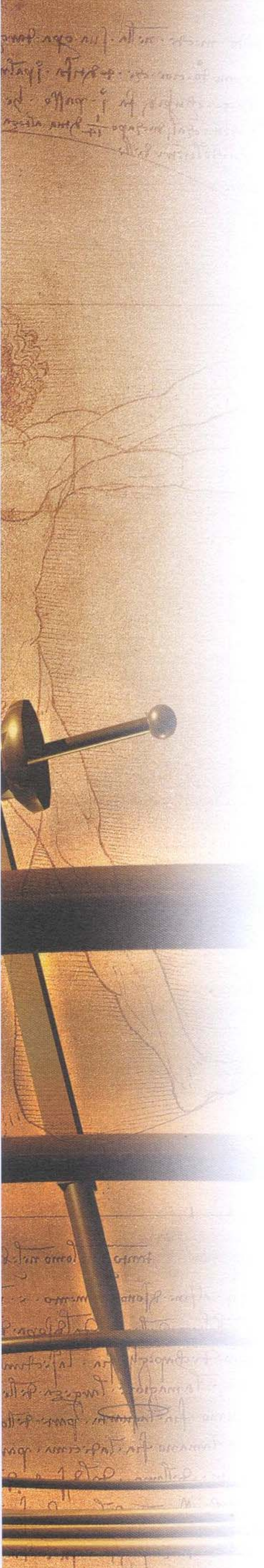

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Nolan Financial Report

Executive Attraction and Retention "The Right Solution"

REVERSE DISCRIMINATION

Attraction and retention of key employees continues to rank among the top five concerns of today's Chief Executive Officers. To test this statement, we searched the words "Attraction and Retention" on Google and were rewarded with 1,430,000 postings. Obviously, this is a subject of considerable interest for many companies.

According to one recent financial article, eight out of ten corporate executives will receive less than 33 percent of their pre-retirement income as retirement benefits from Social Security and corporate qualified plans.[1] As corporations, large and small, recognize the pension limitations and restrictions of the Employee Retirement Income Security Act of 1974 (ERISA), they are increasingly looking to the benefits and flexibility of Nonqualified Deferred Compensation (NQDC) and Supplemental Executive Retirement Plans (SERP). Because these plans provide for supplemental retirement income, they serve as highly effective executive retention tools. Attracting and retaining key executives in a struggling economy has become a top priority for corporate management, and executive benefit planning is a crucial component of that effort.

While nothing will ever replace good management and leadership as an integral part of attraction and retention, the economic package that an employer can offer to an executive candidate certainly plays a key role. Broad changes in the design and structure of qualified retirement plans in recent years have added greatly to the appeal of nonqualified plans.

The qualified plans offered by most employers are now limited to defined contribution style plans, such as 401(k) plans and profit sharing plans. The more desirable defined benefit plans that provide for a percentage of prior income at retirement are no longer the standard, and in fact, are becoming increasingly rare. This shift to defined contribution plans requires the executive to take a more active role in managing and funding his or her retirement.

The advent of the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006 has focused attention on the development and design of nonqualified plans. We believe that a NQDC plan, with or without an employer match, offers companies and executives the best of all worlds in executive compensation planning. As a result of the recent legislation, NQDC plans have a very solid future in the executive benefits arena and, in fact, are a necessary component if one expects to attract and retain a high caliber of executive talent.

EXECUTIVE ATTRACTION & RETENTION

A typical nonqualified plan has three components:

1. an agreement between the corporation and the executive / employee,

[1] Mark W. Lyon. "The 'silver bullet' of executive retention and compensation plans." Leader's Edge. 1 June 1999.






2. a high quality funding vehicle, and
3. an administrative platform that can properly administer the plan design and all of its nuances.

These three components allow management to design and build a supplemental compensation plan that precisely meets the needs of both parties. For example, the Board might say to a prospective CEO or executive whose employment contract is about to expire, "If you would commit to stay with us for ten years, at retirement we'll pay you a supplemental benefit of $100,000 a year for ten years. If you die before retirement, we'll pay your family $100,000 a year for ten years!" Unlike the typical "golden handcuffs" arrangement, this plan, commonly called a SERP, provides for salary continuation whether the executive lives or dies.

DESIGN

Nonqualified plans are typically custom designed to attract, retain, and reward executives and managers through an agreement entered into between the executive and the corporation. These agreements are specifically tailored to meet the needs of the corporation and executive. These plans do carry a higher risk of forfeiture, but they can be protected from a company “Change of Heart” or “Change of Control.” However, they cannot be protected from bankruptcy. For this reason, these plans are generally limited in use to the top 10-15% of the executive population of a company. It is expected that at this level in an organization, participating executives are much more aware of the financial soundness of their company and thus enter into these types of plans with a greater sense of comfort and knowledge of their company’s financial soundness.

Plan design is critical. The majority of our time with clients is spent on the subject. If done properly, this will drive the proper funding and administration and, most importantly, create the attraction and retention device that was sought by the company in the first place. These plans require the assistance and guidance of an expert professional executive benefits consultant if they are to meet corporate goals and expectations.

FUNDING FLEXIBILITY

Although there are many approaches to funding a non-qualified plan, one approach that is usually considered is Corporate Owned Life Insurance (COLI). This is one funding vehicle that can deliver timely and sufficient benefit amounts to allow the corporation to meet its obligations under the NQDC or SERP agreement, whether the executive lives or dies.

In the event the executive fails to meet the terms and conditions of the NQDC or SERP agreement, or under other appropriate circumstances, the corporation has the complete freedom to access the policy cash values via policy withdrawals and/or loans. If structured properly, there is little or no tax consequence to the company and no penalty for early withdrawal.

Utilizing COLI within a Grantor Trust, otherwise known as a Rabbi Trust, affords the participating executive not only the best protection available from any “Change of Heart” or “Change of Control”, but also gives him or her comfort that the assets needed to pay his or her NQDC or SERP benefits will be there.

There is no other investment vehicle that so efficiently meets the funding requirements of a NQDC or SERP plan. The insurance contract may, at any time prior to executive retirement, provide a death benefit sufficient to continue the executive's benefit according to the agreement. When the executive retires, a COLI contract may deliver the cash needed to meet the salary continuation requirements. Finally, after the benefit






payment period has ended, the insurance contract (based on non-guaranteed projected performance) should still be fully intact and will likely contain a significant amount of cash value. The net result can be a substantial net gain to the corporation that will offset their initial loss of the tax deduction and the expense of on-going administration and a happily retired executive.

Any initial objections to plan funding with COLI usually disappear when informed CFO's and executives consider the truly unique benefits of COLI contracts. In its simplest form, COLI is a leverage tool, which allows the corporation to move its money from one account pocket to another. Accumulated funds grow on a tax-deferred basis within the COLI policies. Funds may be taken from the insurance contracts via policy withdrawals and/or loans to offset the cost of paying plan benefits to the executives.

EASE OF ADMINISTRATION

These plans require no IRS approval, no top-heavy discrimination testing and no tax filings and can be utilized with any or all eligible and participating executives without violating the non-discrimination provisions of ERISA. They can be changed or restructured as the needs of the parties may change, simply by mutual consent of the parties. In addition, they have no limitations on contributions, no age restrictions, and no penalties for early withdrawal. While there are some restrictions as noted under IRC Section 409A as it relates to the changing of in-service distribution dates, with proper guidance, plan administrators can easily work within these restrictions.

TAXATION

Executive Taxation

Because the executive enjoys no economic benefit due to the corporation's ownership in the funding asset, the executive is not taxed during the accumulation period. The company is also required to forgo its tax deduction until the actual benefits are paid out to the executive.

Corporate Taxation

An attractive feature to CFO's, the accumulated assets within the plan are often carried as assets of the corporation on its balance sheet. Somewhat similar to an annuity, the plan utilizes after-tax contributions to fund the plan and the plan's assets may grow tax-deferred if COLI is used as the funding vehicle, and the contract is kept in force. If properly structured, the company can withdraw those assets at the executive's retirement or other in-service distribution date on a tax-free basis and pay out the benefit to the executive on a tax-deductible basis. In the event of the death of the executive, the corporation receives insurance proceeds tax-free, subject only to possible alternative minimum tax (AMT) considerations.

SUMMARY

A well-designed and well implemented nonqualified plan is truly the "Right Solution" to meet a company's executive "attraction and retention" needs. A quality nonqualified plan can distinguish a company from its competition.

While we expect that the attraction and retention of key management personnel will always be among the top five concerns of CEO's, we also know that there are now solutions available to address the financial security and retirement concerns of top executives.

Nolan Financial has successfully designed and implemented plans for both for-profit and non-profit organizations. We can help you do the same.

If you have any questions or interest in regard to designing, funding or administering a NQDC or SERP plan, please contact:

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