A Strategy to Hold Your Best Employees–Retention Bonus Plan

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As a small-business owner, there are a number of reasons why you may want to "handcuff" your top employees to your company for a set period of time. Some of those reasons include:

- To ensure their expertise and assistance in fulfilling a long-term contract.
- To help you to run your company while you gradually transition ownership to your children.
- To retain employees as part of your exit strategy to eventually sell your business to your top employees or a third party.
- To beat back competitive pressures for top talent.
- Because they have unique and hard-to-find skills and experience.
- Because they are the top executives, managers, technicians or revenue generators of your company.
- Any other reasons where you need your top employees to stay tied to your company for an extended period of time.

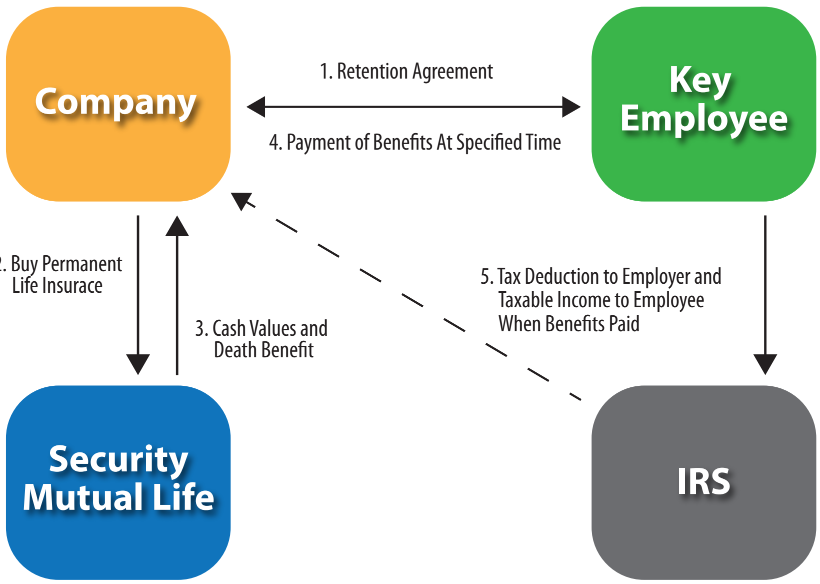
In those situations, even though you may be providing a robust employee benefits package, more may need to be done for the best employees. A retention bonus (a/k/a "stay bonus") plan may be the answer.

A retention bonus plan is a relatively simple concept and strategy. In consideration of your employee staying for a predetermined period of time (e.g., 7 or 10 years), as well as continuing to perform at a high level, when that time period is met your employee will receive a substantial lump sum bonus. If they don't stay for the time period required, they don't get the bonus. This plan should be offered very selectively. It is not for everyone.

The arrangement is embodied in a legal agreement. The bonus is typically paid within 2½ months of the close of the employer's tax year through which the employee is required to stay, in order to meet certain legal requirements, including Internal Revenue Code (IRC) §409A. When the bonus is paid, it should be a deductible expense to your business provided it is considered reasonable in order to meet the requirements under IRC §162. Performance objectives can also be made a part of the plan to induce performance and potentially increase the benefit.

A cash value life insurance policy, such as a whole life policy designed to build up cash values as quickly as possible, is typically purchased by the business on the life of the key employee. Certain employer-owned life insurance rules must be followed in accordance with IRC §101(j). Cash value life insurance is used for several reasons:

- The insurance policy is a tool to help you accumulate the money needed for the bonus payment.
- It provides the potential of cost recovery for the business upon the employee's death.
- The cash values in the policy help to offset the promised bonus on the company's balance sheet, thereby strengthening the balance sheet.
- Also, if the employee is important enough to your business for you to offer such a retention bonus plan, then the life insurance can be used as key employee insurance to safeguard the business from the financial impact the key employee's death would have on sales, revenues, growth, profits, and hiring and training a replacement.



Here's a simple example: Brenda is the owner of a tech company that is really taking off. Harry, her top salesperson, is so good that he is constantly approached by the competition to switch companies. Even though Harry is well-paid, Brenda knows that she can't afford to lose him, so she contacts her life insurance advisor from Security Mutual Life Insurance Company of New York ("SML") for suggestions. With the help of Brenda's attorney and CPA, they decide to implement a retention bonus strategy. Brenda agrees to pay Harry a bonus of $200,000 if he agrees to stay for at least 10 years. That is in addition to the compensation, bonuses and benefits that Harry currently receives. Brenda's company purchases a SML whole life insurance policy designed to build cash values as quickly as possible and pays premiums for 10 years. Based on non-guaranteed values, at the end of 10 years, the policy is anticipated to have enough cash value to pay out the retention bonus and still have enough death benefits to help Brenda's company eventually recover the paid benefit.* Of course, product choice, policy design and policy funding may impact the effectiveness of this strategy. Also, many companies may opt to pay the bonus out of current cash flow or reserves and not rely upon the policy. The death benefit also acts as key person insurance to offset any financial consequences to the company in the event of Harry's untimely death. This is a win-win scenario for Brenda and Harry. Ten years from now, Brenda and Harry may decide to do this again!

Harry's Attained Age	Year	Premium	Cumulative Premium	Surrender Value	Death Benefit	Retention Bonus Paid
45	1	$20,000	$ 20,000	$ 16,672	$639,135	
50	5	$20,000	$100,000	$ 96,213	$639,135	
55	10	$20,000	$200,000	$226,524	$687,076	
56	11	$ 0	$200,000	$ 27,504	$484,652	$200,000
60	15	$ 0	$200,000	$ 34,334	$475,792	
65	20	$ 0	$200,000	$ 46,989	$464,300	
75	30	$ 0	$200,000	$ 99,986	$448,122	

** This example assumes that dividends are used to purchase paid-up additional insurance for 10 years, and thereafter, premiums will be paid by dividends, the surrender of paid-up additional insurance, or policy loans, rather than cash. This premium payment technique is often referred to as a non-guaranteed Premium Offset. Non-guaranteed surrender values and death benefits may be greater than guaranteed values. Loans from the policy will reduce the death benefit and cash surrender value and may cause the policy to lapse. Lapse of a policy with a loan may have tax consequences. Note, that the above illustration is hypothetical and is not intended to serve as a projection of any specific life insurance policy. The material presented should not be interpreted as a recommendation.*

As you can see, this can be a powerful tool to help you retain your best employees through a specified period of time. It is a unique strategy that is selectively applied to retain your best employees. They will appreciate the benefit and know that it will help them financially in their own lives including additional money for college education, retirement and other lifestyle needs. For more information and to discuss the appropriate strategy or variation for your unique circumstances, please contact your local Security Mutual life insurance advisor.

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