Lincoln Financial Group®
You're In Charge®

Retaining top talent

Strategy for business owners

Case study of a supplemental executive retirement plan (SERP) funded by life insurance

The value of offering customized benefits to selected key employees can be important. A supplemental executive retirement plan (SERP) is generally an employer-funded deferred compensation agreement that provides supplemental retirement income to a key employee, based on the employee meeting certain vesting or other specified conditions.

Designed to supplement your company's basic retirement benefits package, a SERP can help address an employee's retirement income shortfall. It also provides a powerful recruitment and retention solution for employees who are key to your company's success.

Many employers use life insurance to informally fund SERPs because it may provide tax-advantaged cash value growth, which could be used to pay benefits in the future.

How it works

- Your business enters into a SERP agreement with selected key employees. The business purchases a life insurance policy on the life of a key employee with their consent.
- Your business owns the life insurance policy, pays a nondeductible premium, and is named the policy beneficiary.
- Upon the key employee's retirement, death or disability, your business pays the promised benefit. This payment is generally tax-deductible to the business and taxable to the employee. Payments may be made from policy loans and/or withdrawals,[1] or current cash flow.
- If the key employee dies before retirement, your business receives the death benefit income tax-free.[2] It may use the proceeds to pay the promised taxable survivorship benefits to your employee's family, creating a tax deduction for the business.

Considerations for your business

- Cash values accumulate tax-deferred and can be accessed on a tax-advantaged basis.[1,3]
- Can help you recruit and retain valuable employees.
- Unlike qualified plans, you decide which employees participate.
- Requires less administration and funding requirements than traditional qualified plans.

Considerations for your employee

- Your key employee is rewarded for their contribution to the business with supplemental retirement income potential.
- The plan may offer a supplemental death benefit for your employee's designated beneficiary.
- In the event of the employer's bankruptcy, your employee is considered a general unsecured creditor of your business.

[1] Policy loans and withdrawals will reduce a policy's cash value and death benefit and may cause the policy to lapse.
[2] If certain requirements under IRC Section 101(j) are not met, the death benefits of an employer-owned life insurance contract entered into after August 17, 2006, will generally be taxable income to the employer to the extent the death benefit proceeds exceed the premiums paid.
[3] Annual increase in policy cash values and death benefit proceeds may have corporate alternative minimum tax implications.

Meet Derrick and Bob

Derrick and his wife, Ali, own a craft brewery.
Bob, age 45, is their vice president of operations.

Derrick and Ali own a successful, midsize craft beer business, established as a C-corporation. They've been in the brewing industry for more than 15 years, and their business consistently makes healthy profits. Derrick and Ali know that much of their success is directly attributable to the daily contributions of their vice president of operations, Bob.

The owners recognize that the craft beer business is becoming more competitive, so they want to take steps to entice Bob to stay with the company. Even though they already provide a competitive benefits package, Derrick and Ali are looking for an additional way to reward Bob for his top-notch performance, and encourage his continued commitment to their company.

The owners' challenge

They would like to keep Bob as an employee until he retires and reduce the risk of his leaving to work for a competitor.

Bob's challenge

Bob is contributing the maximum amounts to his qualified retirement accounts. He realizes that in order to continue with a comfortable lifestyle during his retirement years, he will need to find a way to supplement his retirement income.

The supplemental retirement strategy

After discussing the situation with their advisor, Derrick and Ali decide to implement a supplemental executive retirement plan for Bob. The SERP allows them to provide Bob supplemental retirement income, as long as he meets the vesting conditions spelled out in the agreement. If Bob dies before he retires, the SERP may provide survivor benefits to his family.

Though Derrick and Ali could choose to pay the future promised benefits to Bob out of the business income or investment funds, they decide to informally fund this future obligation with an indexed universal life (IUL) policy. IUL has the potential for strong cash value growth that can be used to pay the promised supplemental retirement income to Bob.

With Bob's consent, the company purchases the policy on his life, makes nondeductible premium payments, and is the owner and beneficiary of the policy. The policy cash values grow tax-deferred. At Bob's retirement, Derrick and Ali may use policy cash values to pay some or all of the promised retirement benefits to Bob, taking a business deduction at the time the payment is actually made. Bob or his survivors would pay income tax on any benefits received.

The outcome

An IUL benefits the business and the employee

The business will pay $20,000 annual premium for 20 years:	$400,000 total premium
Bob gets $102,034 annually for 20 years starting at age 65:	$2,040,680 total retirement supplement
Business deductions for promised benefits paid to Bob:	$428,543 total business deductions
Death benefit owned by the business at Bob's age 85:	$953,043 remaining death benefit

This hypothetical example assumes a male, age 45, employee tax rate of 24%, employer tax rate of 21%, standard nontobacco, premium paid to age 65, minimum non-MEC death benefit, an increasing-by-cash value death benefit option that switches to the level death benefit option at age 65, annual participating loans starting at age 66 that continue for 20 years, GPT, and 100% premium allocation to the 1 Year Point-to-Point Perform Plus Indexed Account, 7.10% interest crediting. **At 1.00% with no policy loans taken, policy lapses at age 82.**

The owners found a cost-effective way to reward and retain a valuable employee.

An IUL has choice and flexibility through

- Indexed accounts tied to the S&P 500 Index[4] (excluding dividends) performance — providing access to market opportunity and varying levels of protection to meet client needs and preferences.
- Policy values not directly invested in the market, so the business would be protected from market downturns.[5]
- Possible optional riders to enhance high early policy cash values and to help address business financial needs.[6]

[4] The S&P 500 Index is a product of S&P Dow Jones Indices LLC, a division of S&P Global, or its affiliates ("SPDJI"), and has been licensed for use by The Lincoln National Life Insurance Company and Lincoln Life & Annuity Company of New York. Standard & Poor's® and S&P® are registered trademarks of Standard & Poor's Financial Services LLC, a division of S&P Global ("S&P"); Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"); and these trademarks have been licensed for use by SPDJI and sublicensed for certain purposes by The Lincoln National Life Insurance Company and Lincoln Life & Annuity Company of New York. The Lincoln National Life Insurance Company's and Lincoln Life & Annuity Company of New York's products are not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, S&P, their respective affiliates, and none of such parties make any representation regarding the advisability of investing in such products nor do they have any liability for any errors, omissions, or interruptions of the S&P 500 Index.

[5] Guarantees are subject to the claims-paying ability of the issuing company. Policy charges remain in effect and could reduce your policy value.

[6] Subject to availability and certain requirements.

Strengthen your business by maintaining your competitive edge.

Talk with your advisor about how Lincoln solutions can help protect and grow your business.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

LincolnFinancial.com

Lincoln Financial Group is the marketing name for Lincoln National Corporation and its affiliates.

Affiliates are separately responsible for their own financial and contractual obligations.

LCN-2427197-021519
POD 2/19 **Z03**
Order code: LIF-SERP-FLI001

Lincoln Financial Group®

You're In Charge®

Important information:

Lincoln indexed universal life insurance policies are issued by The Lincoln National Life Insurance Company, Fort Wayne, IN, and distributed by Lincoln Financial Distributors, Inc., a broker-dealer. **The Lincoln National Life Insurance Company does not solicit business in the state of New York, nor is it authorized to do so.**

Policies sold in New York are issued by Lincoln Life & Annuity Company of New York, Syracuse, NY, and distributed by Lincoln Financial Distributors, Inc., a broker-dealer.

All guarantees and benefits of the insurance policy are subject to the claims-paying ability of the issuing insurance company. They are not backed by the broker-dealer and/or insurance agency selling the policy, or any affiliates of those entities other than the issuing company affiliates, and none makes any representations or guarantees regarding the claims-paying ability of the issuer.

Products, riders and features are subject to state availability. Limitations and exclusions may apply. Not for use in Massachusetts.