M Benefit Solutions®

The single source for all your executive benefit needs

A Primer on Nonqualified Deferred Compensation Plans

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This material is intended for informational purposes only and should not be construed as legal or tax advice and is not intended to replace the advice of a qualified attorney, tax advisor or plan provider.

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 it entails risk, including the possible loss of principal.

Variable Universal Life insurance combines the protection and tax advantages of life insurance with the investment potential of a comprehensive selection of variable investment options. The insurance component provides death benefit coverage and the variable component gives you the flexibility to potentially increase the policy's cash value.

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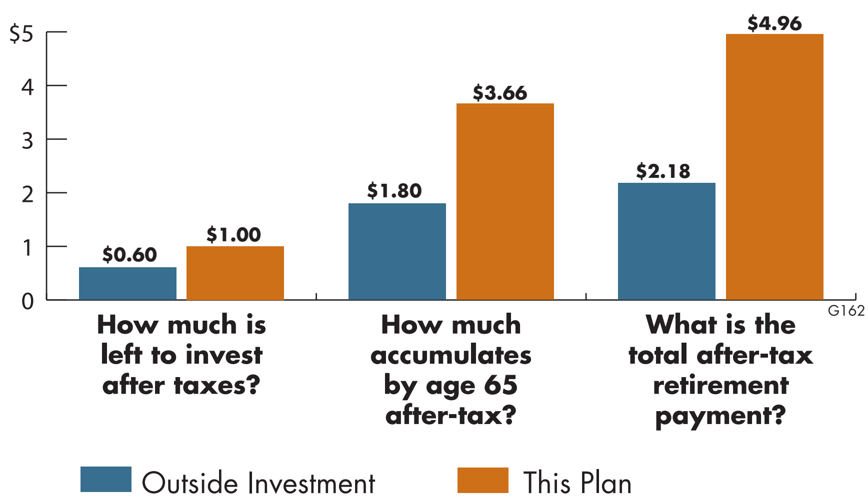
OVERVIEW

- 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.
- Many deferred compensation plans 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



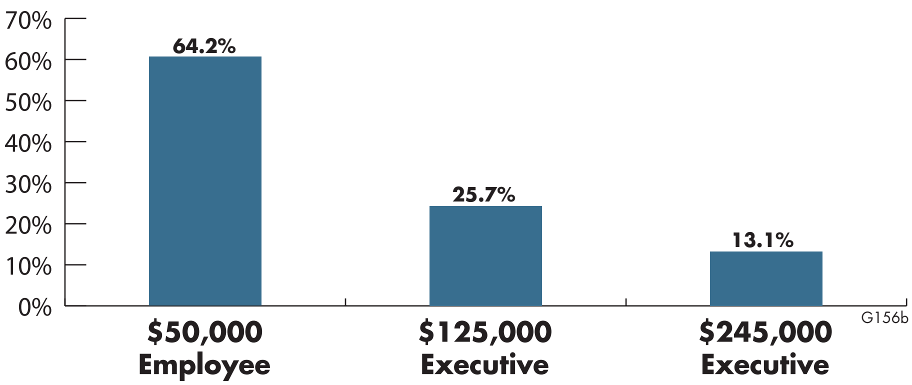
Assumptions

- Employee's Age—40
- Annual Growth Rate—7.5%
- Employee Tax Bracket—40%
- Payout—10 years

WHY SPONSOR AN 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—5.00%
- CPI—2.75%
- Payout—15 years
- Growth Rate—7.50%
- Max 401(k) Contribution to Age 62

MECHANICS OF A TYPICAL NDCP

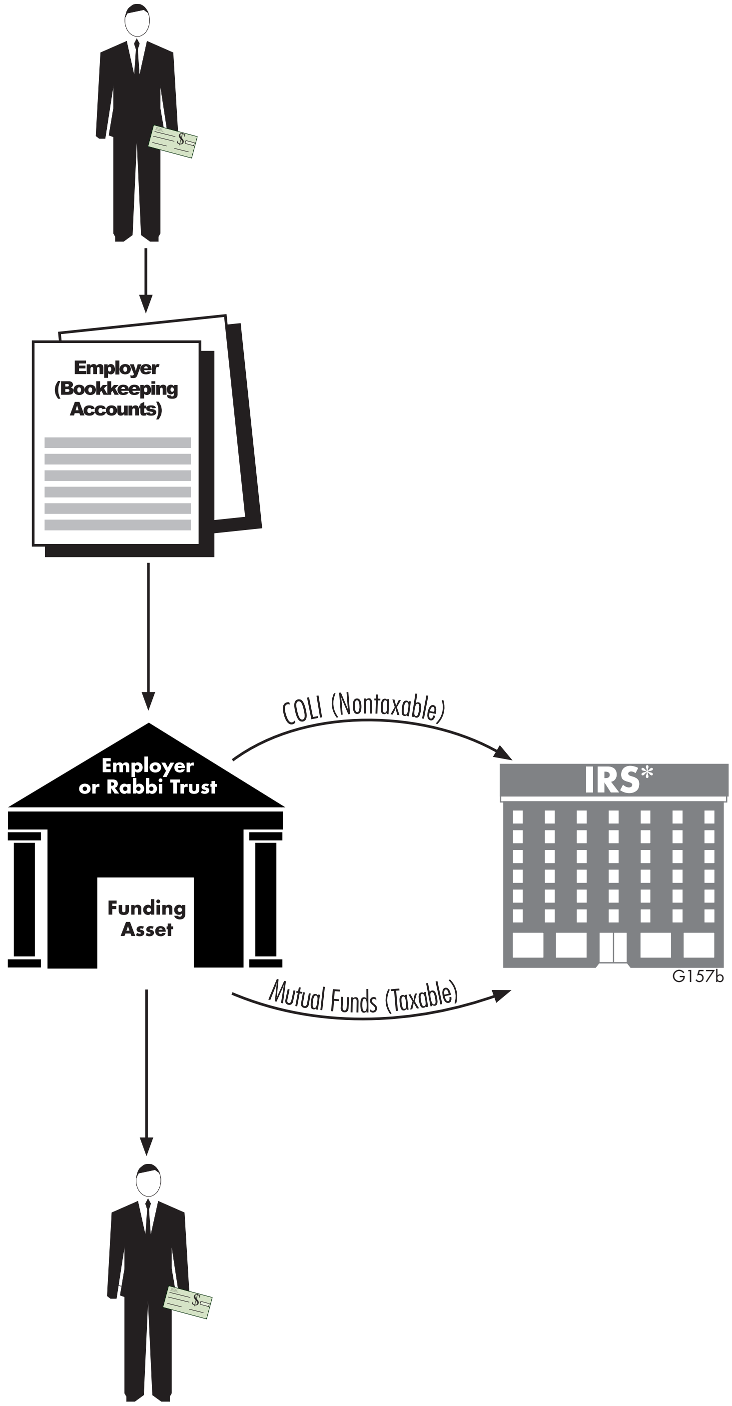
Participant makes election to defer salary, bonus, or other compensation.

Company may make matching and/or discretionary contributions.

Bookkeeping accounts are maintained by the Employer. Earnings are applied to balances on a tax-deferred 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/desired. Excess funding assets can revert to corporation and can offset plan costs (e.g., COLI death benefits).



**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

RABBI TRUSTS

- Rabbi trusts are 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.

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.

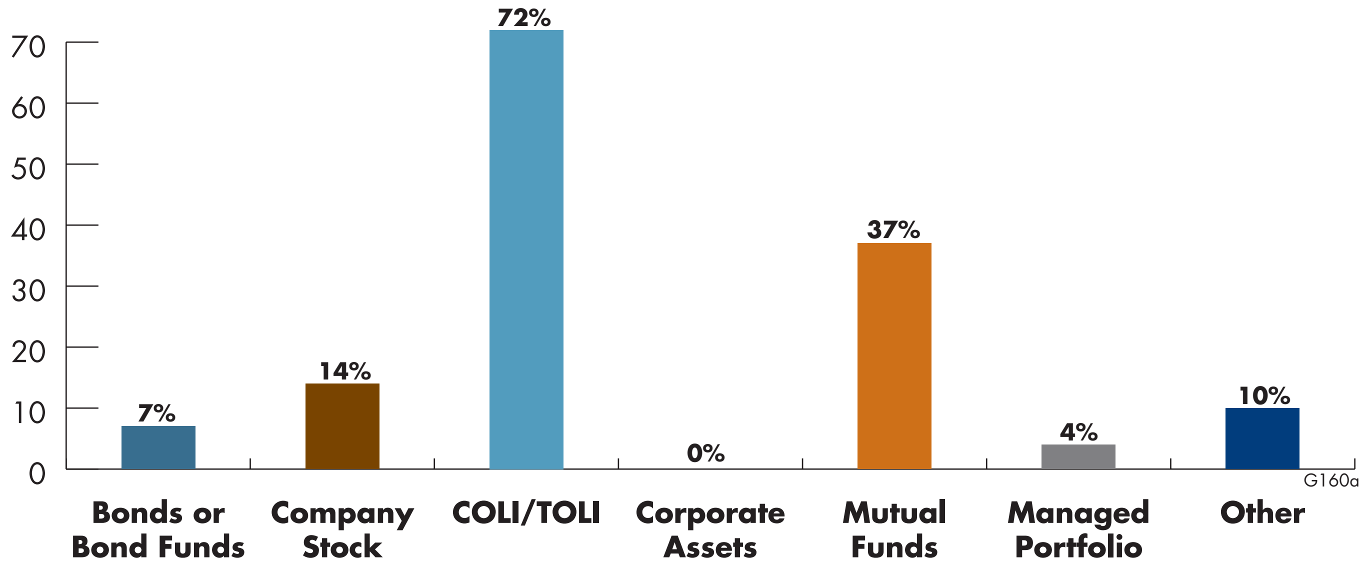
EMPLOYEE

- 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.

VARIABLE CORPORATE-OWNED LIFE INSURANCE (COLI) COMPARED TO MUTUAL FUNDS

In a 2007 survey* of nonqualified executive retirement plans, 72% of responding *Fortune 1000* companies that fund their nonqualified deferred compensation plans do so with COLI, while only 37% use mutual funds (see below for results of survey). The primary reason is that unique COLI tax advantages may result in greater long-term asset accumulation.

2007 SURVEY—TYPES OF NDCP PLAN FUNDING



NOTE

*"Executive Benefits—A Survey of Current Trends," Clark Consulting.

MUTUAL FUNDS—THE TAXATION PROBLEM

Mutual fund gains create tax liabilities to the corporation that reduce the effective after-tax yield. The following events are all taxable events to the corporation:

Capital Gains Generated When the Corporation Sells Fund Shares*

Mutual fund shares are commonly sold to:

- Generate funds for benefit payments.
- Transfer funds to bring asset allocation back in line with preferred risk/return levels.
- Transfer funds to coincide with participant fund selections in deferred compensation "mirror" plans.

Pass-Through Income Distributed by the Mutual Fund

Dividends

Corporate owners can usually exclude 70% of dividends distributed by the mutual fund.

Interest Income

From, for example, money market funds, bond funds, etc.

Capital Gains*

These gains are created when a fund sells securities in its portfolio, which can occur for a variety of reasons:

- The portfolio manager is actively buying and selling to manage portfolio risk and return.
- The portfolio has experienced "style drift" and securities must be sold to return to the fund's stated investment objectives.
- Other fund shareholders are liquidating holdings, so the fund must sell shares to generate cash for redemptions.

With dividend, interest and capital gain pass-throughs, the owner (the corporation) has no control over the timing of taxation. Furthermore, taxation can even occur in years in which the fund has negative returns.

NOTE

*Corporations pay taxes on capital gains at ordinary income rates.

Investments in securities involve risks, including the possible loss of principal. When redeemed, shares may be worth more or less than their original value.

Please refer to page i for important disclosure information.

VARIABLE CORPORATE-OWNED LIFE INSURANCE (COLI)

While offering similar portfolio alternatives to mutual funds, variable COLI possesses many favorable tax characteristics, including:

- Cash values grow tax-deferred (tax-free if held until death).
- Insurance death benefit proceeds are tax-free to the corporation.
- Fund transfers among variable subaccounts are tax-free (unlike gains on sales which are required when transferring balances among mutual funds).

If funds must be accessed from the insurance prior to death, cash values can be withdrawn basis first.

NOTE

Loans and partial withdrawals from life insurance will decrease the death benefit and cash value and may be subject to policy limitations and income tax.

Please refer to page i for important disclosure information.

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