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NOLAN FINANCIAL REPORT

SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS

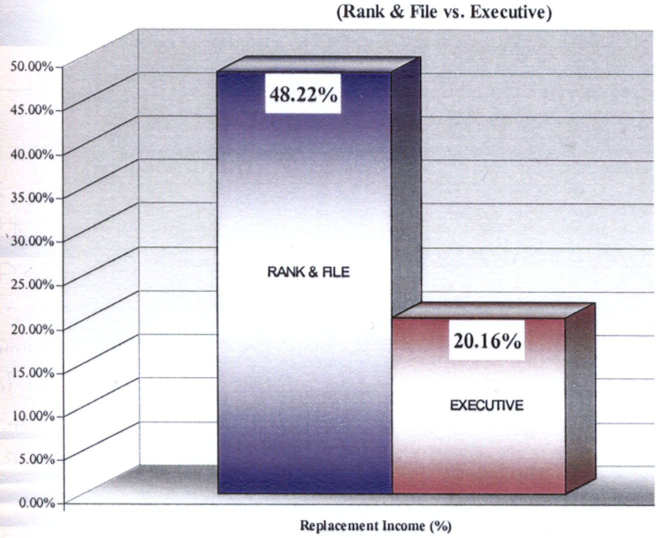
RETIREMENT TRENDS

Traditional core benefit plans such as defined benefit pension plans and 401(k) plans can't come close to providing the benefit levels that most executives and other highly compensated professionals will need during retirement. Estimates of post-retirement income levels needed to maintain pre-retirement standards of living range from 75% to 87% in studies made by a 1981 Federal commission on pension policy and a 1993 academic study by Georgia State University.

Government limits on tax-qualified retirement programs continue to erode and severely limit the retirement income levels that they can produce for highly compensated individuals as compared to rank and file employees. Some of these restrictions include:

- Limitations on 401(k) maximum contributions and matches
- A limitation on the maximum compensation that can be taken into account in qualified plans, and
- Limitations on employer contributions to defined contribution plans.

Percentage of Replacement Retirement Income
(Rank & File vs. Executive)



In recent years, executives have seen the value of their 401(k) accounts, stock options and other equity based benefits undermined by negative economic trends. More than ever, executives are looking to their employers to provide a more diversified portfolio of retirement benefits that can address the reverse discrimination generated by tax-qualified plans.

NON-QUALIFIED PLANS

Companies are increasingly turning to non-qualified plans to meet executive compensation and retirement planning needs. Non-qualified programs are flexible arrangements established for a select group of management or highly compensated employees without Federal qualified plan restrictions and limits concerning discrimination, vesting, reporting, etc. Unlike qualified plans, they do not qualify for favorable corporate tax treatment and non-qualified benefits are not secure from the claims of creditors. However, many viable and attractive approaches have been developed in recent years and many types of companies are adopting non-qualified plans.

ONE COMMON APPROACH

One way that companies correct the limitations on payments from regular pension plans is by establishing a Supplemental Executive Retirement Plan, commonly referred to as a SERP. The company decides which executives will participate, pays retirement or survivor benefits from general assets and takes a tax deduction for benefits as they are paid.

A SERP is a non-qualified plan that allows employers to provide supplemental retirement benefits to key executives beyond those provided by a qualified plan. It is an effective way for an employer to enhance an executive's retirement income to attain a certain target percentage of the executive's final average compensation.

Most employers strive to provide retirement benefits equal to at least 60% of final average compensation for senior executives.

A TARGET OFFSET SERP

A SERP may be set up to provide a percentage of compensation that is to be offset by other retirement benefits provided to the executive, such as a 401(k) match, Social Security, benefits from a qualified pension plan, etc. This is known as a Target Offset SERP. The SERP benefits may also be subject to a vesting schedule so that benefit percentage levels are based on years of service.

MECHANICS OF A SERP

The employer enters into a SERP agreement with its key executives and agrees to provide supplemental retirement income to them in return for the attainment of agreed-upon objectives. These benefits are not currently taxable to the executives because they represent only a promise to pay and they are subject to a "substantial risk of forfeiture" in the event of an insolvency of the employer.

However, when these benefits are distributed to the executive or are no longer subject to a substantial risk of forfeiture, they become tax-deductible to the employer and reportable as income to the executives.

FUNDING OF A SERP

A SERP may be either formally or informally funded with a number of different investment vehicles including:

- Mutual Funds
- Company Stock
- Individual Securities
- Corporate Owned Life Insurance (COLI)

In analyzing an employer's specific plan needs and designing a customized SERP design for corporate clients, Nolan Financial uses a sophisticated proprietary Decision Matrix to arrive at the best possible funding solution.

ADVANTAGES OF A SERP

A properly structured SERP has minimal ERISA requirements and can be offered to a select group of executives exclusively. The plan can be custom designed to meet the particular needs of an individual executive. The executive avoids the "reverse discrimination" that results from qualified retirement plans alone.

Retirement income is accumulated without current taxation to the executive and can be designed to provide an additional death benefit to the executive's heirs in the event of the executive's death.

SUMMARY

Non-qualified benefit plans including SERP's have become an integral component of executive compensation. Careful consideration of a company's philosophy, executive benefit priorities, and cost constraints, as well as discussions with experts in the field like Nolan Financial, will lead managers to the non-qualified plan decisions that will help their company stay competitive in attracting and retaining top executive talent.