A Twist on Golden Handcuffs, Carrots & Watches

Attracting and retaining valuable people to their amazing company are issues faced by many employers. A great work environment, competitive salaries, and employee benefits may be enough for the majority of new hires, but highly sought after prospects require more creativity to be enticed. With retirement as a concern for mature executives, employers are also increasingly looking for ways to reward their key executives and keep them in place.

At some point in his/her career, every key employee begins to see employment as a partnership with the company; one requiring special perks and additions to their compensation.

Employers and Human Resources advisors wrestle with how to recruit, reward, and retain key people. What kind of golden wonders can be offered to secure individuals? Can tax advantaged funds for retirement purposes be implemented to minimize key person turnover? If RRSPs and/or pension opportunities are already maximized, what other retirement funding options can be explored? How can the company protect itself from the unexpected loss of a key person and the resulting loss of momentum and profits?

Clearly, these aren't your everyday questions and not every business is in a position to begin to address them. With many questions and just as many solutions working differently for each company, where do you start?

PAY-AS-YOU-GO

This solution has a number of problems associate with it. Namely, it is reactive and reliant upon the company being in a great financial position. If the business unexpectedly loses a key person, the assumption is that there is cash in the bank to find, hire, and train the replacement. It also assumes there is no disruption in sales and that the banks don't call business loans. Upon retirement of a key person, the business also assumes a healthy cash position for the purpose of funding a retirement payment.

This approach mortgages the future cash flow of the business. Push forward 10-15 years, and a bank loan may not be possible when these key man transition events occur. A reactive plan creates insecurity for the key person as there is no guarantee that money will be there for them at retirement. Ultimately, pay as you go is a short term option which is not great for morale or reducing turnover, and should be considered only as a bridge to more long term, proactive solutions.

SECULAR TRUST

With this arrangement an employer funds retirement benefits on an after-tax basis through the executive. The executive is expected to have a trust set up to hold these funds; identifying the employee as the beneficiary of the trust. The trust also contains special terms that constrain the timing and the amount of any withdrawals keeping it confined to retirement. The executive is taxed on any income earned by the trust. If an exempt life insurance policy was used as the funding vehicle, there would be no tax payable annually on any growth and would instead be deferred until retirement. The main disadvantages related to this option are the annual trust filings and the related administrative costs.

KEY PERSON INSURANCE

This shared-ownership, creative solution benefits both the employer and the employee. Key person insurance is normally taken out on the life of an employee or shareholder whose contribution is essential to the success of the company. Under a reverse shared ownership the business would be beneficiary of the life insurance death benefit and the employee would pay into the savings portion and control the cash values of the policy.

Features of this structure include employee access to a very attractive tax-deferred investment vehicle, and opportunity for the company to have the death benefit to fund its key person requirements. It can also offer an attractive tax-free benefit to the key person at no additional cost to participants; at retirement, the company signs over ownership of the policy to the employee. The cash value can be used to supplement the employee’s retirement income and the insurance used as part of the estate planning. This program demands the participation of a certified professional to navigate the related complex legal requirements and tax planning.

RETIREMENT COMPENSATION ARRANGEMENT (RCA)

With an RCA, the employer makes contributions to a custodian to fund benefits payable to an employee on, after, or in contemplation of that employee’s retirement. It may also exist where benefits are to be paid to an employee upon termination of employment or as a consequence of any major change in services provided by an employee.

RCAs are directed at two types of key people. First, senior executives of large public corporations making over $100,000, who want to supplement their pensions. Second, owners of medium to large mature businesses who also wish to create tax advantaged retirement funding. To enjoy the many benefits of this option, you must be prepared to secure professional advice and assistance related to the requirement for a trust agreement, and complex legal and tax filing requirements.

ENHANCED / EXECUTIVE RETIREMENT ACCOUNT (ERA)
Similar to the Key man life option, an ERA provides a funded retirement pool, based upon a legal agreement, where the employer pays for the cost of key man insurance but there is only one owner of the policy. The employee buys a key man life insurance policy making the company the irrevocable beneficiary of the face amount of the death benefit on the policy, subject to a legal agreement. The employer assumes the cost of the insurance and the employee contributes to the policy to build up tax-deferred cash values.

Tax issues are easiest to control with this option. Upon retirement or termination of the employee, the legal agreement allows for the company to be removed as beneficiary of policy, and for the employee to access fund values in various ways at retirement.

TAKE 5
Add these five options to your treasure chest of golden carrots to attract those brilliant industry “whiz kids” that everybody wants on their team. These solutions are designed for the longer term; to help a company retain and reward executives and key people, over time. Each brings their own merits depending on the industry and the stage of development of the business, as well as the strategic intent around people practices. As certified professionals, The Intueri Group can help you make sense of your options, and create HR and financial strategies for success, including plans to attract, retain and reward your key people.

www.theintuerigroup.com

To have a deeper conversation about how this subject will affect your business, please contact:

Mandie La Montagne MA, CHRP
Certified Human Resources Professional & Business Consultant

mandie@theintuerigroup.com
C: 604 644 0177

Sean Farrell BA, CFP, CHS
Certified Financial Planner & Business Consultant

sean@theintuerigroup.com
C: 604 760 7205