M Benefit Solutions®
Bank Strategies
Total solutions for attracting, retaining, and rewarding top talent

ICBA Preferred SERVICE PROVIDER

Second Quarter 2012

THE BOTTOM LINE
EXECUTIVE AND DIRECTOR BENEFITS AND BOLI

Retaining Top Talent at Closely Held Banks

by Mark Boomgaarden

A typical dilemma for a closely held bank is how to incent and retain executive management who are not part of the ownership group. Often times, closely held banks do not want to dilute ownership in the bank by providing ownership to executive management. That puts them at a disadvantage in retaining top management talent when compared to publicly traded banks or privately held banks that are able to provide equity/ownership incentives. Historically closely held banks have gravitated toward using nonqualified benefit programs such as Salary Continuation Programs to retain executive management. These programs have worked well but, in the wake of the recent banking environment, the desire to make nonqualified benefit programs more performance based has increased. We have worked with several banks recently to create nonqualified retirement programs that are based on bank performance. For the participating executive this has an "equity like" feel with the upside of being rewarded if performance of the bank is strong. For the bank it provides a powerful incentive, but does not lock them in to an expensive executive retirement program if performance of the bank does not warrant it.

Nonqualified Plan Summary

Nonqualified benefit programs are plans established by an employer for the benefit of key individuals. Primary reasons banks use nonqualified benefit programs are to attract and retain valuable individuals. By using a nonqualified benefit plan, a bank can selectively reward certain executives and key individuals without regard to the nondiscrimination and reporting requirements of qualified plans. By definition, nonqualified plans are unfunded and have no specific assets set aside to settle the benefit obligation. Therefore, an individual with this type of plan has no legal right to the payment of the benefit beyond those of an unsecured, general creditor.

Nonqualified Performance Driven Retirement Plan

For performance driven benefit plans, the plan design is similar in concept to a profit sharing program. The value of the future benefit is usually directly related to the profitability or performance of the employer. The critical difference is that no real shares of stock are issued at any time in this arrangement. Instead the account value of this benefit is generally measured by the employer's ROE and/or ROA performance on a bookkeeping account basis only. In addition, future benefit payments to the individual are paid in cash and not actual shares. The individual generally is not expected to contribute any of his or her own compensation to this type of plan; rather, a contribution is made by the bank on an annual basis as an award for meeting specific performance criteria as approved by the Board of Directors. The award criteria are typically based on bank performance, but can be based on individual performance criteria as well. An award may be credited to the individual's account by

(Continued on next page)

achieving certain desired performance levels. This may be accomplished by allocating a specific dollar amount or a targeted percentage of salary. The award may vary from year to year based on the extent to which the performance targets were met. This account balance is then increased over time based on future contributions/awards and the performance of the crediting rate index which is often a percentage of the bank's ROE. After the appropriate years of service are obtained, most commonly at retirement, benefit payments will commence. At that time the accrued liability is distributed to the individual per their election. These payments may be in a lump sum, but are usually over a selected number of years. The remaining account balance is credited with interest at a predetermined rate (usually not tied to performance after retirement) until all payments have been made. Since no actual shares are issued, the bank does not dilute their existing ownership nor give up any voting control. The individual's bookkeeping account generally does not participate in dividends, therefore no payments of cash or real shares of stock need to be made. Many banks find that these advantages, combined with the incentive structure of these performance plans, provide a win-win benefit package for their key individuals.

BOLI Financing

It is extremely common for banks that institute a performance driven retirement program to also purchase Bank-Owned Life Insurance (BOLI) at the same time to informally fund the cost of the program on the bank's P&L statement. Historically, BOLI returns have had a significant spread versus the after-tax returns of other bank permissible investments. This is due to the tax favored status of BOLI. Cash values in these policies grow tax-deferred and are tax-free if held until death. If the bank purchases BOLI with funds that are generating a lower after tax return than the BOLI generates, the BOLI purchase will create incremental earnings on the bank's P&L that can be used to offset the expense of providing the benefit program and potentially even leave the bank in a neutral P&L position.

Moody's Comments on Capital Levels and First Quarter 2012 Financial Results for U.S. Life Insurers

Moody's Investors Service published a special comment stating that the U.S. life insurance industry continues to remain well capitalized. The comment followed a review of year-end 2011 financial statements filed by companies rated by Moody's. Moody's said that while the median NAIC RBC ratio declined to 448% from 462% at the end of 2010, overall the ratio is a healthy sign for the industry as consolidated statutory capital and surplus was up 4%. Moody's said companies continued to actively manage their capital programs with share repurchases and increasing dividends to shareholders.

Upcoming Event: 2012 ABA Annual Convention

October 14–16, 2012

Hilton San Diego Bayfront, San Diego, CA

M Benefit Solutions - Bank Strategies is once again proud to be an exhibitor at the 2012 ABA Annual Convention. Please join us at **Booth 804**:

- Enter to win an Amazon Kindle Fire
- Pick up your bank's customized BOLI Empowerment Page

For more information on the convention, please visit http://www.aba.com/Training/Conferences/Pages/annual.aspx

We look forward to seeing you in San Diego.

Advisor Firms

M Benefit Solutions - Bank Strategies is structured to provide our clients with consistent nationwide coverage. We have identified several Advisors with superior reputations in bank executive and director benefits and BOLI to provide consulting services to clients nationwide.

Distributed throughout the country, these Advisors work interactively with M Benefit Solutions and bank clients to design programs which meet each bank's specific needs and to ensure high quality administrative and compliance services.

ECI/Bank Benefits

Thomas V. Lynch
tlynch@ecicompanies.com

Minneapolis, MN
Phone: 952.885.2727; Fax: 952.885.0995

Evergreen Consulting, Inc.

James Cheney
jcheney@evergreenci.com

Robert Kozloski
rkozloski@evergreenci.com

Chattanooga, TN
Phone: 423.756.3828; Fax: 423.265.0735

Financial Designs Ltd.

Gerald Middel
jmiddel@fdltd.com

Denver, CO
Phone: 303.948.4068; Fax: 303.832.7100

Goldstein Financial Group

Murray Hoyt
mhoyt@goldsteinfinancial.com

Deerfield, IL
Phone: 720.838.8978

GW Financial, LLC

John Gagnon
jgagnon@bolicoli.com

Reading, MA
Phone: 781.942.5700; Fax: 781.942.5710

M Benefit Solutions - Bank Strategies

Mark Boomgaarden
mark.boomgaarden@mben.com

St. Peter, MN
Phone: 952.334.3239

Douglas Harper
douglas.harper@mben.com

Carefree, AZ
Twin Falls, ID
Phone: 480.223.8141

Thomas J. Jordan
tjordan@ecicompanies.com

Austin, TX
Phone: 512.656.9950

Dan Wagner
dwagner@mben.com

Chesterfield, MO
Phone: 636.530.1635

About M Benefit Solutions - Bank Strategies

M Benefit Solutions - Bank Strategies, based in Portland, Oregon, is a division of M Benefit Solutions, a Subsidiary of M Financial Group. Please go to www.mfin.com/DisclosureStatement.htm for further details regarding this relationship. M Benefit Solutions is a recognized leader in the community bank executive and director benefits and BOLI marketplace. Through a network of firms located in key markets across the country, M Benefit Solutions - Bank Strategies helps banks attract, retain, and reward key executives and directors through the design, implementation, and administration of benefit programs that maximize the use of a bank's financial resources. M Benefit Solutions - Bank Strategies is the Independent Community Bankers of America's ("ICBA") Preferred Service Provider for executive and director benefits and BOLI. For more information, please visit www.mben.com/bank.

M Benefit Solutions®
Bank Strategies

An M Financial Group Company

ICBA Preferred SERVICE PROVIDER

M Benefit Solutions - Bank Strategies
M Financial Plaza
1125 NW Couch Street, Suite 900
Portland, OR 97209
503.238.1813
fax: 503.238.1815
www.mben.com/bank