Innovative Employee Benefit Financing

CCS

Comprehensive Corporate Strategies

2860 Johnson Ferry Road
Marietta, Georgia

Value Proposition

Regardless of market or business strategy, all successful organizations find a way to attract and retain top quality employees. In fact the competition for highly qualified employees and executives has grown so rapidly that most organizations list employee recruiting and retention as one of their top priorities. Benefit consultants estimate the cost of replacing and training fully operational professional employees at one year's salary. For top management, this cost can easily exceed three times salary.

At the same time, employee and executive benefit costs continue to increase at a rate far beyond general inflation rates. This forces organizations into a razors edge balance between an effective employee population and burgeoning employee benefit costs.

Why Choose CCS

Comprehensive Corporate Strategies was established to help organizations deal with this challenge. We provide a full array of employee benefit solutions which have proven highly successful at attracting and retaining the best employees and executives. More importantly, we offer organizations financially attractive financing strategies to reduce the impact of employee benefit programs. These time-proven strategies have been used by most of the nation's largest corporations for over thirty years, with excellent results. CCS offers comprehensive analysis, design, implementation and servicing of employee and executive benefit programs, as well as specialized financing vehicles used to support these programs.

CCS principals each have over twenty years of experience in this market and have overseen the implementation of over six hundred programs ranging from Fortune 100 size firms to small privately owned businesses. Our experts act as our client's extended staff, ensuring seamless implementation and long term program management.

Principal Bios

Guerry P. Magidson - Principal

Guerry is a founding Principal of Comprehensive Corporate Strategies (CCS). He has over twenty years experience in the design and financing of executive benefit programs. He was formerly President and Director of MAGNER.NETWORK'S Retirement Services market initiative. Prior to joining MAGNER.NETWORK, he served as Chairman, President and co-founder of The Benefit Marketing Group, Inc. (BENMARK). BENMARK is an industry leader in the area of Bank Owned Life Insurance and Executive Benefit Programs for financial institutions.

Stephen Roy - Principal

Steve is a founding Principal of Comprehensive Corporate Strategies (CCS). He has over twenty years experience in the financial services industry, primarily focused on the design, development and placement of corporate funding and finance vehicles. He was with CIGNA for nine years, supporting specialized corporate financing programs. Subsequently, he was appointed Managing Director of Management Compensation Group, SE a Specialty Brokerage operation. Steve was a founding Principal and Executive Vice President of MAGNER.NETWORK, LLC., a financial services organization focusing on financial institutions.

Plan Administration

A key aspect of any benefit financing program involves ongoing plan servicing and risk management. Traditionally, this service has been provided by the financial advisor. CCS can offer this service directly to our clients. However, there has been a recent trend toward organizations utilizing independent service providers for these mission critical tasks. It has been suggested that use of an independent recordkeeping and servicing organization may provide management with greater independence in the ongoing management of the program. In many instances, this is a financially prudent strategy and one more consistent with the long term nature of the transaction.

In many regulated industries, an independent plan administration function is the preferred method. For example, for bank programs the OCC suggests the following:

> *OCC Bulletin 2004-56, clearly states that "...reliance solely upon pre-packaged, vendor-supplied compliance information does not demonstrate prudence with respect to the purchase of insurance." In addition, the OTS states, in RB 32-26 "...OTS considers it an inappropriate transfer of the fiduciary responsibilities of the board and management to an outsider with a vested interest in selling product."*

We strongly recommend our clients use the added protection offered through the combination of CCS program management and oversight, coupled with the record-keeping and administration from the Pangburn Company and TPC Consulting, one of the country's most respected independent third party administrators.

TPC Consulting has over twenty years of experience in the administration of complex employee benefit programs and the insurance products used to fund these programs. With over 1,400 total plans and approximately 300 financial institution programs currently being administered, our service providers stand ready to provide the type of accurate and timely administrative support necessary to meet the needs of this long term transaction. TPC is a fee for service administrator and receives no compensation from the placement of any insurance products, ensuring impartiality.

Some of the clients currently administered by TPC Consulting include:

- Costal Commerce
- Community First
- Synergy
- Gwinnett Community Bank
- Union Planters
- First Bank
- Atlantic Coast Federal
- Community Bank of West Georgia
- Atlantic Central Bankers Bank
- Middlesex Savings
- American Bank and Trust
- Merrimack County Savings Bank
- First Federal
- Gouverneur Savings & Loan
- First Century Bank
- Community First Bank & Trust

CCS Principals monitor all aspects of product and carrier performance on an ongoing basis to ensure the process remains seamless and efficient.

CCS is uniquely positioned to provide organizations with this mission critical service. Our principals work directly with your staff to provide a customized solution. We would be happy to discuss your needs and provide you with an analysis of the marketplace, including what other organizations in your industry and region are doing to attract and retain key employee and executive talent in a long term basis.

For more information contact

CCS

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Bank Owned Life Insurance – *Overview*

1. ***What is Bank Owned Life Insurance?*** - Bank Owned Life Insurance (BOLI) is a financing transaction involving the purchase of specially designed life insurance policies on the lives of key bank executives and directors. The bank is the owner and beneficiary of these tax efficient policies, which provide the bank with the ability to offset the cost of new or existing benefit programs, while providing a tax effected return in excess of other bank authorized investments.

   Bank Owned Life Insurance is a highly valued asset which provides portfolio diversification and outstanding asset liability matching capabilities. BOLI can improve the bank's balance sheet and offer attractive risk based capital treatment.

2. ***How Does BOLI Compare to Other Bank Authorized Investments*?** - The combination of preferential returns and tax deferred growth allows these insurance policies to typically generate tax effected yields in excess of other bank authorized investments, often by as much as two to three hundred basis points.

3. ***Why is BOLI so Attractive?*** - Bank owned life insurance provides preferential returns due to a variety of factors, including the bank's access to low cost funds, the underlying insurance company portfolio composition and the fact that earnings on Bank Owned Life Insurance assets are not taxed when credited and are converted to tax free receipts upon the death of the insured (subject to AMT status).

4. ***What Are the Drawbacks of BOLI?*** - BOLI is a long term investment. It may be accessed via policy withdrawals or loans, but such withdrawals and loans may subject the bank to disadvantageous tax consequences. A greater level of due diligence is required in the implementation and administration of a BOLI program.

5. ***How Prevalent is BOLI?*** - The following represents the estimated percentages of institutions using Bank Owned Life Insurance on a nationwide basis:
   - Large Financial Institutions 90%
   - Mid Size Financial Institutions 60%
   - Small Financial Institutions 40%

6. ***How Do Regulators View BOLI?*** - Bank Owned Life Insurance transactions have been used for over thirty years. Regulatory authorities have become quite knowledgeable about the purpose and structure of such programs. As long as established guidelines (OCC 2004-56 and subsequent regulations and communications) are followed (part of the standard implementation and administration services), such programs involve little incremental regulatory attention.

7. ***How Does a BOLI Transaction Work?*** - The bank is the owner and beneficiary of the BOLI life insurance contracts. During the life of the insured, a market rate of return (comparable to treasuries) is credited to the BOLI cash surrender value. The bank books the monthly earnings as "other income". These earnings are not taxed when credited and are used to offset the cost of any benefit programs as well as provide incremental positive earnings on the bank's financial statement. When the insured dies, the bank receives its portion of the life insurance policy on a tax free basis (subject to AMT), allowing the bank to recover any prior benefit related cash flows.

Bank Owned Life Insurance - *Uses*

Bank Owned Life Insurance is not an executive benefit plan. In fact, BOLI is not a benefit plan at all. Instead, it is an attractive, tax- efficient asset which provides the bank with returns comparable to other bank authorized investments (10 year treasuries) without imposing taxation on earnings.

BOLI can be used to offset any employee benefit expense; however a bank will typically implement BOLI for one of the following reasons.

1. To provide a financing strategy for new benefit programs (typically executive reward and retention program such as a non-qualified SERP program).
2. To offset the rising cost of existing employee benefit programs, allowing the bank to retain those programs on a competitive basis.
3. To improve overall earnings by providing the bank with a greater tax adjusted return on a portion of their assets.

Bank Owned Life Insurance - *Operation*

A BOLI transaction simply reallocates one asset (typically cash in due) with another (cash value of officer's life insurance). Though accomplished through the payment of an insurance premium (typically a one time deposit) this does not represent a bank expense, but rather the reclassification of an asset.

The bank books BOLI income on a monthly basis, much as it would a bond portfolio. In fact, the overall operation of a BOLI transaction is similar to a zero coupon long term bond portfolio with a balloon payment paid at maturity (in the form of a death benefit).

Bank Owned Life Insurance may be structured as either a *general account* or a *separate account* product. Each structure has its own advantages and costs. ***General Account*** products are more prevalent in the community bank market and offer simplicity, predictable returns and minimum guaranteed crediting rates. ***Separate Account*** products provide greater issuer credit protection, defined margins and preferable risk based capital treatment. Regardless of which structure is chosen, the products operate in a substantially similar manner.

The following compares the operation of a bond investment with BOLI, assuming net investment returns of 4.5% and a corporate tax bracket of 40%.

	Bond Portfolio	BOLI Asset
Deposit	$2,500,000	$2,500,000
Pre-Tax Return	4.5%	4.5%
Pre-tax Earnings	$ 112,500	$ 112,500
Tax Due on Earnings	$ 42,750	$ 0
Cost of Insurance (est.)	$ 0	$ 12,125
Net Profit to Shareholders	$ 69,750	$ 100,375
Increased Earnings from BOLI	N/A	$ 30,625
Tax-Effected Yield	N/A	6.69%

Bank Owned Life Insurance – *Issuers*

The BOLI market is highly specialized and supported by a limited number of insurance carriers who understand its requirements and have designed dedicated products meeting a broad spectrum of bank needs.

- As in all markets, variations in external ratings exist between carriers. Carrier ratings should play a role in the final issuer analysis, however all BOLI carriers are high quality and financially strong and would typically be considered a preferred loan customer by the bank.

- Variations in current crediting rates exist among carriers at any given point. As in any other portfolio, different managers will over-perform or under-perform the market. The structure of investment pools used to support BOLI products is highly regulated and the market is quite competitive. Over time, most yield variances between carrier portfolios will narrow substantially. This fact has been recognized by regulatory authorities who admonish banks not to move from carrier to carrier for the purpose of pursuing hot yields, since such yield differentials diminish with time.

We analyze all active BOLI carriers and make recommendations based on the client's particular needs. This analysis includes projected performance, issuer ratings, commitment to the market, viability of the particular product design, as well as individual bank criteria.

Product recommendations are typically made from the following carriers. Each of these issuers has shown a commitment to the market and a willingness to support the unique needs of the Bank Owned Life Insurance market.

Carrier	Product Structure	Guaranteed Rate	A. M. Best Rating	S&P Rating
New York Life	Separate Account	2.5%	A++	AA+
Ohio National	General Account	4.0%	A+	AA
Lincoln Benefit Life (AllState)	General Account	3.0%	A+	AA
Sun Life	Separate Account	n/a	A++	AA+
Met Life	General Account	3.0%	A+	AA
Mass Mutual	General Account	2.5%	A++	AAA
Transamerica (Aegon)	Separate Account	n/a	A+	AA
American General (AIG)	General Account	3.0%	A++	AA+
Acacia Life (UNIFI)	General Account	3.0%	A	AA-
Security Life of Denver (ING)	General Account	3.0%	A+	AA
Union Central (UNIFI)	General Account	4.5%	A	A+
General American (MET)	General Account	2.5%	A+	AA
Jefferson Pilot	General Account	2.5%	A+	AA
West Coast Life	General Account	3.0%	A+	AA

Bank Owned Life Insurance – *Analysis Criteria*

As in any investment, the bank should look at issuer ratings and current performance projections. However, due to a variety of factors unique to the BOLI market, these criteria represent just a small part of the review process. CCS conducts a comprehensive review of all applicable issues and how they may affect the purchase decision. The following identifies key issues addressed in this review.

1. **Risk Weighted Capital Position** - The bank should analyze its current risk weighted capital position in the context of a BOLI transaction. General Account products are classified as a 100% risk weighted assets. Separate account products may allow banks to use either 20% or 50% risk weighted treatment (depending on underlying separate account portfolio composition).

2. **Product Guarantees** - Separate account products offer no guaranteed crediting rate. Though the use of stabilization riders allows for book value treatment, it will not create a minimum crediting rate. If the bank is concerned with the possibility of an extended low interest rate environment during the projected life of the transaction, it may wish to pursue a general account alternative.

3. **Credit Risk and Security** - All quality BOLI carriers have strong financials. However, such a transaction can extend over a forty year period. Separate account products offer stronger insolvency protection since assets are protected from claims of general creditors.

4. **History** - Though both product lines have experienced strong success, separate account products have historically been more prevalent in larger banks and where underlying benefit plans are equity return based. The vast majority of community banks have used general account based products.

5. **Transparency** - A separate account product is governed by SEC disclosure requirements. Such products are required to disclose, among other things, the fees associated with their investment returns. A general account product operates on a gross and net yield basis but the margin retained by the carrier is not typically disclosed.

6. **Simplicity** - General account products are simpler to understand and easier to monitor. Elements such as stabilization riders (required to allow separate account products to report book value) add complexity to the product process.

7. **Underwriting** - Results for either a general account product can be affected by specific underwriting results. Different carriers will treat different health risks in disparate ways. In order to avoid inconsistent underwriting results or to accommodate large groups, banks may opt for a guaranteed issue program, which does not require medical exams or individual underwriting. Such programs reduce net yields by an average of 15 – 30 basis points.

8. **Benefit Accruals** - Though a bank should always look for optimal product performance, it may opt for a particular product structure which most closely meets the requirements of whatever benefit obligations it seeks to offset.

Executive Retention

Historically, Fortune 1,000 companies have recognized the strategic value of recruiting and retaining top quality executive staff. Over the years, most large corporations (and a substantial number of smaller organizations) have implemented executive benefit programs designed to both retain existing executive talent and attract new executives. This trend has been particularly prevalent with banking institutions. In many markets nearly fifty percent of banks have implemented some form of executive benefit retention plan.

Studies indicate that in order to maintain their lifestyle, executives should strive for post-retirement income levels of between 75% - 90% of pre-retirement compensation. Life insurance protection of between 5 - 10 times salary is also typically recommended. However, most executives are unable to generate sufficient retirement income and lifestyle protection through broad based benefit packages (qualified retirement plans, group disability, etc.). These programs are focused on rank and file employees, not the needs of the executives.

Demographic developments make this situation even more pressing for credit unions. A substantial percentage of credit union executives will retire within the next five years. As credit unions expand their offerings, and provide more sophisticated financial alternatives to their members, the competition for top quality executives will only increase, making competitive benefit alternatives a critical strategic issue.

Credit unions face even greater challenges in attracting and recruiting key executives due to their organizational structure. As not-for-profit financial cooperatives, credit unions cannot offer equity based alternatives such as stock options, which often make up an important executive benefit component. This can create a particularly difficult hurdle due to the increasingly active mergers and acquisition activity currently occurring in the bank market. Thus credit unions find themselves needing to recruit ever more capable and sophisticated executive talent while be constrained in what they can offer these individuals by their not for profit structure. Further, not-for-profit non-qualified benefit alternatives are subject to restrictions under IRC section 457, creating additional hurdles in structuring competitive executive benefit solutions.

Benefit Program Operation

Non-qualified benefit programs have evolved to help executives fill this gap. In general, these programs operate much like qualified program alternatives, but without many of the associated limitations. They can be provided to any chosen management staff and can be customized to specifically meet the credit union's recruiting, reward and retention strategy. These programs may include one or any combination of the following alternatives, though retirement income and death benefit protection programs are the most common.

- **Supplemental Retirement Income Program (SERP) (subject to 457(f))**
  These programs provide incremental retirement income to a designated number of executive participants for a set period of years. It is currently estimated that 45% of credit unions with more than $100 million in assets offer a SERP program and existing programs average $700 thousand dollars in lump sum benefits, at an average age pay-out of 59$^{1/2}$.
  CUNA 2003/2004 Compensation Research

- **Split Dollar/DBO Programs**
  These programs provide a specified level of death benefit protection to designated executives and allow the credit union to recover its cost of the program when the executive dies.

- **Group Term Carve Out Programs**
  These programs use individually owned, enterprise-paid level term life insurance to carve senior executives from the existing group term coverage. This program provides enhanced coverage to the senior participant group, often with a resulting reduction in the group term cost sufficient to offset the cost of the carve-out premium and more importantly, mitigates the volatility of ongoing group term premiums since the insurance coverage provided to the senior group (which tends to be older and have greater benefits) is a level term premium, not subject to change for the coverage period.

- **Executive Long Term Care Programs**
  These programs are typically designed to provide a paid up level of long term care coverage to a designated number of executive participants and potentially their spouses.

- **Disability Buy Up Programs**
  These programs provide disability protection to bridge the difference between necessary disability coverage as a percentage of actual compensation and existing group disability coverage limits.

Each of these benefit programs has a cost (explicit insurance premium expense or accounting accrual for a future benefit) which is offset by the earnings gains associated with the financing strategy chosen.

Funding Overview

Unlike Executive Disability or LTC programs, non-qualified benefit programs have no explicit funding requirements. They may be structured on a pay as you go basis, though required accounting accruals may make this alternative less attractive. Companies may establish a sinking fund to offset benefit accruals and, if structured appropriately, to recover the cost of the program.

Taxable Investments – A taxable investment strategy may appear best:

- Taxation on generated earnings is not typically a concern.
- Taxable alternatives are perceived as easier to manage.

However, taxable alternatives are a cash flow management tool, not a true funding strategy. Once established, they simply represent a means for managing the benefit expense. The benefit costs expended in this approach are not recovered.

Annuities - Though the tax deferred nature of annuities is not highly valued, the ability to guarantee a payment stream for life can represent an important advantage. As with taxable alternatives, this approach offers no strategy for recovering benefit costs.

Corporate Owned Life Insurance - Historically, most companies entering into non-qualified benefit programs have used COLI as a funding strategy. The prevalence of COLI is even greater in the financial institutions. Over 90% of non-qualified benefit programs in financial institutions are funded with COLI.

Funding Overview – Why Corporate Owned Life Insurance

Non-qualified benefits are frequently financed with specially designed corporate owned life insurance policies. These policies provide substantial funding flexibility. As non-profit financial cooperatives, credit unions have no need for the tax preference of life insurance. However, credit unions continue to take advantage of corporate owned insurance designs for a variety of sound business reasons.

Corporate Owned Life Insurance Operation

Though tax advantaged growth in a life insurance asset is not important to a non-profit, a Corporate Owned Life Insurance transaction still represents an attractive financial opportunity for three primary reasons:

- The insurance policies acquired invest in assets which may yield a higher aggregate return than other authorized investments (e.g. an insurance company's general account is often composed of high grade corporate bonds and mortgage backed instruments). This asset acts as an offset for the benefit accrual or explicit LTC or disability premium.

- Credit unions have access to low cost funds which may be allocated to the acquisition of such insurance based alternatives, allowing them to create an arbitrage between the cost of the funds and the asset return.

- Most importantly, Corporate Owned Life Insurance allows the credit union to recover the cost of providing the designated benefit when the executive dies. Insurance is sized to create an appropriate asset offset for the benefit liability, provide any required death benefit component to the participant's beneficiary and still have sufficient death benefit to allow the company to recover its cost of program benefits.

Corporate Owned Life Insurance Mechanics

1. The credit union converts a designated asset (existing investment, operating funds, additional borrowing, etc.) to cash for use as the Corporate Owned Life Insurance premium, with a resulting life insurance cash value asset. This premium is used to purchase life insurance on the lives of designated key management. The insurance asset is reported as a credit union asset.

2. During the life of the insured, earnings accrue to the insurance asset on a monthly basis. Such earnings is based on the underlying investments in the insurance company's general account (high grade corporate bonds and mortgage backed instruments) or in the designated asset pool of the separate account used. The credit union is the owner of these assets and accrues the earnings on a monthly basis.

3. Upon the death of the insured, the credit union's portion of the death benefit (some designs pay a portion of policy death benefits to the insured's beneficiary) is paid to the credit union and is used as a cost recovery vehicle for any benefit costs incurred in the program.

When appropriately structured, corporate owned life insurance programs allow the company to create a matching asset offset for accrued benefit liabilities and ultimately recover their costs of providing that program (along with associated cash flows)

Insurance Carriers

The Credit Union market is highly specialized and supported by a limited number of insurance carriers who understand its requirements and have designed dedicated products meeting a broad spectrum of bank needs.

- As in all markets, variations in external ratings exist between carriers. Carrier ratings should play a role in the final issuer analysis, however all chosen carriers are high quality and financially strong and would typically be considered a preferred loan customer by the bank.

- Variations in current crediting rates exist among carriers at any given point. As in any other portfolio, different managers will over-perform or under- perform the market. The structure of investment pools used to support these products is highly regulated and the market is quite competitive. Over time, most yield variances between carrier portfolios will narrow substantially.

At CCS we analyze all active carriers and make recommendations based on the client's particular needs. This analysis includes projected performance, issuer ratings, commitment to the market, viability of the particular product design, as well as individual credit union criteria.