Non-Qualified Deferred Compensation

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In today's highly competitive work environment, top-performing executives are hard to recruit and retain. The usual employee benefits aren't enough. As a result of changes in the tax laws designed to benefit rank-and-file employees, higher-paid executives often find that the benefits from qualified pension, profit-sharing and 401(k) plans are, in many cases, significantly reduced and insufficient. For example, if a company's 401(k) plan has low participation rates by rank-and-file employees, the ability of key executives to make pre-tax contributions could be significantly reduced. Highly paid executives also are surprised to learn that their qualified retirement plan benefits may be insufficient, at retirement, to meet the lifestyle they are accustomed to. As a result, many businesses need to seek alternative arrangements to retain their most talented executives. Businesses also need to prevent competitors from hiring their best talent away with more attractive benefit programs.

How does a business owner develop a plan to recruit and retain one of the biggest assets the business has – its key executives?

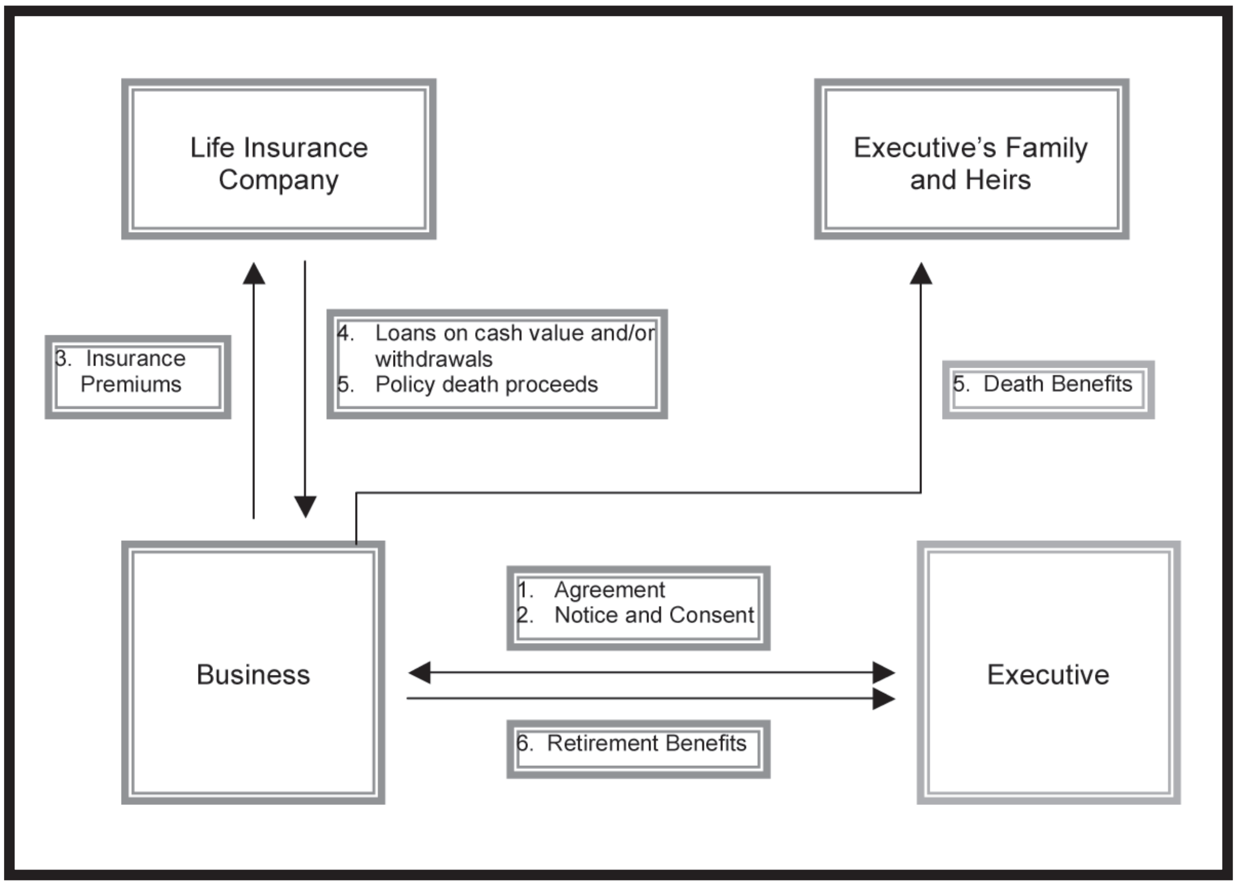
One Solution – Non-Qualified Deferred Compensation Plans

Non-qualified deferred compensation ("NQDC") arrangements are one of the most common and attractive plans for businesses seeking to reward and retain their top performers because they are flexible and customizable to the executive.

NQDC plans come in two basic forms. The first is often referred to as a "Supplemental Executive Retirement Plan" or SERP. As the name implies, a SERP is a plan that provides retirement benefits in excess of those available under the business' qualified plan. A SERP is an agreement where the business promises to supplement the executive's income at retirement. This arrangement is negotiated and can be customized for each key executive. It is also funded entirely by the business and documented by a contract between the business and the executive. When the executive retires, the payments made to the executive by the business are taxable to the employee but deductible by the business.

The second form of NQDC plan is commonly referred to as a "Salary Reduction/Deferral Plan." As the name implies, the executive defers his or her own salary to fund the plan. The salary amounts deferred are not currently taxable to the executive, but will be at retirement and then deductible by the business. A common variation of a Salary Reduction Plan mirrors the company's 401(k) plan and provides matching contributions.

NQDC plans are most tax-efficient when the business sponsoring the program is a C corporation.



How this works (see chart)

1. The business and executive enter into an agreement where the business agrees to provide specified retirement benefits.

2. The business provides the executive with the proper notice required by law, and obtains consent that the business can and will take out a life insurance policy on the executive. The business also provides notice of the plan to the U.S. Dept. of Labor, Employee Benefit Security Administration.

3. Although a business is not required to set aside assets to pay future retirement benefit payments, many businesses choose to "informally" fund their benefit promise through the use of a business owned permanent life insurance policy. This also provides a level of comfort to the executive that the benefits will be paid. The business is the applicant, owner, beneficiary and premium payor of a life insurance policy on the executive's life.

4. In the event that the executive dies before reaching retirement, the business receives the policy's death benefit income tax-free and pays survivor benefits to the executive's designated beneficiaries. These payments are deductible by the business and reportable as taxable income to the beneficiaries.

5. The business has a choice of how to cover the cost of paying the executive's retirement benefits. Policy cash values can be utilized via loans and/or withdrawals to make the required payments. Alternatively, the business can pay the benefits from current cash flow and cost-recover the benefit payments.

6. Upon the executive's retirement, the employer makes retirement income payments according to the terms of the agreement. These payments are taxable income to the retired executive and tax deductible by the business. There are some IRS reporting requirements.

Advantages

To the Company:

- Flexibility to decide who is allowed to participate
- Ability to attract new talent and retain current executives
- Coordinates with existing qualified plans and can be individually tailored to complement other benefit programs
- Benefits are tax deductible to the business when paid at retirement
- Policy cash surrender value subject to business control
- Tax-deferred accumulation and high early cash value can offset hit to earnings charges
- Two options for cost recovering benefit payments

To the Executive:

- No current income taxation and ability to reduce taxable income
- Tax-deferred growth on the account balance
- Increased retirement income
- Pre-retirement death benefit for designated beneficiaries
- Retirement income shortfall can be reduced or eliminated

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