ADVANCED PLANNING

LIFE INSURANCE-BASED STRATEGIES TO ATTRACT AND RETAIN KEY EMPLOYEES

Executive Compensation Plans

Life Insurance

- Not FDIC insured • Not insured by any federal government agency
- Not a deposit or other obligation of, or guaranteed by, any bank or its affiliates
- Subject to investment risks, including possible loss of the principal amount invested

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

Prudential

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HOW PRUDENTIAL CAN HELP

The Prudential Insurance Company of America and its affiliates offer a wide range of insurance products that can help your business continue successfully in the event of your death or disability. Insurance is a vitally important business tool that is often overlooked.

Whether your business is a sole proprietorship, a partnership, a limited liability company, or a closely held corporation, Prudential can help. Purchasing insurance for business needs may prove to be one of the most important decisions of your life.

Executive Compensation Plans

Executive compensation strategies— how they can work for you.

As a business owner, you are keenly aware of how difficult it is to attract and retain key personnel. The competition for superior technical, managerial, and executive talent is so fierce that you're constantly faced with finding ways to make your executive compensation package more attractive.

However, restrictive economic and regulatory factors make it difficult to reward key contributors using traditional compensation and benefit strategies in a cost-effective manner. That's why, for most business owners, designing an effective executive compensation plan requires guidance from experienced professionals.

Your financial professional can help you sort through your options, both traditional and nontraditional, to arrive at sound solutions.

This brochure describes how using life insurance-based executive compensation strategies may help you attract, reward, and retain executives and key employees while also providing your business with important financial advantages.

Nonqualified plans pick up where your qualified plan leaves off.

Deducting the cost of benefits is a key consideration in an executive compensation strategy. A tax-qualified plan, such as a 401(k), SEP, or SIMPLE, is the cornerstone of an executive compensation package. The contributions made to these plans are generally income tax-deductible, and the plans provide the opportunity to accumulate money on an income tax-deferred basis. That money is generally not included in an executive's income until distributed.

TAX-QUALIFIED DRAWBACKS:

- Government mandates regarding employee eligibility.
- Employer/fiduciary reporting and disclosure requirements.
- Limitations on max employee contributions and benefits.
- Excise taxes if the contribution limits are exceeded.

Tax-qualified plans are a good starting point, but considering the drawbacks, many business owners turn to nonqualified strategies to supplement their tax-qualified plans.

Life insurance can play an important role in unlocking the advantages of using nonqualified plans.

Life insurance is a unique financial instrument that, as an informal funding mechanism, offers:

- An opportunity for income tax-deferred growth.
- Tax-favored withdrawal and loan provisions.[1]
- Potential for loved ones to receive death benefits income tax-free under IRC §101(a).

And can offer flexibility with regard to:

- The amount and frequency of premium payments.
- Policy ownership and beneficiary designations.
- The design of death benefits to meet plan formulas.

[1] Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences.

Nonqualified plans can be customized to fit your needs.

Nonqualified plans can be structured to enable you to provide benefits that address precise business objectives to only those key employees or executives your company wishes to reward and retain. They even allow you to fund the plan in a way that will help your company recapture plan costs.

In other words, when it comes to benefit levels, eligibility, and control of plan assets in a nonqualified plan, you, as the business owner, are the one with the power to make those decisions.

The following nonqualified plan strategies could help your business effectively address the specific needs of its executive compensation program.

- NONQUALIFIED DEFERRED COMPENSATION PLANS
- EXECUTIVE BONUS IRC SECTION 162 ARRANGEMENT
- RESTRICTIVE EXECUTIVE BONUS ARRANGEMENT (REBA)
- DEATH BENEFIT ONLY (DBO) ARRANGEMENT
- SPLIT-DOLLAR LIFE INSURANCE

What are my nonqualified choices?

NONQUALIFIED DEFERRED COMPENSATION PLANS

These plans provide income tax-deferred supplemental retirement, death, and/or disability benefits. Referred to by various names, these plans are contractual arrangements between the employer and the executive and may involve:

- **A traditional deferred compensation plan:** This arrangement involves the deferral of the executive's current income including salary and/or bonus.
- **A supplemental executive retirement plan (SERP):** This arrangement involves the funding of future benefits strictly with employer benefits.
- **A blend of the two.**

In deferred compensation plans, participants or their beneficiaries receive benefits after a particular event occurs, such as retirement, death, disability, or termination of employment.

As the employer, you may specify a minimum service requirement before your employee qualifies for the benefits. Benefit payments, which may be in installments of specified amounts and duration, are generally tax-deductible to your business and taxable to the recipient.

ADVANTAGE TO YOU:

These plans may be an excellent solution when your company needs to supplement its qualified retirement plan for key employees. If life insurance is used as an informal funding device, the policy proceeds may even be enough to recoup the plan's costs.

EXECUTIVE BONUS IRC SECTION 162 ARRANGEMENT

Under this arrangement, the executive buys a life insurance policy and the business pays for it. The major advantage of this strategy is simplicity.

- The only document needed is a corporate resolution, if appropriate.
- The executive's only cost for insurance is the income tax due when the bonus (the insurance premium) is paid.
- The premium for the insurance policy may be deductible as a business payroll expense for you.
- If a permanent life insurance policy is purchased with the bonus, it will have the added benefit of income tax-deferred cash value growth.[1]

ADVANTAGE TO YOU:

This is a good strategy when your company is seeking a current income tax deduction for contributions to the arrangement but is not concerned about controlling the policy values. Your executive will see the life insurance bonus as providing a meaningful, immediate benefit that is completely portable.

RESTRICTIVE EXECUTIVE BONUS ARRANGEMENT (REBA)

Similar to an executive bonus plan, with a REBA, the employee owns the policy while the employer pays the premium cost. However, in a restrictive executive bonus plan, the employee's ability to exercise certain policy rights is limited through the use of a restrictive endorsement placed on the underlying policy.

- The restrictive endorsement remains in effect until the employee meets the terms negotiated in a separate employment contract.
- If the plan is properly established, the premium may be deductible to you.
- Like the bonus arrangement, the executive's only cost for the insurance is the income tax due on the bonus.
- The restrictive endorsement acts as "golden handcuffs," encouraging the executive to remain with the company.

ADVANTAGE TO YOU:

This is a good strategy when your company is seeking a current tax deduction for contributions to the arrangement and wants to restrict the employee's access to the policy values.

[1] Outstanding loans and withdrawals will reduce policy cash values and the death benefit and may have tax consequences.

DEATH BENEFIT ONLY (DBO) ARRANGEMENT

A DBO arrangement is an agreement to provide survivor income benefits at the death of a key employee.

- The income benefit is often based on a formula aimed at replacing all or a portion of an executive's salary for a period of years after death.
- From a tax standpoint, DBO plan benefits are treated the same way as benefits under a nonqualified deferred compensation plan.
- The survivor pays taxes on the benefits, while the business is generally able to deduct the benefit payment as a compensation expense.

ADVANTAGE TO YOU:

A DBO plan for selected executives may be the plan to choose when your company is in need of a tax-favored way to supplement the existing death benefits provided by the company's basic group life insurance and/or qualified pension plans.

SPLIT-DOLLAR LIFE ARRANGEMENT[2]

In a split-dollar arrangement, your company facilitates the purchase and pays most or all of the costs of a permanent (cash value) life insurance policy on an executive's life.

- The business acquires a sufficient ownership interest in the policy so that its premium advances are repaid by a share of the policy proceeds.
- Either the executive or the designated beneficiary receives the remaining policy value.
- A written split-dollar agreement spells out the rights of all parties under the contract.

ADVANTAGE TO YOU:

A split-dollar arrangement is an excellent way to provide an executive with a substantial lump-sum death benefit with minimal current tax impact, while the company maintains control of the plan assets. Split-dollar benefits may also be combined with nonqualified deferred compensation benefits.

[2] The Sarbanes-Oxley Act makes it a crime for publicly traded companies to, directly or indirectly, enter into a loan with certain directors and officers. It is unclear whether the Act applies to split-dollar. Clients should contact their own tax advisors concerning their specific situations.

Which strategy is right for me?

There are several powerful strategies available to help you supplement your executive compensation plan for key employees. Life insurance is a key element in these strategies and can be a tool that helps you meet your goals while minimizing costs. **Now you're ready for the next step—a confidential fact-finding meeting with your financial professional.**

Working with your financial professional, you and your tax and legal advisors can develop a life insurance-based executive compensation plan that is just right for your company. For more information about these strategies, contact your financial professional.

THE PROTECTION COMPANY FOR OVER 145 YEARS

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