

In Nonqualified Benefit Plans, One Size Does Not Fit All

By: *Todd Carpenter* | April 8th, 2021



Employers have long struggled with the ability to attract, retain and reward key talent at their company.

Government limits and restrictions on the amount that employees and employers may contribute toward qualified retirement plans such as a 401(k) leave many highly compensated executives without enough retirement income to sustain their current standard of living.

A supplemental executive retirement plan (SERP) is a defined benefit and a great way to solve both governmental limits and the ability to attract, retain and reward talent. SERPs are typically designed to make up for a retirement income shortfall, because executives at most companies tend to be in their late 40s and 50s.

But when consultants design SERPs solely for retirement income — because the decision-makers are concerned about retirement — they often make the mistake of designing a plan that fails its primary goal: attracting, retaining and rewarding key talent.

Consider the following: Executive A is 57, married with no children. He is maxing out his company's 401(k) plan but still has not saved enough for retirement. His employer wants to reward him for his 15 years of service and keep him for another 10 years until his retirement. Putting a SERP in place that promises to pay him 40% of his final pay for 15 years will accomplish the employer's goal because he is only 10 years from retirement and concerned about it.

Now let's take a look at his successor in training. Executive B is 40 years old, married and has three kids, ages 4, 6 and 8. He is contributing very little to his 401(k). His employer wants to retain him to succeed Executive A. The employer offers him the same SERP that will pay him 40% of final pay at retirement. Three years go by, and Executive B leaves the company for a higher paying job. The plan failed the employer's goal because to most 40-year-olds, short-term incentives are king. Promising a benefit 27 years down the road does little to retain an executive in the short term.

That is where many consultants and employers make mistakes during the design process. They don't ask themselves: If they were in a similar stage in life as the executive, what would matter most? They also fail to ask the executives being considered what's important to them. Many employers and executives hesitate to answer honestly. That's where a consultant can be invaluable during the planning process. Asking the important questions to establish goals is key to making a plan work effectively.

Once the bank has a good understanding of what is important to top talent, they can design a plan to

accomplish the goals. Plans can pay out benefits at certain pre-set dates or life events while still employed to accomplish goals other than retirement. Here are a few examples:

- Lump sum in 5 years for mission work.
- Four annual payments starting in 10 years to help pay for college.
- Lump sum at age 50 to buy a boat.

Consider the following alternative benefit design for Executive B and its value to him. Executive B is 40 years old. He is married with three children, ages 4, 6 and 8. After being interviewed, he is most concerned about paying for his children's college. Therefore, instead of offering him a SERP that pays out at retirement, his employer offers him a SERP that allows the executive to receive some payments while still employed.

This plan allows Executive B to direct up to half of the employer contribution into a short term or "college funding" bucket. This bucket will start paying in 10 years, when his oldest child starts college. The other half of the contribution goes into a "retirement" bucket. This is set aside for supplemental retirement income.

Will this accomplish the employer's goal? It definitely has a better chance. This two-bucket approach is of great value to Executive B, because it addresses his immediate need to save for college and also starts to build a retirement account.

Using alternative approaches to the traditional design of focusing on retirement is more important than ever. Employer can accomplish their goals using a nonqualified plan, as long as they remember that "one size does not always fit all."

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