

**Summary of New Law  
Affecting Nonqualified Deferred Compensation Plans**

<b>Plan Provision Affected</b>	<b>New Restrictions</b>	<b>Examples</b>
<p><b>Scheduled Payment Dates for Deferred Compensation</b></p>	<p>By its terms and in practice, a plan that provides deferred compensation must allow payment only on:</p> <ul style="list-style-type: none"> <li>• Separation from service (plus 6 months for top 50 officers)</li> <li>• Disability (as defined by the new law)</li> <li>• Death</li> <li>• Specified payment date or schedule</li> <li>• Unforeseeable emergency (as defined by the new law)</li> <li>• Change in ownership or control (but only to the extent permitted by regulations)</li> </ul> <p>Plan termination is <i>not</i> a permitted payout event. Payouts on plan termination penalized like other non-permitted distributions, even on, <i>e.g.</i>, employer’s going out of business (unless Treasury provides an exception).</p>	<p>(1) SERP provides for payment on death, hardship, disability, termination of employment, or change in control. To comply with the new law, the “hardship” standard must be conformed to “unforeseeable emergency”; “termination of employment” with “separation from service” (plus 6 months for top 50 officers); and “disability” and “change in control” with the new law.</p> <p>(2) SERP paid as a lump sum or life annuity as requested by employee, at discretion of the compensation committee. Discretionary provision must be deleted.</p> <p>(3) Plan awards SARs that are exercisable, settled in cash, any time after vesting. Open-ended settlement date prohibited.</p>
<p><b>Haircuts and Other Accelerations</b></p>	<p>Employee may not elect to accelerate the payment of deferred compensation, even if subject to a “haircut” or other reduction of the amount payable.</p>	<p>(1) Plan awards incentive pay, payable at termination of employment. At any time, a participant can take an earlier distribution with a 10% haircut (reduction). The acceleration/haircut must be deleted.</p> <p>(2) Same as above, except the participant can take an earlier distribution, without haircut, but only at the discretion of the compensation committee. The discretionary provision is an acceleration (as well as prohibited payout event) and must be deleted.</p> <p>(3) Employer going out of business terminates plan and distributes amounts to participants. The distributions on plan termination are a prohibited acceleration (unless Treasury provides an exception).</p>

**Important Note:** Many central features of the new law are unclear, pending Treasury guidance. The conclusions of this summary are thus subject to change.

Plan Provision Affected	New Restrictions	Examples
<p><b>Election to Make Initial Deferral</b></p>	<p>Election to defer payment of compensation must be made by:</p> <ul style="list-style-type: none"> <li>• Year before the year the service period begins.</li> <li>• For performance-based compensation, 6 months before the service period ends.</li> <li>• For new participants in the plan, 30 days after participation commences.</li> </ul> <p>Any election made by these deadlines is <b>not</b> subject to 5-year rule and other restrictions on changes in elections (see below).</p> <p>Any “performance” standard must be in writing within 90 days after services begin, and conform to certain other rules.</p>	<p>(1) Beginning 2005, employee earns bonus payable December 31, 2007, if still employed on that date. She wants to defer payment to January 1, 2008. Election permitted if made by December 31, 2004.</p> <p>(2) Same as (1) except the bonus is paid only if qualifying performance criteria are satisfied by December 31, 2007. Election permitted by June 30, 2007.</p> <p>(3) In 2005, the employee is granted a restricted stock unit (RSU) payable in cash on December 31, 2007 if she is employed on that date. Election to defer payment to January 1, 2008, permitted if made by December 31, 2004. <u>Possible exception under consideration by Treasury</u>: Long-term incentive awards can always be deferred if election made 12 months before scheduled payout, subject to 5-year “second election” rule below.</p>
<p><b>Election to Change an Earlier Deferral</b></p> <p>(Whether earlier deferral was <i>elective</i>, like a bonus deferred at employee’s election, or nonelective, like a SERP)</p>	<p>An election to change the timing of a deferred payment</p> <ul style="list-style-type: none"> <li>• Election must defer 1st payment at least 5 years (except payments made on death, disability or unforeseeable emergency).</li> <li>• For compensation scheduled to be paid (or to begin) on a specified date, election must be made 12 months before date of first scheduled payment.</li> <li>• For compensation scheduled to be paid (or to begin) upon the occurrence of a specified event, election must be made 12 months before it can “take effect” (not yet defined).</li> </ul>	<p>(1) Employee’s bonus (non-performance based) is payable on January 1, 2008. On July 1, 2007, he tries to elect to defer payment for 5 years. His election is not permitted, because it is after the 12-month deadline for payments that begin on a fixed date. Bonus must be paid on originally scheduled date, January 1, 2008.</p> <p>(2) SERP provides life annuity commencing on separation from service. Twelve months before she intends to (and does) retire, employee elects to defer commencement of annuity until 5 years after separation. Election permitted, because made 12 months before it takes effect.</p> <p>(3) Same as above, except that 6 months after she makes election, employee is terminated. Results not entirely clear. Possibly: (i) Entire election retroactively invalidated, and annuity commences 6 months after separation, or (ii) First 6 months of annuity paid on separation (because election did not take effect as to them under 12-month rule); remaining payments begin 5 years later.</p>

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<b>Rabbi Trusts</b>	<p>Amounts in a rabbi trust (plus earnings) generally taxable immediately if</p> <ul style="list-style-type: none"> <li>• The trust is off-shore; <i>or</i></li> <li>• Plan states that assets are restricted to payment of benefits upon a change in the employer’s financial health.</li> </ul>	<p>A rabbi trust provides that benefits are available to satisfy the claims of creditors in bankruptcy, but that assets are restricted to payment of benefits if company bond ratings drop below certain targets. Corpus and earnings are currently taxable to participants.</p>
<b>Old Vested Deferrals Are Grandfathered</b>	<p>Amounts already earned and vested by December 31, 2004, and future earnings, are not subject to the new law, if the plan is not “materially modified” after October 3, 2004.</p> <p>Exercise of an existing right is not a material modification.</p> <p>But addition of a new benefit, right or feature, or (probably) benefit increase or enhancement of old accruals, is a material modification.</p>	<p>(1) Amounts under deferred compensation plan are vested when earned, subject to noncompete clause. Amounts are payable at termination of employment, with earlier payouts permitted subject to a “haircut.” Deferrals as of 12/31/04 are grandfathered — “haircut” accelerations permitted even on and after January 1 for grandfathered amounts.</p> <p>(2) Same as (1), except that prior awards may be rescinded at the discretion of the compensation committee. Old deferrals are <i>not</i> vested, and so not grandfathered.</p>
<b>Penalty-Free Payout Window</b>	<p>For non-grandfathered pre-2005 deferrals, one-time window to rescind election and take amounts into income without penalty.</p> <p>(Details awaiting Treasury guidance)</p>	<p>(1) Participant has \$50,000 deferred compensation with “haircut” acceleration. Amounts vest February 1, 2005 (<i>i.e.</i>, they are not grandfathered). Unwilling to lock up amounts until scheduled payout date, participant rescinds election during window period. Amounts are taxed when they vest.</p> <p>(2) Same as (1) but participant exercises haircut election February 1, 2006, and plan mistakenly pays. Amounts are taxed and penalties apply.</p>