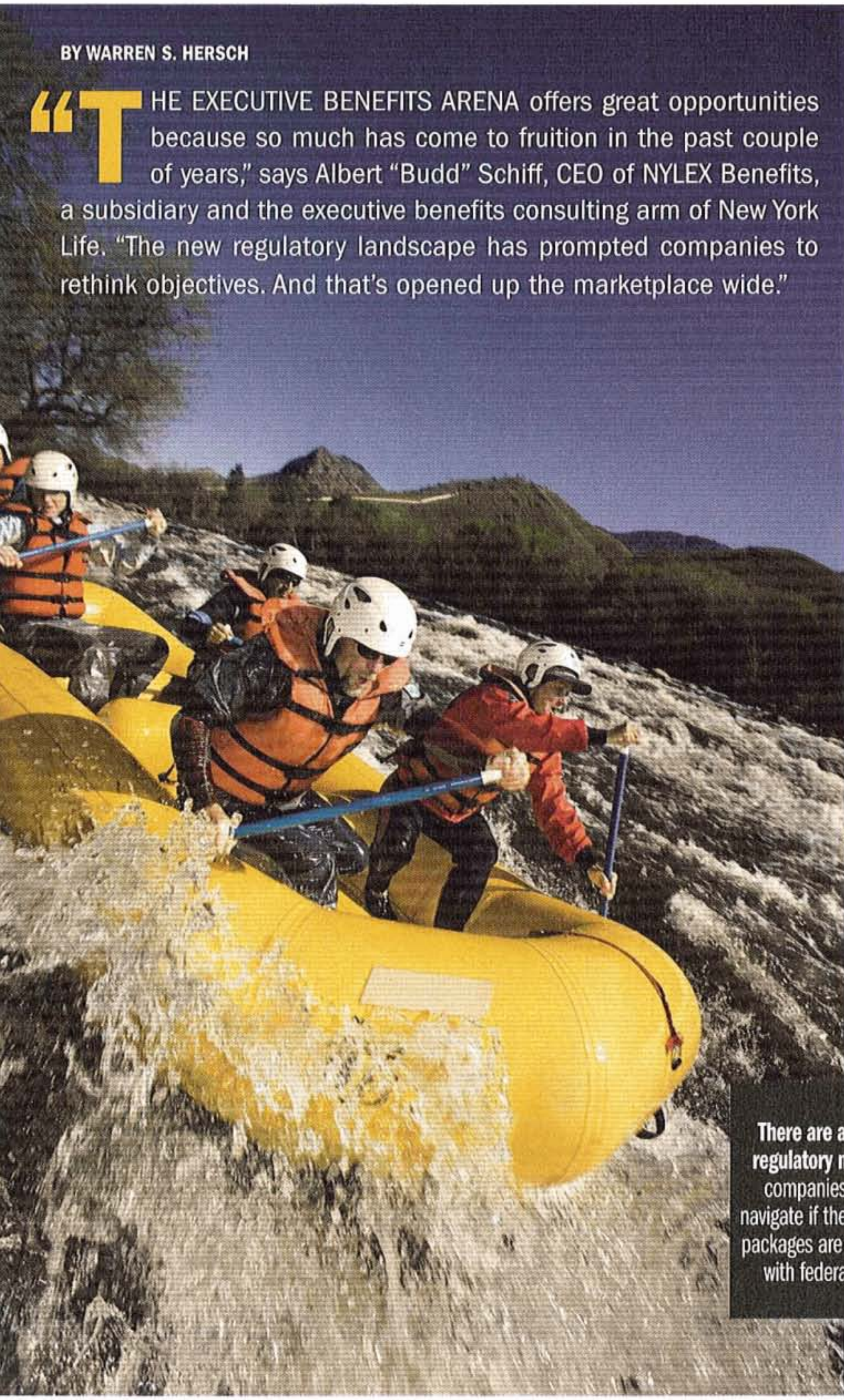
Navigating The Hazards Of The

BY WARREN S. HERSCH

"THE EXECUTIVE BENEFITS ARENA offers great opportunities because so much has come to fruition in the past couple of years," says Albert "Budd" Schiff, CEO of NYLEX Benefits, a subsidiary and the executive benefits consulting arm of New York Life. "The new regulatory landscape has prompted companies to rethink objectives. And that's opened up the marketplace wide."



Forcing that rethink, Schiff and others say, are a host of new regulatory mandates that companies will have to navigate if their executive benefits packages are to pass muster with federal authorities. Among them:

- Finalized 409A rules governing life insurance-funded non-qualified deferred compensations plans that come with a year-end compliance deadline.
- The Pension Protection Act of 2006, which imposes new notice-and-consent requirements on employer-owned life insurance policies, but also allows advisors to market new hybrid life/long term care and annuity/long term care products.
- Finalized rules from the Financial Accounting Standards Board respecting the booking of collateral assignment split-dollar life insurance arrangements.

Amid the regulatory upheaval, life insurance continues to hold a prominent place in executive benefit packages, at least among mid-size and large companies. In a survey of 271 C-level executives conducted in 2006 by Windsor, Conn.-based LIMRA International, an average of 52% of respondents at firms with 100 to 999 employees indicated they offer life insurance to key employees.

Firms mostly use the policies to informally fund deferred compensation plans, which 33% of respondents report having implemented. Less widely adopted are stock option plans (30%), long term care insurance (30%), paid financial planning services (17%) and supplemental executive retirement plans (16%) that provide a defined benefit.

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Company size and legal structure, the report adds, "clearly influence" which benefits get adopted. Executives working in the services industries, for example, are more likely to have a defined benefit plan and a non-qualified deferred compensation plan, but less likely to have a stock option plan, than is true of their

Executive Benefits Arena

counterparts at financial institutions.

Sources interviewed by *National Underwriter* note that deferred comp plans are also less likely to be adopted by small businesses than by mid-size or large firms because of the plans' generally higher administration costs and complexity relative to alternative packages. Adding to that complexity is IRC Section 409A, an outgrowth of the American Jobs Creation Act of 2004.

Finalized by the U.S. Treasury and the IRS on April 10, the rules specify events when execs can take distributions on deferred compensation (e.g., no sooner than 6 months after separation of service, death, disability or an unforeseeable financial emergency). And, certain exceptions notwithstanding, the code also prohibits an acceleration of the specified time or fixed schedule for paying benefits, as when employing "haircut distributions."

BENEFITS BY TYPE OF ORGANIZATION

PERCENT OF EXECUTIVES WITH BENEFITS

	Size of Firm			Organizational Structure					
EMPLOYEE BENEFITS	Total	100-499	500-999	1000+	Public	C-corp	S-corp	LLC	Other
▶ Retirement savings plan	93%	89%	93%	97%	92%	95%	94%	90%	91%
▶ Defined benefit pension plan	34	30	31	40	26	35	21	15	57
EXECUTIVE BENEFITS									
▶ Life insurance for key employees	52%	63%	52%	42%	42%	58%	49%	45%	59%
▶ NQDC plan	33	23	27	50	62	27	23	5	37
▶ Stock option plan	30	18	26	47	85	27	11	15	7
▶ Long-term care insurance	30	30	28	31	34	32	17	20	33
▶ Paid financial planning services	17	16	16	19	9	23	11	10	24
▶ SERPs	16	11	10	28	25	11	11	0	26

Source: Executive Benefits – A Survey of Current Trends, Clark Consulting, 2005.

Businesses that now legitimately operate beyond 409A's scope would either have to amend compensation packages by year-end 2007 to bring them into compliance or terminate them. The rules apply not only to deferred comp plans, but also to SERPs, endorsement split-dollar arrangements and plans that reimburse executives for post-retirement medical expenses.

"The final regulations are very favorable to our industry because they spell out precisely how to get money into the plan and the 6 contingent distribution events," says Richard Landsberg, a director of advanced sales at Nationwide Financial, Columbus, Ohio.

Adds Albert Kingan, an assistant vice president of estate and business planning at MassMutual, Springfield, Mass.: "If you do everything right, you won't have a problem. I really don't see the new rules impacting our ability to use life insurance in deferred comp packages. The market should be just as strong after 409A as before 409A."

Perhaps, but experts caution that companies need to ensure they have the wherewithal to administer plans so as to comply with the code—or risk steep financial penalties for failing to do so. David Herrick, a corporate vice president at The Nautilus Group, a New York Life unit that services clients of the insurer's top 200 producers, says companies that cannot manage the plans internally should look to a third-party administrator, or TPA.

(The critical importance of proper administration extends to compliance with new 101(j) rules rolled out the U.S. Treasury Department and the IRS last August as part of the Pension Protection Act of 2006. But while sources express confidence in their ability to satisfy the new code provisions, many remained concerned about still-unresolved compliance issues.)

Not everyone agrees that section 409A has had a salutary effect. Ron Merolli, an advanced sales director at National Life Group, Montpelier, Vt., says the regulations have "definitely put a damper" on the deferred comp plans because of the rules' complexity and restrictions. He says the Wilmington, Del.-based Small Business Council of America, of which he is a board member, is now pressing Congress to exempt small businesses from 409A, as well as from IRC Section 457(f), which governs deferred comp plans offered by non-profits.

"Why should legislation that was aimed at [former Enron executives] Jeffrey Skilling and Ken Lay and [former New York Stock Exchange Chairman and CEO] Dick Grasso now apply to non-profits?" asks Merolli. "The problem is the rules are too broad. They're making life difficult for business owners and their advisors."

That's true, at least, of the mid-size and large firms where most deferred comp plans reside. Small firms that have a single owner-employer and/or a few key executives tend to opt for simpler packages, notably executive bonus arrangements that are free of 409A's restrictions. Illustrative of this division in benefits planning are the experiences of NYLEX Benefits, which services firms with 50-plus employees; and The Nautilus Group, which focuses on small businesses.

Whereas, says Schiff, NYLEX is enjoying "a big surge" in demand for deferred comp plans, The Nautilus Group sells few of them. But like NYLEX, Nautilus does a robust business in IRC Section 162 executive bonus plans and restrictive endorsement bonus arrangements, or REBAs.

Under such arrangements, the employer pays the life insurance policy premium and the executive owns the contract.

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Generally easy to set up and maintain, the plans are not subject to ERISA's nondiscrimination testing rules and can be administered and terminated without IRS approval. The premiums are usually tax-deductible for the employer, and policy cash values, which the executive can secure at retirement as a lump sump or in periodic payments, grow tax-deferred.

Regulatory considerations aside, bonus arrangements can be more easily tailored than deferred comp plans to individual retirement goals and incentive packages. The most flexible of these plans, says Schiff, are funded with variable universal life insurance policies, which let the employer vary premium payments and which offer the executive a wide choice of investments.

He adds that traditional bonus plans and REBAs—bonus arrangements that come with a vesting schedule to induce executives to stay with firm for a period of years—are most widely used by small professional firms and businesses in industries that have a significant demand for certain skill sets.

Other solutions are well-suited to small businesses. David Herrick, a corporate vice president at the Nautilus Group, says the company will frequently recommend a non-qualified defined benefit plan or SERP for top-tier execs or "interim managers" who are charged with running family-owned businesses until such time as the owners' children can assume control. Alternatively, a short duration incentive plan, such as a defined contribution-based account balance plan that vests in 5 years, might be suggested to owners of a high-tech start-up who are looking to attract young workers.

"Many young executives won't want to commit to staying 20 or 30 years at a business," says Herrick. "Small entrepreneurs who are looking to attract highly paid hotshots can offer [incentive-based] golden handcuffs to compete with larger firms searching for top talent."

They can also offer other perks, including LTC and disability income insurance. Neal Sullivan, an advisor and president of Sullivan Financial Group, Mahopac, N.Y., says DI products are particularly attractive to owner-executives because they can help fund a buyout of the business in the event of a principal's disability.

The most senior executives at companies frequently enjoy employer-paid DI and LTC policies. But even if not fully subsidized, individual policies offered through an employer can often be secured at a substantial discount (typically 15% or more) off the street price. Pam Delaney, a corporate vice president of health and executive benefits at MassMutual, says individual DI, LTC and life insurance products are the "3 big sellers" among the company's voluntary executive benefit offerings.

What's selling poorly? Dick Nottingham, an advisor and president of Cape Financial, Virginia Beach, Va., says he has gravitated away from split-dollar plans (arrangements wherein premiums and policy benefits are divided between the employer and employee according to a pre-determined formula) since 2003, when new IRS and Treasury Dept. rules removed the pre-2003 favorable tax treatment of equity split-dollar plans.

Other observers point out, however, that alternative plan types, notably death-benefit-only and collateral assignment split-dollar arrangements, continue to be attractive among some businesses. They note also that these plans are exempt from 409A.

"Now that the finalized [409A] regs are out, we're starting to hear more talk about split-dollar," says Nationwide's Landsberg. "Even if structured on a loan regime or collateral assignment basis, the plans give companies leverage. And leverage works." NU

LTC RESOURCES

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scenario, the number of aging Americans receiving paid home care would more than double between 2000 and 2040, from 2.2 million to 5.3 million. The number of older nursing home residents would also more than double over the period, from 1.2 million to 2.7 million.

The institute's models show that even under the most optimistic scenario, LTC burdens on families and society in general would increase substantially in coming decades. If disability rates decrease steadily and substantially over time, the number of older adults using paid home care will increase by three-fourths between 2000 and 2040 and the number in nursing homes will increase by two-thirds.

Between 2000 and 2040, the average number of paid hours of help per frail elder will increase by about 36%, from 163 hours per month to 221 hours.

The projected increase in the intensity of paid home care, combined with the increase in the size of the frail older population, would significantly increase the total number of paid home care hours received by older Americans. Under the intermediate disability growth scenario, total paid home care hours would more than triple between 2000 and 2040. Under the high disability model, total hours would almost quadruple.

Future policy choices by national decision makers could have a big impact on how LTC arrangements actually evolve, the report notes. For instance, efforts to encourage purchase of private LTC insurance might add funding for future services and increase the use of paid care, while Medicaid and Medicare expansions could also make services more affordable.

At the same time, problems with recruiting and holding on to LTC workers could limit the availability of paid services and sharply raise costs, the report warns. NU

HOME EQUITY: SURVEY

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Why do retirement-age boomers stay put? The report cites a deep-seated attachment that many have to their house and neighborhood. Additionally, boomers are protected from potential rapid increases in rents they might face if they sold and entered the rental market. A third factor is that the house is treated favorably under Medicaid and other means-tested programs.

Dictating a sale in worst-case scenarios, the report says, is the pre-retiree's declining health, as the proceeds from the sale may be needed to fund medical, assisted living or long term care expenses.

"The home needs to be part of an advisor's financial plan," says Soto. "People should be encouraged to put money into the house, pay off the mortgage and keep the house as a safety net should they need to [access home equity] during retirement." NU