



## M Benefit Solutions® Bank Strategies

Total solutions for attracting, retaining, and rewarding top talent

First Quarter 2009

THE BOTTOM LINE  
EXECUTIVE AND DIRECTOR BENEFITS AND BOLI

## UNDER PRESSURE TO “MOVE MONEY”?

### WHY BANKS SHOULD CONSIDER BOLI

by: John Gagnon, Partner, GW Financial; Advisor Firm to M Benefit Solutions - Bank Strategies

We are all being encouraged to “move money.” The question is where? Moving money is a key to energizing this stagnant economy. The Fed agrees and is reducing the funds rate to near zero in an attempt to wrench open the liquidity spigot by emboldening banks, investors and borrowers to shift out of now poor performing “safe haven” investments. In theory, these low rates should result in banks moving their money into more loans and out of treasury and agency paper as the rates fall below their cost of funds. Investors should also move money out of low yield money market investments back into stocks and bonds, while borrowers should take advantage of historically low mortgage rates. However, not too long ago, the government was also encouraging community banks to invest in preferred shares of Freddie Mac and Fannie Mae, and we all know how that turned out. The Fed is doing all it can to get the money out of the proverbial mattress. However, this means taking a leap of faith by consumers and banks in an economic environment where being risk-averse seems to be the logical choice.

Consumers are being forced to simplify and deleverage their balance sheets. Savings is no longer a dirty word; our grandparents are looking down saying “it’s about time!” The likely

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### COME SEE US



Stop by our booth for **free ice cream** on Wednesday, March 18<sup>th</sup>, beginning at 11:00 a.m.

**Come see our presentation:**  
“Turning Lemons into Lemonade:  
Conquering the New Economy”  
Friday, March 20 at 1:30 p.m. in Room 129B.  
Enter drawing to win a **Canon Powershot SD790IS Digital Camera**

MARCH 18-19: VISIT OUR BOOTH (#512/514) AND ENTER TO WIN AN ODYSSEY WHITE HOT XG 2-BALL F7 PUTTER

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result will be a large increase of funds to banks as depositors move from low yielding money market investments into CDs. In the past a lack of liquidity in the banks has often been an issue, especially when it came to considering a BOLI investment. Tying up cash within a BOLI contract for an extended period of time has always been an issue even though the average internal portfolio maturity is 5–7 years. There is growing likelihood that 2009 may instead become a dilemma due to excess liquidity. With the slowing of loan demand and growing consumer saving sentiment and with \$4 trillion in money market investments with yields now below 1%, how much of this market will move to banks and how much will you want?

On top of this, almost \$800 billion in bonds have been downgraded from AAA with less than \$50 billion remaining at AAA.<sup>1</sup> The remainder is spread 50% A and above and 50% rated between BBB to CCC.<sup>1</sup> A review of top BOLI carriers shows that a high percentage of their portfolios are still invested in high quality investment grade bonds. Subprime exposure at these same carriers has been below .05% of assets with virtually no altered ratings from any of the major services despite significant changes in other industries. Insurance company BOLI portfolios, regardless of general account or separate account, are primarily comprised of MBS (Mortgage-Backed Securities) Pass-throughs with varying degrees of Treasuries, Agencies, CMBS (Commercial Mortgage-Backed Securities) and CMOs (Collateralized Mortgage Obligations). As the housing market credit losses peak in 2009 as many believe, this should allow for a strong second half recovery in high quality nonagency AAA MBS, AAA Agency and MBS. Given that this is what comprises most BOLI portfolios, now is the time to evaluate BOLI as an appropriate investment.

Although the BOLI market over the past several years has begun to move from general account to

separate account, in many circumstances there may be reasons to consider staying with general account policies. Some of the advantages for choosing separate account products are the greater transparency that these products have, the potential for lower risk weighting for risk-based capital treatment and protection from carrier insolvency.<sup>2</sup> However one advantage that general account products have is the carrier's ability to blend in some equity exposure in its general account. Considering that we have just experienced back-to-back 40%+ bear markets, which have not occurred for 70 years, and that one third of S&P 500 stocks are trading below book value, it would seem that the ability to have some exposure to equities could be valuable. The good news is that banks have several options to suit their particular needs.

In comparing crediting rates of four top BOLI carriers—John Hancock, Mass Mutual, New York Life and Met Life—between January 2005 and 2009, only one is crediting less today on its policies. In a review of carriers in the market the average crediting rate is still between 4.75%–5%. BOLI also presents an additional tax arbitrage opportunity due to its tax-favored status. Given the cost of funds at most banks, the profit margin has likely never been better. So, if you're contemplating "moving money," BOLI deserves consideration.

*This information discusses general market activity, industry or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice.*

<sup>1</sup>Downgraded balances from 2007 to present. SOURCE: JPMorgan, HSH as referenced on page 10 in the "Sun Life Assurance Company of Canada (U.S.) MBS Sub-Account—GSAM Fixed Income Portfolio Review," dated January 22, 2009.

<sup>2</sup>OCC 2004-56 Interagency Statement on the Purchase and Risk Management of Life Insurance—page 19–20.



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## SECTION 409A VIOLATIONS: CORRECTIONS

This article is a summary of the M Benefit Solutions' White Paper, *You Have a Section 409A Violation: Now What?* which is available at our website [www.mben.com/bank](http://www.mben.com/bank).

A Section 409A violation is a dread relatively new to sponsors of nonqualified deferred compensation plans and their consultants. Not only is a Section 409A violation easy to commit—all you have to do, for example, is to over- or underwithhold on a participant's bonus deferral—but the result can be draconian. The full penalty for a Section 409A violation requires that a participant's vested account balance be subject to immediate income taxation, that an additional 20% penalty tax be levied on this amount, and that a premium interest rate will be charged for each part of the account balance, calculated from the year in which the original deferral took place (even if the tax year of the original deferral is closed).

In Notice 2008-113, the IRS provided guidelines detailing the process for corrections of certain operational violations and providing the corresponding tax results. The advantage of corrections made under Notice 2008-113 is the full or partial avoidance of the Section 409A taxation and penalties described above.

The Notice prescribes certain eligibility requirements before the opportunity to correct under the Notice will apply. For example, the failures must be operational and the employer must take commercially reasonable steps to avoid the error again. Other eligibility requirements are listed in the White Paper.

The table on the following pages lists the types of Section 409A operational violations that may be corrected, how and when they may be corrected, and the tax results of the correction. Other than document failure, a typical Bank plan, assuming no deferral elections and no distribution elections, will most likely commit an operational violation of Section 409A through distributions that are earlier or later than those specified in the plan.

The table, of course, presents a simplified overview and is not intended to provide complete guidance in the event of an actual Section 409A violation. In such a case, you should immediately contact your counsel or M Benefit Solutions, if we are your plan administrator.

**NOTE:** Errors with respect to insiders<sup>1</sup> are often subject to more stringent rules than non-insiders under Notice 2008-113.

<sup>1</sup>*Directors, officers, and 10% shareholders of company determined in accordance with Section 16 of the Securities Exchange Act of 1934 regardless of whether the employer is public or whether the employer is a corporation.*

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## SECTION 409A—FAILURES AND CORRECTIONS SUMMARY TABLE

409A VIOLATION	CORRECTION TIMING	CORRECTION	RESULT
<b>DOCUMENT FAILURE</b>	<ul style="list-style-type: none"> <li>In year failure found</li> </ul>	<ul style="list-style-type: none"> <li>Not eligible for Notice 2008-113 Correction</li> <li>Amend/terminate Plan</li> </ul>	<ul style="list-style-type: none"> <li>No mitigation of 409A penalties</li> <li>Account value taxed may be distributed</li> <li>After amendment, amounts deferred in later years untainted by violation</li> </ul>
<b>OPERATIONAL FAILURE</b>			
<b>ERRONEOUS DISTRIBUTIONS (INCLUDES FAILURES TO DEFER)</b>	<ul style="list-style-type: none"> <li>In the same taxable year as failure</li> </ul>	<ul style="list-style-type: none"> <li>Repayment by employee to employer</li> <li>Insiders may need to pay interest on repayment</li> </ul>	<ul style="list-style-type: none"> <li>No income taxation</li> <li>No 20% penalty</li> <li>No interest penalty</li> </ul>
	<ul style="list-style-type: none"> <li>By the end of the taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>Repayment by non-insider employee to employer</li> <li>Insiders not eligible for this correction</li> <li>Interest on repayment must be paid in some cases</li> </ul>	<ul style="list-style-type: none"> <li>Taxable income to employee in year of erroneous payment</li> <li>Deduction for repayment</li> <li>No 20% penalty</li> <li>No interest penalty</li> </ul>
	<ul style="list-style-type: none"> <li>By the end of the second taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>If erroneous payment less than 401(k) deferral limitation for year, no repayment is necessary but payment is reportable as income</li> </ul>	<ul style="list-style-type: none"> <li>Taxable income to employee in year of erroneous payment</li> <li>20% penalty payable</li> <li>No interest penalty</li> </ul>
	<ul style="list-style-type: none"> <li>By the end of the second taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>Repayment by employee to employer</li> <li>Insiders may need to pay interest on repayment</li> </ul>	<ul style="list-style-type: none"> <li>Taxable income to employee in year of erroneous payment</li> <li>No deduction for repayment (but later distribution will not be taxable)</li> <li>No 20% penalty</li> <li>No interest penalty</li> </ul>



409A VIOLATION	CORRECTION TIMING	CORRECTION	RESULT
<b>OPERATIONAL FAILURE</b> (CONT.)			
<b>EXCESS DEFERRALS</b>	<ul style="list-style-type: none"> <li>■ In same taxable year as failure</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment to employee</li> <li>■ Employer may pay interest</li> <li>■ Account balance for insider must be adjusted for earnings retroactive to date of failure</li> <li>■ Account balance may be adjusted for losses</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment is treated as income</li> <li>■ No amount is subject to Section 409A</li> </ul>
	<ul style="list-style-type: none"> <li>■ By the end of the taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment to noninsider employee</li> <li>■ Account balance reduced by earnings if any (losses may, but are not required to, be adjusted)</li> <li>■ Employer may not pay interest to employee</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment is treated as income in year of payment</li> <li>■ No amount is subject to Section 409A</li> </ul>
	<ul style="list-style-type: none"> <li>■ By the end of the second taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>■ If excess deferral less than 401(k) deferral limitation for year, employer payment to employee</li> <li>■ Earnings forfeited or paid to employee</li> <li>■ Losses permanently disregarded or subtracted from the payment</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment is treated as income in year of payment</li> <li>■ Payment is subject to 20% penalty tax</li> <li>■ No interest penalty</li> </ul>
	<ul style="list-style-type: none"> <li>■ By the end of the second taxable year following the year of failure</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment to employee</li> <li>■ Account balance reduced by earnings, if any (losses may, but are not required to, be adjusted)</li> <li>■ Employer may not pay interest to employee</li> </ul>	<ul style="list-style-type: none"> <li>■ Employer payment must be treated as income in year of failure</li> <li>■ Payment is subject to 20% penalty tax</li> <li>■ No interest penalty</li> </ul>

# NEW RESTRICTIONS ON EXECUTIVE COMPENSATION FOR TARP RECIPIENTS

New and more extensive restrictions on compensation arrangements for executives employed by financial institutions that have received or will receive funds under the Troubled Asset Relief Program (TARP) were enacted as part of the American Recovery and Reinvestment Act of 2009 (the Act).

The Act raises many issues, which the Treasury has not yet addressed. For example, the Act prohibits paying or accruing any bonus, retention, and other incentive compensation to senior executive officers and a number of the next most highly compensated employees, depending on the extent of TARP aid received by the institution.

Issues raised by the statutory language include the meaning of “accruing,” the meaning of “most highly compensated employees,” and whether commissions are considered bonuses.

M Benefit Solutions will provide an analysis of the Act’s provisions in its second quarter newsletter with the help, we hope, of guidance from the Treasury Department.



# WELCOME NEW TEAM MEMBER

**Theresa MacPherson**  
**Financial Analyst**

M Benefit Solutions is pleased to welcome Theresa MacPherson as a Financial Analyst in our Consulting Services department. Prior to coming to M Benefit Solutions, Theresa was working as an Institutional Equity Research Associate for D.A. Davidson & Co. Theresa’s previous experience also included internships with Silver Oak Solutions, Durig Capital, LLC and the United States Department of Defense. Theresa earned her Bachelor’s degree from Portland State University.



## COMPLIMENTARY ONLINE COMPENSATION BRIEFINGS

Tom Jordan, Advisor to M Benefit Solutions - Bank Strategies and Founder and CEO of The Executive Compensation Institute (ECI Companies) invites you to join ECI’s VisionLink for Banks monthly Complimentary Online Compensation Conversations. Each conversation will last under one hour and you’ll come away with valuable information on current compensation issues in the community bank marketplace.

For more information on how to attend these events, please email [webinars@ecicompanies.com](mailto:webinars@ecicompanies.com) or call 1.800.577.2261.

## ECI’S UPCOMING VISIONLINK FOR BANKS WEBINAR SERIES

March 25 at 10:00 AM (CST)  
“21<sup>st</sup> Century Compensation Strategies for a TARPed Economy”

March 31 at 12:00 Noon (CST)  
“The 5 Essentials for Pay for Performance”

April 7 at 12:00 Noon (CST)  
“Under Pressure to Offset Benefit Costs”

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# ABOUT M BENEFIT SOLUTIONS - BANK STRATEGIES

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