



 **BIOCOM** *Executive Suite*  
WEBINAR SERIES

*Brought To You In Partnership With*



**RetirementDNA**

Mapping Retirement & Executive Benefits For Biotech and Life Sciences Leaders

RETIREMENT PLANS ■ EXECUTIVE DEFERRED COMPENSATION ■ COMPENSATION CONSULTING

**Plan Design Strategies To Maximize  
Benefit Security & Retirement Income**

***A Non-Qualified Deferred Compensation Plan  
Benefit Security Primer  
For BIOCOM Members***

October 12, 2006

# RetirementDNA

Mapping Retirement & Executive Benefits  
For Biotech and Life Sciences Leaders

RETIREMENT PLANS ■ EXECUTIVE DEFERRED COMPENSATION ■ COMPENSATION CONSULTING

## Retirement & Executive Benefits Services To Match Your Corporate Lifecycle

Start-Up Companies

GO

Private & Growing Companies

GO

Public Companies

GO

### Spotlight On Science

#### Joe Panetta

Chief Executive Officer  
BIOCOM

Leading the premiere biotech and  
life sciences association representing  
450 member companies in  
San Diego and Southern California.



### Discovery Abstracts

Understanding Non-Qualified  
Deferred Compensation (NQDC)

 **BIOCOM** A Proud BIOCOM Member

Lead Program Sponsor



# About Retirement DNA

## Recruit. Reward. Retain.

Services We Offer To The Biotech & Life Sciences Sector:

- Company Sponsored Retirement Programs
- Executive Benefits and Deferred Compensation
- Compensation Consulting

# Today's Topic

**Plan Design Strategies To Maximize  
Benefit Security & Retirement Income**

***A Non-Qualified Deferred Compensation Plan  
Benefit Security Primer  
For BIOCOM Members***

Daniel T. Dubois  
Managing Partner & Senior Consultant  
RetirementDNA

## What We'll Cover Today

- ' Why Even Consider A Deferred Compensation Plan
- ' How Non-Qualified Deferred Compensation (NQDC) Plans Work
- ' How Do Executives Know They'll Receive Their Money: Benefit "Insecurity" Issues
- ' The BRIDGE Plan: Benefit Security & Unlimited Contributions
- ' BRIDGE: Income During Retirement
- ' Questions & Answers

## Why Consider A Non-Qualified Deferred Compensation Plan

“Your employees are not your best assets. Your best people are your best assets. Everyone else is cannon fodder”

- Dick Marcinko

The Rogue Warrior

Legendary Navy SEAL Commander

## Why Consider A Non-Qualified Deferred Compensation Plan

- ' Your best and most highly compensated people need to save money for retirement, college and other financial needs
- ' The 401(k) plan is usually inadequate as a retirement and tax savings strategy for highly compensated executives
- ' \$15,000 deferral amount in 2006 may only replace a small amount of retirement income for your high earners
- ' The 401(k) plan could be as insignificant as Social Security to a high earning executive
- ' The result is a substantial “income replacement gap” for high earners
- ' When properly designed, they can be powerful “Find, Win, Keep” plans to attract the best and brightest

## How NQDC Plans Work: Basics

- ' Qualified vs. Non-Qualified plans
- ' Retirement plans deemed to be “qualified” under ERISA include the 401(k) plan; ERISA plans offer complete protection from creditors
- ' Qualified plans have contribution limits - \$15,000 in 2006 (\$20,000 for age 50+)
- ' Non-discriminatory guidelines as well as a host of other ERISA compliance issues
- ' Note: qualified plans are really reverse discrimination for high earners because they limit their savings ability!
- ' How to address the problem created by ERISA for high earners?

## How NQDC Plans Work: Basics

- ' Sponsoring a NQDC plan allows high earners to save more
- ' Non-qualified plans are not subject to the filing, funding or fiduciary responsibilities under ERISA
- ' Provides executives with a “non-qualified” savings plan
- ' Allows executives to defer a portion of salary, bonus and other compensation in excess of the 401(k) limits; IRC allows unlimited funding of NQDC plans
- ' The allowable deferral amount – X% of salary and Y% of bonus - is set by the company and is part of the plan design process
- ' Best Practice: 80% - 90% of salary and 100% of other comp

## How NQDC Plans Work: Tax Issues

- ' The participant in a NQDC plan is not taxed on the amounts deferred until the money is received by them
- ' The company sponsoring a NQDC plan cannot take a compensation expense deduction at the time of the deferral by the executive
- ' The company instead books a deferred tax credit equal to the amount deferred and takes a deduction when the deferral amount is paid to the executive
- ' The company also records the deferral as a liability on its balance sheet
- ' The executive, of course, has an asset, equal to the company's liability

## The Unfunded Requirement of NQDC Plans

- ' NQDC plans have to be unfunded plans
- ' “Unfunded” means that all money deferred by a participant becomes a general account asset of the company and cannot be set aside to “guarantee” the plan’s future obligations
- ' If the company goes bankrupt or insolvent, the amounts deferred by plan participants are subject to the “claims of the creditors” as company assets
- ' Contrast this with 401(k) assets – as a “qualified” plan, assets in the plan have ERISA protection and cannot be used by company creditors

## The Unfunded Requirement of NQDC Plans

- ' The “unfunded” aspect of NQDC plans is the reason for its tax-deferred status (risk of forfeiture by executive and lack of constructive receipt) for participants
- ' The exposure of plan assets to general creditors is why only highly compensated employees may participate
- ' The Department of Labor has determined that highly compensated employees must be intelligent and therefore can understand the trade-off between tax-deferral and asset risk on deferrals
- ' This is the tipping point for executives – are my deferrals secure?

## “Informally” Funding NQDC Plans

- ' Companies try to provide some benefit security comfort to executives by “informally” funding plans to match assets and liabilities
- ' Informal funding refers to the company investing participant deferrals (company asset) to try and match the liability to its executives; an asset / liability management strategy
- ' Even when a company invests and informally funds the NQDC plan, these assets are still subject to creditor claims – even if held in a Rabbi Trust with the Moglia language
- ' Where does this leave executives?
- ' Two roads diverged in a yellow wood and I took the one ...with better benefit security but lower contributions or the one with lower security and higher contributions?

# The Challenge For Executives

- ' **401k Contributions**

  - Pre-tax contributions

  - Low contribution limits reduces value for retirement income

  - Assets are segregated and fully funded

  - Assets are protected from creditors

- ' **NQDC Plan**

  - Pre-tax contributions (no income tax on deferral amounts)

  - Unlimited contributions

  - Assets are not segregated and are unfunded

  - Assets are exposed to corporate (and individual) creditors

## The BRIDGE Plan

- ' Bridging the Retirement Income Deficit Gap for Executives
- ' A plan that provides complete benefit security and unlimited contributions
- ' A fully-funded plan with assets that are segregated for the executive
- ' BRIDGE Plan assets are ERISA protected and exempt from creditor claims
- ' The ERISA protection of a 401k plan with the unlimited contributions of a NQDC plan
- ' Tax-deductible by the company and income taxable for the executive

## The BRIDGE Plan: Contributions

- ' After-tax contributions are made into the BRIDGE plan
- ' \$100,000 of taxable bonus; \$30,000 paid in taxes; \$70,000 net available for BRIDGE
- ' BRIDGE Plan loans back the \$30,000 lost to taxes to allow for a full \$100,000 contribution; pre-tax level funding
- ' After-tax contribution plus a loan is also how most real estate investments are made
- ' Theoretically identical to how a 401k plan works
  - ↳ 401k – Government makes \$4,500 loan until retirement (30% in taxes deferred on a \$15,000 contribution)
  - ↳ BRIDGE – Plan makes \$30,000 loan until retirement (30% in taxes on a \$100,000 bonus)

## The BRIDGE Plan: Why After-Tax?

- ' Pre-tax contributions are not always a better strategy
- ' Growing belief in the financial planning world that passing up on a tax-deduction today in exchange for a more valuable tax-benefit later – tax-free withdrawals during retirement – is a better deal
- ' Roth IRA and the new Roth 401k plan are two examples
- ' After-tax funded retirement plans provide protection against a very real retirement risk – higher income tax brackets on income during retirement
- ' Are income tax rates low today in light of Medicare and Social Security deficits that will likely get plugged with higher taxes?
- ' Rates have been trending down since the 1950s (90% top marginal rate in 1952); where are the next 50 years going?

## The BRIDGE Plan: Investment Choices

- ' BRIDGE provides participants with complete control over their account
- ' Access to separate account portfolios called “sub-accounts” run by leading investment managers such as Fidelity, Franklin Templeton, Vanguard, American Funds and more
- ' Over 50 investment options allow for personalized asset allocation
- ' Dividends, interest and capital gains earned from the sub-accounts are credited directly to the participants account without any current taxation
- ' Identical to the tax-deferred accumulation of a 401k or NQDC plan

## The BRIDGE Plan: Retirement Options

- ' Flexible planning options upon reaching retirement
- ' Option 1: Lump-sum payment based on the cash value of account
- ' Option 2: Non-taxable retirement income each year; executive could take the money over 5, 10, 15, 20 or 25 years
- ' Option 3: Non-taxable death benefit (well in excess of account value)
- ' Option 4: Any combination of the above
- ' More flexible than either a 401k or a NQDC plan
- ' No required minimum distributions at age 70 \_

## The BRIDGE Plan: How Does It Deliver Its Tax Benefits

- ' How are the tax-benefits delivered on the BRIDGE Plan?
- ' The investment engine of the BRIDGE Plan is an institutionally priced, specially designed VUL (variable universal life) insurance policy
- ' VUL is the primary funding choice for Fortune 500 NQDC plans (Source: Clark Consulting)
- ' The special VUL policy is available only to business entities; individual customers cannot but the policy
- ' Priced and structured to address the needs of a corporate buyer
- ' VUL policy offers the initial loan to offset the taxes, the investment choices, the tax-free loans for retirement income and the tax-free death benefit

## The BRIDGE Loan

- ' Policy loans of up to 50% available, secured against the death benefit; assuming that the policy is held to maturity
- ' \$70,000 After-Tax Contribution
  - Can borrow \$30,000 from policy to create power of pre-tax contributions to help offset the impact of taxes on the salary or bonus
  - Can borrow \$30,000 from an alternative lending source to create power of pre-tax contributions
  - Can contribute just the \$70,000 without the borrowing (comparable to a Roth 401k with higher contribution limits and a death benefit)
- ' Interest rate on policy loan is based on LIBOR + 1.5%; currently about 6.9% (5.4% LIBOR + 1.5%)
- ' Policy loan is non-recourse and no requirement to pay prior to taking non-taxable distributions

## The BRIDGE Plan: Company Perspective

- ' Creates no liability for the company so there is no impact on the firm's future financial condition as is the case with a NQDC plan or SERP plan
- ' No requirement to comply with Section 409A
- ' No need to wait 30 – 40 years to recover the cost of the plan as is the case with a NQDC plan funded with VUL
- ' Provides executives with a secure, ERISA protected asset off limits to company creditors – an attractive Find, Win, Keep benefit for top talent
- ' No ongoing administration or recordkeeping services – participants self-direct their accounts online as they would handle their 401k plan

## The BRIDGE Plan: Company Perspective

- ' Very low costs for sponsoring the plan as compared to other benefit programs
  - One-time set-up fee of \$2,500
  - \$5,000 annual fee
  - \$225 annual participant fee (TPA costs)
- ' All contributions to the plan – both the executive's contribution and any additional company contributions – are tax-deductible
- ' This could be offered in addition to a 401k and a NQDC plan; analogous to offering executives a 401k and a Roth 401k; they have the flexibility to decide the most appropriate way to save while also weighing tax strategy and benefit security issues

## Designing A Plan: Considerations

- ' Some key questions
  - \_ Who is it for and what is the purpose? Multiple purposes?
  - \_ Employee deferral or employer contributions? Or both?
- ' Common purposes for the BRIDGE Plan are:
  - \_ Finding and winning key employees
  - \_ Retaining key employees
  - \_ Rewarding key employees
  - \_ Incentive for key employees
- ' BRIDGE can serve all four, but it is helpful to rank your company's priorities

## Designing A Plan: Considerations

- ' A company may have multiple different BRIDGE plans
- ' Deferral only program for middle management
- ' SERP design for senior management or just the CEO and a smaller group
- ' A single plan can also have multiple classes of participants with different restrictions
- ' The key is to go through a comprehensive process for designing and/or reviewing an existing plan
- ' DeferredCompAudit is our process
- ' Guarantee that if a plan has not been reviewed in the last two years, we'll find savings or opportunity for improvement or all consulting fees are reimbursed

## Summary

- ' High earning employees need to save for their goals and tax-deferral is a powerful incentive
- ' NQDC plans allow for executives to save at a high level, but they do create a benefit security risk as their deferrals are a company asset
- ' With the BRIDGE Plan, the executive is not a general creditor of the company and enjoys ERISA protection
- ' BRIDGE provides investment flexibility, tax-deferral on plan earnings, non-taxable distributions and a non-taxable death benefit
- ' Company has no balance sheet liability
- ' Company receives current tax deduction for contributions

# Additional Resources

[www.biocom.org](http://www.biocom.org)

## RetirementDNA

Mapping Retirement & Executive Benefits For Biotech and Life Sciences Leaders

RETIREMENT PLANS ■ EXECUTIVE DEFERRED COMPENSATION ■ COMPENSATION CONSULTING

[www.retirementdna.com](http://www.retirementdna.com)

Dana Tennis or Dan Dubois

**800.423.4891**

 **BIOCOM** *Executive Suite* WEBINAR SERIES

Presented by BIOCOM and RetirementDNA

## **Carving Out Executives for Other Key Benefits**

**November 9, 2006 11:00-12:00**

- \_ Executive Long Term Care Insurance
- \_ Executive Disability Insurance
- \_ Deferred Compensation

***Register Today***

**[www.retirementdna.com](http://www.retirementdna.com)   or   [www.biocom.org](http://www.biocom.org)**

## Important Information

Investors should consider the investment objectives, risk and charges, and expenses of the contract and underlying investment options carefully before investing. The prospectus contains this and other important information about the investment company and may be obtained by contacting RetirementDNA / Retirement Strategies Group at 800-423-4891. You should read the prospectus carefully before investing and call us with any questions you may have.

The BRIDGE Plan is offered exclusively through RetirementDNA alliance firms. RetirementDNA is affiliated with Brecek & Young Advisors, Inc., an NASD member firm, and ProEquities, an NASD member firm.