SECURITY MUTUAL LIFE

The Company That Cares.®

Attracting and Retaining Your Best Employees with Non-qualified Deferred Compensation Plans

In today's business environment, the competition for the most talented and skilled workers is a constant battle. Keeping your best, brightest and most skilled employees is a must for continued business success. Placing a "golden handcuff" on these employees would be ideal to tie the employee to the company. Golden handcuffs are financial incentives or lucrative perks, given by the employer, that encourage a key employee to stay.

One of the most common and effective "golden handcuff" strategies is a non-qualified deferred compensation (NQDC) plan. While they are commonly used by larger companies, they are increasingly used by smaller businesses too. They can be designed in many ways:

- using vesting schedules based upon various factors such as years of service, performance goals, and more;
- offering customized benefits to suit the needs of the business and the employee;
- offering a fixed or inflation-adjusted retirement benefit;
- offering benefits to provide financial security to the employee's family upon a premature death; and
- providing potential cost recovery of the plan to the employer.

NQDC plans are unique plans typically offered only to the top employees. Indeed, according to IRS rules, NQDC plans can only be provided to "select management or highly compensated" employees. They are custom tailored to meet the specific situation.

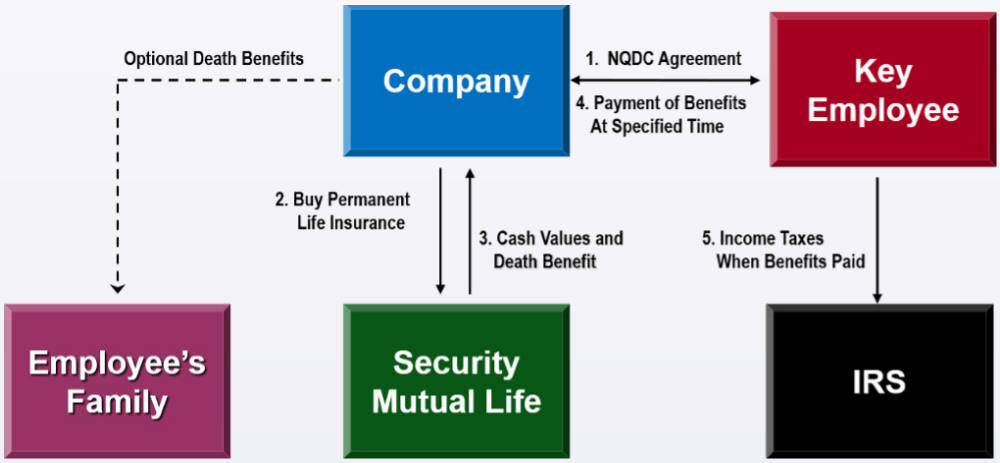
NQDC plans generally come in two variations. The first is a traditional salary deferral plan where:

- the employee opts to defer a portion of his or her salary or bonus for the future;
- the employee will not be currently taxed on this deferral but will be taxed when benefits are distributed;
- the employee can potentially manage income tax brackets;
- it is common for highly compensated employees who may be prohibited from contributing the maximum to their company's 401(k) plan due to the "top heavy" 401(k) rule; and
- 401(k) contribution limits are typically insufficient to fund retirement for highly compensated employees.

In a traditional deferral plan, the company agrees to hold the money and pay out the accumulated account balance at the agreed upon date pursuant to agreed terms. A legal document is executed that clearly sets forth the terms and conditions of the plan. The plan may apply a growth rate or "informally fund the plan" with investment choices set forth in the plan document. While the plan remains in place, the assets "informally funding" the plan remain the property of the company and not the employee. The assets are subject to the claims of company creditors. In addition to deferring income, the income taxes are also deferred until benefits are paid.

The plan agreement may allow the employee to choose among the investments if more than one are offered. Cash value life insurance on the life of the employee is a common funding vehicle because cash value growth is tax-deferred, unlike securities and mutual funds, which makes it attractive for the company's income statement.[1] Life insurance also has a positive impact on the company's balance sheet and potentially provides cost recovery to the employer. The death benefit may also provide a pre-retirement death benefit to the employee's family upon a premature death. At the agreed retirement date, the accumulated account balance is paid out over the agreed upon period. The payments will be income taxable to the employee at that time.

The second variation is called a Supplemental Executive Retirement Plan or SERP. In this variation, the employee does not defer his or her own compensation but rather the employer agrees to solely fund the plan. SERPs are more common than traditional salary deferral plans in small businesses and are stronger "golden handcuffs." Plans can be designed with many variables making them very flexible to meet the needs of the business and employee. Of course, the employer and employee can agree to a combination of both types of plans.



If you're looking for an effective way to recruit, retain and reward your best employees, consider a non-qualified deferred compensation plan. Contact your Security Mutual Life insurance agent today to get the process started. Your agent will assemble your team and coordinate with your attorney and tax professional to review your situation and to determine which plan is appropriate for you and your business.

[1] Companies purchasing life insurance on employees must follow the Employer Owned Life Insurance ("EOLI") rules of IRC Section 101(j).

The information presented is designed to provide general information regarding the subject matter covered. It is not intended to serve as legal, tax or other financial advice related to individual situations, because each person's legal, tax and financial situation is different. Specific advice needs to be tailored to your particular situation. Therefore, please consult with your own attorney, tax professional and/or other advisors regarding your specific situation.

The applicability of any strategy discussed is dependent upon the particular facts and circumstances. Results may vary, and products and services discussed may not be appropriate for all situations. Each person's needs, objectives and financial circumstances are different, and must be reviewed and analyzed independently. We encourage individuals to seek personalized advice from a qualified Security Mutual life insurance agent regarding their personal needs, objectives, and financial circumstances.

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