

# PREPARING FOR SUCCESSFUL SUCCESSION PLANNING

Retaining and Recruiting Key Talent



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# SUCCESSION PLANNING FOR TOP MANAGEMENT

- **Key Questions for Ownership / Board of Directors:**
  1. What personnel changes (retirement, etc.) do you anticipate in the next five years among key employees?
  2. Does your Company have a succession plan for all of the key personnel?
  3. What are the advantages and disadvantages of recruiting outside talent to your organization?
  4. Do you need an executive benefits package to attract/retain/reward key employees?
  5. If a plan is adopted, what are the funding options / costs?



# SUCCESSION PLANNING FOR TOP MANAGEMENT

## ▪ Key Questions for the President / CEO / GM:

1. Have you identified key employees to train and groom for the next generation of leadership?
2. What executive benefit plans are available to help attract/retain/reward key employees and board members?
3. What happens in the event of death of the covered key employee?
4. What is the age of your workforce and how does that impact your planning horizon?
5. What's the best way to monitor the performance of the plan over time?



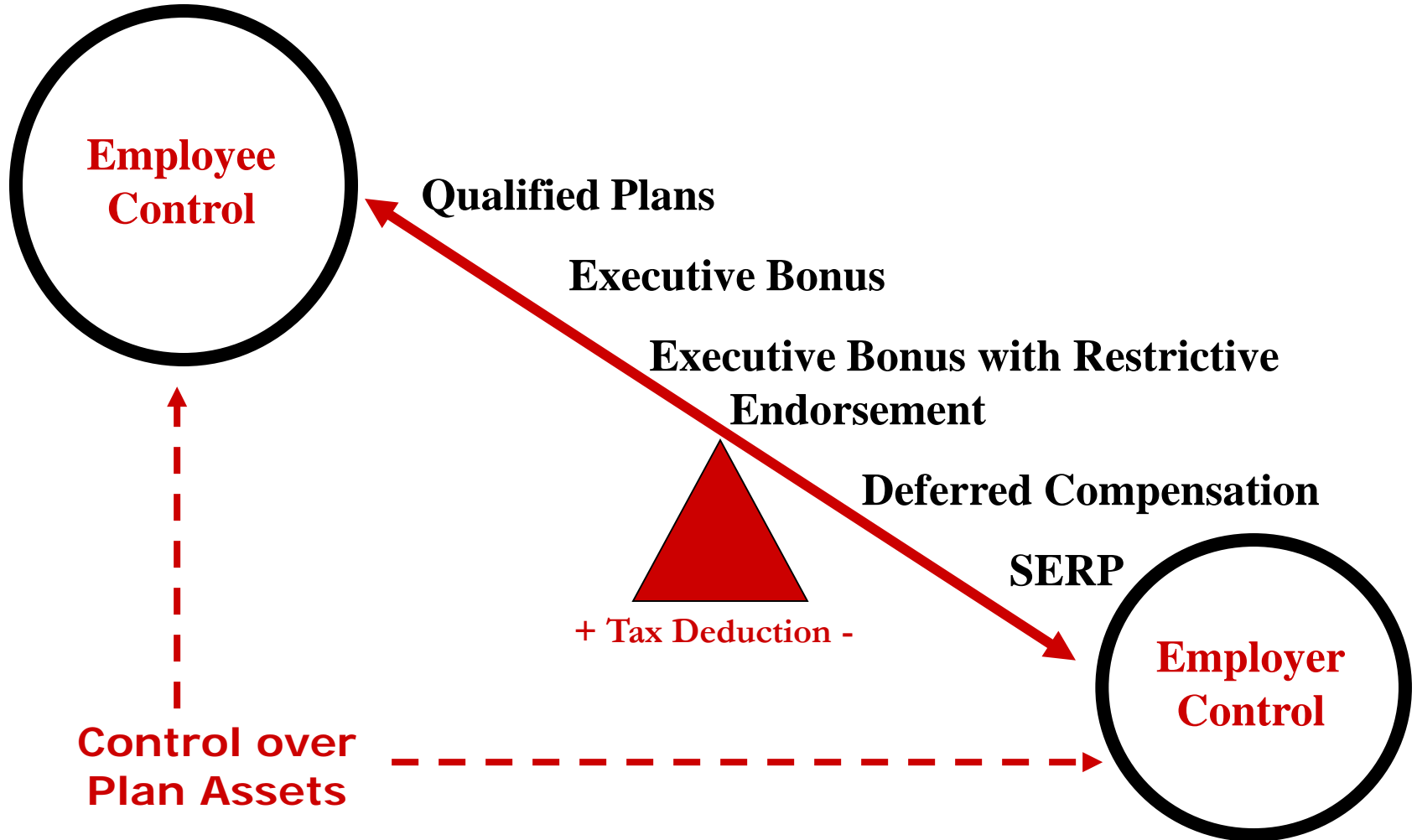
# The Effects of Reverse Discrimination of Qualified Plans

Due to limits on contributions for qualified plans and social security benefits, high-income earners find that a diminishing percentage of their current compensation can be replaced at retirement through these two sources. Employers should implement supplemental plans which restore lost benefits to key, highly compensated employees.

<b>Compensation at Age 45</b>	\$50,000	\$70,000	\$100,000	\$150,000	\$200,000	\$250,000
<b>Qualified Plan Contributions</b>	\$5,000	\$7,000	\$10,000	\$15,000	\$17,500	\$17,500
<b>Benefits at Age 67 from Qualified Plans</b>	\$17,148	\$24,012	\$34,307	\$51,467	\$60,046	\$60,046
<b>Benefits at Age 67 from Social Security</b>	\$20,364	\$24,984	\$29,172	\$31,908	\$31,968	\$31,968
<b>Total Benefits</b>	\$37,512	\$48,996	\$63,479	\$83,375	\$92,014	\$92,014
<b>Percent of Compensation Provided by Age 67</b>	75.0%	70.0%	63.5%	55.6%	46.0%	36.8%

Various Financial Planning studies suggest a need for 70% - 90% or more of pre-retirement income as sufficient for post-retirement income needs.

# SLIDING SCALE OF EXECUTIVE BENEFITS



# TOOLS & TECHNIQUES

- **Death Benefit Only Plan (DBO)**
- Provides income to the executive's beneficiaries after the executive's death using life insurance death benefit proceeds
  - **Pros:**
    - May be discriminatory
    - Provides a supplemental income to the executive's beneficiaries at death
    - Company may recover cost of premiums and benefits paid
  - **Cons:**
    - Executive must be an insurable risk
    - Benefits not deductible until paid
    - Benefit taxable to the beneficiaries

# TOOLS & TECHNIQUES

- **Insured IRC 162 Bonus Plans**
- Providing individual life insurance for select group of employees
  - **Pros:**
    - Employer contributions are immediately tax deductible
    - Bonus amounts may be discretionary
    - Employee controls the asset (but may be subject to restrictive endorsement)
    - May use “overfunded” premium design to build tax deferred savings
  - **Cons:**
    - Weak retention device
    - Insurability and employment time-horizon impact who may receive the benefit
    - Can be administratively complex
    - “Retail” insurance policy expenses and surrender charges difficult to justify

# TOOLS & TECHNIQUES

## ■ Supplemental Executive Retirement Plans (SERPs)

A *PLAN* for key employees providing for post-retirement supplemental income to make-up for shortfalls in qualified plan benefits due to contribution limitations (may be informally funded with COLI)

### ■ Pros:

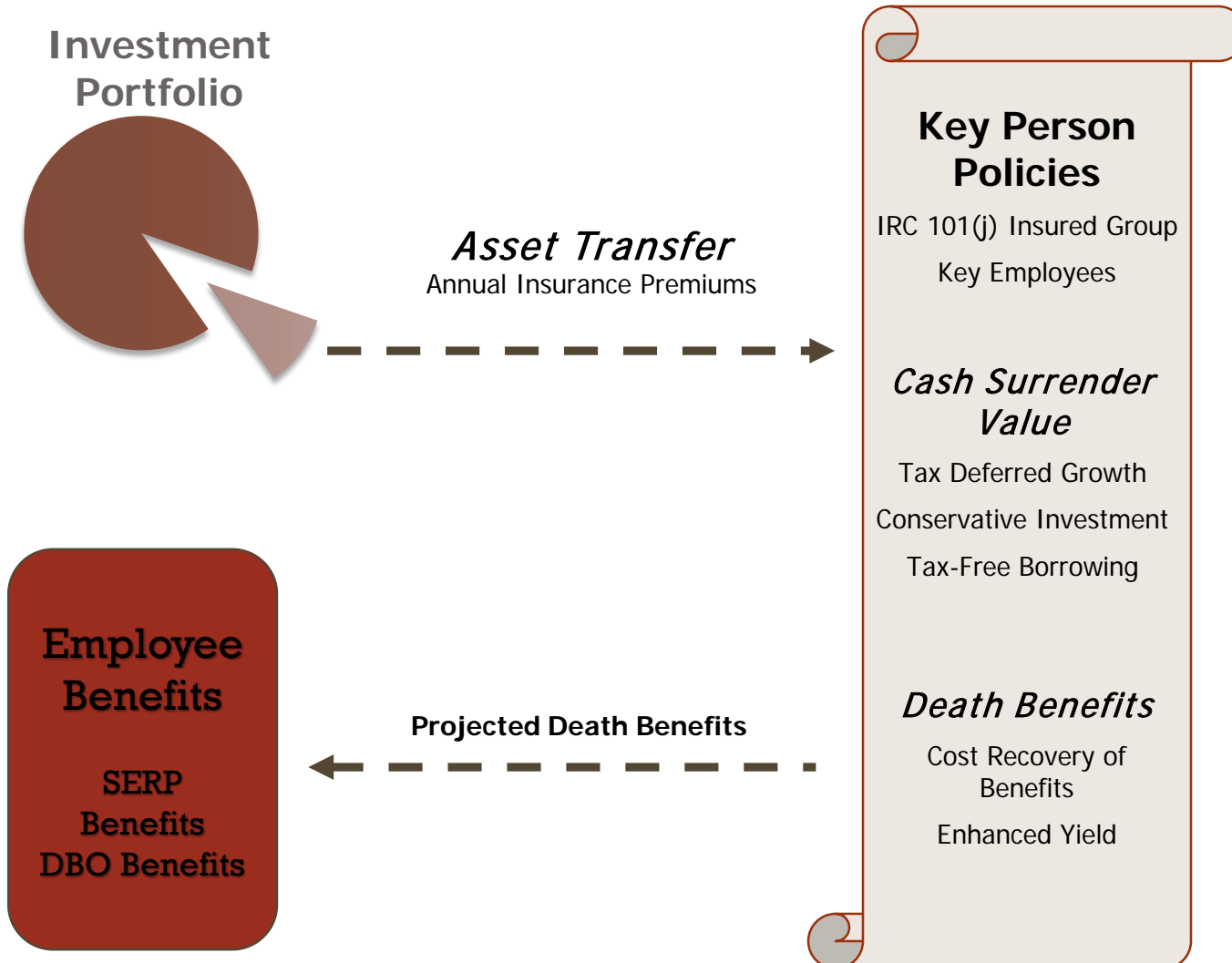
- Fully discriminatory among ERISA “Top Hat” group
- Employer controls timing and amount of benefit
- Strong retention device; plan benefits can mirror company stock performance

### ■ Cons:

- Significant tax and accounting costs to company
- Administratively complex
- Expensive if left unfunded



# Combining Key Person Insurance with a SERP



# EXAMPLE CASE STUDY - PROBLEM

- **Texas S-Corporation**
  - GM 55 years old, retiring at age 60
  - CFO 40 years old, heir apparent to GM role
  - 10 other key management / supervisory personnel
- **Plan Goals:**
  - Enhance / Reward GM Retirement package
  - Tie CFO to organization for succession plan
  - Provide enhanced benefits for other key employees
  - Provide enhanced board benefits
  - Deploy low yielding assets more economically



# EXAMPLE CASE STUDY - SOLUTION

- **SERP Benefit for Top Management**
  - 5X Salary for GM at retirement, immediate vesting
  - 5X Salary for CFO at retirement, full vesting after 10 years
- **Death Benefit Only Plan**
  - \$250,000 for 12 top management and key employees
  - \$20,000 benefit for active board members
- **Key Person Life Insurance**
  - \$450,000 key person policy owned by business on each of 12 key employees
  - Reposition \$1,500,000 from low yielding assets into key person insurance policies
  - Business owns and is sole beneficiary of policy proceeds
  - Ultimate death benefits reimburse business for cost of SERP and other general employee benefits (e.g. health insurance, qualified plan contributions, etc.)
  - IRR on plan funding with life insurance = 4.50% after tax



# PRE & POST SALE IMPLEMENTATION AND SERVICE

- **The board and senior management team should:**
  - Find an appropriate administrator for your Key Person life insurance and SERP Benefit plans
  - Implement a Policies & Procedures Manual
  - Conduct Annual Review of Benefit Plans
  - Conduct Annual Life Insurance Review

## **ABOUT *THE EXECUTIVE BENEFITS GUY***

- 29 years of life insurance wholesale, distribution and retail sales experience
- Joint-venture partner for executive benefit and ownership succession strategies involving wealth accumulation & preservation

[www.executivebenefitsguy.com](http://www.executivebenefitsguy.com)

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