Executive Benefits/Non-qualified Plans in a High-Tax, Low-Interest Environment

Construction Industry

CFMA

February 11, 2014

Pinnacle Financial Group

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BOSTON | CHICAGO

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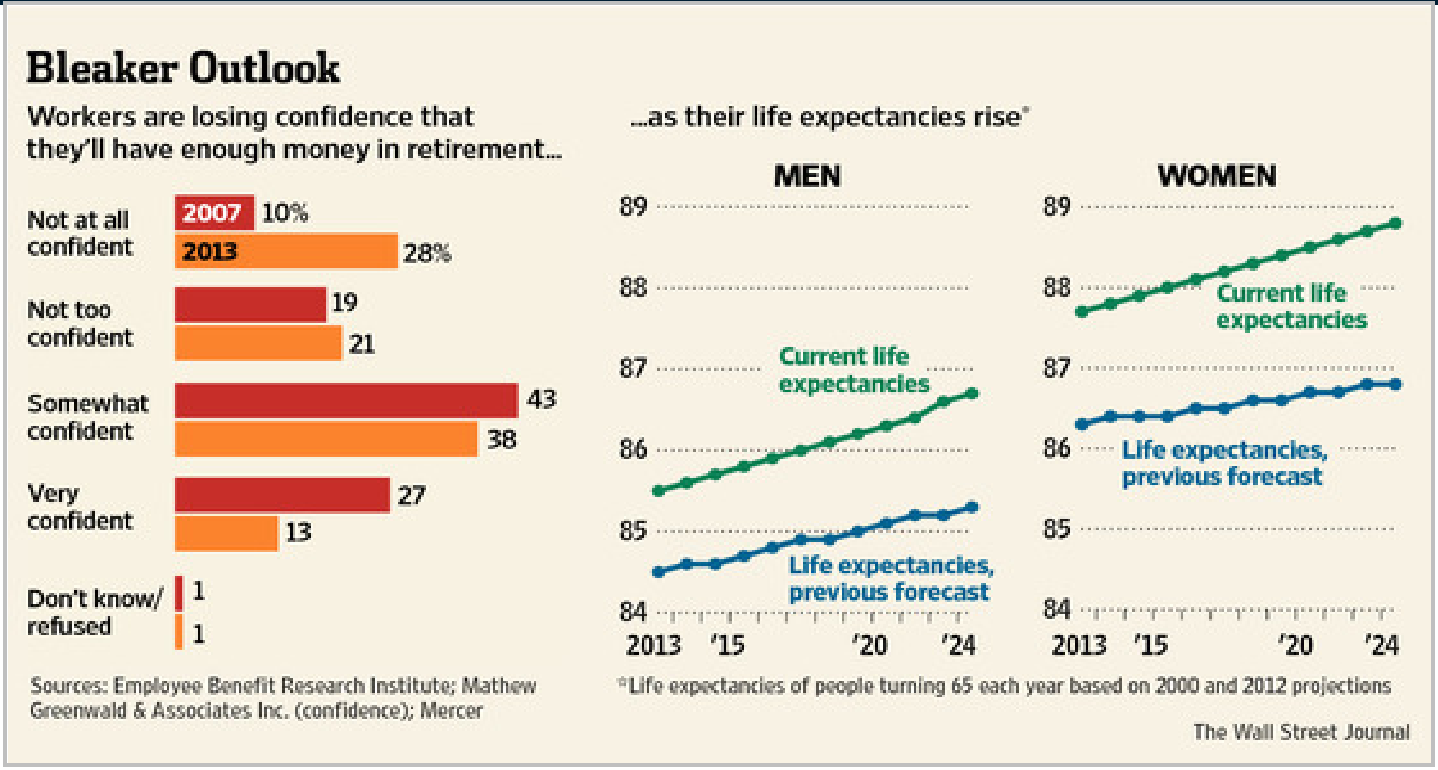
U.S. Retirement Outlook

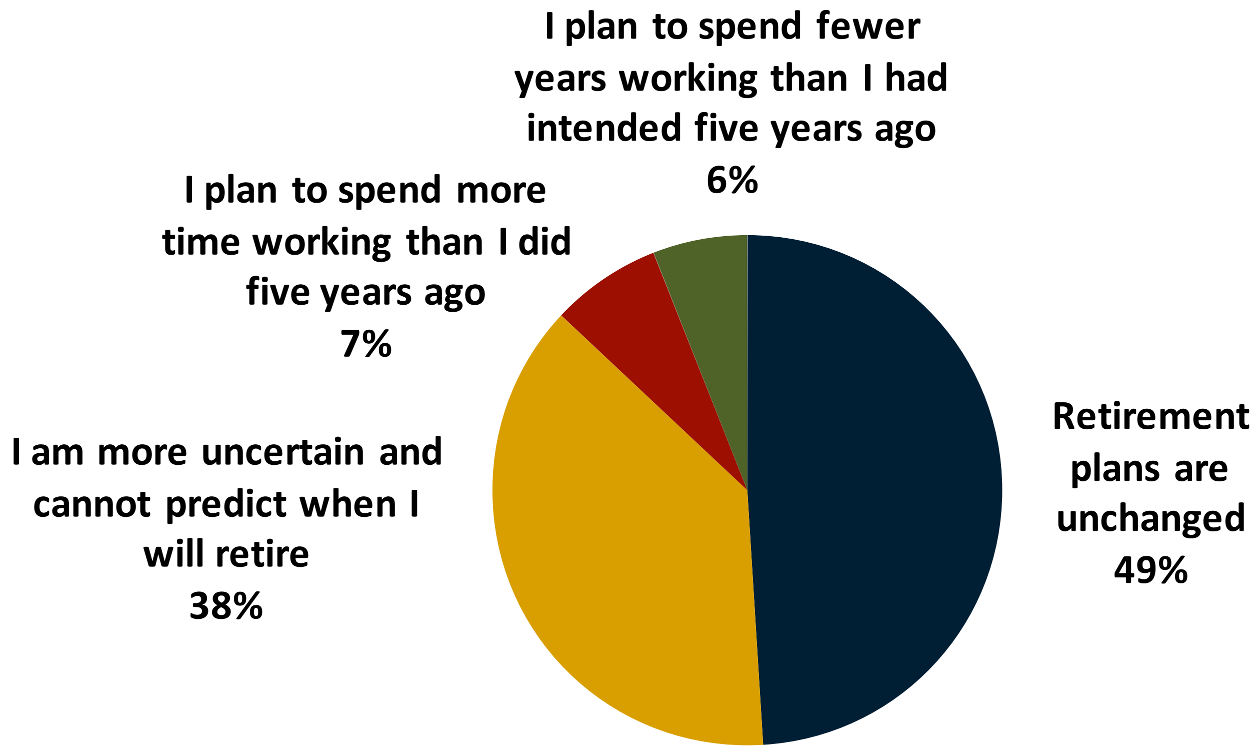


Source: The Wall Street Journal, "Workers Saving Too Little to Retire" March 19, 2013

- 57% US workers report < $25,000 household savings/investments
- 28% of Americans have no confidence they will have enough money to retire comfortably - highest in study's 23-year history
- 1 in 3 babies born today will live to 100!

Executive Retirement Statistics

CFOs were asked, *"How, if at all, have your retirement plans changed in the last five years?"* Their responses were:



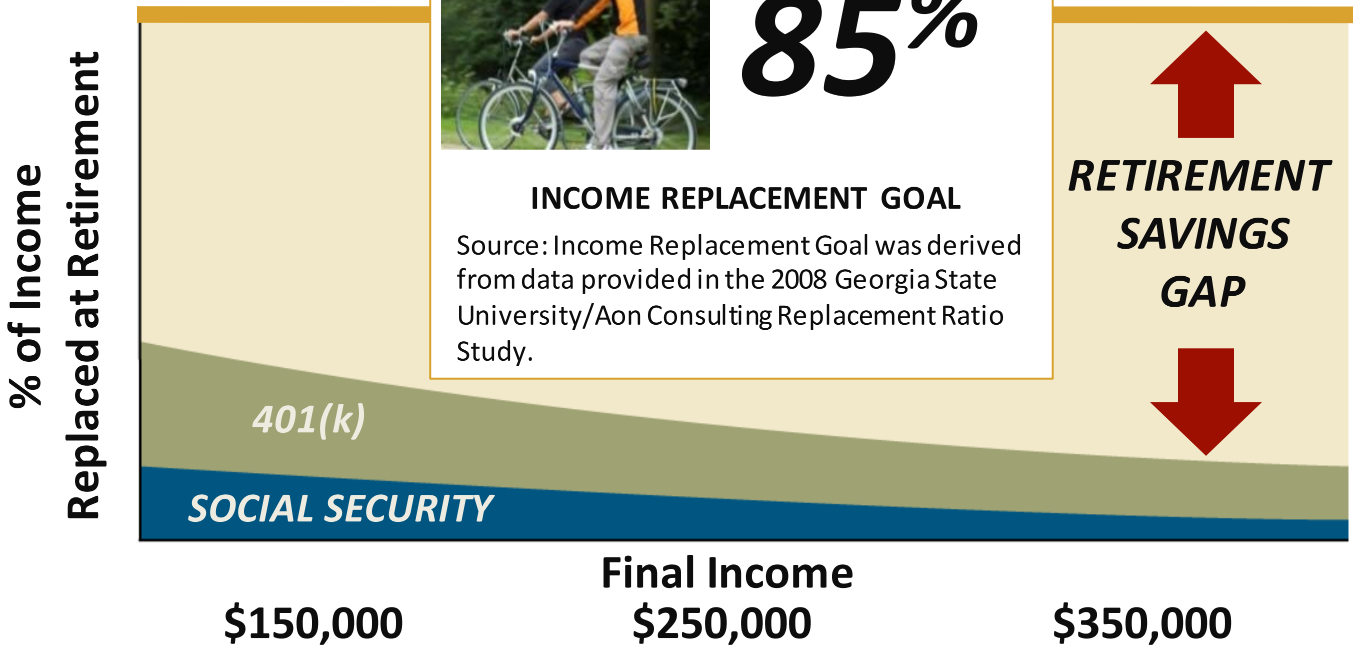
Source: PLANSPONSOR.com, "Executives May Be Rethinking Retirement." February 21, 2013

The Need To Defer

85%

INCOME REPLACEMENT GOAL

Source: Income Replacement Goal was derived from data provided in the 2008 Georgia State University/Aon Consulting Replacement Ratio Study.



6% *RATE OF RETURN*

ASSUMPTIONS

- Age 45 retiring at 65, 20 years of retirement payout
- Max 401(k) contribution each year
- Assumed $17,500 in 2013; inflation rate thereafter (rounded to the nearest $500)
- Level 401(k) payout

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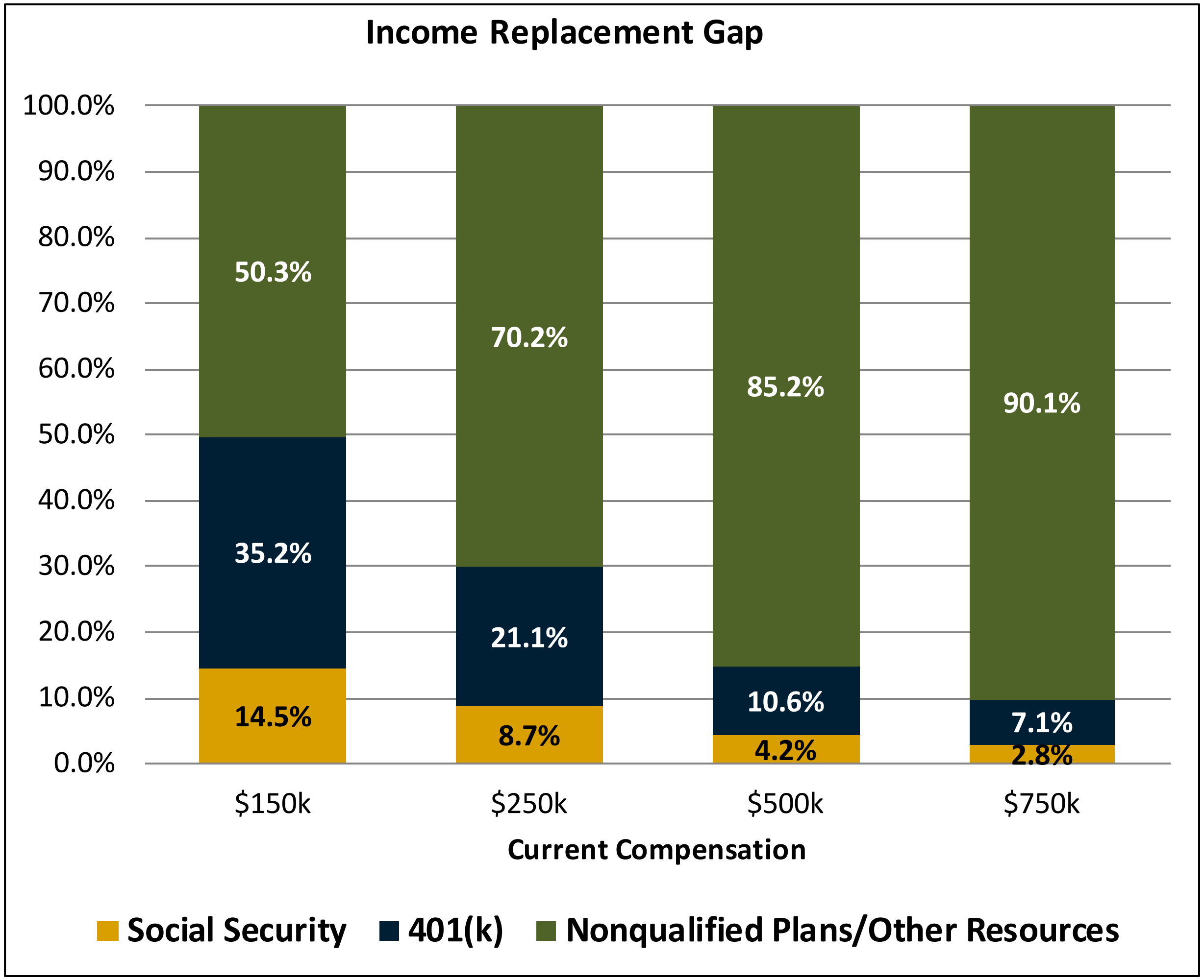
Retirement Needs Can Be Substantial

ASSUMPTIONS

- 45 years old
- Plans to retire at 65
- $75K starting 401(k) balance
- Makes maximum annual contribution, including catch-up
- Earning 6%
- ***4% annual salary growth***



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Future of Retirement – The Numbers

- 1935 - Social Security ACT signed by FDR
- 17 Cents - First payment to Ernest Ackerman – lump sum
- 1965 - Medicare passed into law
- 64 – life expectancy in 1935
- 2024 – Medicare will run out of money
- 2033 - Social Security will run out of money

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The Changing Landscape of US Taxes

TAX	2012	2013+
Top Federal Income Tax	35%	39.6%[1]
Medicare Tax on Investment Income	0%	3.8%[2]
Capital Gains Tax	15%	20%[1]
Dividends Tax	15%	20%[1]
Social Security Payroll Tax	4.2%	6.2%
Medicare Payroll Tax	1.45%	2.35%[3]
Top Gift and Estate Tax	35%	40%
Personal Exemption Phaseout	-	Reduced by 2% for each $2,500 exceeding threshold[4]
Itemized Deduction Limitations	-	Reduced by 3% of the amount exceeding threshold[4]

[1] Imposed on taxpayers with ordinary income exceeding $450,000 for joint filers ($400,000 for individuals)
[2] Imposed on taxpayers with Adjusted Gross Income exceeding $250,000 for joint filers ($200,000 for individuals)
[3] Imposed on wages in excess of $250,000 for joint filers ($200,000 for individuals)
[4] Imposed on taxpayers with Adjusted Gross Income of $300,000 and above for joint filers, $275,000 for Heads of Household, $250,000 for Single filers and $150,000 for taxpayers Married Filing Separately – not to exceed 80%

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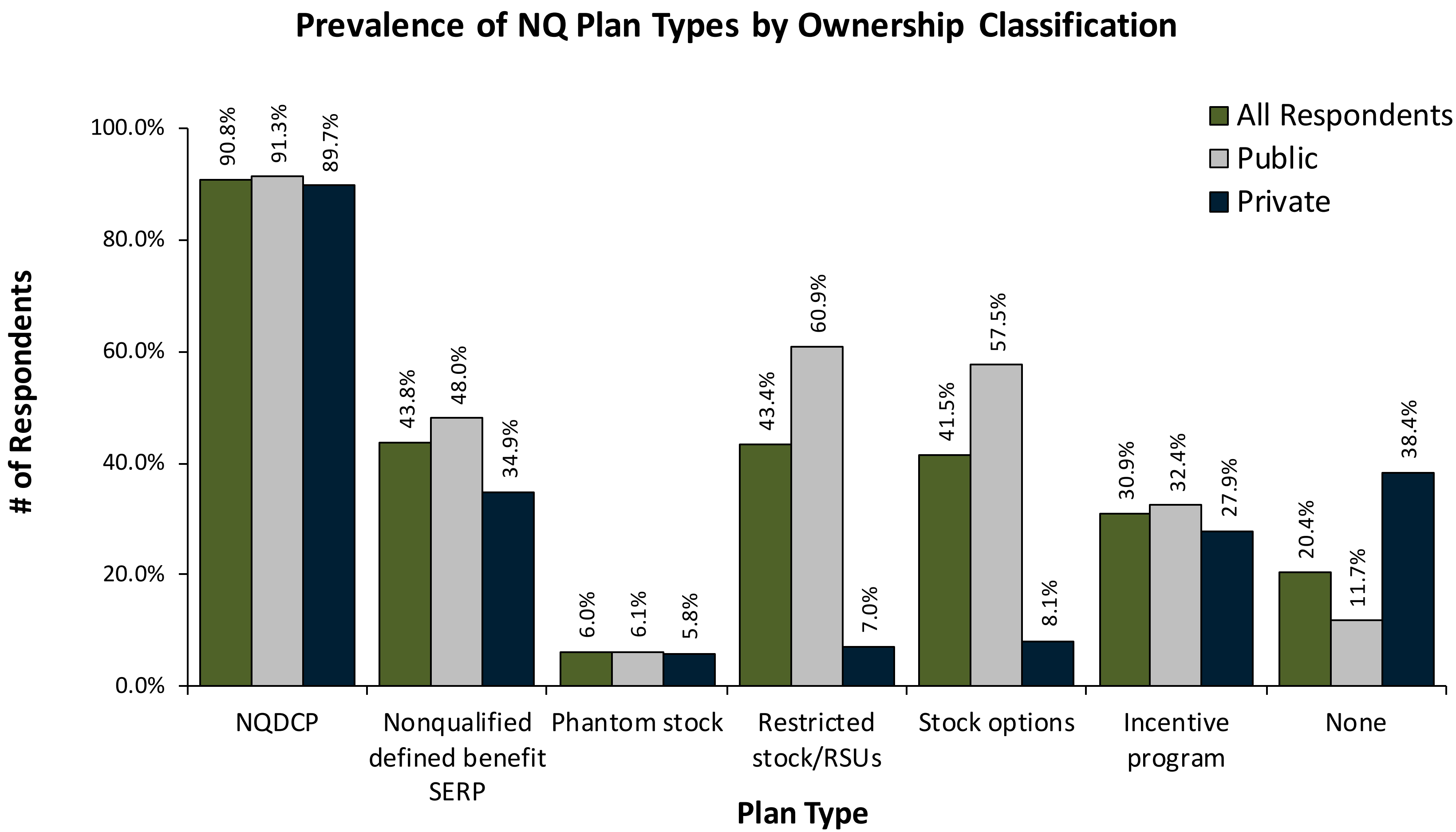
Nonqualified Deferred Compensation Plans



* Based on 2012 PLANSPONSOR Executive Benefits Survey.

401(k) versus NQDC

Qualified Plan - 401(k)	NQDC
• For all employees	• For the highly compensated
• Up to $17,500 for 2013 • $23,000 for those age 50 and over	• No statutory max contribution – Up to 80% salary and – 100% bonus earned
• Payout at 59½ without penalty	• Penalty-free payouts at any age, while still employed or after
• Investment options	• Investment crediting options
• Must be formally funded	• Cannot be formally funded
• Protected by ERISA	• Not constrained by ERISA's participation, funding, vesting or fiduciary provisions • Participants are general creditors of the company

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NQDC Pros and Cons

Plan Advantages	Unique Risks
▪ Defer amounts in addition to a 401(k)	▪ Bankruptcy or insolvency of Company (general creditor status)
▪ Opportunity to accumulate additional amounts with compounded pre-tax savings	▪ Investment risk (mitigate with 3%-4% fixed rate)
▪ Reduce current income taxes (lower AGI)	▪ No rollovers to IRA; not portable
▪ Distribution and investment flexibility to plan for life events (payouts while still employed)	▪ Future tax rates uncertain
▪ Fixed rate 3%-4% (if funded with COLI)	
▪ Rabbi Trust segregates assets, protects against change of control	

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NQDC - Compliance

Plan AND operation must be compliant with 409A including:

- No distributions for 6 months following separation of service
- May not change deferral elections during the plan year
- No deferral realized gains from exercising stock options
- No use of trusts that place assets outside the reach of creditors
- Participants must have “substantial risk of forfeiture”
- No unscheduled withdrawals (except in the event of hardship)
- No acceleration of scheduled distributions

PENALTIES

Fully taxable plus 20% additional tax plus retro interest

Executive Benefits – Misconceptions

- I have to offer the plan to all employees
- It will impact my bonding capacity
- Owners will not be able to participate
- Too complex to include family members
- Plan is expensive to maintain
- Plan will not help me retain top performers
- Plan does not make sense if tax rates rise

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Plan Design Levers to Achieve Goals

Plan features that will "Attract, Retain, Reward"

- Company match – extend 401(k) match to NQDC plan
- Pre-tax deferred retention/sign-on bonus
- Pre-tax performance bonus – company paid if performance criteria are met
- Ability to defer at least 75% of total compensation
- Eligibility beyond just the C-suite
- In-service distributions – elect payout as early as three years from deferral date
- Post-retirement distributions – distributions over as many as 10-20 years
- Investment lineup covers all market sectors including alternative investments
- Attractive fixed rate alternative 3%-4% plus death benefit (if COLI)
- Pre-retirement death benefit for participants

Non-qualified Plan Alternatives – 2 Choices

- **Defined contribution (DC)** - program where company may contribute annually:
  - Performance bonus based on meeting criteria
  - Sign-on bonus
  - Vesting from above provides retention element
  - Executives may reduce income by deferring pre-tax compensation
  - Tax deduction on contribution and earnings at distribution
- **Defined Benefit (DB) -** Supplemental Executive Retirement Program (SERP)
  - Tax deduction at distribution
- May offer pre-retirement death benefit for both DC and DB plan

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Non-qualified Plan and Bonding Capacity

- Goal – offer non-qualified program without adverse "Bonding"
- Company may informally fund non-qualified program
  - Assets remain on company "books"
  - Unfunded liabilities adversely impact bonding
- Rabbi trust may result in lost bonding capacity since trustee owns assets
- Company must weigh bonding versus plan participant benefit security
  - Rabbi trust not prevalent in construction industry

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Restricted Executive Bonus Arrangement

- IRS "Bonus 162" Program
- REBA -- impact on employer
  - Tax deductible to employer immediately
  - Helps attract and retain (vesting requirement)
  - May have adverse bonding impact
- REBA -- impact on executive
  - Pay tax now not later (employer may bonus the tax)
  - Asset grows tax free
    - May be fixed rate or market based
    - Tax free retirement income
    - Tax free death benefit
    - Estate enhancement planning opp

What are Informal Funding Options?

- No Funding
  - “Unfunded” plan
  - Potential benefit risk
- Taxable Securities
  - Range of investment alternatives — all market sectors and top managers
  - Most effective if company is not a tax payer; Net Operating Losses (NOLs) > longer than five years
  - Some tax and accounting limitations
- Life Insurance (COLI)
  - Range of investment alternatives — all market sectors and top managers
  - Most effective if company is “generally” a tax payer; NOLs < five years
  - Generally superior accounting treatment relative to taxable securities
  - Affords tax-deferred asset build-up and tax-free death benefit
- Hybrid (Taxable Securities & COLI)
  - Most effective when company currently not taxpayer; NOLs 3-10 years

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Succession Planning

- Help future management/owners "buy out" current owners
- Allows executive or family member to "retire"/ let go
- Avoid burdening next generation, "social security syndrome"
- Can be linked to buy sell or partnership agreements
- Offers security and sign of commitment to non family member executives
- Effective program ensures long term management loyalty
  – Attract and retain "right" talent long term

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Informal Funding Comparison

Comparison	Taxable Investments	COLI *
Large selection of available funds	Yes	Yes
Simple to implement	Yes	Yes
Can match 401(k) breadth of funds	Yes	Yes
Quality investment choices and advisors that can provide valuable diversification to existing 401(k) funds	Yes	Yes
Taxation on investment, dividends, and interest	Yes	No
Taxable event when changing allocation	Yes	No
Tax due on any unrealized gains upon Plan withdrawal	Yes	No
Tax-deferred investment income	No	Yes
Annual expenses	Minimal	Initially higher; tax advantages outweigh insurance costs
Tax-free proceeds	No	Yes**
Cash accumulation tracks deferred compensation balances	Yes	Yes
Eliminates taxes on investment income	No	Yes
Tax-free access to cash to make benefit payments	No	Yes
Can be accretive to corporate earnings	No	Yes

*Taxation of life insurance is subject to IRC sections 72, 101, 817, 7702 and 7702A and assumE the taxpayer is not in AMT. Please consult your tax advisor for additional information.
**See Notes on Life Insurance and Notes on Life Insurance Distributions located at the back of this report for additional detail on when death proceeds are tax-free as well as other important information.

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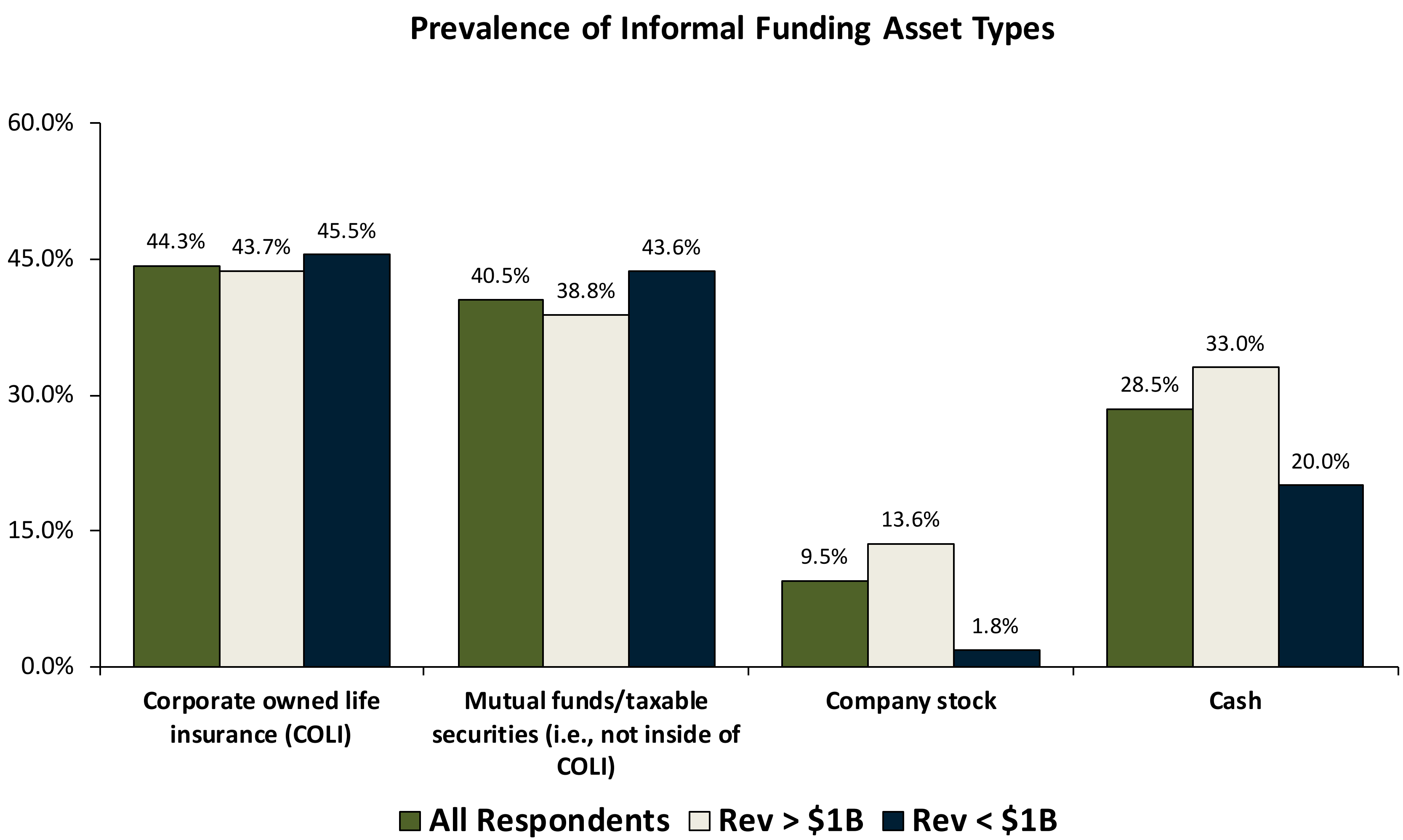
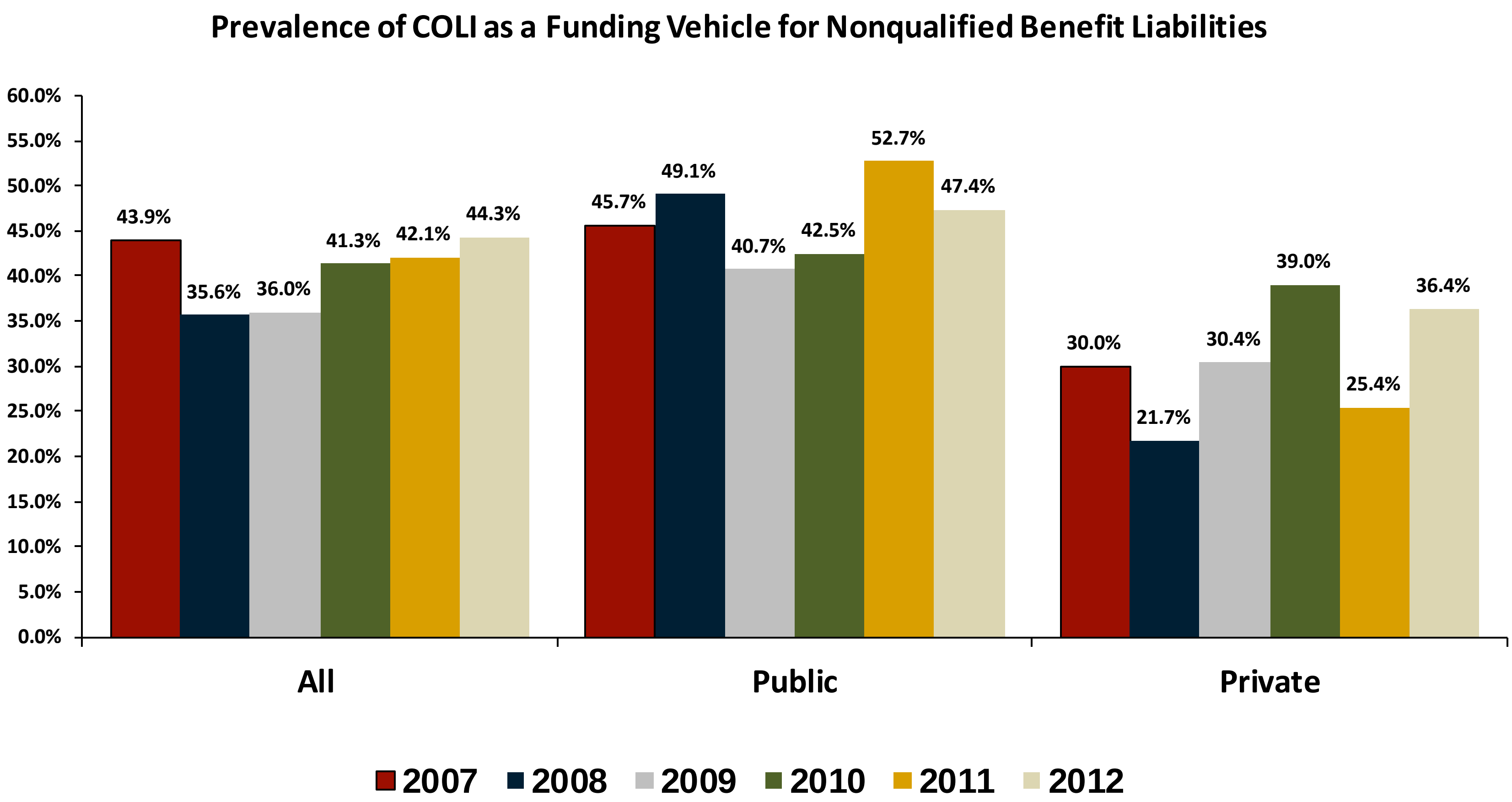
Informal Funding



* Based on PLANSPONSOR Executive Benefits Survey.

Prevalence of COLI



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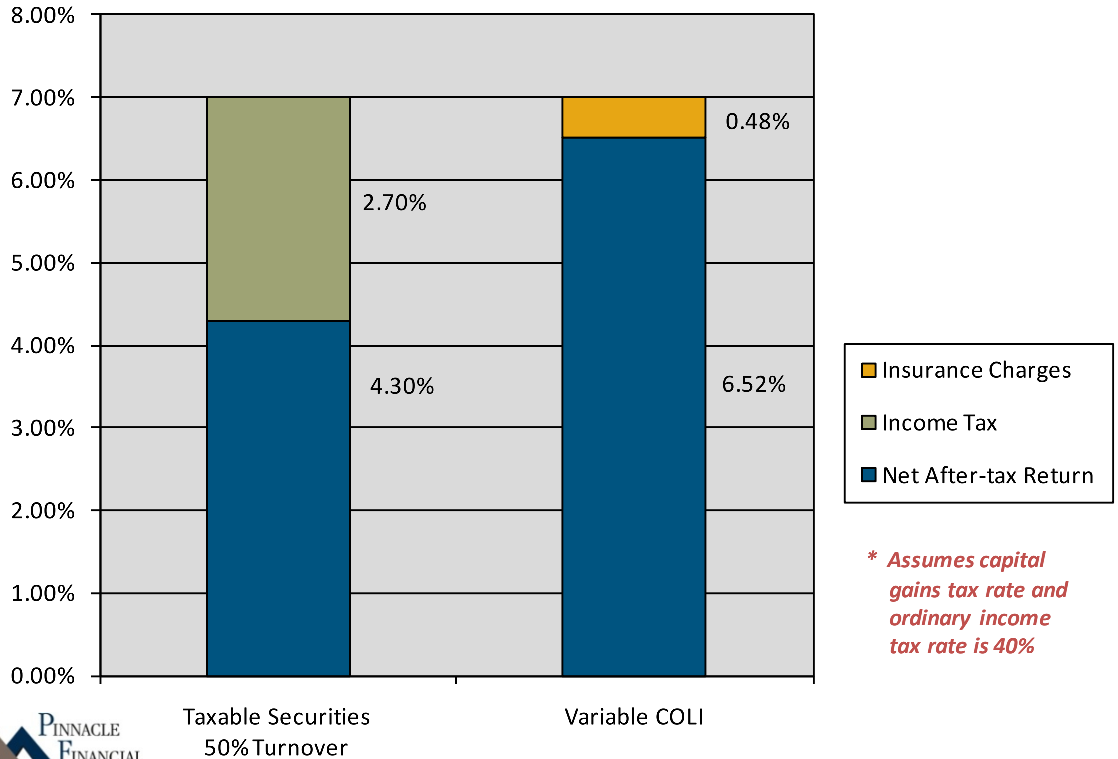
COLI vs. Taxable Investment*

	Taxable Securities (50% Turnover)	Corporate-Owned Life Insurance
Pretax Return	7.00%	7.00%
Impact of Income Tax	(2.70%)	0.00%
Impact of Insurance (Charges)/Gains	0.00%	(0.48%)
Life of Investment Net After-tax Return	**4.30%**	**6.52%**

SAVINGS USING COLI **2.22%**



** Assumes capital gains tax rate and ordinary income tax rate is 40%*

This chart incorporates hypothetical values that, while believed to be accurate, are not guaranteed nor are they a representation of past or future results. Actual results will vary. See Notes on Life Insurance located elsewhere in this report for additional detail.

The hypothetical taxable security values have been prepared to assist in analyzing informal funding alternatives. These values are not guaranteed nor are they a representation of past or future results. Investments in securities involve risks, including the possible loss of principal. When redeemed, shares may be worth more or less than their original value.

The preceding chart illustrates the effect of the income tax characteristics of life insurance on after-tax results by assuming, hypothetically, that each alternative generates the same pretax rate of return.

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Case Study #1

Issues / Challenges

- No NQDC in place
- Failed discrimination testing – executives receive refunds
- Company considering adding safe harbor – large expense

Solutions

- Implemented NQDC “Wrap” plan – eliminate refunds from failed testing
- Includes company contributions tied to performance
- Fund plan with hybrid COLI and mutual funds
- Insurance acquired on key executives
  - Death benefit provided for both executives and ownership
- Improved ability to save for retirement – attract and retain
- Avoided expense of safe harbor plan

Case Study #2

Issues / Challenges

- 401(k) plan and NQDC with large 401(k) plan provider
- Little NQDC expertise and service – 409A violations
- Low plan participation – 14 out of 56 eligibles
- Significant tax cost from mutual fund taxable gains in Rabbi Trust

Solutions

- Converted to expert with both 401(k) and NQDC expertise
- Improved communication and education increased participation to 39 of 56
- Improved technology and administrative oversight and accountability
- Implement hybrid funding COLI and mutual funds
- Resulted in P&L pickup and reduced tax cost
- Added death benefit for executives

Case Study #3

Issues / Challenges

- 409A violations
- NQDC funded with “retail” COLI – insurance expenses > taxes
- Low plan participation – only 9 out of 38 eligible
- Money Market portfolio crediting close to 0%; no other fixed-rate choice
- Distributions limited to termination, no in-service

Solutions

- Exchanged to institutional insurance carrier; lower insurance charges
- Significant incremental P&L pick-up
- Added “while active” distributions and fixed rate crediting option
- Education initiatives increased participation to 31 out of 38 eligible
- Improved technology and administrative oversight and accountability

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Why Implement a Plan?

No Current Nonqualified Plan in Place

- Low-cost method to deliver benefits
- Fill retirement savings gap
- Discrimination testing make-up – 401(k) “Wrap” plan
- Reduce current taxable income in new high tax rate environment
- Make-up for qualified plan limits
- Education/communication → Participation
- Succession planning

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I Have a Plan. Now what?

Currently Have Nonqualified Plan in Place

- Due diligence/Audit plan design and funding
- Identify plan strengths, weaknesses and actionable opportunities:
  - Is the plan compliant with current regulatory requirements?
  - Is this plan helping plan sponsors reach their goals?
  - Is this plan helping plan participants reach their goals?
  - Is the communications program driving enrollment?
  - Can the cost of the plan be reduced? What is the impact of an informal funding strategy and alternatives?
  - Is current funding vehicle most appropriate and competitive?

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Over 40 years of proactive service and creative solutions for health & welfare, retirement planning, executive benefits and high-net worth clients.

Pinnacle Core Principles

- Put the clients first.
- Be the best through expertise and innovation.
- Create an empowering environment.
- Be a leader in corporate citizenship.

Executive Benefits

- Clients range public and private mid-size companies to Fortune 1000
- Over $1B in nonqualified retirement assets under management
- David Hauptman, Partner and Managing Director
  - ✓ Over 25 years experience
  - ✓ Renowned for incisive plan assessments, executive education and optimal, compliant plan design solutions

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Notes on Life Insurance

The charts and spreadsheets in this document incorporate hypothetical cash and death benefit values from sample variable life insurance contracts typical of the contracts available for sale today. The values are included for illustration purposes only and do not constitute an offer or a solicitation for the sale of any security or insurance product. Offers of securities may only be made by prospectus. The sources of the hypothetical values are computer-generated illustrations produced by software provided by the sample carriers. The computer-generated illustrations are not intended to be, and should not be relied upon as, either a representation of past performance or a prediction or forecast of future results. Rather, the purpose of the illustrations is to show how the performance of the contract's underlying investment accounts could affect the contract's cash and death benefit values in future years.

Copies of the computer-generated illustrations used in incorporating the hypothetical values are available upon request. The computer-generated illustrations also provide hypothetical values based on guaranteed maximum contract charges and on a zero percent rate of return applied to the contract's underlying investment accounts.

For additional and more detailed information about the life insurance contracts set forth in this report, ask to see the prospectus. Copies of the prospectus are available at the address listed at the front of this document. Please read it carefully before you invest.

Variable life insurance products are long term programs and may not be suitable for all investors. The acquisition of variable life insurance entails fees and charges and is subject to fluctuating values of the underlying investment options. Variable life insurance entails risks, including the possible loss of principal. Early withdrawals may trigger tax penalties. The death benefit coverage of variable life insurance is based on the claims-paying ability of the insurance company.

Values in “Alternative Investments’ After-Tax Results” Illustrations

Source of Variable Life Insurance Values – The “Alternative Investments’ After-Tax Results” illustrations incorporate hypothetical values from a variable life insurance contract based on the assumptions set forth in this report. The hypothetical values are not a prediction of future investment results. The contract is typical of those variable life products currently being marketed by life insurance companies to major corporations to informally fund nonqualified plans.

Ownership, Insurable Interest and Consent – The owner and beneficiary of the life insurance contract is illustrated as being the employer. Therefore, it is assumed that the employer has an insurable interest in the employee insured and that the employee has consented to the employer’s purchase of the contract.

Timing of Life Insurance Cash Flows – The illustration is based on the assumption that no loans or cash withdrawals will be taken from the life insurance contract during the insured’s life, but rather, that the investment return cash flows from the life insurance contract will be received as income tax-free death proceeds at the time of the insured’s death. If loans or cash withdrawals were to be taken from the life insurance contract prior to the insured’s death, the contract’s death benefit would be reduced (or eliminated), income tax might be due, and the contract’s rate of return would be lowered.

Net After-Tax Return Analysis – The illustrated net after-tax return for the life insurance contract is a calculated internal rate of return value based on (i) assumed cash outflows for premiums paid and (ii) assumed cash inflows for death proceeds received. The insurance expenses figure is solved for as the difference between the calculated net after-tax return and the assumed hypothetical pretax gross rate of return, net of money management expenses. The net after-tax return, being based on a life of contract analysis, does not represent either the actual growth of cash value each year or the actual incidence of insurance expenses each year.

“Trading” Versus “Available for Sale” – SFAS 115 outlines two approaches for the accounting of mutual funds. An alternative to the "Trading" method illustrated here is "Available for Sale". Under the "Available for Sale" approach all realized gains flow through the earnings statement. Unrealized gains bypass the earnings statement and go to Shareholder Equity. Results under this approach are similar to the high turnover results under "Trading". Accounting pronouncements are not 100% clear on which approach, if either, is always appropriate to reflect the accounting of mutual funds used within a rabbi trust. For more information, contact your accountant.

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Notes on Life Insurance Distributions

If a life insurance policy is deemed a Modified Endowment Contract (MEC) under IRC § 7702A, all distributions are generally taxed as income to the policyowner to the extent there is a gain in the policy. Distributions are treated first as gain (if any), then as cost basis. Distributions from a MEC may also be subject to an additional penalty tax of 10% on amounts includable in gross income.

Assuming a life insurance policy is not a MEC, withdrawals (but not loans) are generally taxed under the "cost recovery rule" and are taxable only to the extent the withdrawal exceeds the cost basis of the policy. However, during the first 15 policy years, some withdrawals may be taxed under the "gain first rule" as described in the recapture ceiling provisions of IRC § 7702(f)(7). If a loan is outstanding when a life insurance policy is surrendered or lapses, the loan is automatically repaid from the cash surrender value of the policy and generally results in taxable income to the extent the net surrender value plus the amount of the repaid loan exceeds the cost basis of the policy.

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