



Highlights of Proposed Rules For Nonqualified Deferred Compensation Plans Issued on October 4, 2005

Provision Addressed	Highlights of Proposed Regulations
Definition of Nonqualified Deferred Compensation Plan	<ul style="list-style-type: none"> • A nonqualified deferred compensation plan is any plan that provides for the deferral of compensation, including section 457(f) plans. • There are four general categories of nonqualified deferred compensation plans: <ul style="list-style-type: none"> • Account balance (defined contribution) plans; • Non-account balance (defined benefit) plans; • Separation pay arrangements; and • Other plans (e.g., equity-based compensation). • However, the section 409A rules do not apply to the following types of deferred compensation plans: <ul style="list-style-type: none"> • Qualified retirement plans (e.g., 401(k) plans or tax qualified pension plans), tax-deferred annuities under section 403(b), simplified employee pension (SEP) plans, SIMPLEs and section 501(c)(18) trusts; • Certain welfare benefit plans, including bona fide vacation leave, sick leave, compensatory time, disability pay, and death benefit plans; • Section 457(b) plans.
Definition of Deferred Compensation	<ul style="list-style-type: none"> • Compensation is deferred if an individual has a legally binding right during a taxable year to the compensation that has not been actually (or constructively) received, it has not been included in gross income, and is payable to the employee in a later year.
Short Term Deferrals	<ul style="list-style-type: none"> • Compensation is considered to be “short term deferrals” rather than “deferred compensation” if the individual receives it by the later of: 2½ months following the end of his tax year, or 2½ months after the end of the employer’s fiscal year in which that compensation is no longer subject to substantial risk of forfeiture. • Short-term deferral arrangements do not have to be in writing. • A short-term deferral arrangement will not become a nonqualified deferred compensation plan if payment is delayed past the 2½ month deadline due to administrative or economic reasons.
Plan Aggregation	<ul style="list-style-type: none"> • All amounts deferred with respect to an individual under a particular type of nonqualified plan (e.g., an account balance plan)

SOURCES: Proposed Regulation §1.409A-1 through 1.409A-6

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Rules	sponsored by the same employer (controlled group rules apply) are treated as being deferred under a single plan of the same type.
Written Plan Requirement	<ul style="list-style-type: none"> While the law does not explicitly state that a plan or arrangement must be in writing, the proposed regulations require written plan documentation.
Initial Deferral Election Rules	<ul style="list-style-type: none"> Election must be made by the last day of individual's tax year (generally, December 31) immediately preceding the year in which the compensation will be received. The election must also indicate both the time and form of distribution. "Evergreen" elections (i.e., elections that stay in effect year after year unless changed) are acceptable. A newly-hired or eligible individual may make a deferral election within the first 30 days of participation but that election will only apply to compensation earned after the election is made. The portion of any performance bonus that can be deferred is determined by multiplying the compensation by a ratio of number of days remaining to end of performance period over total days in the performance period.
Performance Based Compensation	<ul style="list-style-type: none"> Defined as: compensation that depends on the satisfaction of pre-established performance criteria. Does not include any amount that will be paid regardless of performance or based upon a level of performance that is substantially certain to be met. Performance criteria can be established up to 90 days after the performance period begins.
Time and Form of Payment	<ul style="list-style-type: none"> The plan must designate either a specific date or calendar year following the occurrence of a specified event for making the related payment. A payment is considered to be made on the designated date if it is made by the later of date it is administratively feasible to make the payment or the end of the calendar year containing the designated date (or the end of the calendar year if only a year is designated). For a plan that designates only the year in which the payment is to be made, the first scheduled payment is deemed to be scheduled to be paid as of January 1 for purposes of making a change to the payment schedule (i.e., 12 months prior to scheduled payment date would be 12 months prior to January 1).
Key Employees	<ul style="list-style-type: none"> Identification of key employees is based on the 12-month period prior to an "identification date." Those people are then

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	<p>determined to be key employees for the 12-month period beginning on the 1st day of the 4th month after the identification date. For example, if the identification date is 12/31/05, the person is a "key employee" for the 12-month period beginning 4/1/06.</p> <ul style="list-style-type: none"> • The identification date can be any date chosen by the employer; can only change it 12 months in advance. • Separation from service payments made to a key employee must be delayed at least 6 months following his separation from service. A plan may designate that payments due within the 6-month period can be aggregated and paid in a lump sum at the end of the 6-month period or that the payments begin at the end of the 6-month period. This can be changed by amendment but the amendment effective date must be at least 12 months in the future.
Disability	<ul style="list-style-type: none"> • A plan may rely on the Social Security Administration's determination that an individual is disabled. • A plan may consider an individual to be disabled if he determined to be disabled for purposes of a disability insurance program, as long as that definition of disability complies with the general 409A definition.
Multiple Payment Events	<ul style="list-style-type: none"> • A plan may allow different forms of payment to be made upon the occurrence of the earlier of two events or the occurrence of the later of two events. For example, a plan may allow for installments upon termination or, if earlier, a lump sum upon death.
Delay in Payment by Employer	<ul style="list-style-type: none"> • In certain situations (e.g., payment will not be tax deductible because it constitutes excess compensation under Code section 162(m)), a scheduled payment may be delayed. • Plan documents must permit such delayed payment. A plan may be amended to add such a provision but the amendment effective date must be at least 12 months in the future. An amendment to remove such a provision is considered an acceleration of payment.
Voluntary Plan Terminations	<ul style="list-style-type: none"> • Voluntary plan terminations are permitted: <ul style="list-style-type: none"> • If an employer wants to terminate a certain category of plan (e.g., account balance plans) and make distributions as a result of such termination provided that: <ul style="list-style-type: none"> • All arrangements of the same type (e.g., all account balance plans) must be terminated; • No payments other than those due under the plan may be made within 12 months of the termination; • All other payments are made within 24 months of the termination; and, • The employer cannot adopt a new arrangement of the same type for a period of five years. • Within 12 months of a change of corporate control; or



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	<ul style="list-style-type: none"> • Within 12 months or a corporate dissolution, or with the approval of a bankruptcy court.
<p>Unforeseeable Emergency – Termination of Deferral Elections</p>	<ul style="list-style-type: none"> • A plan may allow a deferral election to terminate if an employee obtains a payment from a nonqualified plan due to the occurrence of an unforeseeable emergency or if the cessation of deferrals is required to obtain a hardship distribution under a qualified plan. • The deferral election must be terminated for the rest of the deferral period and not merely suspended.
<p>Changes in the Time and Form of Payment</p>	<ul style="list-style-type: none"> • A plan can designate an installment payout as a series of individual payments or as a single payment. The plan must treat installment payments consistently. • The rules regarding changes in the form and time of payment apply separately to each payout election. For example, if the participant elects to receive a distribution in 5 annual installments upon separation from service or in a lump sum upon death, the participant can change the form of one distribution without changing the other form. • An intervening event may override an existing payment schedule already in payment status. For example, a plan could provide that a participant will receive 6 installment payments upon termination, but also provide that if the participant dies after the payments begin, all remaining benefits will be paid in a lump sum.
<p>Nonqualified Plans Linked to Qualified Plans</p>	<ul style="list-style-type: none"> • Nonqualified plan payments may be based on a payment election made under a qualified plan only until December 31, 2006. • An amendment to increase or decrease benefits or to cease future accruals under a qualified plan does not result in a deferral election or an acceleration of a payment under a linked nonqualified deferred compensation plan. • The addition, removal, increase or reduction of a subsidized benefit or ancillary benefit or a participant's election of that benefit under the qualified plan, will not constitute either a deferral election or an acceleration of a payment under the linked nonqualified plan. • If a person increases or decreases deferrals under a 401(k) plan, that action can increase or decrease deferrals to the NQ plan as long as the change in deferrals is limited to the deferral limit under the 401(k) plan, e.g., \$15,000 for 2006. This rule applies separately to the corresponding change to any employer match. • A nonqualified plan can transfer, or <i>wrap</i>, deferrals to a qualified plan. The amount is the maximum amount that may be deferred under the 401(k) plan, not to exceed the applicable deferral limit for the year. This addresses those situations where deferrals made to a nonqualified plan are transferred to the 401(k) plan after the completion of the 401(k) plan's ADP and ACP

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Material Modifications	<ul style="list-style-type: none"> • If a plan is materially modified but that provision is removed before the date the modification is exercised by any participant or, if earlier, the end of the calendar year in which the change was made, the change will not be treated as a “material modification” of the plan. • It is not a material modification to change a notional investment to a predetermined actual investment or to add a rabbi trust.
Transition Relief Extended to 2006	<ul style="list-style-type: none"> • The deadline for amending plans to reflect the provisions of the new law and guidance has generally been extended to December 31, 2006. • Plans need only be operated in “good faith compliance” with section 409A and the proposed guidance throughout 2006. • Plans may be amended to provide for new payment elections and participants may make new payment elections on or before December 31, 2006, without violating the new rules. However, new payment elections may not be made for any payment due in 2006 and any payment due after December 31, 2006 cannot be paid in 2006. • Nonqualified plan distributions may remain linked to a distribution option selected under a qualified plan, through December 31, 2006.
Transition Relief Ending on December 31, 2005	<ul style="list-style-type: none"> • Participants must make elections to defer regular 2006 compensation by December 31, 2005. There is no extension of this deadline. • Participants who want to lower or cancel deferral elections or terminate participation in the plan and receive a cash-out, and avoid the application of the new section 409A rules to these actions, must have made those elections by December 31, 2005. Plan amendments providing that participants made such elections also must have been made by December 31, 2005. • Plan sponsors that want to terminate their nonqualified plans to avoid the application of the section 409A rules must do so by December 31, 2005.