executive deferred compensation plans continue to be the most frequently offered plan type, at nearly twice the usage rate of long-term incentive plans. More than a third of supplemental executive retirement plans (SERPs) were frozen. Separately, more than half of firms (59%) reported multiple active plans and 37% had single active plans.

Status of Plans Offered



Note: small base size (76 total respondents).
Bases vary by specific plan (see chart).

Employers contribute to 81% of plans

Seventy percent of firms used account balance plans (employees get a statement of the balance of the total obligations of the firm to them) and 17% used non-account balance plans (employees get a statement of the payout they can expect to receive). These figures are not greatly changed from our 2014 survey, in which 78% used account balance plans and 19% used non-account balance plans. Forty-one percent of plans had both employee and employer contributions, while only employers contributed in 40% of plans and only employees contributed in 18% of plans.

✓ **Implications:** As the number of active SERPs decreases, employers may want to consider adding executive deferred compensation plans. These can potentially be useful for firms seeking ways to enhance opportunities for highly compensated employees (HCEs) to increase tax-deferred savings. Section 409A of the Internal Revenue Code applies to compensation that workers earn in one year but is paid in a future year.

Different animals

In our sample, we see plans in which only employers contribute and those in which *both* employers and employees contribute were evenly divided (40% and 41%, respectively). But that difference in contributors led to significant differences in plans. Generally speaking, employees with skin in the game find more flexibility in their plans.

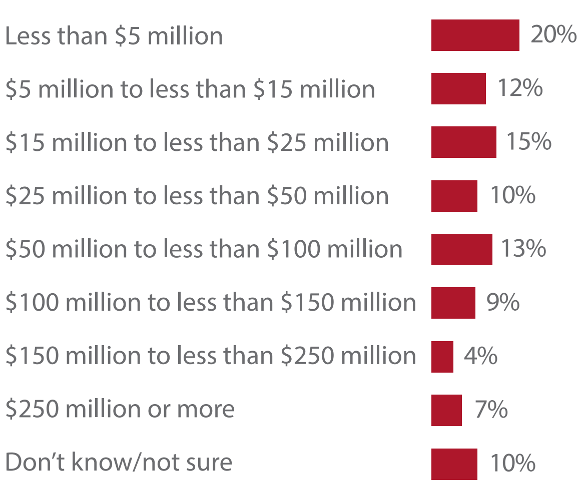
Employer contributes	Employer and employees contribute	
17%	**65%**	Likelihood to use mutual funds to credit participant accounts
10%	**75%**	Allow in-service distributions
3%	**68%**	Allow unforeseeable emergency withdrawals
10%	**55%**	Allow subsequent election deferrals
50%	**90%**	Allow one-time lump sum installments
33%	**81%**	Allow annual installments
70%	42%	Are on vesting schedule (versus immediate vesting)
33%	**81%**	Likely to use advisors
30%	**61%**	Place importance on *ability to provide plan design guidance*
32%	**52%**	Place importance on *being able to offer all nonqualified plan services under one umbrella and not needing to work with separate entities*

Plan flexibility increases when employees contribute

NQDC plan liabilities varied considerably

Executive nonqualified deferred compensation (NQDC) plans demonstrated the largest benefit obligation in our sample, reflecting their dominance of plan types. Fifty-four percent of benefit obligations were attributed to the NQDC plans, dwarfing SERPs (18% active/4% frozen), long-term incentive plans (16%), and 401(k) mirror plans (8%). Total liabilities were all over the map.

Total liabilities in NQDC plan



Liabilities ranged from less than $5 million to $250 million or more

Tax reform

Washington raised some concerns

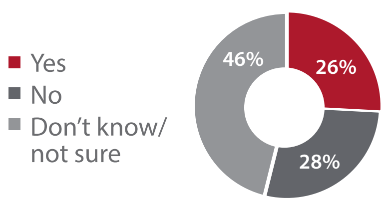
Fortunately, steadier hands prevailed

Tax reform was in its initial stages when our survey was fielded late last fall. At that time, a variety of proposals raised the specter of using retirement plans as a funding mechanism for reform, with the result that nearly half of responding firms (46%) indicated they weren't sure what to expect. Among those who felt tax reform would impact NQDC plans, more than half (55%) felt it would impact their ability to maintain plans, and a further 30% weren't sure.

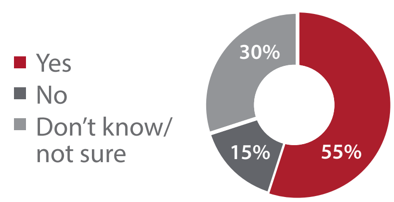
46% of firms weren't sure if tax reform would impact NQDC plans

"We learned several important lessons through this process," wrote Peter Quinn, Senior Vice President of the Executive Benefits team at Wells Fargo Institutional Retiremant and Trust.[1] "First, we learned that legislators in Washington see the elimination of 409A plans as a potential source of revenue, so we know these plans will likely continue to be a target. Second, the lobbying efforts to strike the language to eliminate 409A plans were indeed effective and resulted in swift action."

Tax reform impact on NQDC plans



Impact on ability to maintain NQDC plans



Note: Small base size (total respondents 76);
Believe tax reform will impact firm's NQDC plans (n=20)

When asked if tax reform could affect executives' decisions on whether to participate and how much to contribute, 85% said that was possible and another 10% weren't sure. Responses were more mixed about potential effect on use of insurance products, as reflected in these verbatim comments:

85% felt tax reform had the potential to affect participation and contributions

"I do not think it will affect our use of insurance products."

"It depends on the final implications of insurance as a funding mechanism versus mutual funds."

"We will still use a tax-advantaged funding vehicle (COLI)."

✓ **Implications:** The Tax Cuts and Jobs Act of 2017 expands deduction limitations of Section 162(m) of the IRS Code to more companies, for more compensation payable to a broader group of employees. Employers should review their plan documents for provisions requiring deferral of amounts subject to Code Section 162(m) and consider amending these documents to the extent permissible under Code Section 409A and related regulations.

1. Wells Fargo Institutional Retirement and Trust *Spotlight*, "The Tax Cuts and Jobs Act of 2017 and Executive Benefits—What's Next," by Peter Quinn, January 2018.

Full participation achievable across firm sizes

Firm size varied considerably in the study, from 17% of firms with less than 1,000 employees to 30% with 10,000 or more. Likewise, eligible employees varied from less than 101 employees (55%) to 1,001 or more (8%). Participation rates also varied, even among firms of similar size, though the average was generally around two-thirds. The great range of participation rates highlights the importance of such variables as employer contribution, vesting schedules, and eligibility standards in attracting employees to the plan. As mentioned on page 1, 37% of firms had 100% participation, a goal that was achieved across enterprises of all sizes.

Participation varied from near zero to 100%; two-thirds was about average

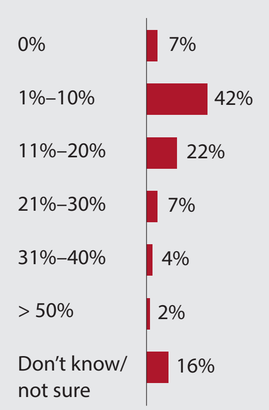
Number of full-time employees	Range of participation rates among eligible employees	Average participation rate among eligible employees
Less than 1,000	27%–100%	79%
1,000–2,499	6%–100%	60%
2,500–4,999	5%–100%	75%
5,000–7,499	20%–100%	76%
7,500–9,999	46%–100%	73%
10,000+	3%–100%	60%

Note: Small base size (76 total respondents)

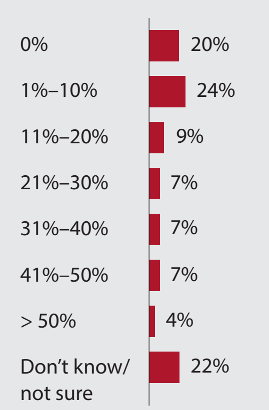
A percentage of compensation is most commonly used

Nearly 9 out of 10 participants deferred a percentage of their compensation, followed by 9% who contribute an absolute dollar amount. The most common contribution percentage was the 1% to 10% range, whether as a percentage of salary, of income, or of bonus deferred.

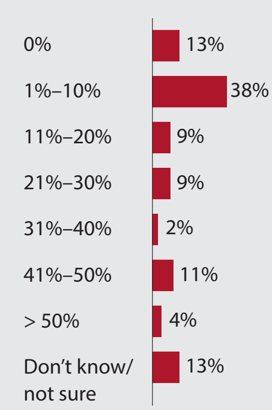
Average percent of salary contributed



Average percent of other income



Average percent of bonus deferred



1% to 10% was the most popular range for contributions

Firms with less than 50 participants are more likely to use title

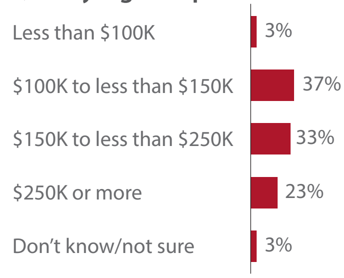
Title edges compensation for eligibility

More than half of firms (53%) used title to determine plan eligibility, with compensation a close second at 41%. Plans with fewer than 50 participants are more likely to use title (71%), while those with 50 or more participants are more likely to use compensation. Typically, plans using title include another qualifier such as salary or management level, while requirements for those that use compensation vary considerably.

Additional qualifiers for title

Salary/pay grade	20%
Title/level (unspecified)	10%
Management level	7%
Director or above	7%
Nothing/none	19%
Don't know/refused	17%

Qualifying compensation

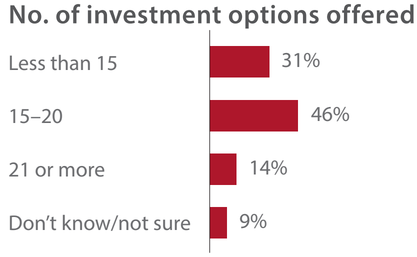


Average investment options offered: 16

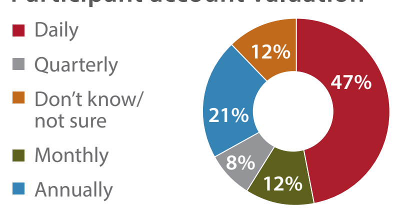
Mutual funds lead participant investments

Almost half of firms (46%) use mutual funds as a means of crediting participant accounts and offer participants an average of 16 investment options. Other choices varied between company stock (17%), fixed crediting rate (13%), company-owned life insurance (COLI) subaccounts (12%), and other investment types (28%). Half of firms value accounts on a daily basis, with annual valuation being the second-most-popular option.

No. of investment options offered



Participant account valuation



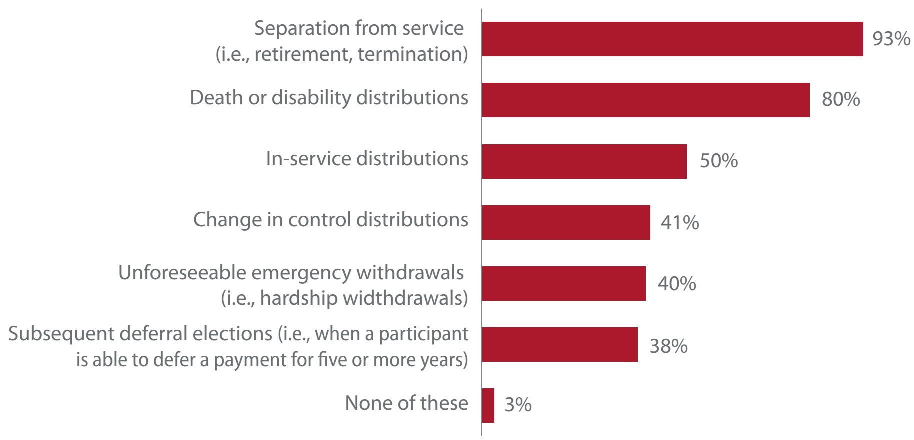
✓ **Implications:** Employers have choices when it comes to determination of eligibility for executive benefit plans. Plan sponsors should remember that the IRS hasn't specifically established the maximum number of eligible participants allowed under top-heavy requirements. Plan design factors such as the number of investment options offered, valuation frequency, and whether to include company contributions should be considered in conjunction with overall business objectives and philosophy.

Mutual funds are subject to risk. Investment returns may fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost.

Most matching firms use percentage of compensation

Fifty-eight percent of firms that allow employees to contribute to plans provide an additional match, up from 52% of firms in our 2014 survey. Of those that provide a match, 73% matched up to a certain percentage of total compensation, similar to our 76% finding in the 2014 survey. Only 12% of firms indicated they match contributions with company stock. And about one in three firms with employee contributions also make discretionary contributions.

Distribution options



Note: Small base size (76 total respondents)

Lump sum, installments lead distributions

As noted earlier, plans where *both* employer and employees contribute generally have more flexibility than plans with employer-only contributions. The most common options are separation from service and death or disability distributions. Half of respondents offered in-service distributions.

The most common distribution payment options are a one-time lump sum and annual installments spread over an average maximum of 11 years. Plans with less than 50 participants are significantly more likely to use annual installments (80%) than those with 50 or more (49%). Plans where *both* employer and employees contribute are more likely to use one-time lump sum (90%) and annual installments (81%) versus plans where only the employer contributes (50% and 33%, respectively).

58%

of firms provide an additional match

11

The average maximum number of years for annual installments

Vesting and funding

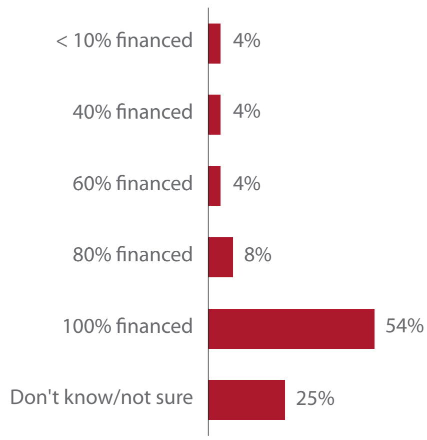
Equal divide between immediate, schedule vesting

Firms are about evenly split between immediate vesting and vesting on a schedule (49% immediate/51% on schedule). Plans in which the employer is the sole contributor are more likely to vest on a schedule (70%) than those where both employer and employee contribute (42%). Cliff vesting is the most common type (60%), for those that vest on a schedule, followed by graded schedules (38%), and *other* (11%).

A third of plans are financed

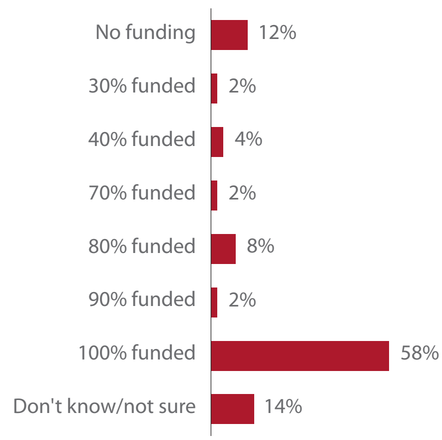
About a third of firms indicate their plan is financed, but another quarter of respondents weren't sure. Of those with financed plans, the majority (54%) report 100% financing. Sixty-eight percent of firms have a rabbi trust set up to fund plan liabilities, with 58% of those trusts fully funded.

Percent of plan's financed liabilities



Note: Small base size (76 total respondents). Plan is financed (24 respondents)

Liabilities funded in rabbi trust

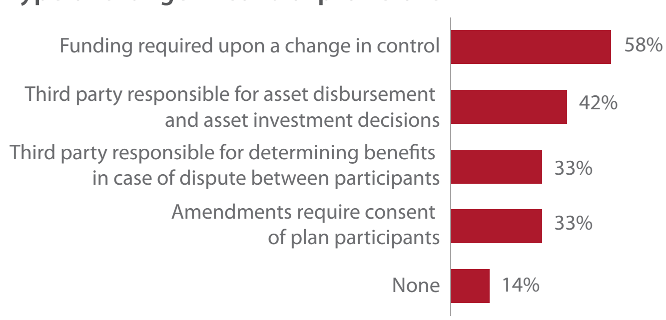


Note: Small base size (76 total respondents); has a rabbi trust (52 respondents)

More firms (42%) are using third parties for handling asset disbursements and investment decisions than in 2014 (24%)

Another 12% indicated no funding for the trust at this time. Most firms with a rabbi trust (69%) have change in control provisions in place, and most have reviewed them in the past year (42%) or the past quarter (11%). A third reviewed provisions more than a year ago.

Type of change in control provisions



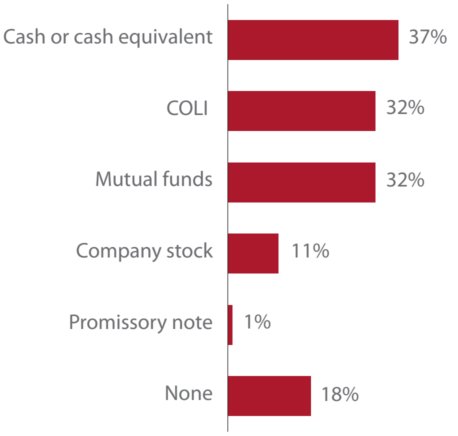
Base: Has change in control provisions in rabbi trust to cover plan. Note: Small base size (36 plans)

Rabbi trust assets are not protected in bankruptcy and are subject to the claims of the company's creditors.

A trio of financial instruments build assets

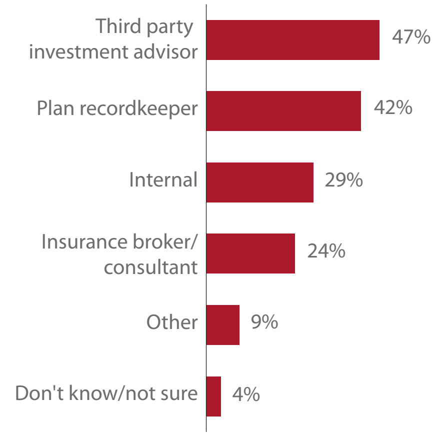
For tax benefits and other financial reasons, companies reported using cash or cash alternatives, COLI, and mutual funds most frequently to accumulate assets. Ease of tracking was cited as an advantage for cash, while others cited the tax benefits of COLI and liked the alignment mutual funds provided to participants' investment options.

Instruments used to accumulate assets



Caution, small base size varies.
Base: Evaluated active plan (n=73)

Types of advisors used



Base: Firm uses advisors for financial decisions (n=45)

Guarantees are based on the claims-paying ability of the issuing insurance company.

More than half of firms use advisors

More than half of firms (59%) said they use advisors when making plan decisions. These might include third-party investment advisors, plan recordkeepers, internal advisors, insurance brokers/consultants, or others. Plans where both employees and employers contribute are more likely to use advisors (81%) than those where only the employer contributes (33%).

Firms use a variety of advisors in their decision-making

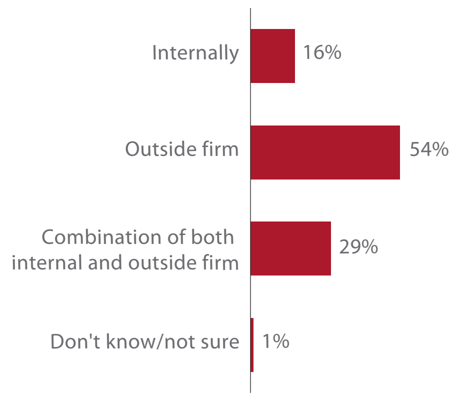
✓ **Implications:** There is no requirement to set aside funds to pay future benefits promised to executive benefit plan participants. Employers should consider what sources of funds they will access to pay benefits. A variety of external firms are available to assist with plan financing, recordkeeping, and administrative processing requirements. Regularly assess the approach to financing future payments that are due to plan participants and the benefits and advantages to leveraging external parties.

Recordkeeping sees shifts in use of outside firms

Combined resources see an increase over 2014

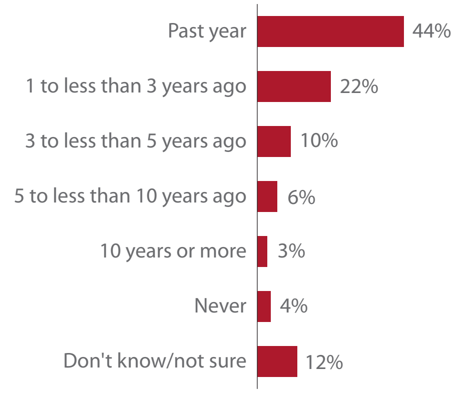
Most firms execute their recordkeeping with an outside firm (54%) or, increasingly, with a combination of internal resources and an outside firm (29%, up from 12% in 2014). Thirty-seven percent of firms said they use the same company for recordkeeping and financing products, down from 48% in our 2014 study. Forty- four percent of firms used the same company for recordkeeping and plan design, also down from our 2014 study when it was 64%.

How recordkeeping is executed



Base: Total respondents (n=76)

Recency of third-party reviews



Base: Evaluated active plan (n=73)

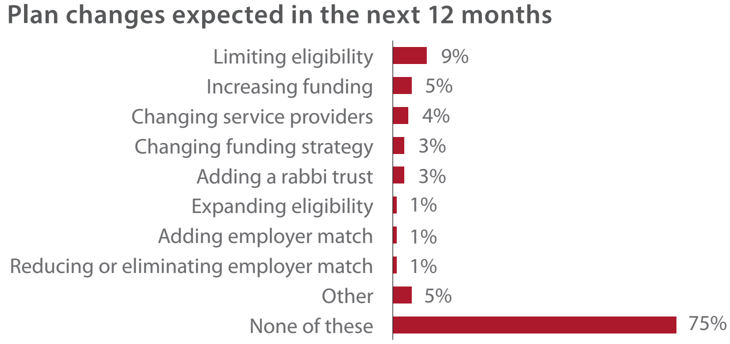
Many firms had a recent third-party review

A quarter of firms might adjust eligibility

Sixty percent of firms say their plans are on a formal review schedule, and plans using compensation for eligibility are more likely to be on a formal schedule (77%) than those that use title (49%). Forty-four percent of firms report their plans have undergone a third-party review within the past year. Another 22% of plans were reviewed within the past three years.

Few firms (3%) planned to launch new NQDC plans in the next 12 months, but nearly a quarter said it was likely they'd change eligibility. Of those, 9% planned to limit eligibility, citing cost and other concerns, while 5% planned to increase funding, and another 4% planned to change providers.

Plan changes expected in the next 12 months

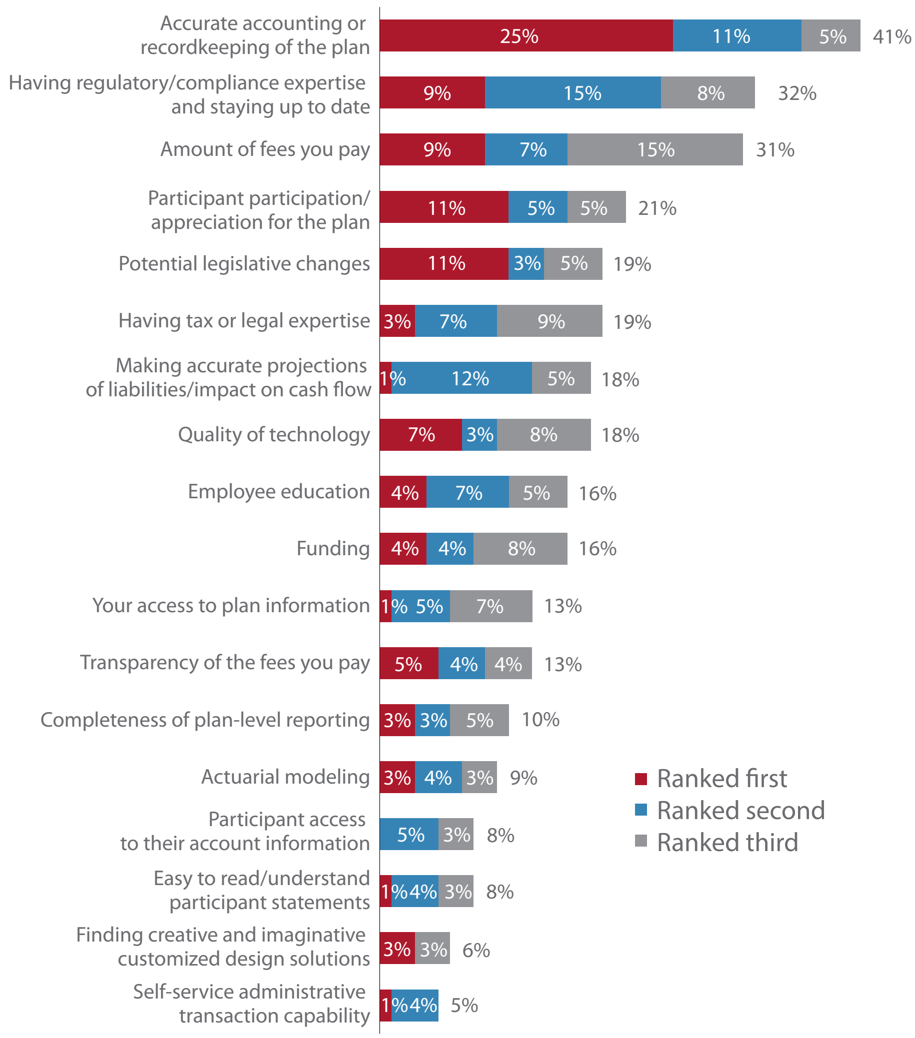


Note: Small base size (76 total respondents)

Accuracy and expertise top plan concerns

When asked the five biggest concerns or challenges regarding their nonqualified plan, firms responded with a list of 18 areas of concern. The two most prevalent responses, however, were "accurate accounting or recordkeeping of the plan" (41%) and "having regulatory/compliance expertise and staying up to date" (32%). An additional 30% of firms cited "amount of fees you pay." Accurate accounting/recordkeeping was the first choice of 25% of firms.

Top concerns/challenges with NQDC plan



Note: Small base size (76 total respondents)

✓ **Implications:** Deferred compensation plans can be complex, and regulatory rules are sometimes unclear or unfamiliar. Periodic review of plans, service providers, and ever-changing regulatory requirements should be top of mind.

Background and methodology

About the survey

On behalf of Wells Fargo, MarketVision Research conducted more than 75 online surveys with human resource, finance or treasury managers/executives at large employers, including Fortune 1500 firms, large private companies, and nonprofits during October and November 2017. The surveys explored the use of nonqualified plans and their design, funding, and administration.

About MarketVision Research

MarketVision Research is a full-service, primary research firm focused on providing market-based insight to help clients make better decisions about their products, services, and markets. Since 1983, MarketVision has grown throughout the U.S. while developing an established international presence. With a broad base of industry experience, its professionals are guided by the values of the firm: quality, craftsmanship, and authenticity. MarketVision Research is a third-party research firm and is not affiliated with Wells Fargo Institutional Retirement and Trust or its affiliates.

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