John Hancock
LIFE INSURANCE

Sales Strategy

Supplemental Executive Retirement Plans

RETAIN, REWARD, AND RECRUIT

For many highly compensated executives, savings in qualified retirement plans will not be sufficient, due to qualified plan contribution and income limits. A Supplemental Executive Retirement Plan (SERP) can be a great benefit to offer highly compensated employees, because it can help alleviate worries that an employee may have about retirement income shortfalls. A SERP can be used to fill in the gap between the retirement income that highly compensated employees are eligible to save in qualified plans and the amount of retirement income that the employee needs to receive to maintain a certain standard of living in his or her post-retirement years.

Since a SERP is a non-qualified deferred compensation plan, the employer has flexibility in selecting the employees and the amount of benefits that it wants to provide for each employee. This flexibility differentiates the SERP from qualified plans. Qualified plans require participation by all "rank and file" employees and have a number of limitations, such as the amount that the employee may contribute, and the amount of total compensation that can be used to calculate retirement benefits. A SERP is desirable for many top executives because the benefits are not taxed until the employee receives the income. Moreover, SERPs can offer survivor benefits in the event of an early death.

WHAT IS A SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP)?

A SERP is an employer-sponsored, non-qualified deferred compensation plan. It allows employers to provide key, highly compensated employees with additional retirement benefits beyond those provided by qualified plans, such as a 401(k) plan. A SERP is financed with employer contributions only and is typically offered in addition to a qualified plan as a way to retain, reward, and recruit talented employees. The employee does not contribute to the plan. A SERP can also provide a survivor benefit payable to the employee's spouse upon the death of the employee.

HOW DOES IT WORK?

The employer and employee enter into an agreement that states that the employer will provide the employee with a certain amount of money at retirement. In most instances, a survivor benefit is included in the plan design. This benefit will be paid to the employee's spouse if the employee dies before retirement. A SERP may be financed in several different ways. One of the best ways is to informally fund it with a life insurance policy. A variable life insurance policy with a potential for high cash value accumulation can be a good choice for funding a SERP. The employer purchases a life insurance policy on the life of the executive and is the owner and beneficiary of the policy. The employee does not pay any costs associated with the policy.

Upon retirement, the employee will receive the deferred compensation benefit from the employer. This benefit payment may be in either a lump sum or in a series of installments. The employer will use the policy cash value to recover its cost of the benefits. The employee will pay ordinary income taxes on the benefits received, and the employer may take an income tax deduction on the benefits. The plan terminates upon the death of the executive and the employer then receives the death benefit of the life insurance policy. The policy death benefit is used to recover the employer's cost of implementing the plan.

BENEFITS

- **Flexibility for Employers.** Employers can select which employees will participate in a SERP and how much they will contribute to the plan.
- **Supplemental Income for Key Employees.** A SERP can be used to supplement qualified plan savings with additional retirement income for highly compensated executives.
- **Tax-Deferred Growth.** If a SERP is informally funded with life insurance, the policy cash value will grow tax deferred.
- **Tax Deduction for Employer.** When benefits are paid to the employee, the employee will recognize taxable income and the employer should receive an income tax deduction. The employer should receive the policy death benefit free of income tax.[1]
- **Wide Range of Investment Options.** John Hancock's variable life insurance policies such as Accumulation VUL offer a diversified array of separate account options that covers nearly every major asset class and investment style, managed by some of the nation's leading asset managers.

CONSIDERATIONS

- **Full Taxation of Benefits.** Once an employee has "constructive receipt" of deferred compensation benefits, the entire benefit may be included in his/her taxable income.
- **Informal Funding and Creditors Claims.** To avoid the majority of ERISA requirements, SERPs should not be formally funded (i.e., plan assets should remain part of the general assets of the employer and may be subject to the claims of corporate creditors.)
- **Must Meet 409A and COLI Best Practices Requirements.** SERPs will need to comply with Sections 409A and 101(j) of the tax code.
- **Avoid Creating a MEC.** Policies classified as MECs may be subject to tax when a loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½. Therefore, life insurance purchased for a SERP should not be structured as a MEC.
- **Policy Charges.** Variable life insurance policies have charges associated with them, including withdrawal charges, cost of insurance charges, and investment management charges. Your clients should consult the prospectus of the specific variable life insurance product offered for a detailed explanation of all charges and fees.
- **Death Benefit Reduction.** Withdrawals and loans can reduce the policy death benefit and cash surrender value and may cause the policy to lapse. Lapse of a life insurance policy can cause the loss of the death benefit and potential adverse income tax consequences.
- **Cash Value Not Guaranteed.** Cash values are not guaranteed if the client is invested in the investment accounts. There are risks associated with each investment option, and the policy may lose value.

INFORMALLY FUNDING A SERP WITH LIFE INSURANCE

A SERP may be funded a number of different ways. It may be financed with mutual funds or marketable securities, or funded only from the employer's balance sheet. However, by paying from the company's existing assets, the company may be strapped for cash if a number of employees retire at the same time. When a SERP is financed with mutual funds or securities, the employer has to pay tax on the income earned each year. However, when an employer elects to informally fund a plan with life insurance, they receive all the tax benefits of a life insurance policy. The potential cash value grows tax deferred; thus more of the cash value will be available to recover cost. The employer is able to take loans and withdrawals from the policy on a tax-deferred basis and the employer receives the death benefit free from any income taxes.

CASE STUDY: ISABELLA WILLIAMS

Isabella Williams (age 45, Preferred Non Smoker) is a Senior Vice President of Research and Development at Erie Enterprises, a manufacturer of auto parts. Erie Enterprises is very pleased with Isabella and wants to ensure that she remains with the company. Isabella's projected compensation (salary and bonuses) when she retires in 20 years will be $379,043. Erie Enterprises promises to pay Isabella a SERP benefit of 50% of her salary at retirement, or $189,522, for 15 years. With Isabella's consent, Erie will then apply for a $1,839,073 Accumulation VUL policy on Isabella's life, with a premium of $51,566 a year.[2] Erie also agrees to pay Isabella's heirs a death benefit of $2,000,000 should Isabella die before retirement.

Based on gross growth rate of 6% (5.26% net) and current charges, Erie will be able to take loans and withdrawals from the policy to pay Isabella her benefit. Upon Isabella's retirement, Erie Enterprises will use this policy to recover their costs on the SERP plan. They will not have any additional out-of-pocket costs. Erie will be able to take advantage of the tax-deferred accumulations of life insurance cash values, and upon Isabella's death will receive the entire death benefit free from income taxes.

Year	Policy Premium	Retirement Benefit	After-Tax Cost of Retirement Benefit	Loans/ Withdrawals	Corporate Tax Savings	Net Policy Cash Surrender Value	Net Death Benefit
1	$51,566	$0	$0	$0	$0	$17,617	$1,882,879
10	$51,566	$0	$0	$0	$0	$577,090	$2,416,163
20	$51,566	$0	$0	$0	$0	$1,578,059	$3,293,548
21	$0	$189,522	$123,189	$123,189	$66,333	$1,525,791	$3,170,359
25	$0	$189,522	$123,189	$123,189	$66,333	$1,286,628	$2,677,603
30	$0	$189,522	$123,189	$123,189	$66,333	$905,701	$2,053,250
35	$0	$189,522	$123,189	$123,189	$66,333	$380,814	$1,346,317

This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration and appropriate prospectuses. The data shown is taken from an illutration, the purpose of which is to show how the performance of the underlying investment accounts could affect the policy cash value and death benefit. It assumes a hypothetical rate of return and/or current interest crediting rate and may not be used to project or predict investment results. Unless indicated otherwise, these values are not guaranteed. At 0% and gross maximum charges, the policy will lapse in year 25.

Tax and ERISA Consequences

The possible application of ERISA should be considered for all non-qualified executive benefit plans, including a SERP. In most instances, a SERP may be exempt from most ERISA requirements as a "top hat" plan. A plan may qualify as a top hat plan if it is created for the purpose of providing deferred compensation for select management or highly compensated employees.[3] A top hat plan must be in writing and a written plan document must be filed with the Department of Labor within 120 days. Qualification of a SERP as a top hat plan must be considered on a case-by-case basis.

In addition to ERISA considerations, Section 409A of the Internal Revenue Code can apply to any non-qualified plan that provides for the deferral of compensation. If a Deferred Compensation Plan does not comply with Section 409A, a participant(s) income may be subject to immediate income taxation, as well as interest and a 20% excise tax on the taxable income. Section 101(j) of the tax code (also known as COLI Best Practices) can also apply to a SERP and unless all of the requirements of Section 101(j) for an employer owned life insurance policy are met, a portion of the death benefit may be subject to income tax.

Summary

A SERP is an excellent addition to an incentive compensation package. A SERP may be combined with a qualified plan benefit, and the employer can reward, retain, and recruit key, highly compensated employees by supplementing retirement income. SERPs may be illustrated in the JH Solutions Business Planning Series.

For more information on SERPs or JH Solutions, please contact your local John Hancock representative or call the Advanced Markets Group at (888) 266-7498, option 3.

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1. Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are a few exceptions such as when a life insurance policy has been transferred for valuable consideration. Comments on taxation are based on John Hancock's understanding of current tax law, which is subject to change. No legal, tax or accounting advice can be given by John Hancock, its agents, employees or registered representatives. Prospective purchasers should consult their professional tax advisor for details.
2. Based on Female, Preferred Non Smoker age 45, living in Ohio. Annual premium of $51,566 will be paid for 20 years. At 5.26% net and current charges, the policy will remain in force until age 120.
3. Before implementing any non-qualified deferred compensation plans, the possible application of ERISA (Employee Retirement Income and Security Act of 1974) should be considered. Please contact your financial and tax advisor for more information.

Insurance policies and/or associated riders and features may not be available in all states.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

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