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Congress Puts Supplemental Retirement Plans Back on Track

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Due to a series of sensational news stories and legislative uncertainty over the past two years, many American businesses have been frozen in their tracks as they evaluate the best ways to structure executive retirement programs.

The Senate Finance Committee, however, has recently taken action that helps companies to better attract and retain their best people, promote retirement savings, and increase shareholder value. It has reviewed and soundly beaten back an ill-conceived proposal that would have impacted the use of corporate-owned life insurance (COLI).

For several decades, companies have used COLI to finance supplemental, nonqualified retirement plans. The plans help companies to cost effectively attract and retain key executives.

Some companies, during the late 1980's and early 1990's went much further, instituting broad-based leveraged COLI on all employees. This occurred whether employees were notified about the coverage, or consented to it, with the corporation often being the sole beneficiary of death benefit proceeds.

Though the market for broad-based leveraged COLI was for all intents and purposes ended with a 1996 tax measure, existing policies have remained on the books.

Over the past two years, in a business environment where scandals have mushroomed, many articles have skewered COLI. Unfortunately, these articles have typically failed to distinguish between traditional COLI and the no longer-issued broad based leveraged COLI.

This led Senator Jeff Bingaman, a member of the Senate Finance Committee, to introduce legislation. The measure would have required businesses to pay tax on all COLI death benefits if the person insured had not been a company employee in the year preceding his or her death.

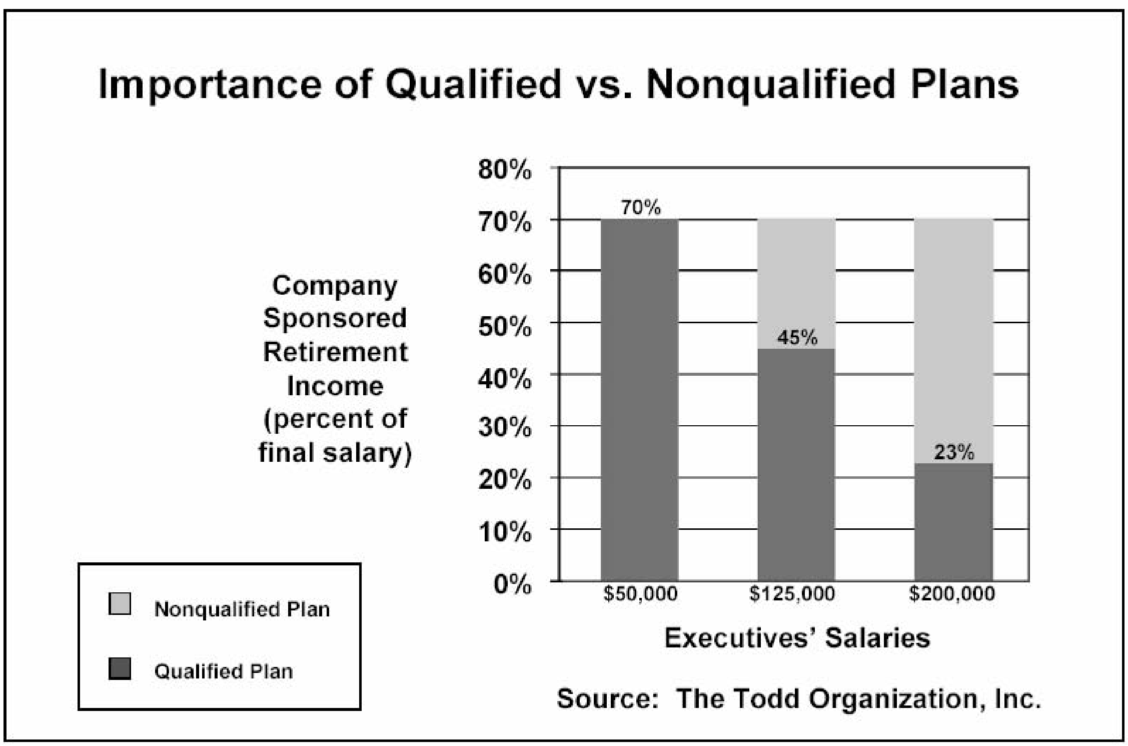
Senator Bingaman's proposal was flawed because it failed to distinguish the questionable uses of COLI from quality, traditional uses of COLI. As a savings vehicle, COLI is quite helpful in generating capital accumulation, assets that can be invested in brick and mortar American businesses.

Such retirement savings are particularly important as there is expected to be an annual shortfall of $45 billion by 2030 between the amount retired Americans need to cover basic expenses and what they have available to meet those expenses, according to a study the Employee Benefit Research Institute.

Why do companies have nonqualified, supplemental retirement plans?

Government regulated qualified retirement plans, such as pensions, profit sharing, and 401(k)s have a variety of limits on what can be contributed and received on a tax-advantaged basis.

As a result, many executives now earning more than $100,000 annually will receive a much lower percentage of their earned income in retirement savings than will mid-level employees who participate in these plans. This is the case, as shown on the accompanying graph, even if the executives make the maximum allowable plan contributions.



COLI is often used as a financing vehicle for nonqualified retirement plans. It is a long-term asset that helps to meet this long-term corporate liability. Cash values grow on a tax-deferred basis, though individuals pay tax when they receive COLI-financed nonqualified retirement plans. Furthermore, the investment compounding that comes in COLI helps to finance these benefits so they not only meeting liabilities, but add to shareholder value.

The Senate Finance Committee, by a near unanimous vote, passed COLI legislation introduced by Senator Kent Conrad. It specified death benefits are not taxable if:

- The deceased individual was an employee within 12 months or death; or

- The death benefits are payable to the employee's family, beneficiary, trust, estate or are used to purchase an equity interest in the employer;

- The employee meets the IRS definition of being a "highly compensated employee" such as by having a salary in the top 35 percent of the company, or being a director of the company.

The Committee also unanimously voted:

- To require that the notice to employees in advance of policy issuance include notification of the maximum face amount of coverage at the time of issuance;

- To require that the employers notify the IRS that all of the employees on whom the employer has life insurance have consented or, if this is not the case, to state the number of employees who have not consented.

"The majority of abuses dealing with COLI were dealt with in 1996 and 1997, when the Finance Committee acted on them," said Senate Finance Committee Charles Grassley in commenting on the legislative action.

"There were outstanding concerns that janitors or other hourly workers could be covered by COLI policies and not know about it. We've now dealt with those two issues: We've limited COLI to the top-level staff, and we've mandated notice and consent for the policy to have a tax benefit," said Grassley.

. The Senate Finance Committee's actions affirm best practices in the use of corporate-owned life insurance to finance retirement liabilities. Companies that have been holding off on instituting or amending their plans can now move forward knowing that the plans can continue to help meet executives' retirement needs, in a shareholder-friendly manner, as they have for decades.

By spurring retirement savings and investment, COLI also helps to strengthen the economy, and address looming savings shortfalls. It's good for executives, shareholders, and the American public.

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