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Agenda

- Executive Compensation Landscape
- Key Considerations in Plan Design
- Plan Design Experiences from My Practice (including challenges)
  - Restricted Executive Bonus (REBA)
  - Split Dollar
  - “Synthetic Equity” - Phantom Stock/Equity and Appreciation Rights
- Questions and Answers

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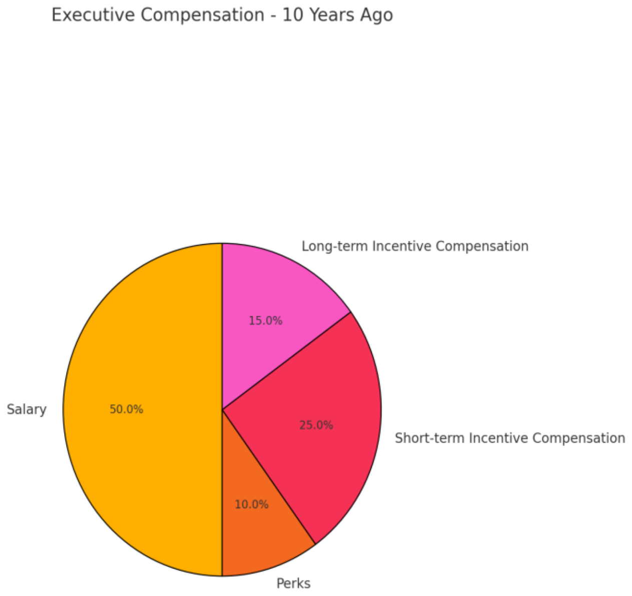
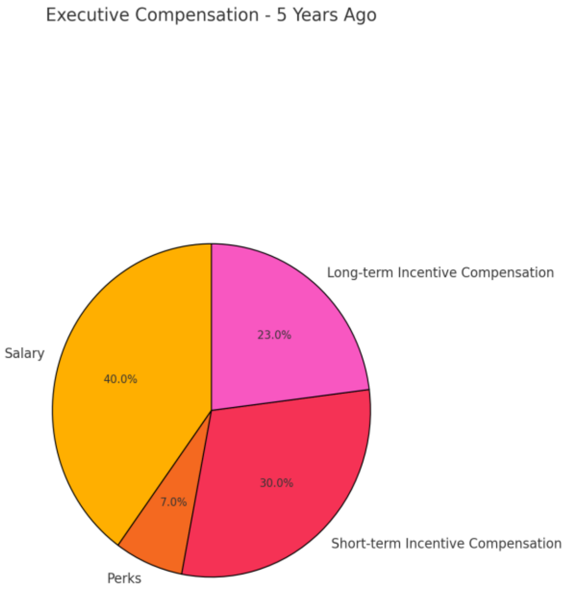
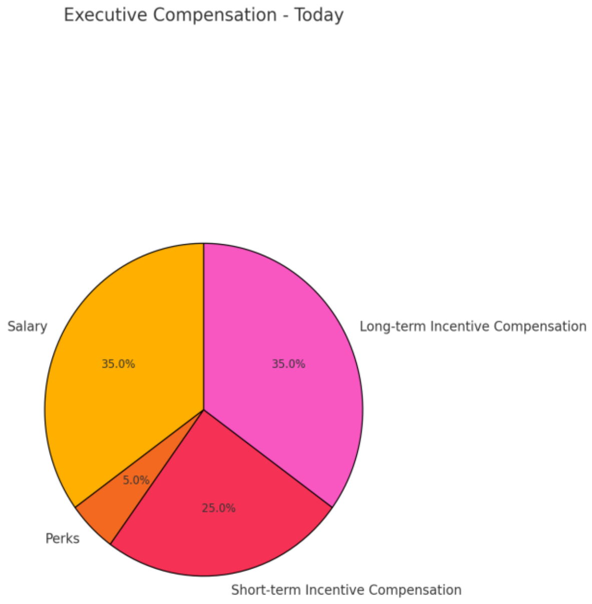
Executive Compensation Landscape







- Base Salary decreased from 50% to 35%
- Perks decreased from 10% to 5%
- Short-term incentives stayed relatively stable – 10% vs. 7% vs. 5%
- **Long-term incentives increased from 15% ten years ago to 35% today**

Industry Studies Support Growth and Identify Issues

- *2025 Morgan Stanley at Work Nonqualified Deferred Compensation Survey*:
  - 200 respondents, 33% were in the “midsize” range ($10M to $100M in annual revenue)
  - 64% of midsize employers reported that they strongly agreed with the statement, “NQDC plans are gaining in popularity”
  - 96% of respondents reported that they strongly or somewhat agreed with the statement, “To compete for Senior Management, it is important to offer NQDC”

Industry Studies Support Growth and Identify Issues

- *NFP US Executive Compensation and Benefits Trend Report*:

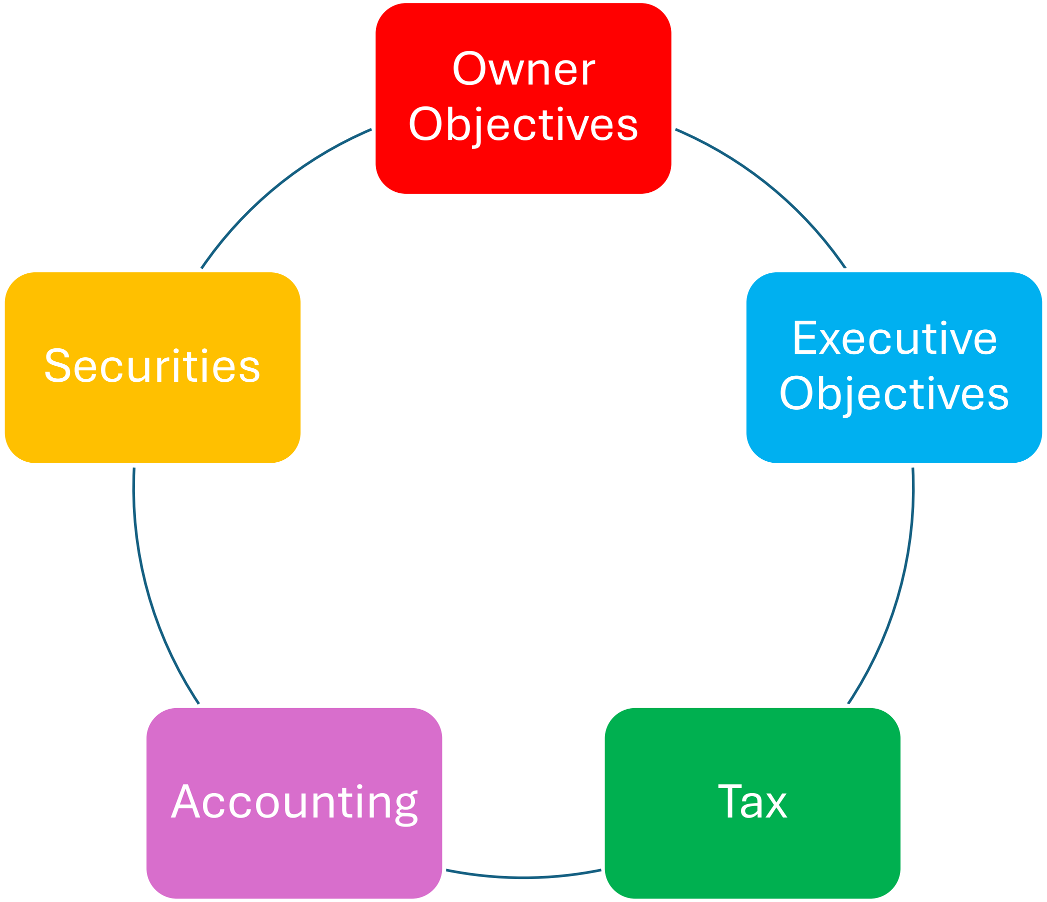
	2024	2025
Business Leaders reporting they “cannot afford to lose top talent”	87%	85%
Reporting these types of incentives have high/moderate impact on plan success:		
• Performance-based (Long or short-term)	90%	91%
• NQDC	82%	82%
• Company Stock/Equity	74%	88%
• Split Dollar Life Insurance	72%	69%
Reporting the top reason for offering Executive Benefits:		
• Executive Retention	73%	68%
• Attract Executive Talent	40%	37%

Issues and Opportunities

- Only **29%** of participants indicated they ***fully understand*** their benefits [1]
- More than half use their insurance advisor or broker to improve their understanding of executive benefits, **<u>BUT</u>** an equal or higher number use industry peers or competitors [2]
- 98% of plan sponsors recognize that they need to do a better job about educating their employees about their plans and suggest the following top 3 preferred methods:
    - Digital/video resources (i.e. webinars and videos)
    - Digital interactive resources (planning tools)
    - In-person group meetings

[1] Both the 2024 and 2025 *NFP US Executive Compensation and Benefits Trend Reports*.
[2] *Id*. Both studies reported 53% use their insurance advisor; 2024 report indicated 53% use peers, 2025 report indicated 59% use peers.
[3] *Morgan Stanley at Work Nonqualified Deferred Compensation Survey*.

Multiple Key Considerations in Plan Design



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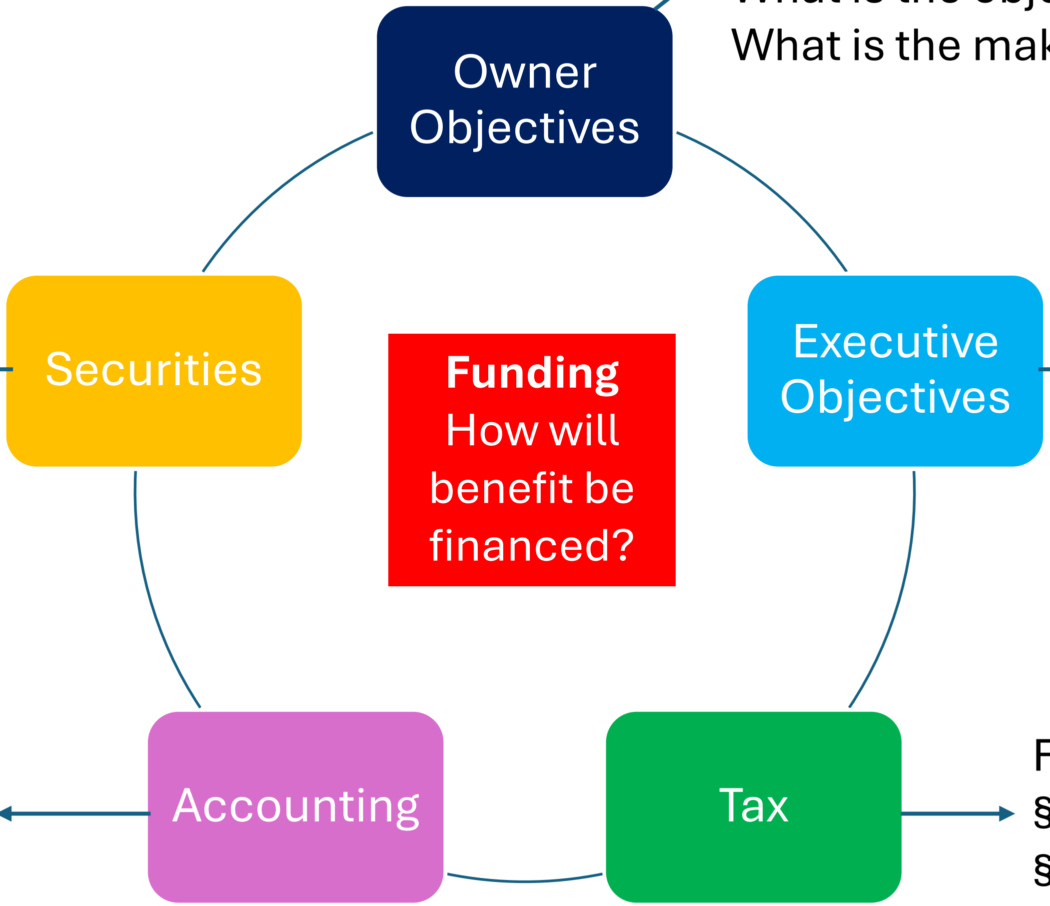
Multiple Key Considerations in Plan Design

Equity or not?
What is the objective of the plan?
What is the makeup of the team?

Securities = registered unless exemption applies
Federal and state law considerations



What do I receive?
When do I receive it?
How will I pay for it?
How will I be taxed?

Flows from plan choice
Equity vs. Liability Accounting

Flows from plan choice
§61, §83 §162, §409A, §422, §280G, §4999

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Key Considerations of **<u>my</u>** (Owner) Client Base

- Simplicity (plan design, participant communication, and particularly administration)
- Retention – time based
- Reward – performance-based
- Cost to the Company

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What Objectives Are Met?

Plan	Recruit	Retain	Reward	Succession
Incentive Stock Options (ISOs)	X	X	X	X
Nonqualified Stock Options (NQSOs)	X	X	X	X
Restricted Equity	X	X	X	X
Cash/Executive Bonus Plans	X		X	
Restricted Exec. Bonus Plans	X	X	X	
Split Dollar Plans	X	X	X	
Traditional NQ	X	X	X	
Phantom Equity	X	X	X	
Appreciation Rights	X	X	X	

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My Personal Observations

- Life insurance-based plan designs - REBAs, split dollar, and traditional NQDC - are ***almost always*** suggested by the insurance advisor
- Equity based plans are ***frequently*** suggested by the Executive/Participant
- “Synthetic Equity” plans are ***frequently*** suggested by the attorney or CPA after discussions with the client about objectives
- Most insurance advisors remain ***unaware*** of the opportunities to informally finance synthetic equity plans with life insurance
- Significant issues occur when plans are not set up correctly, communicated correctly or maintained

Key Takeaways

- Advisors outside the insurance industry need more education and resources about insurance-based plans
- Insurance advisors need a better understanding of life insurance opportunities with “synthetic equity” plans
- Participants place more value on executive benefits if they are educated and plan sponsors cannot be depended upon to provide the education

Plan Design Experience from My Practice

Restricted Executive Bonus

Client Profile

- Small to mid-size business owner who desires to benefit a limited number of employees
- Typically, “younger” participants
- Client desires a retention tool with little administration
- Design typically suggested by insurance advisor

Why it appeals

- Retention with little administration
- Easy to understand - business owner, participants, other advisors
- Taxation is straightforward and from the Company’s perspective, desirable

Restricted Executive Bonus: Bumps in the Road

“Begin with the end in mind”
FranklinCovey

- Other advisors not kept in loop – Attorney and CPA have a role to play
- Documentation deficits beyond carrier requirements
- Employee voluntary or involuntary termination
- Employer insolvency

REBA Challenge:

- Ownership/leadership change in established business made employees nervous – new leadership sought low cost “set it and forget it” retention tool
- Insurance advisor suggested REBA for non-owner/non-board key executives (7 participants) with a 5-year vesting schedule
- In year 4 - former shareholder sued company, new shareholders, Directors and Officers – Officers and Directors prevented from taking any action/incurring liability other than “in the ordinary course”, including payment of bonuses or releasing the collateral assignments
- Bankruptcy is probable and the plan is in limbo

Split Dollar Arrangements

Client Profile

- Small to mid-size business owner who desires to benefit a limited number of employees
- If younger participants – endorsement; older or HNW participant – loan based
- Client desires a retention tool with little administration
- Design typically suggested by insurance advisor

Why it appeals

- Retention with little administration
- Easy to understand - business owner, participants, other advisors
- Taxation is straightforward (maybe) and typically desirable
- Endorsement is flexible and (relatively) inexpensive for Company

Split Dollar Arrangements: Bumps in the Road

- Documentation deficits:
  - Undocumented
  - Incorrectly documented
- Policy issues
- Advisors discontinue support
- Carriers discontinue support
- Increased cost to company as employee ages
- Failure to plan for rollout

Split Dollar Challenge

- Long-term corporate client – employee with loan-based split dollar arrangement retiring; Employer desired to bonus the "cash surrender value" to the employee at retirement
- 2015 – 1035 exchange – no information available regarding policy or split dollar documentation prior to exchange
- At exchange, insurance advisor provided endorsement split dollar agreement (marked "Sample") executed by Company and employee
- Company and employee consistently treated premium payments as "loans", without documentation or calculation of accrued interest
- Needed to "fix" prior to employee retirement

"Synthetic Equity": Definitions

- **Phantom Stock/Equity** – Right to receive cash at a specified date in the future based upon the performance of company equity over a specified period of time (a "Full Value Plan")
- **Appreciation Rights** - Right to receive cash equal to the difference between (a) the value of X units of equity on the grant date, and (b) the value of X units on the exercise date

Synthetic Equity Details

- Synthetic equity plans are deferred compensation plans subject to the requirements of IRC §409A
- They provide opportunities for life insurance professionals as permanent life insurance can be used to informally finance benefits under these plans

Synthetic Equity

Client Profile

- Mid-size company with growth potential and stable cash flow to support investment in plan; sophisticated ownership group
- Owners do not want to dilute equity or decision making, but are willing to share a “piece of the pie” with employees in certain
- Typically driven by executive team request for equity participation, competitors/peers offering these plans, owners describing their objectives

Why it appeals

- Flexibility through individualized awards
- Vesting schedules can be time-based, incentive-based or both
- Employer can determine payout events from the “menu” of “permissible payment events” under § 409A
- Typically, does not require complex administration – may be self-administered

Synthetic Equity: Bumps in the Road

- §409A "reluctance" among advisors
- Valuation Issues
- Little flexibility to change or accelerate payout events
- Noncompliant plan documents
- Payout is taxed as ordinary income (compensation)
- Failure to adequately plan for payouts other than change of control

Phantom Equity Challenge: Valuations

- Treas. Reg. §1.409A-1(b)(iv)(B) provides that the the fair market value of nonpublicly traded stock means "a value determined by the reasonable application of a reasonable valuation method"
- Presumption of reasonableness:
  - For "start ups" – valuation made by a "qualified person", "reasonably and in good faith", "evidenced by a written report" that takes into account "relevant factors"
  - Valuation determined by an independent appraisal no more than 12 months before the relevant date that meets the requirements of §401(a)(28)(C)

Phantom Equity Challenge: Valuations

Calculation vs. Conclusion of Value

Calculation of Value

- Limited scope engagement agreed upon with the client
- Does not consider all valuation approaches
- Lower cost, faster turnaround
- Suitable for internal planning, preliminary estimates, mediation
- **Not defensible before the IRS**

Conclusion of Value

- Comprehensive analysis of all relevant approaches and methods
- Appraiser develops an independent opinion without limitations
- Higher cost, more thorough
- Required for estate/gift tax, litigation, and IRS submissions
- **Defensible under IRS scrutiny**

A calculation is never a substitute for a conclusion when the IRS will examine the work.

Phantom Equity Challenge: Valuations

Key Takeaway:

Employers must **understand** upfront that valuations will be required to report compensation to the IRS **and commit to** the planned costs prior to implementing a synthetic equity plan

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Questions and Answers

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