



Executive Compensation and Related Issues for Non-Profit Organizations

TIAA-CREF Institute
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Diane Oakley, Vice President

Factors that Influence Executive Compensation

- **Marketplace**
- **Demands for Disclosure**
- **Accountability**
- **Changing Tax Laws**

Factors that Influence Executive Compensation

- **Marketplace**

- Attract, retain and reward
- Limits on retirement contributions
- For-profit sector practices
- Plain vanilla – salary and benefits including retirement
- Bonus and incentive – less than 10%

Factors that Influence Executive Compensation

- **Disclosure requirement**
 - 990 statements
 - Intermediate sanctions – private colleges
 - State sunshine laws
- **Public colleges – statements on compensation**
 - 47% on complete compensation
 - 12% on only salary and benefits

Factors that Influence Executive Compensation

- **Accountability**

- Evaluation done by performance review
- Committee, full board, or board chairman
- Public college approval of full board

Factors that Influence Executive Compensation

- **Changing Tax Laws**

- Intermediate sanctions
- Form 990
- Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001

Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

- **Higher compensation limits**
- **Greater contribution to existing pension and TDA plans**
- **Expanded savings opportunities under Section 457 deferred compensation plans**

Retirement Plan Limits

- **The Compensation Section 401(a)(17) Limit is \$200,000**
- **The Defined Benefit Section 415(b) Limit is \$160,000**
- **The Defined Contribution Section 415(c) Limit is--**
 - The lesser of \$40,000 or 100% of compensation
- **MEA is repealed**

Maximum Salary Reduction Contribution – Section 402(g)

- **The limit on elective deferrals to 401(k) and 403(b) plans rises from \$10,500 to \$15,000:**

<u>Year</u>	<u>Limit</u>
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006	\$15,000*

* After 2006, indexing in \$500 increments.

“Catch-Up” Elective Deferral Contributions

- **Individuals who are 50+ can annually make additional (“catch-up”) contributions**

Year	403(b), 401(k)
2002	\$1,000
2003	\$2,000
2004	\$3,000
2005	\$4,000
2006	\$5,000*

- **Special 403(b) years of service catch-up is an additional option**

*After 2006, indexing in \$500 increments.

457 Plans

- **Eligible 457(b) plans – governmental (“public”)**
- **Eligible 457(b) plans – tax exempt (“private”)**
- **Ineligible 457(f) plans – public and private**

Contribution Limits of 457(b) Plans Are Increased

- **The 33 1/3% compensation limit increases to 100%**
- **The limit on deferrals rises from \$8,500 to \$15,000:**

<u>Year</u>	<u>Limit</u>
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006	\$15,000*

* After 2006, indexing in \$500 increments.

Contribution Limits of 457 Plans Are Increased

- **Coordination with 403(b) repealed**
- **Effective on January 1, 2002**

“Catch-Up” Governmental 457(b) Contributions

- **Individuals who are 50+ can annually make additional (“catch-up”) contributions**

<u>Year</u>	<u>Governmental 457(b)</u>
2002	\$1,000
2003	\$2,000
2004	\$3,000
2005	\$4,000
2006	\$5,000*

*After 2006, indexing in \$500 increments.

“Enhanced Contribution Limit” Increased for 457(b) Plans

- **The \$15,000 enhanced contribution limit increased to twice the normal limit**
 - Available to participants in final three years of service before “normal retirement age” (as set in plan)
 - At that time, participant can elect the lesser of:
 - two times the applicable limit, or
 - the applicable limit plus any unused limit in prior years

“Enhanced Contribution Limit” Increased for 457(b) Plans

Underutilized contributions

- **457(b) plan must have been available prior to 2002**
- **Underutilization calculations must coordinate with 403(b) contributions for years prior to 2002**

457(b) Plans

Public Eligible Plans – Key Rules

- Available to all eligible employees
- Accumulations must be held in trust or annuity contract
- Age 50 catch-up contribution is available
- Can use greater of above or enhanced contributions limits

457(b) Plans

Public Eligible Plans – Key Rules

- **Rollovers permitted to/from 401(a), 403(b), IRAs, and other public 457(b) plans**
- **Plan loans are available**
- **Amounts taxable when paid**
- **Qualified plan tax reporting and withholding rules apply**

457(b) Plans

Private Eligible Plans – Key Rules

- **Plan accumulations must be the property of the employer (plan is “unfunded”/rabbi trust)**
- **Plan may only be made available to a “top-hat” group**
 - Select management
 - Highly-compensated
- **Age 50 catch-up is not available**

457(b) Plans

Private Eligible Plans – Key Rules

- **No rollovers, but direct transfers to 457(b) plans of other tax-exempt organizations**
- **Amounts become taxable when made available with option for deferral**
- **Special distribution rules**
- **Tax reporting on form W-2**

Deferred Compensation

Ineligible Deferred Compensation – 457(f) Plans

- **No limit on contributions**
- **Subject to SUBSTANTIAL RISK OF FORFEITURE**
- **Assets owned by employer**
- **Available to creditors**

Deferred Compensation

Ineligible Deferred Compensation – 457(f) Plans

- **Institutional owned annuities or rabbi trusts**
- **Deferred amounts taxed when risk lapses**
- **Private sector plans available only to “top-hat” group**

Deferred Compensation

Ineligible Deferred Compensation – 457(f) Plans

- **Issues:**
 - Vesting
 - Rolling arrangement
 - Early retirement
 - Employment agreement
 - Non-compete clause
 - Consulting services

Deferred Compensation

Qualified Governmental Excess Benefit Plans

- **Permitted under the tax code since 1996**
- **State and local government entities**
- **Pension benefits that exceed Section 415**
- **Compensation limits**
- **Benefits distributed according to underlying retirement plan**

Deferred Compensation Changes

403(b) Contribution for Former Employees

- **Employer can continue 403(b) contributions for up to five years after separation**
- **Contributions cannot exceed Section 415 limit for the employee's final year of service**
- **Effective in 2002 and beyond**

403(b) Contributions for Former Employees

Nondiscrimination Concerns

- **Public colleges and universities**
 - Deemed compliance with nondiscrimination rules
- **Independent colleges and universities**
 - Test contributions for former employees separately
 - Tested as a right and feature under 403(b)
 - Former employees are highly compensated if employee was a highly-compensated employee after age 55

403(b) Contribution for Former Employees (EGTRRA)

- **Employee retires at \$200,000 compensation in final year from a public college**
- **Maximum employer contribution - 100% of compensation but not more than \$40,000 each year for next five years to 403(b) plan**
- **Employee can start pension payments during the five-year period**
- **Modify plan documents to allow employer to make such 403(b) contributions**

Deferred Compensation

Option to Purchase Mutual Fund Shares

- **Section 457 applies after risk of forfeiture lapses for options issued after May 8, 2002**
- **Based on Section 83 tax treatment for stock options**
- **Use of vesting period to retain employees**
- **Exercise price of option to purchase shares is at a discount of 50% to 75%**

Implication of EGTRRA on Deferred Compensation Limit

- **Evaluate all supplemental retirement arrangements**
- **Potential for greater security if switched from ineligible deferred compensation to 457(b)**
- **Consider additional DC options**
 - To replace Section 83 plans

Deferred Compensation Considerations after EGTRRA 2001

- **Decision to use 457(b) or 457(f)**
 - Amount of deferred compensation
 - Final three-year 457(b) contributions – early retirement
 - Risk of forfeiture
 - Payout flexibility
 - Differences between public and private sectors

Deferred Compensation Considerations after EGTRRA 2001

- **Revise government excess benefit plans**
 - New 415 limits
 - Greater TDA limits
 - Compensation limit could still be a concern

Designing Deferred Compensation Arrangements

- **Amount of deferred compensation**
- **Employment security**
- **Tax certainty**
- **Taxation of payments**

Additional Resources...

- **Your TIAA-CREF Institutional Consultant**
- ***"Executive Compensation Arrangements: A Comparison of Features and Benefits", TIAA-CREF Brochure; 2003; Publication # A10818 (Call TIAA-CREF at 1.800.842.2733 x5509 to request copies)***
- **Presidential Compensation in Higher Education: Policies and Best Practices; Atwell, Robert H. and Wellman, Jane V.; Association of Governing Boards of Universities and Colleges; 2000; (Call 1.800.356.6317 or go to www.agb.org to request)**