



CONCEPT
PROFILE

457(f) Supplemental Executive Retirement Plans

ADVANCED MARKETS

A Way to Reward Key Executives

Many people, including highly compensated people, are concerned about having sufficient retirement income. Individuals who make more than \$210,000 a year may not have enough income in retirement to maintain their standard of living due to qualified plan limitations that restrict contributions to qualified retirement benefits. This problem is not only a private sector issue. Non-profit executives also struggle with this. A non-profit organization, like its counterpart in the private sector, can assist its key executives by implementing a 457(f) Supplemental Executive Retirement Plan.

WHAT ARE 457 PLANS?

Internal Revenue Code Section 457 controls qualified plans of non-profit and government organizations. The main purpose of this section is to allow non-profit groups to provide the same type of retirement benefits, both qualified and non-qualified, as the private sector.

There are two types of 457 plans – 457(b) eligible and 457(f) ineligible. A 457(b) plan is similar to a 401(k) plan and has the same contributions structure. The maximum contribution in 2005 is \$14,000. A 457(f) plan is known as an ineligible plan. This type of plan has no contribution limits. However, the executive must face a substantial risk of forfeiture of benefits in order to exclude his or her benefits from gross income for income tax purposes. This means the executive needs to maintain a relationship with the non-profit while receiving benefits so he or she can extend the tax deferral status. There are several ways to set up a 457(f) plan – as a Salary Deferral Plan, as an Executive Bonus Arrangement, or as a SERP, the most popular solution.

WHAT IS A 457(f) SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP)?

A 457(f) Supplemental Executive Retirement Plan is a non-qualified deferred compensation plan that allows non-profit organizations to provide additional retirement income to key, highly compensated executives. It allows the organization to provide the executive with additional income in excess of the 457(b) eligible plan, which is similar to a 401(k) plan. Like a traditional SERP plan, the non-profit may be selective in the executives to whom it provides benefits.

HOW DOES A 457(f) SERP PLAN WORK?

The non-profit and the executive enter into an agreement. The agreement states that the non-profit will pay the executive a certain amount of money either over a period of time or in a lump sum. In a 457(f) SERP plan, to avoid extending the substantial risk of forfeiture, the payment is made in a lump sum or a term of five years. The executive does not make contributions to the plan. In addition, an endorsement split dollar arrangement is often set up to provide the executive's beneficiary with life insurance protection.

INFORMALLY FUNDING WITH LIFE INSURANCE

There are several ways to informally fund a 457(f) SERP plan – sinking fund, self-funding, and life insurance. When a plan is informally funded with life insurance the non-profit organization is both the owner and beneficiary of the policy. Upon retirement, the non-profit may use the potential cash value of the life insurance policy to pay the retirement benefits.

Financing a 457(f) SERP with a life insurance policy provides both the executive and the organization with benefits. The potential policy cash value grows income tax deferred and loans and withdrawals may be taken

up to the policy's cost basis without any income tax consequences.¹ The death benefit will pass income tax-free and is generally used by the organization to recover the cost of the plan.²

ADVANTAGES AND DISADVANTAGES 457(f) SERP PLANS

When implementing any type of plan it is important to review the advantages and disadvantages associated with it to determine if it is the right fit for the organization.

Advantages	Disadvantages
<ul style="list-style-type: none"> • An excellent way to provide highly compensated employees with supplemental retirement income. 	<ul style="list-style-type: none"> • ERISA may need to be considered.³
<ul style="list-style-type: none"> • Employers can select who they want to participate in the plan. 	<ul style="list-style-type: none"> • Funding may be subject to claims of creditors or potential insolvency.
<ul style="list-style-type: none"> • A great way to retain, reward, and recruit key executives. 	<ul style="list-style-type: none"> • Executives may be faced with substantial risk of forfeiture.

SUMMARY

457(f) SERP plans are an excellent way for non-profit organizations to provide highly compensated executives with additional income in retirement. Since these plans do not have any contribution limits or restrictions the only consideration is the substantial risk of forfeiture which, when the plan is properly structured and followed, may be avoided.

For more information on 457(f) SERP plans, please contact your local John Hancock Representative or call the Advanced Markets Group at (888) 266-7498, option 3.

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- 1 Loans and withdrawals may reduce the death benefit and will reduce the cash surrender value and may cause the policy to lapse. A lapse or surrender of the policy while loans are outstanding may cause the recognition of taxable income. Loans and withdrawals from life insurance policies that are classified as modified endowment contracts may be subject to tax at the time the loan or withdrawal is made. A federal tax penalty of 10% may also apply if the loan or withdrawal is taken prior to age 59½.
- 2 Life insurance death benefit proceeds are generally excludable from the beneficiary's gross income for income tax purposes. There are few exceptions such as when a life insurance policy has been transferred for valuable consideration.
- 3 A detailed discussion of ERISA is out of the scope of this piece. For more information on the tax consequences of this plan, please see the 457(f) Sales Strategy.



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