A PRIMER ON NONQUALIFIED DEFERRED COMPENSATION PLANS

The single source for your total executive benefit needs

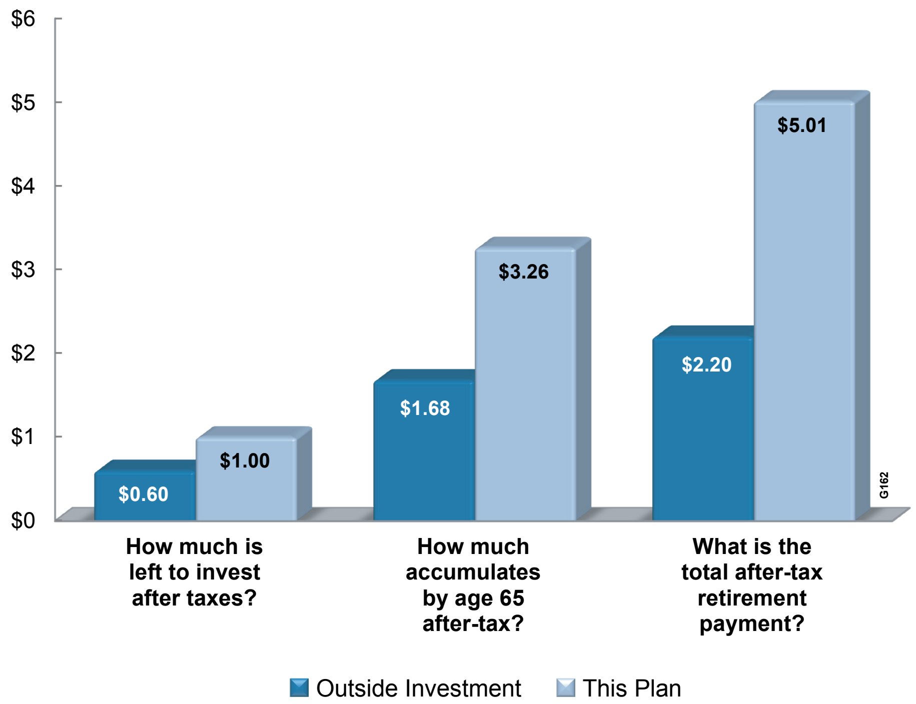
TABLE OF CONTENTS

Disclosure Information

OVERVIEW

- NDCPs allow executives to defer compensation on a pretax basis until some predetermined date or event (e.g., retirement).
  - Unlike qualified plans, nonqualified plans allow an employer to limit eligibility to a select group of key employees.
- Deferred compensation plans can also provide company contributions (for example, deferral matches or profit sharing).
- Bookkeeping accounts are maintained with earnings applied to balances periodically on a tax-deferred basis.
- Benefits paid are ultimately a function of employee deferrals, company contributions, and earnings credited thereon.
- Benefits under NDCPs are unsecured promises to pay by the employer.
  - An employer may informally fund such a plan, holding assets itself or within a trust, to increase the quality of the promise.

The Plan vs. Outside Investment



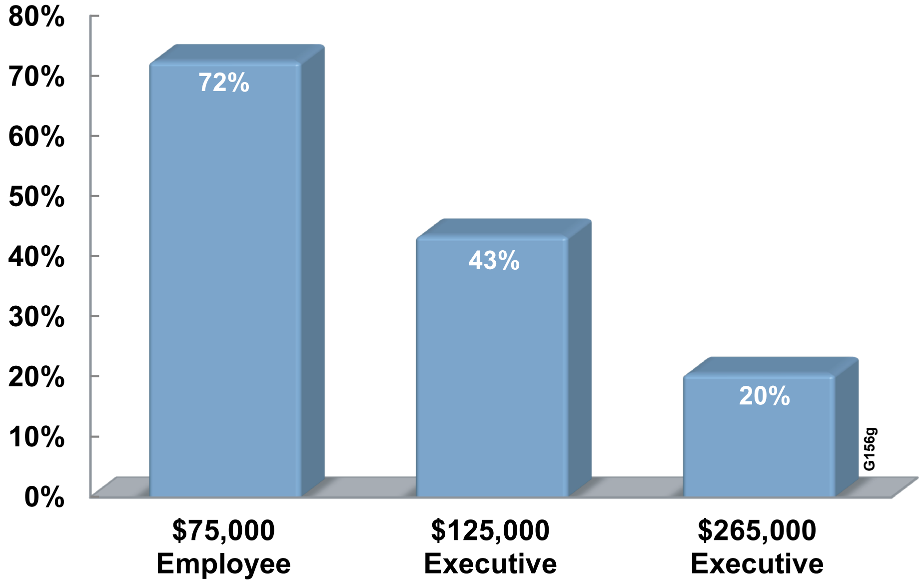
Assumptions

- Employee's Age—40
- Annual Growth Rate—7.0%
- Employee Tax Bracket—40%
- Payout—15 years

WHY SPONSOR A NDCP?

- To provide a tool to help employees save for retirement or other asset accumulation needs on a tax-favored basis.
- To allow employees to make up for limitations placed on qualified plans.
  - 401(k) deferral limits.
  - Eligible compensation limits.
  - Defined contribution limits.
  - Discrimination testing restrictions.
- To recruit, retain and reward key executives.
- To motivate the executive's job performance.

Income Replacement Ratio Potential From a 401(k) Plan



Assumptions

- Employee's Age—45
- Salary Scale—3.00%
- CPI—2.75%
- Payout—15 years
- Growth Rate—6.50%
- Max 401(k) Contribution to Age 62

MECHANICS OF A TYPICAL NDCP

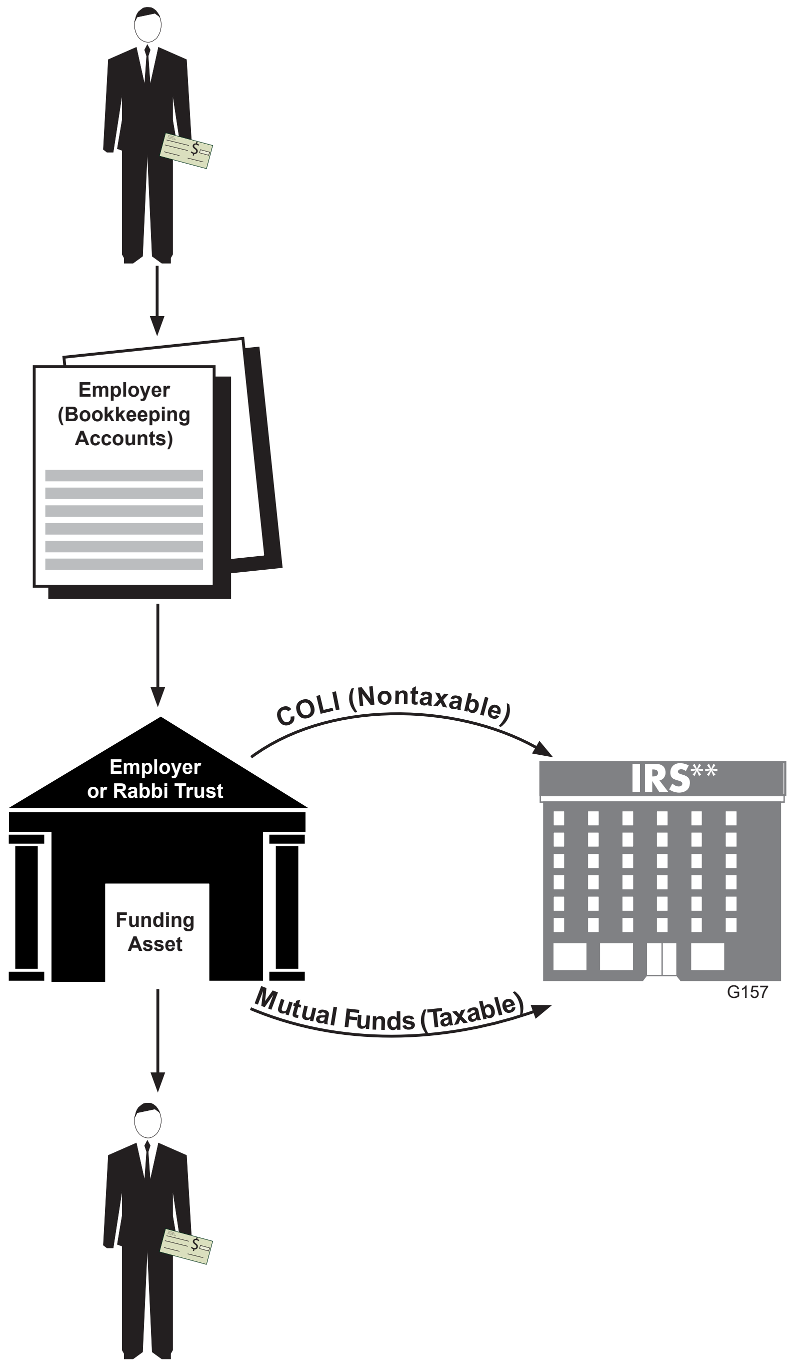
Participant makes election to defer salary, bonus, or other compensation.

Company may make matching and/or discretionary contributions.

Bookkeeping accounts ae maintained by the Employer. Eamings are applied to balances on a tax-deferr ed basis.*

Employer may informally fund plan through purchase of a funding asset. The asset may be held directly by the employer or by a trust whose assets are subject to the creditors of the employer in the event of the employer's insolvency or bankruptcy (commonly called a "rabbi trust," see page 4).

Benefits are paid from corporate assets. The funding asset may also be used, if necessary/desied. Excess funding assets canevert to corporation and can offset plan costs (e.g., COLI death benefis).



**Nonqualified benefits are contractual obligations of the employer; plan participants are unsecured general creditors.*

***Any gains on the funding asset (whether held in trust or not) are taxable to the corporation. Corporate-Owned Life Insurance (COLI) is a common funding asset because its cash surrender value growth is tax-deferred (tax-free if held until death).*

DESIGN ALTERNATIVES

NDCPs provide great flexibility in design, allowing each plan to promote the objectives of the employer. Two of the most common features used to accomplish these objectives are crediting rate and distribution events.

1. Common Crediting Rate Options

- Fixed Rate (e.g., 5%)
- Variable Rate Tied to Underlying Index (e.g., Moody's, Prime, etc.)
- 401(k) Mirror
- Other Investment Indices (e.g., company stock, COLI investment subaccounts)

2. Common Distribution Events

- Preelected Inservice Withdrawal
- Termination
- Retirement
- Disability
- Death
- Change in Control

RABBI TRUSTS

- Rabbi trusts are often used to secure deferred compensation and provide protection to executives in the event of:
  - Change of control.
  - Change of heart.
  - Change in financial position, short of bankruptcy.
- Assets are subject to the claims of the employer's general creditors in the event of employer's insolvency or bankruptcy.
- Assets generally cannot be used for any corporate purpose other than to pay benefits as long as the employer is solvent.
  - Most trusts are structured to allow some or all excess assets to be returned to the employer.
- For book and tax purposes, the trust and its assets remain on the corporate balance sheet. Earnings on trust assets flow directly to the income statement (i.e., the trust is a grantor trust).
- Use is prevalent and consistent with Internal Revenue Code Section 409A.

TAXATION

Employer

- Compensation is not deductible when deferred.
  - For C-Corporations, value of future deduction can be recognized as deferred asset for P&L purposes.
- FICA and Medicare taxes are payable when compensation is deferred or employer contributions vest.
- Benefits are deductible when paid.
- Gains on trust assets are taxable to the corporation in the same manner as if held directly by the corporation.
- If funded with COLI:
  - Premiums are not tax deductible.
  - Cash surrender grows tax deferred (tax-free if held until death).
  - Death proceeds are tax-free.

Employee

- FICA and Medicare taxes are payable when compensation is deferred or employer contributions vest.
- Employee is not subject to income tax until distribution.
- Income from plan is taxed as ordinary income.
- Distributions are not subject to FICA and Medicare taxes to the extent they were previously subject to such taxes.

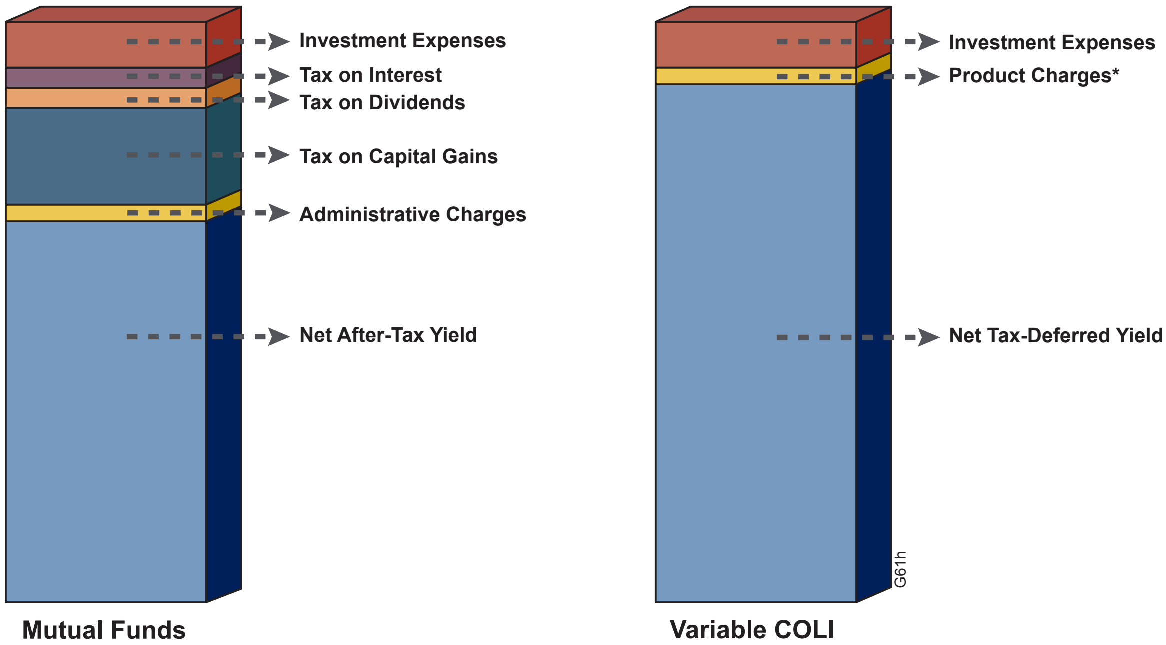
BENEFIT FUNDING

Why Do Companies Fund Nonqualified Benefits?

- To create an asset to offset emerging liabilities.
- To shift the burden of funding to current management.
- To neutralize shareholders to the financial impact of emerging liabilities.
- To provide a level of security that is as close as possible to the security level available to qualified plan participants.

In choosing an appropriate funding device, there are many important factors to consider, including the investment's after-tax yields and how well it tracks plan liabilities. Largely because of these factors, the two most common vehicles used for funding nonqualified benefit plans are mutual funds and COLI.

Mutal Funds Compared to Variable COLI



	MUTUAL FUNDS	VARIABLE COLI
Asset Management Fees	Yes	Yes
Insurance Charges	No	Yes
Death Benefits	No	Yes
Tax Considerations	■ Capital gains** generated by: – Trading within the fund by the fund manager – Liquidation of the funds to pay benefits – Liquidation of the funds to exchange to other funds ■ Dividend pass-throughs from mutual funds*** ■ Interest income pass-throughs from mutual funds** ■ With dividend, interest and capital gains pass-throughs the owner (the corporation) has no control over the timing of taxation	■ Cash values grow income tax-deferred (tax-free if held until death) ■ Insurance death benefit proceeds are income tax-free to the corporation ■ Fund transfers between variable subaccounts are not taxable ■ With most contracts, cash values which must be accessed from the insurance prior to death are with - drawn basis first

NOTE

Product charges include sales expense charges, federal and state premium taxes, cost of insurance, annual administrative charges, and mortality and expense risk charges.

*****Taxed at ordinary income rates for C-corporation owners.***

******50% of dividends are excluded from taxable income and on C-corporation owners.***

Sample Deferral, Executive Age 50

Salary: $200,000; Deferral: $40,000; Bonus: $40,000; Deferral: $20,000

Year	Deferral	Earnings	Total
1	$60,000	$4,200	$64,200
2	60,000	8,694	132,894
3	60,000	13,503	206,397
4	60,000	18,648	285,044
5	60,000	24,153	369,197
6	60,000	30,044	459,241
7	60,000	36,347	555,588
8	60,000	43,091	658,679
9	60,000	50,308	768,987
10	60,000	58,029	887,016
11	60,000	66,291	1,013,307
12	60,000	75,131	1,148,439
13	60,000	84,591	1,293,029
14	60,000	94,712	1,447,741
15	60,000	105,542	1,613,283

	Annual Distribution	Total Payments
Lump Sum	$1,613,283	$1,613,283
5 Year	367,724	1,838,620
10 Year	214,668	2,146,684

Assumptions

- **Investment Rate of Return—7%**
- **Retirement Age—65**
- **Years to Retirement—15**
- **Salary Deferral—20%**
- **Bonus Deferral—50%**

ABOUT BOLICOLI.COM

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We work closely with clients and their advisors to define objectives, identify the best products to fit their needs, and manage their portfolios over the long term.

With years of experience working with public and private companies and long-standing relationships with leading life insurance companies, BoliColi.com is uniquely positioned to deliver differentiated solutions consistent with the objectives of our clients.

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