securian FINANCIAL®

Business Owner Life-stage Design (BOLD)

Individual Life Insurance

Insurance products issued by:
Minnesota Life Insurance Company
Securian Life Insurance Company

FINANCIAL PROFESSIONAL GUIDE

BOLD executive compensation

Designing the right executive compensation program 3

Identifying executive compensation opportunities 5

Take BOLD action — identify your clients' goals 6

Specific executive compensation strategies 12

- Executive bonus arrangements 12
- How executive bonus arrangements work 14

Split-dollar arrangements 18

- Key person plus 19
- How key person plus works 20
  - Employer-financed life insurance 23
  - How employer-financed life insurance works 24

Nonqualified deferred compensation (NQDC) strategy and tools 26

- How NQDC strategies work 29
  - Bonus deferral 29
  - Employer match 30
  - Supplemental executive retirement plan (SERP) 31
  - Protection SERP 32

Often there are exceptional people principally responsible for the growth and success of a company. Because of their value, business owners want to ensure these individuals are happy. Business Owner Life-stage Design (BOLD) is your go-to guide for tailoring executive compensation strategies that enable your clients to successfully retain these key employees.

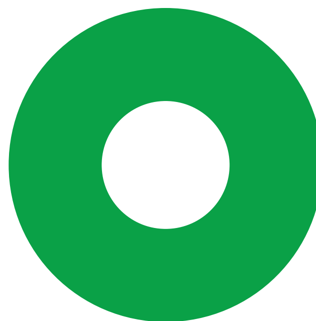
Designing the right executive compensation program

Businesses across industries — both small and large — want to recruit and retain top executives who are instrumental in growing the company. With Business Owner Life-stage Design (BOLD), you have an opportunity to help business owners create compensation packages that encourage these individuals to remain with the company.

What is an executive compensation strategy? It's an agreement between the business and the key employee. Without mutual agreement, an executive compensation solution is impossible. This makes determining a strategy that works for both parties an important part of the process.

An executive compensation strategy that employs life insurance can reward and incent key employees by maximizing a business owner's dollars. And offer even more options for businesses, compared to cash bonuses.

This guide is designed to help you understand the many types of executive compensation strategies available, so you can offer the right solution for your business owner clients — no matter their life stage.



What are employers and key employees concerned about?

Employers want to keep exceptional employees for several reasons:

- Increased productivity and profitability
- More growth in the value of the business
- Cost to replace key employee
- Help ensure continued sales/revenue directly related to key employee expertise
- Position the business for a profitable sale in the future

Business owners are thinking:

- How can I keep this employee?
- Is there another way to benefit this employee beyond qualified plans?
- Can I put golden handcuffs on this benefit for this employee?
- How might this employee eventually take over this business?

Exceptional employees are looking for:

- Financial security for themselves and their families
- Future retirement income
- Potential future growth opportunities

Exceptional employees are thinking:

- Why should I stay here?
- I've maxed out my qualified plan; how else can I put money away for retirement?
- How can I protect my family from the unexpected?

Identifying executive compensation opportunities

You want to engage financially strong and well-established companies. While emerging companies may need to reward their executives, they may not be in a financial position to justify the cost of these programs.

Look for companies with three or more “top hat” executives. Keep in mind Securian Financial can design solutions for as few as one individual. With our executive benefit options, combined with our group life insurance and retirement solutions, we can accommodate all the needs of your business owner clients.

Who are your top business-owner clients?

Who are the top employers in your city/region?

Who could you ask for referrals?

- Existing clients
- Staff
- Centers of influence

Help businesses identify executives for rewards

Generally there may be a small group of high-ranking employees who are key management or earn substantially more than other management, sometimes considered “top hat” executives.

The U.S. Department of Labor considers top hat executives as those who are so valuable to the company that they have the ability to negotiate their compensation packages. These individuals have likely risen to their position because they’re highly talented and have driven the company forward in some way.

- Chief Executive Officer
- Chief Financial Officer
- Chief Marketing Officer
- President
- Executive or Senior Vice President
- Vice President of Sales

Make sure you involve all key decision-makers from the beginning, and possibly meet with key individuals separately throughout the process:

- Company ownership
- Accountant
- Legal team

Take BOLD action — identify your clients' goals

Once you've identified and engaged a company, use our BOLD initial questionnaire (F79732) and executive compensation questionnaire (F79732-3) to help uncover the desires of both the business owner and executive to find an appropriate compensation solution:

- The ideal benefit – policy death benefit or retirement income — that will provide the value to retain the employee
- The primary motivation for seeking the benefit selected
- Who pays to fund the strategy
- How employee retention is best achieved
- The importance of cost recovery

Which is more valuable to the executive?

Aside from current income, a primary motivation for any employee is more income for retirement. Executive compensation strategies often focus on providing additional retirement income. This appeals to executives because:

Retirement income

- They're often at or near contribution limits for their qualified retirement plans.
- They have no real need for additional current income.
- They see benefit in the opportunity to put more money away for retirement.

Death benefit

In addition, financial protection for family members can also be perceived as a valuable benefit.

Compared to the outright purchase of permanent life insurance protection, death benefit protection in an executive compensation package can be far more affordable.

A life insurance death benefit can also be useful for recovering executive compensation program costs, so benefit programs often center around the decision on who receives the death benefit:

- The executive's dependents?
- The company?
- Both?

Most strategies provide both a life insurance death benefit and retirement income, but the taxation and amount of benefit varies. To determine the right strategy, ask business owners whether a death benefit or retirement income is more important to them.

Death benefit protection

The main purpose and advantage for using permanent, cash value life insurance is the death benefit. Some executive compensation strategies provide the death benefit to the executive, some to the employer, and others share the death benefit between the two parties.

Death benefit solely for the executive's beneficiaries

In these situations, the death benefit is not needed by the employer. Overall, the death benefit is part of the benefit provided by the company, in addition to potential supplemental retirement income from the policy's cash value.

Death benefit solely for the employer

In key person strategies, the company protects itself should the executive die. Upon a key person's death, the death benefit can help cover lost sales, lower earnings or added costs for hiring and training a replacement.

In situations where the employer retention strategy calls for only supplemental employee retirement income, an employer may wish to recover the costs of its program through the policy death benefit.

Death benefit shared between employer and key employee's beneficiaries

In split-dollar arrangements and some salary continuation strategies, the two parties may "split" or share the death benefit. The death benefit provides cost recovery for the employer, as well as additional incentive for the executive to remain with the company.

Death benefit recipient	Executive compensation strategy	
Solely for family	• Executive bonus • Golden executive bonus arrangement (GEBA) • Golden executive match (GEM) • Salary continuation	
Solely for employer	• Key person insurance • Supplemental executive retirement plan (SERP) — retirement income only for employee	
Shared	**Split-dollar** • Endorsement (key person plus)	**Salary continuation** • Nonqualified deferred compensation (NQDC) • Bonus/salary deferral • SERP • Protection SERP • Employer match

Retirement income

The decision regarding retirement income requires the business owner to balance the timing of a potential tax deduction, versus the tax ramifications of the key employee receiving the income. Quite simply, the business owner will receive a tax deduction when the benefit is paid, and the executive will be taxed on the benefit at that time.

Strategies	Business tax ramifications	Key employee tax ramifications
Executive bonus **GEBA** **GEM**	Tax deduction today	Taxed today with future tax-advantaged access to cash value
NQDC	Future tax deduction	Tax deferral today but taxed in the future (possibly at a lower tax bracket)

If your client mentions long-term care for the executive benefit, additional considerations may affect the solution you provide.

For assistance, contact our advanced sales team at 1-888-413-7860, option 3.

Who pays?

Another factor for determining the appropriate executive compensation strategy is who will provide the funding. In most cases, the business will fund the arrangement, since it wishes to reward and retain the executive.

In a pure salary deferral NQDC strategy, the executive defers a bonus or a portion of salary into retirement, at which point the executive may be in a lower tax bracket. In other strategies, the employer may also want to match a percentage of the executive's deferral.

When discussing who will fund the strategy, keep in mind:

- **Employee contributions** are typically after-tax dollars (except NQDC salary deferral and employer match)
- **Business dollars** have cost recovery potential with NQDC and split-dollar strategies

Dollars coming from:

Business only	Key employee only	Mostly key employee
Executive bonus • Executive bonus • GEBA **Split-dollar** • Endorsement • Non-equity collateral assignment (employer-financed life insurance) • Loan regime **NQDC** • SERP • Protection SERP **Salary continuation**	**NQDC – Salary deferral**	**GEM** **NQDC – Employer match**

Retention

“Golden handcuffs” are incentives an employer can offer key people to encourage their loyalty to the company. They contain stipulations spelling out benchmarks or timetables that must be achieved in order to gain access to the benefit.

Depending on the industry, the economy and current job market, golden handcuffs may not be necessary. Often, an executive bonus may be enough to keep them. However, it’s important to periodically review the strategies and their effectiveness.

Without golden handcuffs	With golden handcuffs
Executive bonus	**Executive bonus**
• Executive bonus	• GEBA
NQDC — Salary deferral	• GEM (Only on employer’s contribution)
	Split-dollar
	• Endorsement
	• Non-equity collateral assignment
	• Loan regime
	NQDC
	• Employer match (only on employer’s contribution)
	• SERP
	• Protection SERP
	Salary continuation

Cost recovery

Whenever possible, a business will want to recover its costs. Depending on how important this is for the business owner, explore options for cost recovery and determine which strategies best suit their needs.

Strategies with business cost recovery:

Split-dollar

- Endorsement
- Non-equity collateral assignment
- Loan regime

NQDC

- Employee deferral-Employer match
- SERP
- Protection SERP

Specific executive compensation strategies

Executive bonus arrangements

Employers may wish to encourage loyalty from their key employees and drive productivity and profitability. Executive bonus arrangements provide a key employee with a bonus used to fund a permanent life insurance policy:

- The bonus is paid entirely with employer money.
- The life insurance policy provides a death benefit for the key employee's family, if the key employee dies while owning the life insurance.
- The key employee may also withdraw the cash value upon retirement.

The employer may wish to apply some restrictions to the policy values in order to motivate employee loyalty. Under a golden executive bonus arrangement (GEBA), these restrictions may describe a vesting schedule for access to the policy cash value, or a repayment of premiums if the executive leaves the company before the vesting timeframe is complete.

Target employer

An executive bonus strategy may be sought by a company that:

- Wants to reward a select group of key executives
- Wants to avoid plan administration
- Is willing to give up control of the funding vehicle to enjoy current income tax deductibility
- Needs current income tax deduction

In addition to a standard executive bonus strategy, a GEBA may be sought by a company that wants to:

- Temporarily restrict how employee uses policy cash value
- Potentially recover costs, if employee prematurely departs from the company

A golden executive match (GEM) solution may be sought by a company that needs a more cost-effective strategy to provide additional benefits to key employees. The employer provides a bonus to the executive in an amount that equals the tax on the income used to pay the premium on the life insurance policy.

Target employee

All executive bonus arrangements:

- Key executive
- Highly compensated or management
- Has life insurance need or supplemental retirement income need
- Wants maximum control over funding vehicle
- Willing to pay taxes today to achieve control of funding vehicle

GEBA

- Must be a key non-owner employee
- Maxing out all company sponsored retirement plans
- Departure of this employee would significantly hurt business
- Has inadequate insurance coverage
- Wants a tax-advantaged funding vehicle to take withdrawals without penalty during retirement

GEM

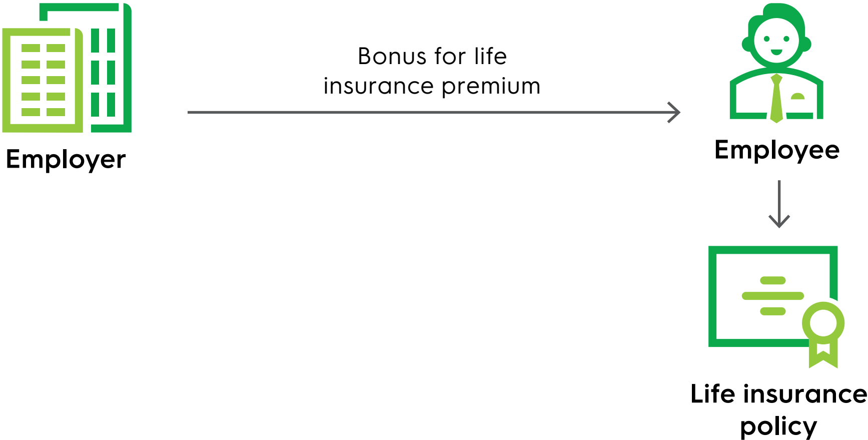
- Is able to or does not mind paying for premium out of pocket

GEBA contains additional documentation regarding restrictions and a vesting schedule for access to policy values.
In a GEM, the bonus paid matches the taxes the employee paid on income used to pay life insurance premiums.

How executive bonus arrangements work

All executive bonus strategies have the same fundamental set-up:

- Employee applies for a permanent life insurance policy and designates the beneficiary
- Employer bonuses premium dollars to a key executive, or pays the premium directly to the insurance company
- The amount of the premium payment is included in the executive's income



Taxation

Employee income taxes

Premium payments are treated as compensation to the employee and are subject to income taxation. The premium payments must be reported on the employee's W-2 form.

At the employee's death, the insurance proceeds are paid out income tax-free. If the employee surrenders the policy, the cash surrender value in excess of the cost of the contract is taxable as ordinary income to the employee.

Employer income taxes

The employer is allowed an income tax deduction for the full amount of the bonus in each year a bonus is paid. The premium payment is deductible as compensation to the employee provided:

1. The employer is not directly or indirectly a beneficiary under the policy, and
2. The premiums constitute additional reasonable compensation for services rendered by the employee.

To ensure the employer will be entitled to the income tax deduction, the arrangement must not allow the employer to be a direct or indirect beneficiary of the policy.

Therefore, the employer must not be entitled to receive any cash value from the policy, nor any portion of the death benefit. The insurance policy is used merely as an incentive for the employee to satisfy the separate employment agreement.

Social Security taxes

The premium payments are subject to Social Security taxes. The full amount of the premium payment will be subject to Social Security taxes, if the employee's salary is below the Social Security taxable wage base.

Benefits and considerations for executive bonus strategies

Employer benefits

- Little to no administration
- Simple and flexible
- Immediate income tax deduction
- Selective participation
- Not subject to employer-owned life insurance (EOLI) rules; avoids ERISA (For more information about ERISA, see the GEBA Foreword to Counsel and Specimen Documents – F71834-13)

Employee benefits

- Cost-effective life insurance protection and choice of beneficiary
- Immediate access to cash value, which can grow tax-deferred
- Supplemental retirement income
- Not subject to employer's creditors
- Estate planning aspects

GEBA

- Provides for golden handcuffs
- Potential recovery of costs if employee leaves

GEM

- Cost-effective alternative to GEBA through employee payment of premiums

Employer considerations

- No control over the policy
- Does not receive policy's death benefit or have access to cash value
- Employer bears full cost of plan
- No retention of asset or cost recovery if employee leaves unless GEBA is used
- No golden handcuffs unless GEBA is used

Employee considerations

- Must be acceptable underwriting
- Death proceeds may be included in estate
- Bonus is taxable income, but employer could pay tax cost via double bonus
- Other limitations and considerations related to owning life insurance

GEBA

- Golden handcuffs restrict access to cash value and loans of the policy

Split-dollar arrangements

Split-dollar strategies split the costs and benefits of a life insurance policy between the employer and employee. For the employee, it provides affordable death benefit coverage while working for the employer. For the employer, it provides a benefit with possible cost recovery and greater control over the life insurance policy.

Section 402 of the Sarbanes-Oxley Act of 2002 prohibits personal loans to directors and executive officers of publicly traded companies. Therefore, we do not recommend pursuing split-dollar arrangements with publicly traded companies.

Split-dollar arrangements can be effective solutions when an employer wants to 1) protect the business from the loss of a key individual and 2) offer incentives or deferred compensation to its key executives when cost is an issue. The employer and key executive split the policy in one or more ways:

- Cash value
- Premium
- Death benefit

This guide includes two versions of split-dollar arrangements as a business strategy: endorsement split-dollar and collateral assignment split-dollar.

Key person plus

Key person plus is an endorsement split-dollar arrangement using a life insurance benefit paid for and provided by a business for key executives or other key employees. The business owns the policy and pays the premium, and a tax-free life insurance death benefit is provided to the key employee's family or other chosen beneficiary.

Target employer

Most endorsement split-dollar arrangements are provided for key employees or business owners who need survivor income or other life insurance coverage.

An endorsement split-dollar arrangement may be sought by a company that:

- Wants to retain or reward key executives with a pre-retirement survivor benefit
- Wants to avoid complicated administration
- Wants to control the policy as a corporate asset
- Wants to recover its plan costs
- Is willing to forego income tax deduction today in exchange for recovering premium costs in future

Target employee

Endorsement split-dollar is most appropriate for individuals who do not have an estate tax issue, because the death benefit will be included in the insured's estate.

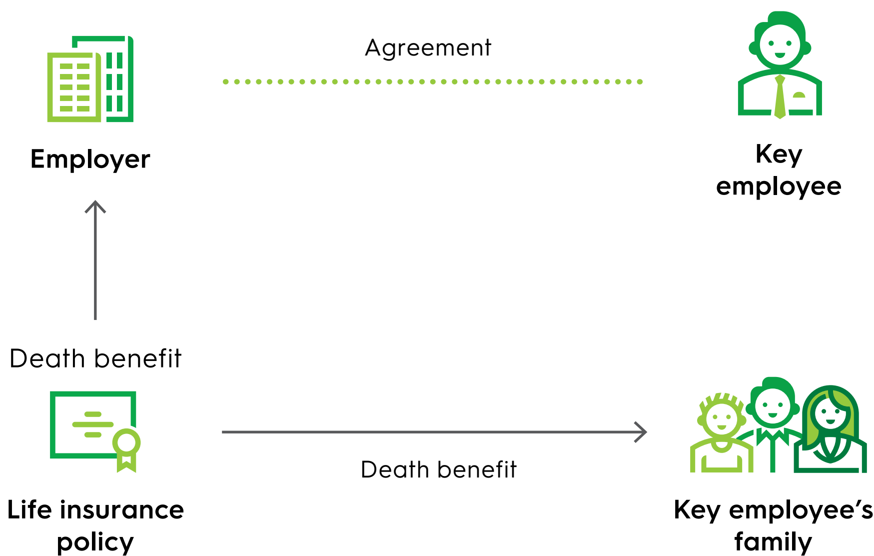
- Executives and other key employees
- Need for income replacement to support family in event of death, but cannot afford premium
- Does not have a federal estate tax problem

How key person plus works

- Company purchases a permanent life insurance policy on the life of the executive and pays all premiums
- Company owns the policy and endorses a portion of the death benefit to the executive as a pre-retirement survivor benefit
- Executive is taxed on the economic benefit of the premium based on the issuing insurance company's term rates or a table of rates provided by the Internal Revenue Service (IRS).

If the executive dies while employed by the company:

The company receives a portion of the death benefit to recover its costs; the executive's beneficiaries receive the balance.



When the executive retires:

The arrangement is terminated:

- Company retains ownership of the policy
- When the executive dies, the company recovers the cost of the arrangement through the death benefit proceeds of the policy
- Company may choose to transfer the policy to the executive as a taxable bonus

Taxation

Below are the tax results of endorsement split-dollar using the economic benefit method of taxation:

Key employee income taxes

- The key employee is taxed annually on both Minnesota Life Insurance Company and Securian Life Insurance Company's one-year annually renewable term (ART) policy costs, and the Table 2001* costs. This is the "economic benefit."
- If the policy is a second-to-die policy, both Minnesota Life Insurance Company and Securian Life Insurance Company's one-year ART-SD term policy costs or the extrapolated second-to-die Table 2001* costs are taxed annually to the key employee.
- The death benefit paid to the insured's chosen family member is income tax-free.

Employer income taxes

- Premiums are not tax deductible for the business.
- If the business is a flow-through tax entity such as a partnership, S Corporation or LLC, the business owners are taxed on their pro-rata share of the nondeductible premium.
- The business cannot income tax deduct the one-year term costs or Table 2001* costs that are taxed to the key employee (insured).
- Assuming that the business met the employer owned life insurance (EOLI) rules before the policy was issued, the death benefit paid to the business should be income tax-free.

*As of publication, there is no indication when the IRS will determine Table 2017 costs for these arrangements.

Endorsement split-dollar benefits

Employer

- Provides a way to reward select key employees
- Cost recovery

Employee

- Provides income to surviving family/beneficiaries in event of death prior to retirement

Endorsement split-dollar considerations

Employer

- Premiums are not income tax deductible
- Must comply with notice and consent rules for EOLI before policy issuance
- Attorney fees

Employee

- Taxed annually on the economic benefit value of the death benefit provided
- Must be acceptable underwriting risk
- Death proceeds may be included in estate without additional planning
- Subject to employer's creditors

Employer-financed life insurance

Employer-financed life insurance is an equity collateral assignment split-dollar strategy that allows a business to provide life insurance for an owner, key executive or other key employee.

Although the employee owns the policy, the business pays the premiums as a loan to the employee. The policy is assigned to the employer as collateral for the loaned premium, and the executive names a beneficiary of the policy's tax-free death benefit.

There are two possible tax methods that can be used with employer-financed life insurance:

- If the economic benefit method of taxation is used, the business receives a portion of the death benefit equal to the greater of the cash value of the contract or the business's premiums paid.
- If the loan method is used, a portion of the death benefit equal to the premiums loaned or cash surrender value is paid to the business.

Target employer

Most employer-financed life insurance arrangements are provided for the key employees or business owners who need survivor income or other life insurance coverage, or have an estate tax problem.

Employer-financed life insurance may be sought by a company that:

- Wants to reward a key executive who has an estate tax problem
- Wants to recover cost eventually
- Does not need an income tax deduction

Target employee

- Can be an owner or key executive
- Needs life insurance
- May have need to exclude death benefit from estate

How employer-financed life insurance works

The policy is collaterally assigned to the business to secure its interest in the policy. The amount assigned to the business depends on which tax method is used for the arrangement.

- If the loan method is used, a portion of the death benefit equal to the premiums loaned or cash surrender value is paid to the business.
- The company loans money to an executive to pay premium on a permanent life insurance policy, which accumulates cash value.
- The executive purchases a policy. Working with a licensed attorney, a split-dollar agreement is established that collaterally assigns a portion of the death benefit to the company.
- The executive names a beneficiary

At rollout or at the executive's death, the company receives a portion of the policy's cash value equal to the premiums paid, plus interest. The executive or the executive's family receive the balance of the policy's death benefit or cash value.

Taxation

The following summarizes the tax results of employer-financed life insurance using the loan method of taxation:

Key employee income taxes

- Any interest paid to the business by the key employee or the trust for the loaned premiums is not deductible to the key employee.
- If the interest due is not paid to the business, the interest amount is deemed income taxable to the key employee.
- If the split-dollar agreement is terminated, the key employee or trust must pay back premiums paid or any other outstanding loan amount.
- The death benefit paid to the insured's chosen family member is income tax-free.

Employer income taxes

- The business cannot income tax deduct the premiums paid.
- If the business is a flow-through tax entity such as a partnership, S corporation or LLC, the owners of the business are taxed on their pro-rata share of the nondeductible premium.
- Any interest paid to the business for the loaned premiums is taxable to the business.

Employer-financed life insurance benefits

Employer

- Employee owns the policy
- Flexible and minimal administrative costs
- Company can select employees it wants to reward

Employee

- Affordable death benefit coverage for employee
- Death benefit paid to insured's beneficiary income tax-free
- Ability to exclude death benefit from estate with proper planning

Employer-financed life insurance considerations

Employer

- No income tax deduction for premium payments
- Special issues for flow-through tax entities (LLCs, partnerships, etc.)
- Costs may not be fully recovered
- Attorney fees for drafting agreement
- Any interest paid to company for loaned premium is taxable to company

Employee

- Taxed annually; method depends on type of taxation option chosen (loan or economic benefit)
- Must be acceptable underwriting risk
- Death proceeds may be included in estate
- Subject to employer's creditors

Nonqualified deferred compensation (NQDC) strategy and tools

Nonqualified deferred compensation (NQDC) is an unsecured and unfunded promise to pay a future benefit for a select group of management or highly compensated employees. There are two parts to the NQDC:

1

The employer and employees agree to defer a portion of the compensation to some point in the future (i.e., retirement), and

2

The employer informally funds the promised benefit.

Employers can choose a number of different financial instruments to informally fund the NQDC plan. However, for some employers, permanent life insurance can be an attractive option. Because its cash value grows tax-deferred, the employer can access cash value in a tax-advantaged manner, and the death benefit can be income tax-free.

Key characteristics of an NQDC strategy:

- Reduces key employees' current taxable income in exchange for a promise to pay benefits sometime in the future (typically retirement)
- Effective when a company offers a qualified plan but key employees are limited in their contributions
- May provide for golden handcuffs, allowing a company to recover all or a portion of employer's contributions to the plan if employee leaves before a particular date
- Companies can select specific key employees to whom it offers the plan
- Commonly funded with permanent life insurance: Employer owns, is beneficiary of and makes annual premium payments on life insurance policy on employee

There are four basic NQDC plan designs:

1. Employee deferral

a. Employer agrees to provide employee with annual bonus that will be deferred, or employee may defer a portion of current salary

b. At a future date (typically retirement), employer pays employee the deferred bonus with interest

c. Employer may then deduct bonuses paid, and employee must report as taxable income

2. Employer match

a. Plan is drafted outlining contribution amounts, match, vesting schedule, distribution, etc.

b. Employee defers a portion of income or a bonus

c. Employer provides a percentage match of employee's deferral

d. Employer purchases permanent life insurance to informally fund the nonqualified liability

e. At employee's retirement, employer pays an annual amount to employee

f. Employer may then deduct amount paid, and employee must report as taxable income

3. Supplemental executive retirement plan (SERP)

a. Employer agrees to pay employee additional benefits in the form of a future retirement payment based on salary and years of service

b. Employee receives benefits upon retiring and satisfying vesting schedule

c. Employer may then deduct amounts paid, and employee must report as taxable income

4. Protection SERP

a. Combines features of endorsement split-dollar (death benefit protection for employee during working years) and SERP (employer-contributed NQDC benefit with no employee deferral).

Target employer

Generally appealing to companies that:

- Are financially strong
- Would like to provide an incentive for key executives to stay with the company
- Need to be selective in offering the plan

While these characteristics generally indicate an NQDC strategy may be an effective solution, additional insights will help identify which specific strategy could be most appropriate:

A bonus deferral strategy may be sought by a company:

- Willing to provide this incentive as an additional bonus (no contribution from employee)

An employer match strategy may be sought by a company:

- Already offering a qualified plan, but key individuals are limited in their contributions

A SERP or Protection SERP strategy may be sought by a company:

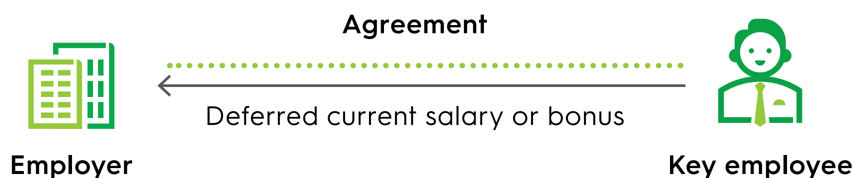
- Willing to provide this incentive as an additional bonus (no contribution from employee)
- Desiring complete control of the plan and assets
- Seeking cost recovery of plan outlay
- Not needing immediate tax deduction
- Willing to fully fund the plan with company money

How NQDC strategies work

Bonus deferral

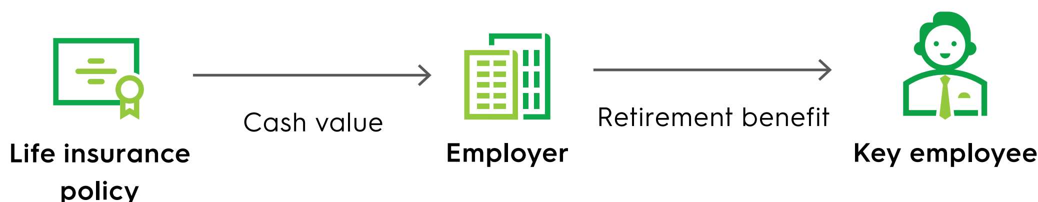
1. Company and key employee implement an agreement, drafted by a licensed attorney, specifying:

- The time at which the key employee can elect to defer compensation.
- The circumstances under which deferred compensation can be paid to the key executive (i.e., separation of service, death, disability, financial emergency, change of control of employer or a specified date).



2. Company determines how the plan will be funded:

- The plan must be unfunded in order to obtain the preferable tax and ERISA treatment.
- The company should consider an informal funding method to meet its obligations under the plan. As an informal funding vehicle, permanent life insurance offers tax-deferred growth potential and tax-advantaged access to policy values:
  - Company is owner and beneficiary of the policy. The employee is typically the insured but has absolutely no rights or ownership in the life insurance policy.
  - Company may choose to provide NQDC retirement benefits on a tax-advantaged basis through policy loans and withdrawals.

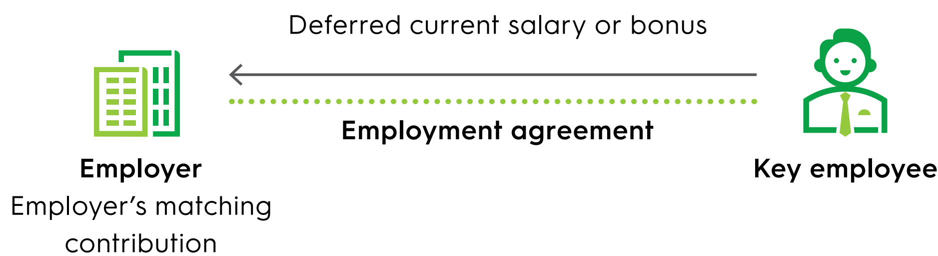


If the company chooses to pay retirement benefits using existing funds and hold the policy until the insured dies, internal gains are not taxed.

Employer match

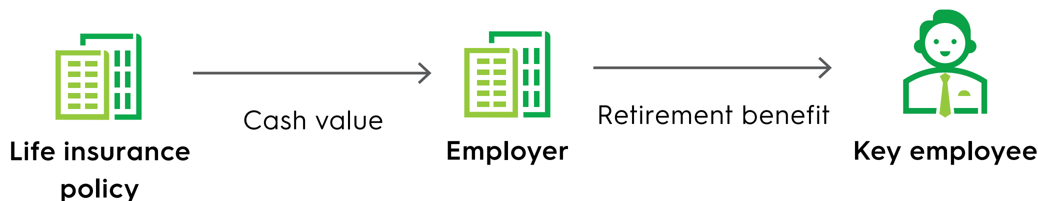
1. Company and key employee implement an agreement, drafted by a licensed attorney, specifying (among other provisions):

- The time at which the key employee can elect to defer compensation.
- The circumstances under which deferred compensation can be paid to the key executive (i.e., separation of service, death, disability, financial emergency, change of control of employer or a specified date).
- The executive's deferred salary.
- The employer's contribution.
- A vesting schedule, if desired.
- Notice and consent requirements.[1]
- Designated beneficiaries.



2. Company determines how the plan will be funded:

- The plan must be unfunded in order to obtain the preferable tax and ERISA treatment.
- The company should consider an informal funding method to meet its obligations under the plan.
- As an informal funding vehicle, permanent life insurance offers tax-deferred growth potential and tax-advantaged access to policy values:
  - Company is owner and beneficiary of the policy. The employee is typically the insured but has no rights or ownership in the life insurance policy.
  - Company may choose to provide NQDC retirement benefits on a tax-advantaged basis through policy loans and withdrawals.



If the company chooses to pay retirement benefits using existing funds and hold the policy until the insured dies, internal gains are not taxed.

1. Section 101(j) of the Internal Revenue Code (IRC) requires that an employer must provide notice and seek consent before placing life insurance on the life of an employee.

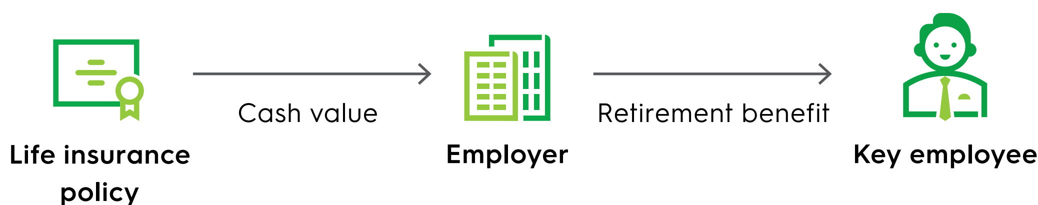
Supplemental executive retirement plan (SERP)

1. Company and key employee implement an agreement, drafted by a licensed attorney, specifying:

- The plan type – defined contribution or defined benefit – details of employer contributions, a method of crediting earnings and a vesting schedule if desired.
- The benefit that will be paid to the executive at retirement.

2. Company determines how the plan will be funded:

- The plan must be unfunded in order to obtain the preferable tax and ERISA treatment.
- The company should consider an informal funding method to meet its obligations under the plan.
- As an informal funding vehicle, permanent life insurance offers tax-deferred growth potential and tax-advantaged access to policy values:
  - Company is owner and beneficiary of the policy. The employee is typically the insured but has absolutely no rights or ownership in the life insurance policy.
  - Company may choose to provide SERP retirement benefits on a tax-advantaged basis through policy loans and withdrawals.



Protection SERP

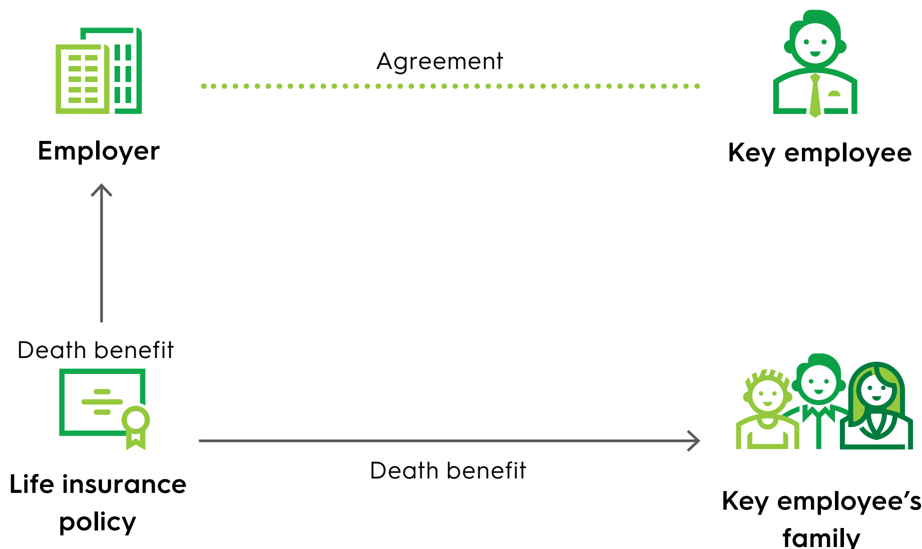
1. Company and key employee implement an endorsement split-dollar agreement, drafted by a licensed attorney, specifying:

- The plan type — defined contribution or defined benefit — details of employer contributions, a method of crediting earnings and a vesting schedule if desired.
- The benefit that will be paid to the executive at retirement.

2. Company determines how the plan will be funded:

- The plan must be unfunded in order to obtain the preferable tax and ERISA treatment.
- The company should consider an informal funding method to meet its obligations under the plan.
- As an informal funding vehicle, permanent life insurance offers tax-deferred growth potential and tax-advantaged access to policy values:
  - Company owns and pays premiums on a life insurance policy insuring the key executive's life. It also endorses a portion of the death benefit to the executive as a pre-retirement survivor benefit for the executive's beneficiaries.
  - Key executive pays tax on the premium or contributes an amount equal to the reportable economic benefit for the amount of premium. The reportable economic benefit is a calculation of the tax obligation for the death benefit provided in a split-dollar arrangement. It's calculated using term life insurance rates.

If the executive dies while employed by the company, the company receives a portion of the death benefit to recover its costs; the executive's beneficiaries receive the balance.



When the executive retires, the split-dollar agreement terminates. The company may use the policy cash value to pay supplemental retirement income.

Taxation

The following summarizes the tax results of NQDC strategies:

Key employee income taxes

Deferrals

- The employer awards additional future compensation without current income taxation to the key employee.
- Deferrals into a NQDC plan are not currently subject to income taxation.
- The key employee may defer current compensation to lower income taxation.

NQDC benefit payments

- NQDC benefit payments to the key employee will be subject to ordinary income taxation at the time received.
- To avoid income taxation on the entire lump sum of the benefit, the plan may be structured to spread out benefit payments over a period of years.
- The benefits received by the key employee each year will be subject to ordinary income tax in that year.

Survivor benefit payments

- Survivor benefit payments to the key employee's heirs will be subject to ordinary income taxation.
- A life insurance policy informally funding an NQDC plan is subject to the notice and consent rules for EOLI. Failure to comply with those rules will subject the death benefit to income tax.

Withholding

- The amount deferred is required to be taken into account for purposes of the Federal Insurance Contributions (FICA) or Federal Unemployment Tax acts (FUTA) as of the later of:
  - The date on which the services creating the right to that amount are performed, or
  - The date on which the right to that amount is no longer subject to substantial risk of forfeiture.
- For instance, when an individual becomes vested in a plan, the NQDC benefit is no longer subject to a substantial risk of forfeiture.

Employer income taxes

When examining the tax consequences of an NQDC plan, the informal funding vehicle must be distinguished from the plan benefits promised to the key employee(s). The informal funding vehicle possesses distinct tax characteristics from the NQDC plan itself:

Deferrals/contributions

- Any deferrals into an NQDC plan are not currently income tax-deductible.
- Therefore, contributions will be deductible to the employer when the executive receives plan benefits.

Premium payments

- Premium payments by the employer may not be deducted for income tax purposes.
- Life insurance used to informally fund an NQDC plan is an asset of the employer.

Retirement benefit payments

- The employer may take an income tax deduction for reasonable compensation paid in the year when that amount is actually paid to the key employee.
- The compensation paid must be reasonable.

Survivor benefit payments

- Survivor benefits paid to the beneficiaries of a deceased key employee are deductible for income tax purposes as an ordinary and necessary business expense.
- The compensation paid must be reasonable.

Withholding

- The amount deferred under an NQDC plan is required to be taken into account for purposes of FICA or FUTA as of the later of:
  - The date on which the services creating the right to that amount are performed, or
  - The date on which the right to that amount is no longer subject to substantial risk of forfeiture.
- For instance, when an individual becomes vested in a plan, the NQDC benefit is no longer subject to a substantial risk of forfeiture.

Reasonable compensation

- Even if the key employee has reported the income for tax purposes, the employer's deduction must still fulfill one more test in order to receive an income tax deduction.
- The payment made to the plan participant must qualify as an ordinary and necessary business expense.

Income taxes — the unfunded requirement

The NQDC plan must be unfunded. The definition of "unfunded" is critical, because it determines whether any assets purchased for meeting eventual obligations will be considered plan assets subject to current income taxation to the key employee/participant and ERISA requirements.

Generally, the employer may meet the unfunded requirement by not dedicating funds to pay plan obligations with any specific assets. Also, the arrangement must not place the funds beyond the reach of its creditors.

It's critical that the employer does not give the key employee any beneficial interest in any particular asset. If these guidelines are met, the plan will likely remain unfunded.

NQDC benefits

Employer

- Selective participation
- Golden handcuffs may be an option
- Access to cash value
- Retention of asset and potential recovery of costs if employee leaves the company
- Cost control possible when employee defers salary
- Income tax-free death benefit

Employee

- Deferral of income taxes on bonuses
- Tax-deferred growth
- Overcomes qualified plan limitations
- Supplemental retirement income

NQDC considerations

Employer

- Deferred income tax deduction (increases current taxable income)
- Greater administrative costs
- Subject to 409A, as well as 101(j) Notice and Consent rules

Employee

- Subject to creditors of employer
- No guarantee employer will be around to pay benefit in future

At Securian Financial, we're here for family. And we're here because of it.

We're guided by our purpose: helping customers build secure tomorrows. Since 1880, we've been building a uniquely diversified company that has outlasted economic ups and downs while staying true to our customers. We're committed to the markets we serve, providing insurance, investment and retirement solutions that give families the confidence to focus on what's truly valuable: banking memories with those who matter most.

Learn more

Businesses come in all shapes and sizes — and so do their executive compensation needs. Use BOLD to identify and implement solutions that fit your client's business and life stage.

Ready to take bold action? To find out more about BOLD, call our advanced sales team:
1-888-413-7860, option 3

For resources to help maximize your sales in the business owner market, visit: securian.com/BOLD

Please keep in mind that the primary reason to purchase a life insurance product is the death benefit.

Life insurance products contain fees, such as mortality and expense charges (which may increase over time), and may contain restrictions, such as surrender periods.

Policy loans and withdrawals may create an adverse tax result in the event of lapse or policy surrender, and will reduce both the surrender value and death benefit. Withdrawals may be subject to taxation with the first 15 years of the contract. Clients should consult their tax advisor when considering taking a policy loan or withdrawal.

This material may contain a general analysis of federal tax issues. It is not intended for, nor can it be used by, any taxpayer for the purpose of avoiding federal tax penalties. This information is provided to support the promotion or marketing of ideas that may benefit a taxpayer. Taxpayers should seek the advice of their own tax and legal advisors regarding any tax and legal issues applicable to their specific circumstances.

These materials are for informational and educational purposes only and are not designed, or intended, to be applicable to any person's individual circumstances. It should not be considered investment advice, nor does it constitute a recommendation that anyone engage in (or refrain from) a particular course of action. Securian Financial Group, and its affiliates, have a financial interest in the sale of their products.

Insurance products are issued by Minnesota Life Insurance Company in all states except New York. In New York, products are issued by Securian Life Insurance Company, a New York authorized insurer. Minnesota Life is not an authorized New York insurer and does not do insurance business in New York. Both companies are headquartered in St. Paul, MN. Product availability and features may vary by state. Each insurer is solely responsible for the financial obligations under the policies or contracts it issues.

Securian Financial is the marketing name for Securian Financial Group, Inc., and its affiliates. Minnesota Life Insurance Company and Securian Life Insurance Company are affiliates of Securian Financial Group, Inc.

For financial professional use only. Not for use with the public. This material may not be reproduced in any form where it would be accessible to the general public.

INSURANCE
INVESTMENTS
RETIREMENT

securian.com

400 Robert Street North, St. Paul, MN 55101-2098
©2016, 2019 Securian Financial Group, Inc. All rights reserved.

F79732-53 Rev 11-2019 DOFU 11-2019
954053