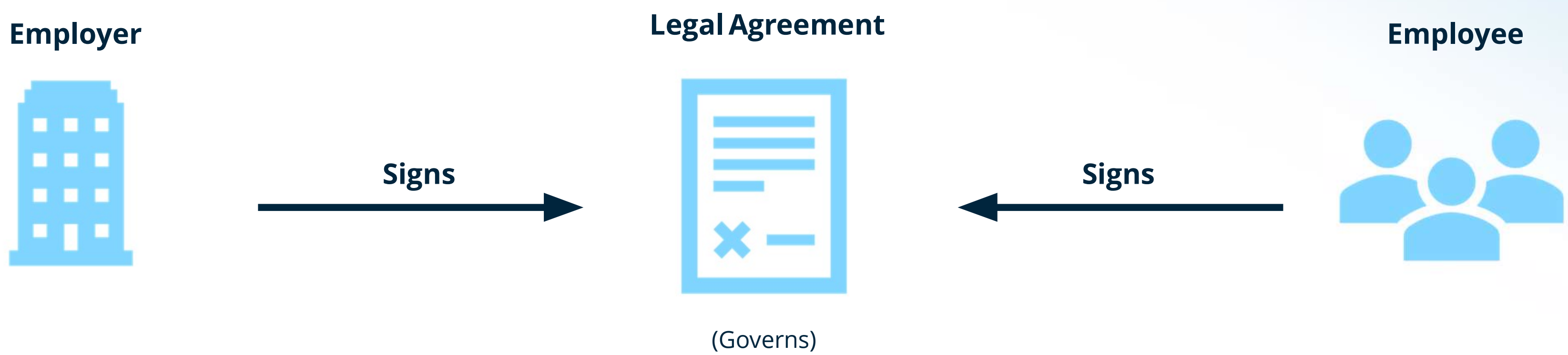
EXECUTIVE BENEFITS PLANNING

PRESENTED BY MODERN CAPITAL EXECUTIVE SOLUTIONS

SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS FOR NON-PROFITS

Employer Funded | IRC 457(f)



Defined Contribution (DC)

- Employer either makes an upfront investment, or defines an annual contribution
- Employee benefit(s) equal to earnings on the upfront investment, or annual contributions plus any stated earnings, to be paid out in a lump sum at a future benefit date(s)
- Employer expenses benefit(s) annually, as required under GAAP
- Employer has OPTION to purchase investment(s) to offset annual expense accrual with annual contribution option
- Employee fully vests on stated payment date(s), and is paid stated benefit(s) at that time
- Employee pays ordinary income and FICA tax on benefit(s) when vested, and uses net proceeds as they deem appropriate
- With upfront investment option, principal retained by Employer

Defined Benefit (DB)

- Employer defines stated benefit(s) to be paid at stated future payment date(s)
- Employer expenses benefit(s) annually, as required under GAAP
- Employer has OPTION to purchase investment(s) to offset annual expense accrual
- Employee fully vests on stated payment date(s), and is paid stated benefit(s) at that time
- Employee pays ordinary income and FICA tax on benefit(s) when vested, and uses net proceeds as they deem appropriate

With either option (DC or DB), the goal of the investment is a
$0 cumulative net impact to the Employer's bottom line at the time of the final benefit payment to Employee

457(F) | Overview

A 457(f) plan is a legal arrangement where the executive receives deferred compensation according to the terms of the agreement, generally targeting a retirement date. An investment product may be logically associated with the benefit, often called a “deemed account”, however, the arrangement always remains “unfunded” and is paid from the general assets of the employer upon the “date of constructive receipt.”

457(f) plans are subject to IRC 409A and are highly restrictive in terms of the ability to move the date of constructive receipt. At a high level, a 457(f) plan can constructed in two ways: (1) a Defined Benefit Plan, or (2) a Defined Contribution Plan. There are many variations inside each construct and there are many ways to combine elements of both plan constructions.

1) A “Defined Benefit 457(f)” plan is constructed by the employer promising a set dollar value or formula for determining a dollar value (such as percent of final salary) upon retirement then expensing that amount between plan start and plan end while accruing it as a liability. The liability pays out to the executive on the “date of constructive receipt” as regular income. The employer invests in a portfolio that earns a high rate of return with the goal of offsetting all the expenses in the plan. The employer bears market risk.
2) A “Defined Contribution 457(f)” plan is constructed by the employer contributing an amount to the plan for the benefit of the executive that is expensed and accrued as a liability. The liability pays out to the executive on the “date of constructive receipt” as regular income. The employer invests in a portfolio that earns a high rate of return with the goal earnings adding to the future benefits of the plan (lowering the effective rate of return to the employer). The executive bears market risk on the earnings and the Non-Profit bears market risk on the contribution amount.
   a) An “Earnings Only” plan is constructed by defining the contribution to the plan as “all the earnings on a specified portfolio” (or portion thereof). All (or part) of the earnings from the portfolio accrue as a liability of the employer to the benefit of the executive(s). The executive bears market risk on the amount over the deposit.
   b) A “Money Purchase” plan contributes a set amount or set percent of income (or other formula) each year into the plan as an expense of the employer that accrues as a liability in favor of the executive. The employer uses an investment portfolio to offset costs. The earnings on the contribution may or may not accrue to either the executive or to the employer.

457(F) | Overview

If properly designed and funded, each option has some probability to yield no net accounting cost but all will have lost opportunity cost to the employer (usually the employer will earn a net 0% on the investment).

The agreement must contain a “substantial risk of forfeiture” from the inception date until the designated date of payment. If the executive were to leave prior to attaining the specified date, other than for change of control, death, or disability, or sometimes involuntary termination, that person would forfeit all benefits payable. If the executive retires early or resigns, they will receive nothing. A 457(f) plan is a “top hat” plan that can only be used for “select management or highly compensated employees.”

On the “date of constructive receipt” the executive is taxed on the total lump sum, regardless of the method of payout, and this cannot be deferred with few exceptions. The IRS has stated that taxation occurs when the “substantial risk of forfeiture” has lapsed thereby creating constructive receipt and taxation occurs on the entire amount. This effectively prevents any vesting in the plan aside from 100% “cliff vesting.” The payment is deemed to be ordinary income and is subject to FICA, FUTA, State and Local taxes. This requires that a Non-Profit wishing to provide retirement income essentially “gross up” the additional taxes.

Section 409(A) prevents “market timing.” The “date of constructive receipt” must be moved at least 2 years in advance and be moved out at least 5 years and the number of moves is extremely limited.

The investment is a general asset of the employer subject to the creditors of the employer in the event of a conservation, bankruptcy, or insolvency. If the investment market value changes, all changes are “marked to market” directly to the income statement[1].

[1]FASB eliminated “Available for Sale Securities” booking against “unrealized gain/loss” equity accounts in ASU 2016-01 for fiscal years starting in 2018.

Employer Funded | Collateral Assignment Split Dollar (IRC 7872)

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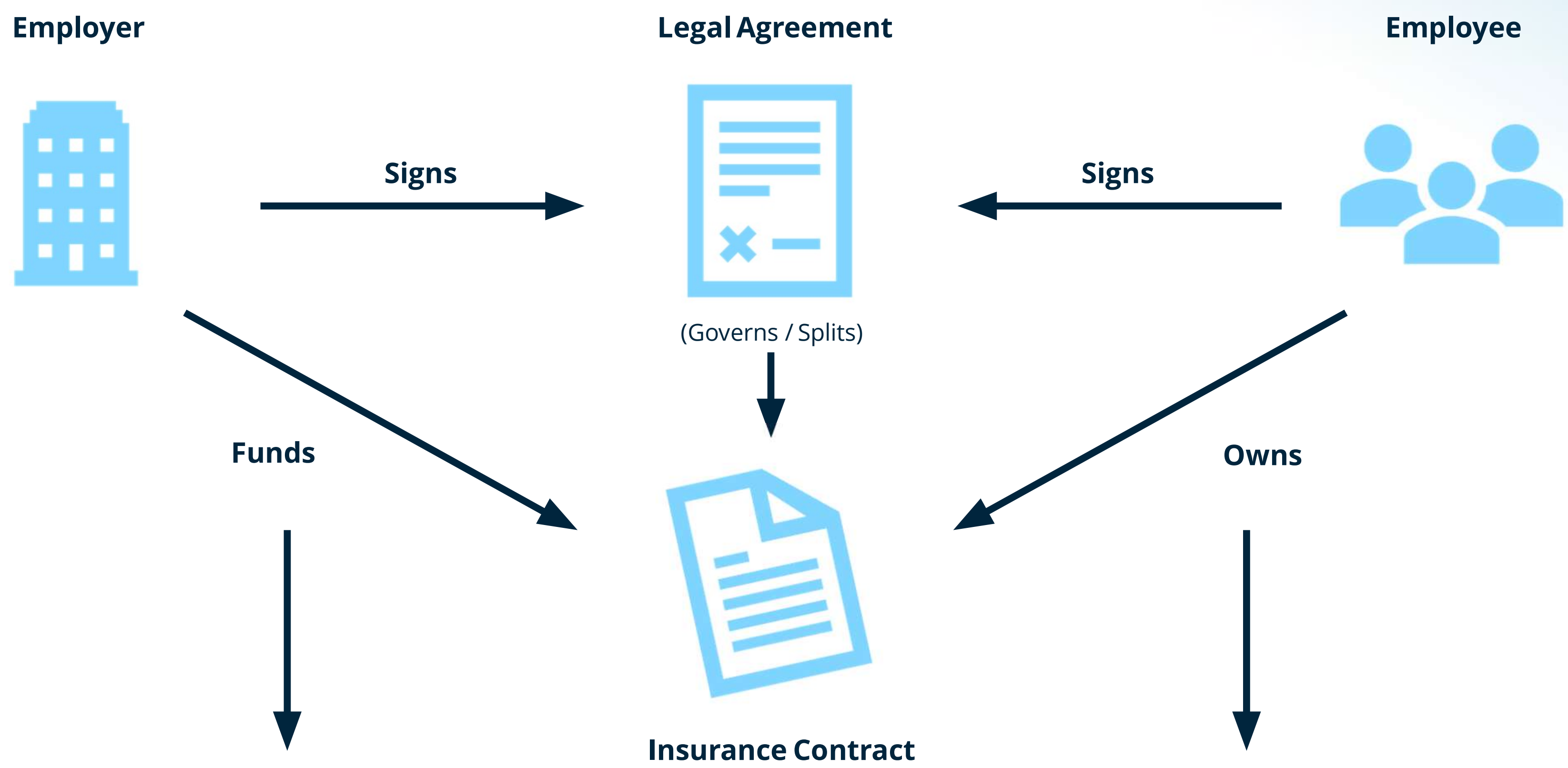

Component #1 (Employer)

- Policy has enough death benefit to repay investment + interest at all times
- Interest on investment accrues each year set at Long-Term Applicable Federal Rate (AFR), or higher
- Plan ends upon Employee/Insured death; death proceeds repay Employer its investment + interest, plus any excess death benefit as defined

Component #2 (Employee)

- Vesting schedule and benefit start date(s) govern when Employee can access policy for income and how much income is available
- Upon vesting and reaching access date(s), Employee has flexibility as to when and how income is taken
- All income is received tax-free
- Upon Employee/Insured death, tax-free death benefit as defined is paid to Employee's designated beneficiary

Collateral Assignment Split Dollar | Overview

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A Collateral Assignment Split Dollar (CASD) program is constructed with an investment structured as a loan governed under IRS §7872.15 to fund a life insurance policy and/or annuity owned by the executive with repayment plus interest to the Non-Profit. CASD plans are subject to IRS guidelines and represent a powerful complement to executive recruiting, retention, and reward while providing full cost recovery to the Non-Profit.

CASD Plan Description

- The Non-Profit invests in the plan, nominally structured as a loan to achieve tax and accounting advantages for both the executive and the Non-Profit.
- The investment purchases a specialized life insurance policy and/or annuity owned by the executive.
- The rights in the policy and/or annuity, including cash values, are assigned to the Non-Profit with an agreement and vesting schedule that limit the executive's access to cash values in the policy and/or annuity and protects the credit union's interest in the investment.
- During retirement, the executive has the right to draw excess cash value earnings from the policy.
- On the eventual death of the executive, the investment plus interest is repaid from the "split" death benefit.

CASD Plan Features

- The Non-Profit pays the premiums of the policy to the insurer via the annuity and the premiums are treated as an investment of the Non-Profit in a note made by the executive.
- Nominally, for IRS and accounting purposes, the executive signs an interest-bearing promissory note with recourse and assigns the policy as collateral. This creates accounting benefits for the NP and tax benefits for the executive while the executive and NP are protected from losses by the master agreement.
- The master agreement stipulates vesting and functional ownership the executive has in the plan including access to cash values, so the NP is protected under all employment termination scenarios.
- The premiums paid are reflected as a Credit to Cash, with a corresponding Debit to Other Investments Assets: A "wash" for accounting purposes. • The Non-Profit recognizes interest income on the investment booked as an accrued asset.
- The Non-Profit is guaranteed repayment by the death benefit of the life insurance and the cash values contained in the policy.
- If the investment return on the note (note interest rate) is "below market rate" tested using IRS rules under section 7872.15 then "Imputed Interest" is added to the executive's W-2/1099 as taxable income. However, the executive has the right to withdraw cash values from the policy to offset any tax burden creating no cost / obligation for the Non-Profit.

Collateral Assignment Split Dollar | Overview

Key Benefits

- The executive enjoys life insurance protection and meaningful retirement income from the policy
- The Non-Profit establishes a strong executive incentive, retention, and recruitment program
- The Non-Profit has no net cost by earning interest with guaranteed principle & interest repayment
- The Non-Profit has minimal administrative and reporting requirements
- The Non-Profit enjoys key person life insurance protection during the early years of the plan

Overview of Policy Mechanics

1. The Non-Profit makes an investment in the plan structured as a loan to the executive. This is a fixed rate interest earning investment accounted as credit to “Other Assets” and debit to “Other Investments” so there is no net expense and a net positive impact to the bottom line. The interest rate that can be earned is capped at the long term average “cost of funds” which, if set at the IRS’s Long Term Applicable Federal Rate (AFR), eliminates executive taxation.
2. The investment amount is paid directly to the insurer to purchase a specialized whole life insurance policy and/or a guaranteed annuity to pay the premiums, both are owned by the executive and collaterally assigned to the Non-Profit.
3. The policy and annuity is “collaterally assigned” as the backing for the investment and a “Split Dollar Agreement” governs the plan so the Non-Profit will always recover the investment plus interest in every scenario.
4. The executive can draw the cash values in excess of the collateral value from the insurance policy, tax free, to fund retirement income. Additionally, the executive can draw any tax consequence from the plan as a result of interest income, if any.
5. Upon the executive’s eventual death, the Non-Profit is repaid in full (investment principal plus accrued interest) and any remaining death benefit, after repaying the Non-Profit, would be payable to the executive’s personal beneficiary.

Collateral Assignment Split Dollar | Overview

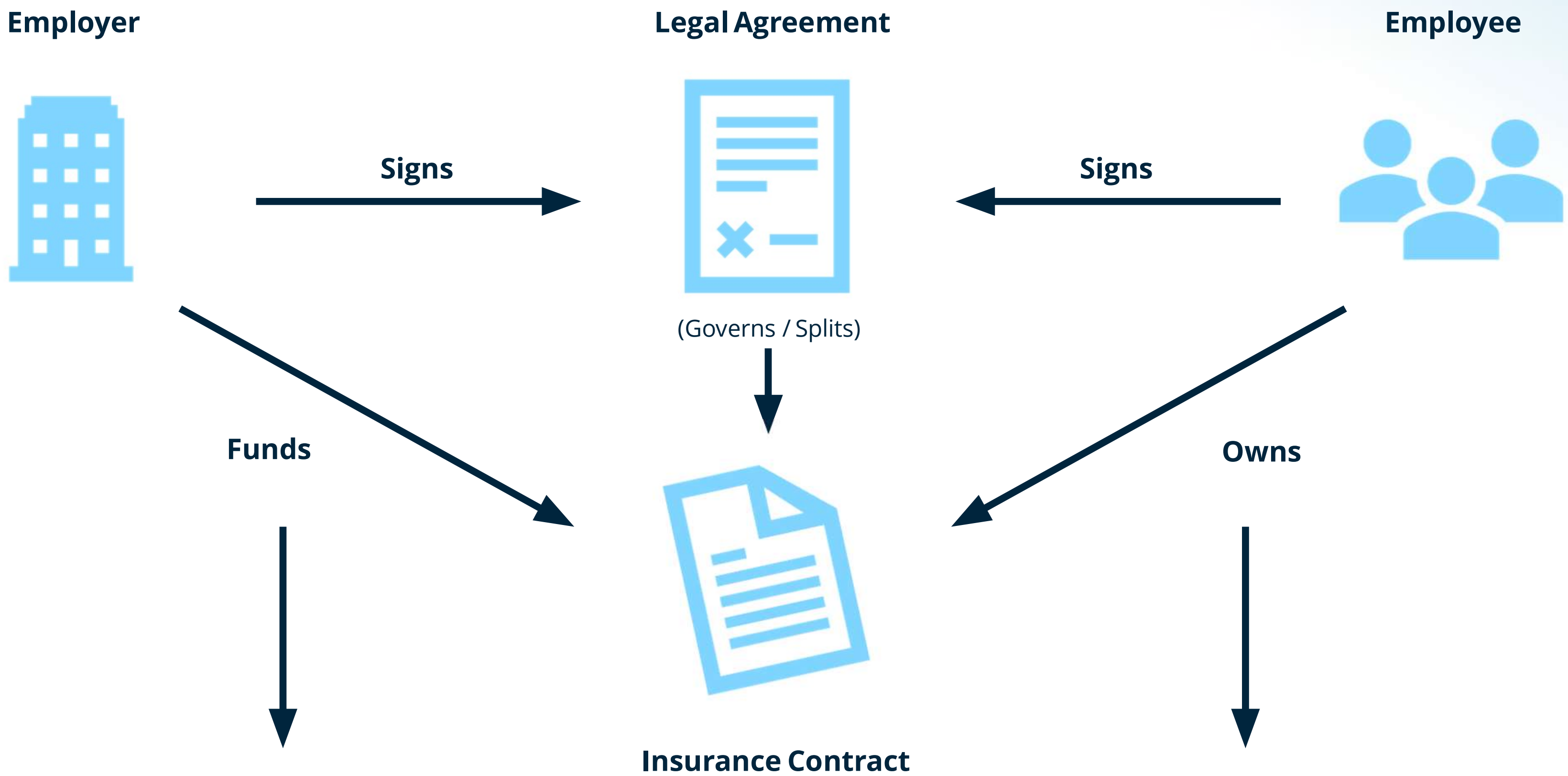
Eligibility

As a discriminatory non-qualified plan, the CASD SERP can be provided on any executive at any time without respect to eligibility criteria and the board of directors in its sole discretion will add or offer such plans to executives from time to time at their own discretion.

As a guideline the board will consider plans for executives who meet one or more of the following criteria:

- Named President or Chief Executive Officer
- At least __ years of service to this healthcare organization and a member of the executive management team
- At least __ years of service to this healthcare organization and an officer of the healthcare organization
- Incorporated as part of an employment contract or recruitment negotiation

Employer Funded | Restricted Bonus (IRC 162)



Employer Involvement

- Funds the plan via bonus to the Employee
- Bonus covers:
    1. annual premium, and
    2. tax on the annual premium/bonus
- Annual expense equal to the premium plus tax gross-up
- Once earlier of end of scheduled premiums or Employee termination of employment, Employer's involvement ends

Employee Interest

- Vesting schedule and benefit start date(s) govern when Employee can access policy for income and how much income is available
- Upon vesting, and reaching access date(s), Employee has full autonomy in when and how income is taken
- All income is received tax-free
- Upon Employee death, tax-free death benefit is paid to Employee's designated beneficiary

Restrictive Bonus Plan | Overview

Restrictive Bonus Plan's key components:

1. The Credit Union pays premiums on a life insurance policy owned by the Executive.
2. Taxation of the Restrictive Bonus Plan is under Section 83 of the tax code. With 83(b) election, the Executive taxed annually on the premiums and no further taxation upon vesting.
3. The Credit Union chooses whether to bonus the Executive for taxes due, and whether to provide a gross-up to cover tax due on the bonus.
4. The Credit Union can require return of all or a portion of the current year's unearned premium, if the Executive terminates prior to 100% vesting.
5. Premiums and tax bonuses cease at the Executive's termination of employment.
6. In retirement, the Executive determines when and how to access policy values. Taking loans from the policy would be tax-free as long as the policy does not lapse during the Executive's lifetime.

Observations

- The Board determines how much premium to pay from year to year based on fair and reasonable level of compensation.
- With the Executive owning the policy, accumulating values are protected against a Credit Union financial failure.
- Following termination of employment, the Credit Union will not contribute any further premiums.
- The Credit Union can choose to offset the cost through the use of institutional insurance or annuities.
- Premiums and bonuses are expensed as paid, no liability accrues on the books.

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Restrictive Bonus Plan | Decision Tree