

EXECUTIVE BENEFIT AND DIRECTOR PLANS



| Our difference is your advantage.

A SOLUTION TO EXECUTIVE COMPENSATION ISSUES

RETIREMENT INCOME-WILL YOU HAVE ENOUGH?

Experts recommend that you will need 80% to 90% of your pre-retirement income to maintain your current lifestyle in retirement. Factor in inflation and the amount needed each year will rise.

You can rely on benefits provided by Social Security to provide only 10% to 15% of that income. Qualified retirement plans provide a certain level of income — but how much? Given the substantial erosion of benefit limits over the last decade, how much can an executive today expect to receive from a qualified retirement plan? The gap between expectations and reality may be uncomfortably wide.

Non-qualified plans are increasingly used by employers to restore or supplement benefits lost due to these limits. Because nonqualified plans are not subject to the same regulatory requirements that apply to qualified plans, employers can provide benefits through nonqualified plans to recruit and retain key employees who cannot be fully compensated through a combination of salary and qualified deferred compensation due to the cost and compliance burdens that arise when similar benefits are provided to all employees.

EXECUTIVE BENEFIT PLANS — A WAY TO CLOSE THE GAP

Executive benefit plans can be designed exclusively for key employees — providing an optimal solution to benefit limitation issues.

An executive benefit plan is a contractual commitment by an employer to a select group of employees to provide supplemental retirement benefits at a future date. Because there are no coverage, eligibility or participation requirements, an employer can decide to provide nonqualified deferred compensation benefits only to a select group of executive or highly compensated employees. This allows the employer to provide rewards and incentives based on an employee-by-employee approach, offering maximum design flexibility.

WHY OFFER AN EXECUTIVE BENEFIT PLAN?

Executive benefit plans are a critical component of any corporate benefits strategy.

Executive benefit plans provide flexibility in developing benefit compensation strategies, as they can be used to:

- ◆ Provide replacement income at retirement based on total (non-limited) compensation
- ◆ Reward, attract and retain key executives
- ◆ Replace benefits lost due to IRS limits on qualified plans
- ◆ Provide benefits in addition to those under qualified plans
- ◆ Defer compensation
- ◆ Provide enhanced benefits in the event of an acquisition or other change of control

WHO IS CONSIDERED ELIGIBLE?

Unlike qualified plans, which must be offered to a non-discriminatory group of employees, a non-qualified plan may be offered to a prescribed group of employees. The Department of Labor (DOL) requires that the plan be designed to cover a select group of management and/or highly-compensated employees. Certain job titles generally meet this description such as: president, chief executive officer, chief financial officer, senior or executive vice president, general counsel, and treasurer. Other employees may be eligible based on their level of compensation and responsibilities.

TYPES OF EXECUTIVE PLAN BENEFITS

DEFERRED COMPENSATION ARRANGEMENTS

Deferred compensation arrangements permit designated executives to defer additional compensation to avoid current taxation. These plans are typically established in order to provide a vehicle for key employees, highly compensated employees and Directors to defer compensation until retirement.

BENEFIT EQUALIZATION PLANS (BEPs)

Benefit equalization plans restore retirement plan benefits lost due to the various limits placed on IRS qualified plans. A BEP can "correct" the plan salary limit, the defined benefit plan maximum benefit limit, and various defined contribution plan limits including maximum 401(k) deferrals and ADP/ACP compliance refunds.

SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS (SERPS)

Supplemental executive retirement plans can provide benefits beyond those provided under the qualified plan. Enhanced benefits might include:

- ◆ A benefit based on a more generous formula than used in the qualified plan
- ◆ Credit for additional years of service under a defined benefit plan
- ◆ Enhanced retirement benefits for executives who retire early
- ◆ A benefit reflecting compensation excluded under the qualified plan's salary definition such as bonuses and deferred compensation

457(b) PLANS

Similar to deferred compensation arrangements, 457(b) plans are deferred compensation plans for employees of local and state governments and tax-exempt organizations. These plans are typically established in order to provide a vehicle for key employees, highly compensated employees and Directors to defer compensation until retirement, when taxes may be lower.

457(f) PLANS

A 457(f) plan is a non-qualified retirement plan which gives the tax-exempt employer an opportunity to supplement the retirement income of its select management group or highly compensated employees by contributing to a plan that will be paid to the executive at retirement.

FUNDING CONSIDERATIONS

The employer has a choice as to whether or not to "fund" an executive benefit plan. A funded plan generally is more secure than an unfunded plan.

Under a funded plan, contributions are made to an independent trust, and benefits are paid from the trust. Under an unfunded plan, payments are usually made from the employer's general assets. Most non-qualified plans are unfunded plans, or "informally" funded plans. Whatever "informal funding" vehicle is used in an unfunded arrangement, the assets belong to the employer, not the employee, and are subject to the employer's creditors.

UNFUNDED EXECUTIVE BENEFIT PLANS

As employers have come to provide a larger portion of retirement benefits through executive benefit plans, they have sought ways to increase the security of these benefits by “informally” funding these plans. There are several ways to design this type of arrangement.

GRANTOR TRUST “RABBI TRUST”

A trust may be established for the sole purpose of “informally” funding executive benefit plan benefits. Under a Grantor Trust, the employer's tax deductions are deferred until benefits are actually paid. Investment earnings on any contributions are treated as taxable corporate earnings. Trust assets may be protected in the event of a change of control in the organization, but are not protected in the case of bankruptcy or insolvency — in which case rabbi trust assets become subject to the claims of the employer's general creditors.

BANK OWNED LIFE INSURANCE (BOLI)

Bank Owned Life Insurance is actually a life insurance contract for the executive. The contract is owned by the employer and used to fund supplemental benefits. Because the employer retains ownership of the policy, the security of the benefit promise is limited and is not protected in the case of bankruptcy or insolvency, in which case the insurance becomes subject to the claims of the employer's general creditors.

MIRRORED FUND

In a mirrored fund, the investment return in a non-qualified account is developed as if the account were part of the qualified plan. That is, the executive's participation in the non-qualified plan is assumed to mirror his or her participation in the qualified plan. This option leaves room for greater volatility on the company balance sheets, and potential risk if the funds do not perform as expected.

TREASURY INDEX

An employee's right to a benefit may be tied to the performance of the U.S. Treasury Index over a specified period of time. Similar to the Phantom stock option, no tax deduction occurs until benefits are actually paid. Although this option is not incentive based, tying performance to Treasury returns can provide greater stability than mirrored funds.

GENERAL ASSETS

A payment or a series of payments is made at retirement (or other eligibility) from the employer's general assets. The administration is simple, but the level of benefit security is relatively low.

FUNDED EXECUTIVE BENEFIT PLANS

An executive benefit plan may be also be funded using several different arrangements.

SECULAR TRUSTS

A secular trust established for the sole purpose of funding non-qualified plan benefits. A significant feature of a secular trust is that the employee has a non-forfeitable right to contributions made to the trust. This creates "constructive receipt" to the employee. These contributions are generally includable in the employee's income in the year they are made to the trust. Contributions to the trust provide an immediate tax deduction for the employer; employees are taxed immediately on all money credited to their respective trust accounts and on any trust earnings in the future.

Although these non-qualified plan benefits are protected against bankruptcy, the tax disadvantages may outweigh the security advantage unless the employer reimburses the participant for the tax liability.

SPLIT-DOLLAR LIFE INSURANCE

In a split-dollar arrangement, cash value life insurance policies are used to fund a non-qualified plan. The employer and employee join in purchasing an insurance policy on the life of the employee and enter into an agreement to split the cost and benefit of the policy's cash value or death proceeds.

ANNUITIES

An annuity may be purchased in order to fund non-qualified plan benefits. If the employee is vested, the employer tax deductions occur as premiums are paid. Annuities are shielded from creditors—an advantage in terms of benefit security—they are however usually subject to immediate taxation to the employee.

DESIGNING AN EXECUTIVE BENEFIT PLAN

DEVELOPING BENEFIT & COST OBJECTIVES

Pentegra assists clients in establishing benefit and cost objectives and formulating innovative programs designed to meet these objectives. Our consultants can work with you to determine the objectives you want to achieve with a non-qualified program by analyzing which employees are being impacted by IRS limits, and which key employees you might wish to reward with coverage under a non-qualified arrangement.

Our consultants work with clients to address questions that lead to a clearly defined benefits philosophy. Typical questions focus on:

- ◆ Where the company attempts to position its compensation and benefits programs relative to its competitors
- ◆ How the company wants to apportion its retirement benefit dollars among various benefit vehicles - pension, savings and non-qualified plans
- ◆ What is the company's attitude toward allocating benefits based on an overall company performance
- ◆ What are the organization's benefit and cost objectives

Based on these consultations, we design a program that fits with your total benefits and compensation strategy.

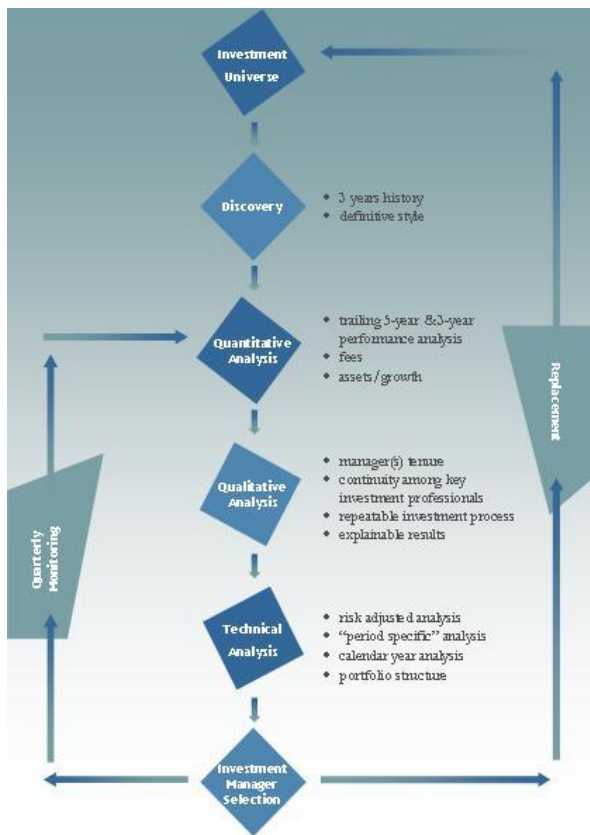
COMPREHENSIVE PLAN DESIGN & CONSULTING SERVICES

- ◆ Plan design
- ◆ Evaluation of plan funding options
- ◆ Plan documents
- ◆ Plan amendments
- ◆ Summary Plan Descriptions (SPD) and Summary of Material Modifications (SMM)
- ◆ Annual plan review
- ◆ Ongoing consulting
- ◆ Legislative and technical guidance
- ◆ Employee education meetings

INVESTMENT MANAGEMENT SERVICES

A comprehensive non-qualified plan solution requires the oversight of a disciplined, institutional investment manager. Pentegra's investment management team focuses on broad diversification and both total return and the amount of risk taken. Our investment management services begin with the establishment of your plan's investment policy and asset allocation. Plan investments are selected based on our disciplined process that combines both quantitative and qualitative factors, as well as a technical analysis to select and monitor investment managers consistent with your plan's investment policy.

- ◆ Investment policy and strategy development, monitoring, and reviews
- ◆ Asset allocation policy and investment structure
- ◆ Investment manager recommendations, selection and monitoring
- ◆ Performance measurement, analysis, and attribution



TRUST, CUSTODY & ADMINISTRATIVE SERVICES

TRUST & CUSTODY SERVICES

As a full-service retirement provider, Pentegra provides comprehensive plan trustee services. Our trustee services keep track of plan-level activity, plan-asset accounting and tax reporting.

- ◆ Custody and investment of plan assets
- ◆ Accurate and timely reporting of contributions, sales and purchases, withdrawals and dividend, and interest income
- ◆ Participant-distribution checks and benefit payments, including lump sum distributions and periodic payments
- ◆ Preparation of principal and income statements
- ◆ Certified plan financial information for plan auditors
- ◆ State income tax withholding services for mandatory states
- ◆ Tax reporting (IRS Form 1099R)

ADMINISTRATIVE SERVICES

Pentegra offers comprehensive non-qualified plan administrative services, closely monitoring every aspect of plan administration to ensure accuracy, efficiency, accountability and control.

Plan administration & recordkeeping

- ◆ Benefit calculations
- ◆ Benefit payment administration
- ◆ Processing of monthly payments and lump sum distributions
- ◆ Form 1099-MISC Reporting
- ◆ Annual census reconciliation including new enrollments, terminations and salary data collection
- ◆ Complete preparation of IRS Form(s) (5300 series, including submission of the employer's individual plan to the IRS for a favorable determination letter)
- ◆ QDRO review and approval
- ◆ Annual individual participant benefit statements
- ◆ Actuarial Services
- ◆ Calculation and reporting of Net Periodic Benefit Cost for the fiscal year
- ◆ Preparation of FAS-87 valuation results
- ◆ Annual response in connection with plan audit
- ◆ FAS 132 and FAS 158 year-end disclosures

Pentegra offers a unique combination of retirement plan expertise, familiarity with industry demographics and comprehensive consulting services that can deliver an Executive Benefit arrangement that meets your benefit and cost objectives. We can work with you to determine the objectives you want to achieve with an Executive Benefit program by analyzing which employees are being impacted by IRS limits, and which key employees you might wish to reward with coverage under an Executive Benefit arrangement.

For more information on our 401(k) program options, contact us at 800-872-3473, or www.pentegra.com



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