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# *Tax Deductible and Fully Secured SERPs*

## *ISOP<sup>®</sup>: A Good Alternative for Funding a SERP*

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**RCG**  
Retirement Capital Group

# About This Report

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The purpose of this report is to explain the new ISOP<sup>®</sup> (Insured Security Option Plan) that we just introduced into the market. It is a plan that we believe may be the best solution for providing SERP participants with greater benefit security, lowering proxy disclosure requirements, and reducing the company's P&L impact. The following is a brief description of the ISOP<sup>®</sup> and explains why we think it is beneficial to both the executive and the company.

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# Issues – Current SERP

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- SERP liabilities must be accrued which produces an annual expense to company earnings.
- New proxy disclosure requirement produce the wrong optics to shareholders.
- Participant's benefits are subject to the claims of the company's creditors.
- For those companies funding these liabilities with corporate-owned life insurance they must wait 30-40 years to recover their cost.

**Is there a better solution?**

# Insured Security Option Plan<sup>®</sup> (ISOP<sup>®</sup>)

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- ❑ Used to pre-fund SERP liabilities – with contributions tax deductible by the company.
- ❑ Annual ISOP<sup>®</sup> contributions are used to reduce company's SERP P&L expense.
- ❑ ISOP<sup>®</sup> provides the executive with a fully secured asset (protected by ERISA) that he or she controls.
- ❑ We have found that the ISOP<sup>®</sup> is more cost efficient than funding traditional SERP.

# The Three Phases of your Money

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- ❑ Phase One: Contribution Phase
- ❑ Phase Two: Accumulation Phase
- ❑ Phase Three: Distribution Phase

# Phase One: Contribution Concerns

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- ❑ Pre-Tax or After-Tax
- ❑ Qualified plan limits – reason for SERP
- ❑ Told that pre-tax is better, but not always true (Real estate investments, for example, are made with after-tax dollars.)
- ❑ Learned very young that *“A penny saved, is a penny earned.”*

## Phase Two: Accumulation Concerns

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- ❑ ROI (Return on Investment)
- ❑ Modern Portfolio Theory means diversification
- ❑ Diversification is why people invest in mutual funds
- ❑ Learned very young that *“We should never put all our eggs in one basket.”*

# Phase Three: Distribution Concerns

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- ❑ Spending or sending – It's not how much you make, but how much you keep.
  - ◆ Taxable as Regular Income
  - ◆ Taxable as Capital Gains
  - ◆ Non-Taxable
  
- ❑ The pudding in which we find the proof.

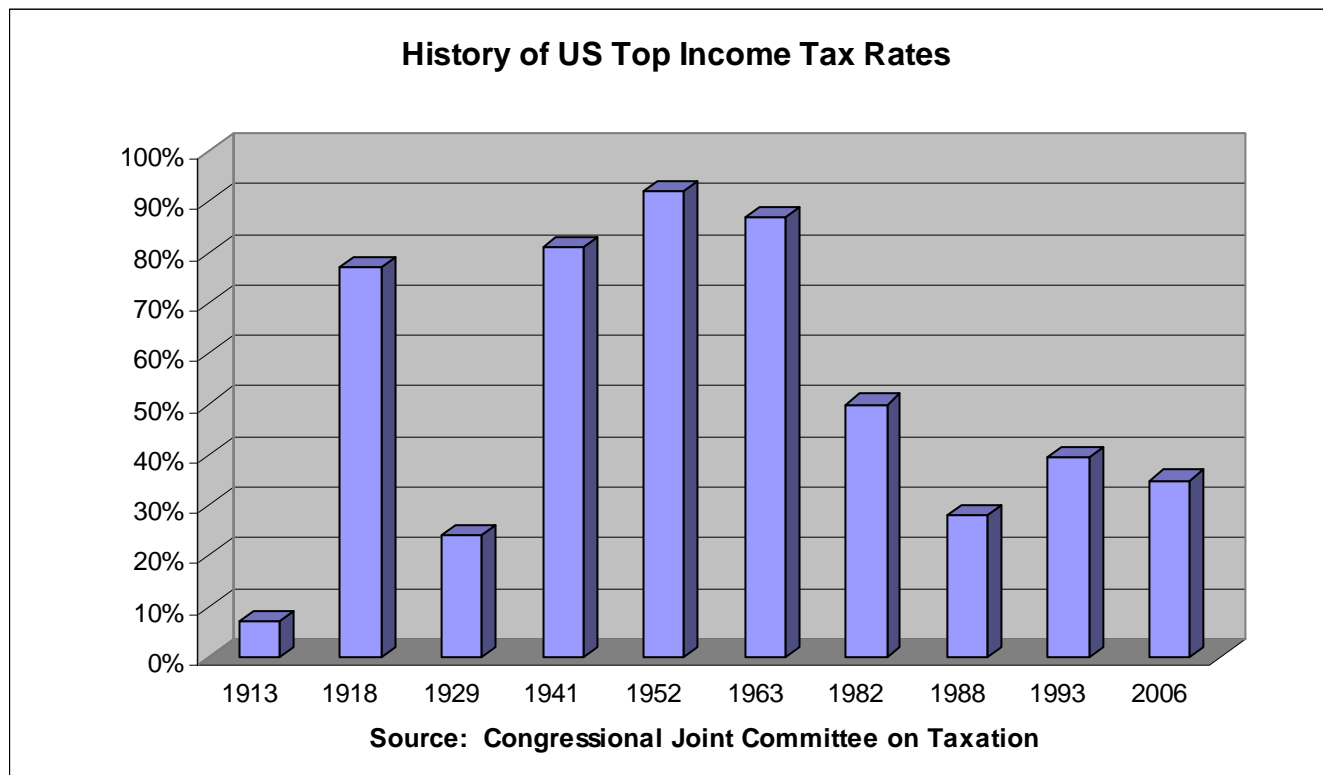
# Diversification Doesn't Just Apply to Phase Two...

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- True diversification should not be thought of as only applying to asset diversity, but distribution diversity as well.
- Some portion of your investments should be designed to provide a hedge against higher tax rates in the future
- The ISOP<sup>®</sup> addresses the other of life's certainties.

# History of US Top Income Tax Rates



## 2020: ???

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- No one can accurately predict the future of top tax rates in the United States.
- Your accumulated wealth should not be dependent on any single asset or assumption.
- An increase in the top tax rate from 35% to 52.5% would mean reducing your distribution assumptions by roughly 50% per year.
- At retirement age is a bad time to be forced to “reduce your distribution assumptions”.

# ISOP<sup>®</sup> – Insured Security Option Plan

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Provides a non-taxable retirement income stream derived from assets safe from both the individual's and the firm's creditors in the event of either's bankruptcy. *(Refer to Note at bottom of page 16.)*

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# What it does...

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- ❑ Provides pre-tax saving power without contribution limits\*, age restrictions\*, or early withdrawal penalties imposed by qualified retirement savings plans.
- ❑ Participants access 50+ investment alternatives called “sub-accounts” from investment managers like Fidelity, Franklin Templeton, Vanguard, and more.

\*Subject to ISOP® variable life insurance policy underwriting guidelines.

## What it does...*(continued)*

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- ❑ Creates no liability for the firm so cannot impact firm's future financial condition, as would be the case when discussing a SERP, or deferred compensation plan.
- ❑ Requires no ongoing administration or recordkeeping services – participants self-direct their accounts online, 24/7, at [www.deferral.com](http://www.deferral.com).
- ❑ Costs the firm sponsoring the plan very little as compared with some other benefit programs – a one time set-up fee of \$2,500, a \$5,000 annual fee, plus \$225 per participant per year (TPA fees).

## What it does...*(continued)*

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- All company contributions are tax deductible\*.
- Unlike current SERP the ISOP<sup>®</sup> is not subject to 409(A).
- Executive can deposit additional money over and above company contributions.

\*As regulated by current tax law

## How it does it...

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- Uses as its investment engine an institutionally priced, specially designed VUL (Variable Universal Life) insurance policy.
- Only made available to business entities. Individual consumers cannot be offered the ISOP<sup>®</sup>'s VUL.
- Priced and structured to address the needs of a corporate buyer.

**Note:** The product offered is the Lincoln Corporate Variable 5 Life Insurance policy, issued by The Lincoln National Life Insurance Company, Ft. Wayne, Indiana. Policy Form number LN939.

# The ISOP<sup>®</sup>'s VUL



- ❑ Policy loans of up to 50% available, secured against death benefit; assuming held to maturity.
  
- ❑ Deposit \$60,000
  - ◆ Can borrow \$40,000 (from policy) to create power of pre-tax contributions. “Helps to offset impact of taxes.”
  - ◆ Can borrow \$40,000 (alternative lending source) to create power of pre-tax contributions.
  - ◆ Can utilize policy without borrowing and have program designed accordingly.
  
- ❑ Interest rate on policy loan based on LIBOR (5.40% on 9/5/06) + 1.5% (which is roughly prime minus one).
  
- ❑ Policy loan is non-recourse and no requirement to pay prior to taking non-taxable distributions.

**Note:** If withdrawals go over basis, they are subject to taxation. Loans, interest accruing on loans, and withdrawals reduce available cash value and reduce the death benefit or cause the policy to lapse.

# How does the ISOP<sup>®</sup> work with the SERP?

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- ❑ Most SERPs provide a **defined benefit** equal to a percentage of final average pay (i.e., 60% of final five years).
  
- ❑ Many SERPs **offset** the final benefit by:
  - ◆ Qualified Plan
  - ◆ Social Security
  - ◆ Company contributions to nonqualified
  - ◆ Prior employers benefits
  
- ❑ ISOP<sup>®</sup> is just another “offset”.

# Executive has many options at retirement

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- OPTION I**      Lump Sum Cash Value
  
- OPTION II**      Supplemental “Non-Taxable” retirement income per year  
Executive could take the money over 5, 10, 15, 20, or 25 years
  
- OPTION III**     Non-Taxable death benefit
  
- OPTION IV**     Any combination of the above

# Summary

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- With the ISOP<sup>®</sup> the executive is not a general creditor of the company (protected by ERISA)
- Executive minimizes tax risk at retirement
- Executive controls asset and directs investment
- Executive owns a non-taxable death benefit
- Company has no balance sheet liability
- Company receives current tax deduction for contributions
- In most cases lower cost than current SERP funding

# Important Information

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