Building A Moat

That’s how nonqualified plans can complement an advisor’s business. **BY JUDY WARD**

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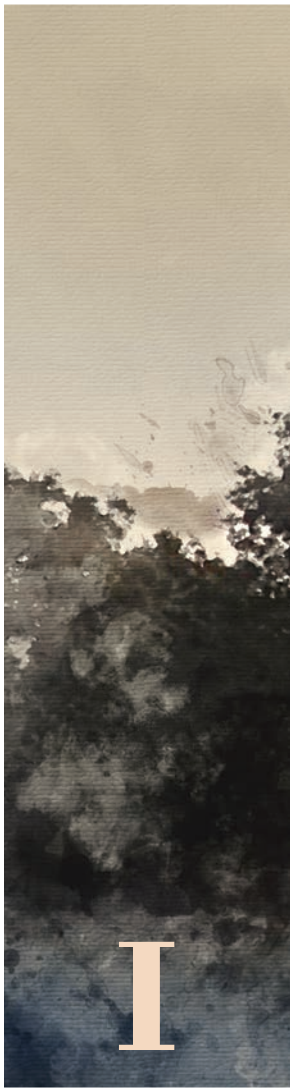

Intensifying competition for 401(k) clients has driven many plan advisors' fees down lately, NAPA President Jeff Acheson says. "So now they're asking, 'What else can I do to develop more relationships and offer more services to my existing clients?'" says Acheson, Certified Private Wealth Advisor with the Advanced Strategies Group in Powell, Ohio. "It's about not being commoditized as an advisor."

Acheson suggests that advisors think about adding work with nonqualified deferred compensation plans (NQDCs) to their service model, as he has. "For advisors competing against other advisors for business, similarities don't sell — differences do," he says. An advisor knowledgeable about NQDC plans can add another dimension, he says: Talking to existing and potential clients about utilizing a nonqualified plan as a way to better recruit, reward, and retain key employees, while also giving those key employees more opportunity to defer income and boost their saving for retirement.

"Think of the client's 401(k) plan as a castle. By adding a nonqualified plan, I'm building a moat around it," Acheson says. "The more things that I'm doing for that employer, the less likely I am to lose that relationship to another advisor. Because I can serve both the qualified and nonqualified plans, I keep the 'barbarians at the gate.' Plus I'm getting paid to deepen my relationship with that client, through the key executives."

A Bridge

For Acheson, qualified plans make up 50% of his work and nonqualified plans another 20%, with wealth management accounting for the other 30%. There's a synergy in that mix, he says: Top executives generally sit on the qualified plan's oversight committee, participate in the nonqualified plan, and are potential wealth management clients as well. "For me, nonqualified plans are a bridge between the qualified plan and my work in wealth management," he says. "When I work on a nonqualified plan, I have a very personal and specific reason to go talk to the highly compensated executives. Talking about the nonqualified plan often flows naturally into a discussion of how that ties into what the executives are doing independently, outside the plans, with their planning and other investments."

Acheson thinks that the Tax Cuts and Jobs Act — which as initially proposed would have killed deferred compensation plans — wound up benefitting NQDC plans. "Both the initial House and Senate versions of the legislation would have decimated nonqualified plans, but they quickly backed away from that," he says. "And the end result has actually had the opposite effect on nonqualified plans." For example, the new limits on state and local income tax deductions may motivate more eligible employees to think about their company's deferred compensation plan. "If they live in a high-tax state, that may cause them to say, 'I want to find ways to defer more income,'" he says. Plus, he says that lower corporate tax rates make the math work better for employers.

Principal Financial sees plenty of potential now for advisors to help employers create new nonqualified plans, says Gregory Linde, Principal's SVP-Individual Life in Des Moines, Iowa. "We think there's a lot of opportunity in the smaller market, at companies with less than 1,000 employees," he says. "With the improving economy and the tighter labor market, companies are having more trouble attracting and retaining key executives. Putting in a good nonqualified plan allows smaller employers to compete for talent on a more even footing with larger companies."

"A nonqualified plan has to evolve as the employer evolves," Linde says. "Some plans have not been kept up to date. Helping a client do that is a way for advisors to differentiate themselves to employers and extend that relationship. The key opportunity is for them to help an employer on a more holistic basis if they're providing advice on both the qualified and the nonqualified plan."

Ryan Campagna, one of this year's NAPA Top Advisors Under 40 (a.k.a. "Young Guns") and a Wakefield, Massachusetts-based senior vice president at Sentinel Benefits & Financial Group, works with both types of plans. "The more you can differentiate yourself as an advisor, the better," he says. "If I can help a sponsor solve the unique issues it has with the nonqualified plan — which not a lot of advisors can help them solve — that can help set me apart."

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— Ryan Campagna, Sentinel Benefits & Financial Group

Asked how to broach the topic of helping a client start a nonqualified plan, Campagna says he looks first for indications of the need for one at a particular client. "Sometimes you will hear the employer talk about how it wants to look at providing an additional benefit to help retain key talent. Sometimes it's key people complaining about taxes or talking about how they want to defer more of their compensation," he explains. "It's more about looking for the warning signs, not about just trying to promote it. And very few people ask for a nonqualified plan by name. The conversation more likely starts with, 'Ryan, here's what I'm ticked off about…'"

Working on a nonqualified plan can be very challenging because of both the considerable flexibility and the expertise needed, Campagna says. "Within the boundaries of the plan documents and the typical plan design, there are only so many ways that you can design a qualified plan. With a nonqualified plan, you can design it any way you want, so the possibilities are limitless," he says. "Also, if you want to advise nonqualified sponsors on areas like how to fund their plan, you're looking at whether to fund it with mutual funds or with life insurance. Now you are bringing in the need for insurance expertise. If you are not comfortable that you're an expert in areas like that, you have to look to partner with someone who is."

Where You Can Add Value

In its work as a nonqualified plan provider, Walnut Creek, California-based Newport Group, Inc. utilizes a diagnostic tool that looks at a plan's status in five major areas: plan design, investment menu, funding strategy, recordkeeping platform, and participant education/communications. "Ninety percent of the time with new clients, we find significant deficiencies for a plan in one or more of those areas," Senior Vice President Mike Shannon says. He and others talked about where a plan advisor could add value on the following four issues.

PLAN DESIGN

"It's all about constructing the plan design to meet the sponsor's goals and objectives *today*," Campagna says. "Oftentimes, you find that they have an antiquated plan design — there is often a 'set it and forget it' approach. As an advisor, you want to make sure that the plan they have today accomplishes what the employer wants it to accomplish."

Nonqualified plans often get designed originally with a lot of input from the key executives who'll participate. "If the plan was set up 10 years ago for the CEO, CFO, and CIO, today the company may have three different people in those jobs," he says. "Is the plan still relevant for them?"

Advisors who become involved in the decisions regarding the design of a nonqualified deferred compensation plan need to keep in mind that highly technical rules in Code Section 409A apply, says attorney Bruce McNeil, a partner at The Wagner Law Group in Boston. These rules differ from the rules that apply to qualified plans, he says, and an advisor should get someone with legal expertise in that area involved. "If the plan is designed in a way that does not satisfy 409A, and the IRS or an auditor finds it, the plan participants can be subject to significant compliance-failure penalties under Section 409A," he explains. "The plan participants can be subject to taxation on their deferred compensation at the highest tax rate, plus an additional excise tax of 20% on the amount involved. The participating executives would be unhappy about that — and if they were unhappy, others with the company would be unhappy, too."

FUNDING AND INVESTMENTS

In a nonqualified plan, deferred compensation does not have to be set aside by an employer, but employers have the option to set money aside in a rabbi trust, McNeil says. Then those assets get invested pursuant to the rabbi trust's terms. "That is where the advisor has an opportunity to help the employer invest the assets and increase the benefits provided by the plan," he says. "Those investments may look exactly like the investment options available under the qualified plan, or they may look very different."

Employers often seek to set aside invested assets to address the nonqualified plan's liabilities, Linde says. "There's a need to review whether the employer has appropriately financed its plan," he says, "to make sure that the employer understands the future liabilities that exist, and has made conscious decisions about if it wants to finance the liabilities — and if so, how to finance the liabilities."

Frequently the same level of oversight has not been brought to investing nonqualified plan assets as in qualified plans — and that's an opportunity for advisors, Shannon says. "Oftentimes the plan provider will say something like, 'Here's the 50 investments we offer,' and the plan will utilize all of them. We like to see the same level of rigor with investment oversight that we see in qualified plans."

VENDOR SELECTION

There is a much smaller universe of providers for nonqualified plans than qualified plans, Acheson says. "If you count the prominent players in the nonqualified space, it is probably less than 15," he says. "But they all differ in what they offer. An advisor can position himself or herself as a concierge to introduce the sponsor to the right third-party vendors."

Don't let the tail wag the dog in picking a vendor for a nonqualified plan, Shannon recommends. "What I mean is that the recordkeeping platform's capabilities should not limit plan design for a nonqualified plan, just because there are certain things the platform can't handle," he says. "You need to look for a platform built specifically for nonqualified plans."

EDUCATION

An advisor can make a meaningful contribution by helping eligible employees understand how the nonqualified plan works and how it differs from the qualified plan, Shannon says. "When we do surveys, it's always true that one of the top reasons eligible executives don't participate in their nonqualified plan is that they don't understand the plan," he says. "Just because someone is an executive doesn't mean he or she will take the time to understand the plan on their own. In actuality, they probably have less time to spend understanding the plan."

» Judy Ward is a freelance writer who specializes in writing about retirement plans.

For advisors interested in this market, NAPA soon will launch a certificate program and an annual conference focused on nonqualified plans. The September 23-25 conference in Chicago will include a bootcamp for advisors seeking an educational certificate, a full day of conference sessions on topics like nonqualified plan design, best practices in business development, and opportunities to network with NQ industry providers.

Additional information about the Nonqualified Plan Advisor Conference is available at **http://napanqdcforum.org**.