

## NQDC Plans: Investment Options

Considerations for mirroring the NQDC investment lineup with the 401(k) plan lineup.  
*By Matt Maier for PSCA's NQDC committee, originally published in the Winter 2024 edition of Insights*

Nonqualified Deferred Compensation (NQDC) plans offer key employees the ability to defer income beyond the limits of qualified plans like 401(k)s. However, selecting the investment options for NQDC plans presents unique challenges for plan sponsors. While it may seem convenient to mirror the fund lineup of a 401(k) plan, this approach is not always optimal. Plan sponsors must carefully evaluate the specific goals, regulatory environment, and participant needs of the NQDC plan to ensure appropriate fund selection and oversight.

### Key Considerations for Selecting NQDC Fund Options

#### Participant Demographics and Investment Needs

NQDC plans are designed for highly compensated employees and executives who often have different financial goals, risk tolerance, and investment knowledge compared to 401(k) participants. Plan sponsors should tailor the NQDC fund lineup to address these differences. Executives may prefer access to sophisticated investment vehicles, such as alternatives or sector-specific funds, that align with their unique financial objectives and existing portfolios. In many cases, these types of funds would not be appropriate for most rank-and-file employees.

#### Flexibility and Customization

Unlike 401(k) plans, NQDC plans are not subject to ERISA's strict fiduciary requirements. This flexibility allows plan sponsors to offer a broader range of fund options. Plan sponsors should use this opportunity to create a customized lineup that provides diverse choices, balancing simplicity for less experienced investors with advanced options for those that are more experienced. **Quick word of caution:** before you go "hog wild", please remember that some alternative investments are not actively traded and can be extremely difficult to administer. Before any decisions are made, it's best to check with your recordkeeping partner or your advisor.

#### Alignment with Plan Objectives

The primary objective of an NQDC plan is often to incentivize and retain top talent. Offering a well-constructed investment menu can enhance the perceived value of the plan. Plan sponsors should consider funds with a strong performance history, low expense ratios, and strategies that align with the financial objectives of key employees.

#### Regulatory and Tax Implications

Unlike 401(k) assets, which are held in a trust for participants, NQDC plan assets are owned by the employer and subject to creditors. Plan sponsors must ensure that fund options are carefully chosen to align with the company's financial stability and liquidity needs, particularly in the case of rabbi trusts.

## The Case for Mirroring 401(k) Fund Options

Mirroring the fund options of the 401(k) plan has certain advantages:

- **Simplicity and Administrative Efficiency:** Using the same lineup streamlines plan administration, reduces costs, and leverages existing fund monitoring processes. This approach also ensures consistency in participant education and communications.
- **Familiarity:** Employees who participate in both the 401(k) and NQDC plans may appreciate a unified investment experience, reducing confusion and improving engagement.
- **Proven Process:** If the 401(k) plan's investment menu has been vetted through a rigorous process, plan sponsors may feel confident in extending these options to the NQDC plan.

## The Case Against Mirroring 401(k) Fund Options

While convenient, mirroring the 401(k) plan may not always meet the unique needs of NQDC participants:

- **Participant Goals Differ:** Executives in an NQDC plan may seek more alpha focused investments, which are typically not included in 401(k) lineups. The one-size-fits-all approach can diminish the perceived value of the plan and fail to maximize its effectiveness.
- **Alignment with Corporate Objectives:** The company's financial goals and risk management considerations must also be factored into NQDC investment decisions. Using the 401(k) lineup may fail to account for the company's liquidity needs or broader financial strategy, making it less effective for long-term corporate planning.
- **Missed Opportunities:** By mirroring the 401(k) lineup, plan sponsors may overlook opportunities to offer specialized funds that align more closely with the advanced financial strategies of highly compensated employees.

## The verdict!

Selecting and monitoring NQDC fund options is a critical responsibility for plan sponsors. While mirroring the 401(k) plan's investment menu offers administrative convenience, it may not fully address the unique needs of NQDC participants. Sponsors should take a strategic approach, considering participant demographics, plan objectives, and corporate financial goals when constructing and monitoring the NQDC investment lineup. By doing so, they can enhance the value of the plan and hopefully have happy plan participants!

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