Summer 2013

VIEWpoint

MANAGEMENT COMPENSATION RESOURCES

Retirement Program Retains Key Employees and Rewards Loyalty

The challenge of retaining and rewarding key employees is something most privately-held companies face — more so during fluid economic times when the allure of greater compensation is the highest.

That was the position a Minnesota-based construction company found itself in during the mid 1990's. A family-owned company with annual revenues of over $100 million, the owners had prided themselves on the tenure of their employees — with 25 percent of employees having been with the company for 10 years or more. Following a period of dramatic growth driven by acquisitions and the formation of subsidiaries, the company's workforce had grown by over 200 percent.

Despite already having a comprehensive benefits package that included medical, dental, disability, 401K and profit-sharing, the executive team felt they needed something else — an added benefit — to reward key individuals for service, incent them to stay, and empower them to save for their retirement.

"With so many acquisitions happening, it was important for us to keep our company together and continuing forward," said the CFO at the time who has now retired. "At the executive level, it was clear that we needed something to keep our culture going; to keep key individuals engaged and willing to take on new roles and responsibilities. We also needed to be competitive when it came to attracting management candidates."

For the company, retaining key employees reached outside of the "executive suite" critical for continued prosperity. If a plant or key subsidiary manager were to leave, there would be a disruption that had the potential for a drop in revenues and profits until a suitable replacement was found.

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According to the CFO, the goal was to create a benefit plan for key middle management employees that would enhance their financial security/retirement situation. They were also concerned with the competitiveness of their current retirement benefits and wanted to do something special for this group of managers — without having to add more benefits and cost to the qualified plans already in place.

"While we had a great benefits package in place, we needed more," said the retired CFO. "For most companies, an employee stock program would have been the perfect solution but because the family controls the stock, it wasn't a viable solution for us. Some sort of deferred plan sounded attractive but we were concerned about the security and safety of our potential nonqualified benefits. We simply weren't sure what would be the best option for a company like ours."

Through a business acquaintance, the CFO was introduced to Scott Rollin, president and founder of Management Compensation Resources, LLC (MCR). Hired to design and implement the plan, develop a benefit security and informal funding strategy, and conduct ongoing employee communications, Rollin and MCR got to know the company's goals and desires and guided them through a process that helped them see the alternatives available.

"When I first met with the executive team, they were interested in creating a deferral plan that would enable key employees to save for their retirement needs," said Scott Rollin. "But as we went through the consulting process,

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State and Federal Legislation … and Other Shenanigans!

Between Minnesota and the U.S. Government, I could probably go into the newsletter writing business … these people are amazing! Thankfully, Gov. Dayton's proposal to tax business-to-business services died on the vine. However, that doesn't mean that Minnesota is done with us.

Along with all of the healthcare legislation flying around, a bill has been introduced in the MN House (H.F. # 506) that would essentially ban the use of non-compete arrangements in MN. While this bill is unlikely to be acted on in the 2013 session, it will remain "alive" for consideration in the 2014 session. The current form of the bill doesn't address the standard "non-solicitation provisions" that prohibit departing employees from soliciting their former employers' employees or customers for a period of time. This could prove very problematic for many MN businesses, so we recommend communicating with your state senator and representative about the negative implications of this legislation.

At the Federal level, the big topic is tax reform and the budget process. Anytime tax reform and budgets are discussed in D.C.,

(*Legislation*, *continued on page 2*)

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it became clear that the company executives wanted more than that; they also wanted protection for the company as well as for key employees and their families."

Since the need extended beyond the executive team, Rollin and MCR recommended a multi-plan approach that included a voluntary Deferred Compensation Plan (DCP) for the most senior executives and a Financial Security Program (FSP) for the middle management employees that they wanted to focus on retaining.

"The combination of these two designs was the perfect fit because it enabled the company to reward a group of employees that added lots of value to the business, but weren't in the most highly-paid group of employees," said Rollin. "It also allowed them to offer an attractive plan for the more highly-paid folks, but didn't create much extra corporate expense since they were already well paid."

The voluntary DCP was offered to senior employees to help them save more of their own compensation for retirement. Through the program, participants can contribute pretax salary and bonus compensation to the plan without IRS limitation.

Announced at a dinner for the selected employees and their spouses, the FSP provides a supplemental retirement benefit (at age 65), based on their actual annual compensation and payable over 10 years. Because of the company's family-centered culture, the FSP also provides a survivor benefit (based on annual compensation) distributed over five years, in case an employee were to die while still employed.

"Unfortunately there has been an instance when the survivor benefit was needed," shared the retired CFO. "The benefit turned out to be a very important resource for the surviving spouse. The FSP payments helped ease her financial worries during a difficult time and provided financial support over an extended period of time."

As MCR took the executive team through the process, Rollin projected the financial impact of the proposed plans, and communicated the accounting and tax issues to the company's finance team and outside auditors. He also provided recommendations for the best informal funding asset and the most efficient method of providing benefit security for the plan.

For the family-owned company, the multi-plan approach was the right solution because it enabled them to offer a different compensation package where individuals could accrue benefits and defer paying income taxes. The plan also was relatively inexpensive for the value it provided and required very little maintenance.

The company's FSP relies on a grantor trust to provide benefit security for plan participants and is informally funded with trust-owned life insurance. While employees may have had life insurance, it was not necessarily like this program and didn't provide a continued income. For the employees, contributions were not required and for the company, the cost was covered by the cash value of the life insurance. If an individual does leave, the cash value of the life insurance can be used to enroll new members.

"Once MCR laid out the plan, it was a 'no brainer' decision to make," said the retired CFO. "The main thing we looked at was that it was a fairly inexpensive benefit that we could target to specific employees. After the initial set up investment expense, the accrued value of the life insurance over time would ultimately cover the benefit payout down the road. It also provided the flexibility to bring new individuals into the plan."

The DCP has also been well-received with two-thirds of the eligible group participating at its peak. The plan provides multiple options for participant payout after retirement, as well as a facility to receive payments while still employed.

"The biggest benefit for us has been that it has helped us keep the talent we already had during a very fluid talent pool in the 2000's," said the retired CFO. "People stayed, had a good attitude and had a good feeling about the Company. And their spouses did too!" In fact, he believes a number of employees have stayed with the company because of the program - and if they had left, it would have made it difficult to grow as rapidly as it did.

From conception to turn-key plan enrollment, implementation, and ongoing program service, Rollin and his team have made the program as low-maintenance as possible.

"The flexibility of the plan design, coupled with the speed with which MCR was able to complete the plan design, enrollment and implementation process, were instrumental in our ability to do what we did during a critical time period. Because of the program, we didn't have to worry about replacing key managers and could focus on the road ahead," said the retired CFO.

Since retiring from the company, the former CFO is now enjoying his retirement — supplemented by the savings he was able to create in the DCP. And MCR continues to provide the company ongoing service and support of both the DCP and the FSP.

"Speaking as someone who has since retired from the program, it was definitely the right solution for us," said the retired CFO. "The deferred compensation package worked well for us because we could accrue money without paying taxes on it at the time. Having the yearly payout for ten years, rather than a lump sum, has been a valuable addition to my retirement portfolio."

(Legislation, continued from page 1)

corporate-sponsored benefit plans (qualified and nonqualified) and corporate-owned life insurance (COLI) are also on the list. Nonqualified benefits are unlikely to be affected in any coming legislation, since they don't "cost the Treasury anything" — based on the scoring system used by Congress.

Qualified benefits, on the other hand, may be impacted but — given the country's savings crisis — any changes would likely be on the margin and/or affect only folks over an income threshold. Of course, income and capital gains tax rates have already increased for anyone making over $200,000 a year — and those changes are likely to stay in place (or even be expanded / lowered).

COLI has always been treated by Congress as a "tax shelter," even though it is purchased with after-tax dollars and gains are fully taxable as income if cashed-in prior to death. Other than the death benefit, this tax treatment is on a par with most other investments but without the potential for capital gains treatment. The insurance industry has a lot of "boots on the ground" in D.C. and will not allow this treatment to change. If anything, we could see an upper-limit on the volume of COLI purchases allowed by banks and large companies, but the impact won't likely work its way down to our clients.

As summer reluctantly arrives here in the Twin Cities, I hope this note finds your business growing and that 2013 turns out to be a banner year. Please let us know if we can be of service to you and your company in any way.

Go Twins!

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