

Reserving Benefit Plan Assets COLI Funding



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Securing Executive Deferred Compensation Plans

In 2006, the COLI Best Practices provisions passed by both the House and Senate added even more guidance and stability to the application of COLI to nonqualified plans.

Unlike a qualified retirement plan in which employee retirement benefits are insulated from the company's creditors, for executives, amounts deferred in nonqualified arrangements must remain unsecured. Believing executive retirement plans should not be at risk, many companies choose to create an asset through an informal funding vehicle.

To properly construct this informal funding, Balser analyzes key factors and determines the best solutions, including vehicles that use corporate-owned life insurance (COLI), mutual funds and alternative investments. The funding vehicle will add security to the promise by management that the company will in fact have the resources for participants' retirement income payments when they come due.

Balser Companies and the client collaborate to determine the appropriate funding vehicle or vehicles. This can be discussed in tandem with the design of a new deferral plan, or once a liability exists. Certain choices about employee eligibility, eligible compensation, valuation, distribution options, and other features (like additional death benefits) influence the structure of the asset created for future payment obligations.

Although COLI became the most common method of funding nonqualified benefits over the past two decades and Balser is recognized as a COLI expert, corporate-owned life insurance is not necessarily the best solution for every situation, and may be only part of a solution. Over a dozen of the large deferred compensation plans we administer have not selected COLI at this time.

Given its advantages (cost recovery / tax and accounting treatment), COLI became the most common method of funding nonqualified benefits over the past two decades with 83% of those that fund this type of benefit choosing COLI.



Comparing Funding Alternatives for Deferred Compensation

Why Corporate Owned Life Insurance is selected by over 80% of companies that fund these future liabilities:

“Next Best” Funding Approach

Mutual Fund Advantages

- Security added to rabbi trust
- Liquidity/Cash Ready
- Investment diversification
- Matches employee deferred investments
- Easily understood

Mutual Fund Disadvantages

- Taxation on mutual fund gains/dividends
- Taxation creates asset/liability mismatch
- Timing and management problematic
- No accounting advantage
- Less than optimal impact on P&L

Most Preferred Funding Approach

COLI Advantages

- Security added to rabbi trust
- No impact on P&L or positive impact on P&L
- Asset/liability matching
- Matched employee deferred investments
- Investment diversification

COLI Disadvantages

- Not as easily understood
- Cost of insurance must be justified by tax advantages

Another recent legislative plus came when congress address benefit funding in its “COLI Best Practices” provisions. These discussions marked a substantial achievement in fostering a better understanding of corporate owned life insurance (COLI), putting in place reforms that assure its responsible use, and preserving the tremendous benefits COLI provides to businesses, employees and their families by codifying the best practices of the industry.



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