# M Benefit Solutions®

The single source for your total executive benefit needs

Third Quarter 2011

MATTERS OF INTEREST

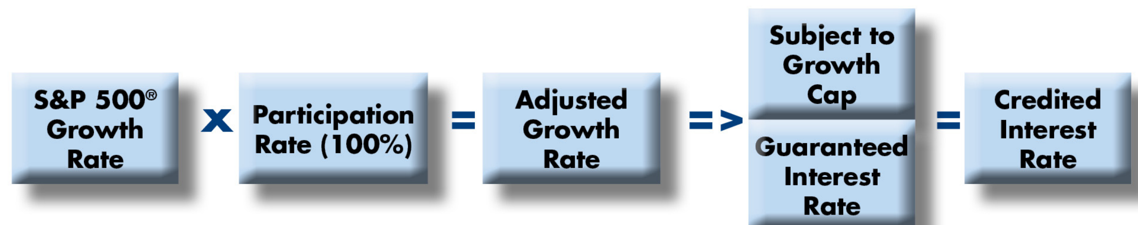
EXECUTIVE AND DIRECTOR BENEFITS AND COLI

## INDEXED ACCOUNTS

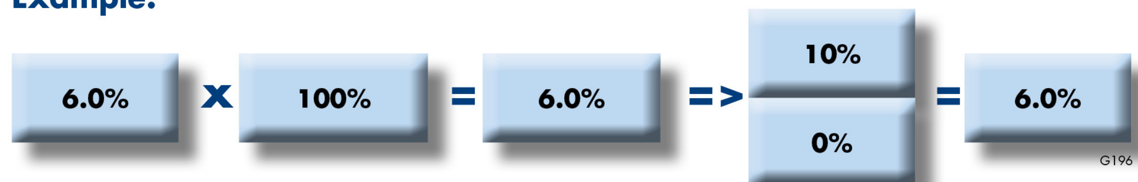
Over the last few years, insurance companies have been developing a new type of investment account within life insurance products. Amounts credited to these accounts are determined by the application of an interest rate calculated under a formula based on a stock price index. Often used is the Standard & Poor's 500® Composite Stock Price Index, excluding dividends ("S&P 500®").

These accounts have been designed to address the issue of stock market volatility. They are intended to stabilize returns while maintaining some exposure to market growth.

### SAMPLE FORMULA FOR DETERMINING CREDITED INTEREST RATE




**Example:**




- The type of formula used to set the interest rate in these accounts can be illustrated by the above graphic.
- The S&P 500® growth rate is its index value at the end of the investment period (a one-year period is assumed in this example) divided by its index value at the beginning of the year, less one.
- The Participation Rate can be 100% and may be greater. The Participation Rate is assumed to be 100% here.

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Securities offered through M Holdings Securities, Inc., a registered Broker/Dealer, member FINRA/SIPC.
M Financial Group is the parent company of M Benefit Solutions and M Holdings Securities, Inc.

- The Growth Cap limits the amount of growth to a stated percentage and may be adjusted by the insurance carrier. It is generally guaranteed to be no lower than a certain percentage. Here we assume it is 10%.
- The Guaranteed Interest Rate is set by the insurance carrier. Often it will be guaranteed to be no lower than 0%.
- The Credited Interest Rate will equal S&P 500® growth rate multiplied by the Participation Rate (Adjusted Growth Rate); provided however, if the Adjusted Growth Rate is greater than the Growth Cap, the Credited Interest Rate will equal the Growth Cap, and if the Adjusted Growth Rate is lower than the Guaranteed Interest Rate, the Credited Interest Rate will equal the Guaranteed Interest Rate.

## Investment Strategy Supporting the Indexed Account Crediting Rate

In order to provide a guaranteed interest rate while providing an exposure to the upside of the equity market, an indexed account will utilize an investment strategy that will invest the bulk of its assets in fixed rate investments just as a fixed account offered by the insurance carrier would do.[1] The return from these investments will support the guaranteed interest rate. The remainder of the assets will be invested in buying (and selling) call options on the stock index. These options are designed to support the crediting rate based on the return of the stock index.

## Interest Crediting on Indexed Account—Example

**Assumptions**

- $10,000 invested in indexed account on December 15, 2007
- An amount is invested in other account(s) from which monthly insurance deductions are taken so that no deductions are made from the indexed account
- 10% Growth Cap and 0% Guaranteed Interest Rate applicable for all Segment Terms
- All amounts reinvested in indexed account after each one-year investment period

Annualized Return Over Example Period: 6.56%

| | 1 FIRST TERM | 2 SECOND TERM | 3 THIRD TERM |
|---|---|---|---|
| Investment Start Date | 12/15/07 | 12/15/08 | 12/15/09 |
| Investment Maturity | 12/15/08 | 12/15/09 | 12/15/10 |
| Account Value at Investment Start | $10,000 | $10,000 | $11,000 |
| Average Investment Monthly Balance | $10,000 | $10,000 | $11,000 |
| Index Growth Rate (Without Dividends) | (40.83)% | 28.27% | 11.44% |
| Growth Cap | 10% | 10% | 10% |
| Guaranteed Interest | 0% | 0% | 0% |
| Crediting Interest Rate | 0% | 10% | 10% |
| Credited Interest | $0 | $1,000 | $1,100 |
| Investment Maturity Value | $10,000 | $11,000 | $12,100 |

1 An indexed account may be offered as part of a securities product known as Variable Life Insurance. Investments in Variable Life insurance products are long-term investments and may not be suitable for all investors. An investment in variable life insurance is subject to fluctuating values of the underlying investment options and entails risk, including the possible loss of principal. Please read the prospectus carefully before investing.

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### Account Restrictions

Investments in an account like this will be subject to various restrictions, which would depend on the particular product offered by an insurance carrier. Restrictions likely would include restrictions on source, amount, and timing of transfers into and out of the indexed account and loans and withdrawals from the account.

It should also be noted that though the crediting rate is based on an equity index an investment in one of these accounts is an investment in the insurance company's general account the same as if the insurance policy owner were invested in the carrier's fixed account where the interest rate is set by the insurance company based on the return of its general account assets.

## The American Jobs Act—Tax Provisions

In September 2011, President Obama proposed legislation called The American Jobs Act (the "Jobs Act") with the stated aim of putting more people back to work, cutting taxes on middle class workers, and increasing taxes on the wealthy. Some of the tax provisions contained in the Jobs Act are described here:

### Temporary Payroll Tax Cut for Employers, Employees, and the Self-Employed

The Jobs Act would extend and expand the existing temporary reduction in payroll taxes. For calendar year 2012, it would: (a) further reduce the Old Age, Survivors and Disability Insurance (social security) portion of the payroll tax that was paid by employees during 2011 from 4.2 percent (reflecting the existing 2 percent temporary reduction from the permanent rate) to 3.1 percent; and (b) add a new reduction in the portion of this tax that is paid by employers from 6.2 percent to 3.1 percent. The employer reduction would apply to up to $5 million of wages that are paid by the employer.

### Temporary Tax Credit for Increased Payroll

For the last quarter of 2011 and for calendar year 2012, the Jobs Act would provide a payroll tax credit that fully offsets the employer social security tax that otherwise would apply to increases in wages from the corresponding period of the prior year. For example, if an employer paid wages subject to social security tax of $5 million in 2011 and $6 million in 2012, the credit to which the employer would be entitled would eliminate the employer's portion of social security taxes on the $1 million of increased wages. The credit would be available on up to $50 million of an employer's increased wages.

### 28 Percent Limitation on Certain Deductions and Exclusions

The Jobs Act would limit the value of all itemized deductions and certain other tax expenditures by limiting the tax value of otherwise allowable deductions and exclusions to 28 percent. No taxpayer with adjusted gross income under $250,000 for married couples filing jointly (or $200,000 for single taxpayers) would be subject to the limitation. The limitation would affect itemized deductions and certain other tax expenditures that would otherwise reduce taxable income in the 36 or 39.6 percent tax brackets. A similar limitation also would apply under the alternative minimum tax. This section would be effective for taxable years beginning on or after January 1, 2013.

### Partnership Interests Transferred in Connection With Performance of Services

Current law allows service partners, such as hedge fund managers, among others, to receive capital

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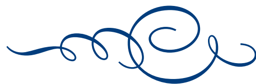
gains treatment on labor income without limit. The Jobs Act would tax as ordinary income, and make subject to self-employment tax, a service partner's share of the income of an investment partnership attributable to a carried interest (such as a hedge fund performance fee) because such income is derived from the performance of services. To the extent that a service partner contributes "invested capital" and the partnership reasonably allocates its income and loss between such invested capital and the remaining interest, income attributable to the invested capital would not be recharacterized as ordinary income. This proposal would be effective for taxable years beginning after December 31, 2012.

The Jobs Act also has provisions for eliminating tax preferences for oil and gas companies and eliminating special depreciation rules for corporate purchases of aircrafts.



## The President's Deficit Reduction Plan: "Living Within Our Means and Investing in the Future"

Shortly after the President proposed the Jobs Act earlier this month (see description above), the President sent to the Congress his plan to pay for the Jobs Act and to realize more than $3 trillion in net deficit reduction over the next 10 years.

The deficit reduction plan, in addition to cuts and reforms to mandatory programs such as Medicare and Medicaid, calls for the Congress to undertake comprehensive tax reform that lowers tax rates, closes loopholes, and observes the Buffett Rule—that people making more than $1 million a year should not pay a smaller share of their income in taxes than middle-class families pay.

In addition to the tax provisions of the Jobs Act and observation of the Buffet rule, the deficit reduction plan also calls for, among other things, the following:

- Allow the 2001 and 2003 high-income tax cuts to expire.
- Return the estate tax to 2009 exemption and tax rate levels.
- Expand pro rata interest expense disallowance for new COLI policies issued after December 31, 2012.
- Modify rules relating to the sales of life insurance contracts, including modification of "transfer-for-value" rules to prevent purchasers of in-force policies from avoiding tax on death benefits.

## SEC Delays Planned Implementation for Dodd-Frank Executive Compensation Requirements

In late July 2011, the SEC revised its Dodd-Frank implementation timeline. The planned adoption of several executive compensation provisions was delayed from the end of 2011 to the first half of 2012. The provisions are:

- Disclosure rules regarding pay-for-performance and CEO pay disparity ratio (Dodd-Frank §953)

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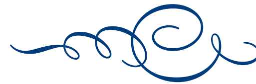
- Rules regarding compensation clawbacks for executive officers (Dodd-Frank §954)
- Disclosure rules regarding employee and director hedging (Dodd-Frank §955)
- Final rules (to be published jointly with other Federal regulators) regarding incentive compensation arrangements at financial institutions (Dodd-Frank §956)

Section 956 rules have been proposed. Rules under the other sections are slated to be proposed by the end of 2011. The revised timeline means that it is unlikely that any of the above provisions will be implemented in time for the 2012 proxy season. Additionally, the clawback rules under Section 954 are subject to implementation by the national securities exchanges, which could delay implementation beyond mid-2012.

The SEC's timeline indicates that it still expects to adopt final rules under Section 952 (exchange listing standards for compensation committee and advisor independence, as well as disclosure rules regarding compensation consultant conflicts of interest) by the end of 2011. The proposed rules under Section 952 contemplate that the national securities exchanges would have an additional one year following publication of the final SEC rules to implement the new listing standards; however, assuming the SEC meets its schedule, it is possible that the new disclosure requirement regarding consultant conflicts of interest will be effective for the 2012 proxy season.



## "Say-on-Pay" Litigation

As of September 23, 2011, there have been nine separate lawsuits filed against corporate boards after shareholders rejected board-recommended executive compensation programs. Executive compensation programs, beginning in 2011, are subject to an advisory shareholder vote under Dodd Frank's "say-on-pay" voting requirements. In one of these lawsuits, filed on behalf of Cincinnati Bell by the NECA-IBEW Pension Fund, a court for the first time, in late September 2011, denied the board's motion to dismiss the suit. The corporate legal community has been expecting these lawsuits to be dismissed as frivolous. The failure to dismiss has made the corporate bar and boards sit up and take notice.

The court began its analysis noting that, normally, a board of directors is protected by the "business judgment rule" when making decisions about executive compensation, and courts "will not inquire into the wisdom of actions taken by a director in the absence of fraud, bad faith, or abuse of discretion." The court also noted that "[u]nder Ohio law, directors will face liability only if it is shown by clear and convincing evidence that their actions were undertaken with 'a deliberate intent to cause injury to the corporation' or 'reckless disregard for the best interests of the corporation.' Ohio Rev. Code Ann. §1701.59(D) (2011)."

**The federal District Court in the Southern District of Ohio framed the issue in this way:**

"This civil lawsuit presents the question, among others, whether a shareholder of a public company may sue its directors for breach of the duty of loyalty when the directors grant $4 million dollars in bonuses, on top of $4.5 million dollars in salary and other compensation, to the chief executive officer in the same year the company incurs a $61.3 million dollar decline in net income, a drop in earnings per share from $0.37 to $0.09, a reduction in share price from $3.45 to $2.80, and a negative 18.8% annual shareholder return."

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The court went on to find, however, that the factual allegations made by the plaintiffs "raise a plausible claim that the multi-million dollar bonuses approved by the directors in a time of the company's declining financial performance violated Cincinnati Bell's pay-for-performance compensation policy and were not in the best interests of Cincinnati Bell's shareholders and therefore constituted an abuse of discretion and/or bad faith."

Where this case goes from here will be closely watched by all in the corporate community. This case will remain of high concern to compensation committees, their counsel and advisors, when considering their responsibilities during the next proxy season in setting appropriate executive compensation levels. In addition to this case, other factors that will need to be considered by compensation committees and their advisors when setting compensation levels include:

- Continuing public concern and even anger at large income disparities, especially at a time when unemployment remains high.
- A declining economy and stock market.
- Potentially stricter positions taken during next year's proxy season by ISS and institutional shareholders.

The information incorporated into this presentation has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy.

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