Audio file

KN10 - Joanne Gagnon.m4a

Transcript

Hello and welcome to the New Knowledge podcast. My name is Mark Singer, partner, meet one advisors and I'm joined today by my colleague Stephen Target, managing partner with our firm Steve. How are.

Welcome. Doing great. Thanks for asking.

Fantastic. We will prove on the Meeting, Knowledge Podcast, meaningful content to our valued advisor community and clients who are interested in learning more about sophisticated insurance related topics, focusing on estate planning and executive benefits. During our podcast, we focus our discussions on content that will deliver unique insights into the people, processes and products that make our. Industry so critical routine one is a national life insurance planning firm delivering customized insurance solution structure to help clients and their advisors engaged in solving the state planning wealth transfer, business succession and executive benefits challenge. We are member of the Financial Group offering our clients access to the nation's most prestigious insurance carriers and innovative products available only through our network. Today we have the privilege in speaking with Joanne Gagnon, Field Vice President of Pacific Life partner carrier, One Financial Joanne Overseas and facilitates business opportunities within the non qualified deferred compensation marketplace. She focuses heavily on cultivating relationships with her partner advisors to assist their business clients that are struggling to attract and retain executive talent. From an increasingly competitive labor market, Joanne brings more than 30 years of experience in the life insurance and financial services industry. She's extremely talented at simplifying ideas. Some with complexities found in the executive benefits world and presenting them in a fashion that is clear and compelling for those benefiting from such solutions. Joanne received her bachelor's degree from Cornell University and is a member of her second. So to move further ado, Joanne Glad to have you on today and welcome. How are you?

I'm great. Thanks for having me Mark and Steve, I really appreciate it.

Thanks for being with us, Joanne. What I'd like to do is is set the stage for our conversation and what I mean by that is let's refer to a statistic that's been presented to us from 2021. It's reported that an average of 3.95 million Americans left their jobs each month. And so this is being called the great resignation and it continues and as it continues, employers are scrambling and asking a lot of questions about what can be done and some of those questions are how should we structure a competitive compensation package. Without breaking the budget, what can we do to hold on to our talent? And how do we attract new talent to our companies and our firms? So in addition to this being called the great resignation, some are calling it the great migration and maybe even the great renegotiation. So let's use this as our basis, Joanne, as we get into a discussion about non qualified. Executive benefits, and I think the best place for us to start, as we often do, is just the fundamental question, what are executive benefits, what are non qualified executive benefits and why are they?

Well, at a very, very high level deferred comp plan is really just an arrangement between the employer and a select group of key employees that allows them to defer some portion of current compensation to some future year. So it lowers current income tax liability and allows them to save more. For retirement on a tax deferred. In terms of importance, it's really one of the only ways that an employer can distinguish between all their other employees, all their rank and file versus their top or tier management or key executives.

Thank you. That's a great explanation. Now is it fair to ask this early in our talk what plans, what non qualified plans are most commonly implied?

I think the most common ones I see are combination plans and the combination plans are because an employer say doesn't want to be tied 100% to 1 obligation or another. And I'll give you some examples. So my father was a lifetime IBM her and that was because of. Pension plan. So there was very little mobility. Well now businesses as a result of just frankly technology in general. But the prevalence of technology and the fact that pensions have gone by the wayside, businesses try to figure out how to keep the. And again, how do they do it in a way that is discriminatory in nature, so the types of plans I see most are combination plans where that select group of participants are eligible. Participants can defer their own money, but the employers can also do discretionary contributions to the plan. Combination plans are the things that I see most often.

Seeing them in the market, is there a particular industry or company type, maybe even a company size that is is implementing non qualified plans more than others?

So with the very high. And you know, the Fortune 500 companies, it's it would be rare not to see a plan, in other words, everybody has them. That's where specialists have focused since that market really emerged, it becomes less prevalent as you move out to the Fortune 1000 and again, less so once you hit the mid market. But of course that means. All the growth is happening in the mid market and it's because like many things, economies of scale have allowed say the mid market to have viable options for non qualified plants. So typically say what I would look for are companies that have. Anywhere between 75 and 1000 employees, that would really be defining that mid market and therefore you might have an eligible group of between 5 and 150 people inside the plan. So I would say at the lower end you know 10 million of revenue is what? You know where we would see the opportunity and the upper end doesn't really have a limit and it's just that when you get to those upper limits, we would tend to look to say different plan size, different scale, etcetera.

And pension plans and and the. Ability for companies to deliver. Opportunities to their employees previously, but let's kind of let's let's take a couple steps back and if we could also talk about the differences between qualified plans and non qualified plans, because there are significant differences and that that allows us the opportunity to create these non qualified executive benefit programs that will benefit. Both the the companies and the employees. So let's let's go. Back and talk about qualified versus non.

Sure. And and I'll start really with that talking about the pension plan, because people did spend an entire career with one company. But when the pensions went by the wayside, the American workforce became mobile, it it would be like sports having free agency. So the non qualified plan is really the the balancing act of companies giving up on their pension plans. And I shouldn't say giving up, it's more like changing them. So if they had more. I guess more modern and less costly retirement plans. So the big difference between a qualified plan and a non qualified plan is the qualified plan has complete security from the risk of the business and it also has creditor protection for the employee. So the contributions to the plans themselves. Are are limited by Arissa. There's full testing every year. To prevent plan from favoring the highly compensated. So for example, in 2022, the maximum contribution to 401K plan is 20,500 and that's without any say catch up provisions. But the most contribution and that's if a business also wants to contribute. Profit sharing is 61,000, so if you do some math and you take somebody making half a million a year, that's equates to 12% of salary and that's at the maximum end. So the most generous and employer could be in a given year. Or only allows someone 12% of their compensation at half $1,000,000. Anybody who's familiar with financial planning knows that it's recommended that you put away 15% of your income for the entirety of your career. So the more money someone makes, the harder it is for them to control. And again, that's if somebody does profit sharing. If you work for an employer that does minimal profit sharing or no profit sharing, then it leaves anybody making $150,000 every year a year or more, very limited in terms of what they do. They'll flip to the non qualified plan, which is nearly the opposite. There's no statutory limitations of contribution and there's very little administration with regard to, say, reporting and ERISA oversight. It's really a one time filing with the Department of Labor and the most critical piece is that the plan must discriminate. So again, completely opposite of the qualified plan, the plan has to be for a select group of key management or highly compensated. And the reason is that the plan is part of the books or an obligation of the company to pay it out in the future. It's not this. Separate tax ID that a qualified plan is. So when someone defers their own money or a company contributes money to the plan. And on behalf of the participants, it becomes an IOU of the company to pay out somewhere down the road. And of course, that means if the business fails or becomes insolvent or filed for protection, the participants in the plan are still owed money. But they're unsecured creditors versus secured creditors such as a mortgage holder or a lien holder. So we call that risk of forfeiture. And it is a primary requirement of a non qualified plan. There has to be some risk to the individual that they won't receive the money and that's what gives that tremendous flexibility of the company to build the plan itself.

There's a lot of different plans and a lot of different titles for these plans. And so I almost hesitate doing this, but I'm gonna. I'm gonna ask you to maybe pick a couple. I hesitate because our industry is known for coming. Put these sometimes marketing names, but you know pulling it down to what we're trying to accomplish and understanding what opportunities are out there to deliver the plans. Would you mind speaking to maybe a a couple or at least one that you see used most oftenly you know and and I'm talking about things like sort plans or? 401K mirror plan. Or just a straight non qualified deferred compensation plan, but help us help us understand what these different types of programs are at A at a, at least at a basic level and what you see out there in, in terms of implementation most often.

And you're right, we do. We love our acronyms and we love our marketing needs. So at the very basic level, they all fall under non qualified deferred compensation and QDC. But there is kind of. Really, two ends of it. The first end is what we would call an elective deferral plan and those are the ones often referred to as 401K near plans or 401K overlay plans. And it's a fancy way of saying that as an individual participant, if you're maxing out on your qualified. And contribution. Or capped at how much you contribute to a plan and you would like to contribute more. If your ability to make an election to defer some portion to the future. And by the way, we talk about retirement a lot, but that election could be for, say, education purposes. Like if you have a. You know, a 10 year old child and you're 40. Five years old. Maybe you're more concerned about paying for college education beginning in eight years versus retiring in 20. So it's just elective defer. Well, allowing you to defer more money. The reason they get called for looking near plans is often someone, and that is highly compensated if it's in a mid size market. In particular, they're either limited for the matching. In other words, they can't even get to the full matching that the employer offers on the 41K. Or in some cases it means you've asked about industries. Some of the industries, if they're heavy on service end, for example, they have a lot of rank and file and a relatively tiny management structure. There are people that are carved out 100%, they can't put a dollar into the qualified plan. So elective deferral plans are helpful to them. And the foil and came near. Peak piece is where the company might provide matching or restoration matching to. That plan, if we go to the complete other side you mentioned SERP SERP stands for supplemental Executive Retirement Plan. It usually is what we call defined contribution where the employer is making contributions to the plan regardless of whether the. Participants elect to defer the. Own money and in some cases they might not have the ability to defer any money of their own. It's just the company deciding they want to do something for a select group. And by the way, there can be three groups within the select group. So for example, I have planned recently that there were 20 people eligible in the plan. And they had three tiers within the plan. So one dollar amount for tier a, another dollar amount for Tier B and a third amount for Tier C Now it can be something that they define in dollars that they're going to do consistently every year or it could be performance based. So a percentage of net revenue or growth or EBITDA to the business. The reason the CERT plans are so popular in the mid market is because many of those businesses are privately held, and whether it's one business owner or three or say a multi generational family business, they often don't want to share equity or growth of their business. And so these type, the SURF plan itself is a way for them to provide their executive team or their key people with incentive to stay and loyalty to stay. But not the route, the ownership or equity of the business. So those are the most common types and frankly combination of the two is what I see the most, the ability to defer money on your own, but really driven by the company wanting to make specific monetary awards. Now, but on the deferred basis for their executive.

Let me throw another one in there that that we've seen and continue to see in the marketplace and that's the the funding, the future retirement obligations and we we see that a lot in the professional service market with law firms and CPA firms where there's a defined age where a partner retires and they're expected to receive some sort of retirement payout maybe for life. And in many cases, those retirement obligations are not are not funded, even informally funded. So are you seeing that as a as a more common planning opportunity for? Non qualified benefits.

Yes and no. And the yes is because businesses that adopt non qualified plans often fund their plans. You know basically if you think about from a book standpoint, if they have this obligation to pay it out in the future, the best way for them to do that is to create the sinking fund. Now, in other words, has an offset an offsetting asset that's earmarked to pay it. The problem is in some of the businesses where they have gotten behind the 8 ball. In other words, they hadn't done that funding already and then they want to begin funding. They have to do it in drips and drabs and and that is OK. But it it really takes that commitment of the business. So while we've seen growth in it. It can be sort of a I guess the current obligation can be daunting to the business, but where we see it, you know very frequently is that the business might try to overtime. Build up the obligation so starting out small and then just picking away at it a little bit at a time. It makes the business more viable from. You know all standpoints because ultimately any credit lines that they want, anything like that, that's just important. It it basically shows that they don't have they're. Not so highly. Leveraged that they can't meet their out.

Yeah. Well, I think one of the things I'm hearing and that certainly we promote in the marketplace is customization. But we have to be careful with customization, right, so. When when the. Company or the sponsor is is determining who they can cover and who they can't cover, what what sort of rules do they need to follow or what sort of? Guidelines should they be aware of?

So this is where it's very different from a non quality or a qualified plan where testing for example very specific to separating 80% from 20% etcetera in terms of compensation on the non qualified side it. The business or the the IRS or the government? Some very loose criteria, what they call top hat rules, and that sounds like weird terminology, but it is real top hat as in what you would wear with a tuxedo. And it says that each business is different and therefore they're highly compensated or executive management team is different than the next business. So on a loose basis and following private letter ruling. A plan should be limited to 15% of your top tier, but at the same time in another business it might only be 5% or somewhere else. It could be 20. So part of it is the structure of the business. Sometimes we see if you're say your top 15%. Income earners, if it's a reasonably small business, might include people. That by definition on the qualified plan side are not highly compensated or their titles do not lend them to be what we would refer to as key management. So we what we have to do is is be able to carve out that they aren't. For example, an executive assistant who makes. Plenty of money, but isn't part of key decision making. So it's key decision makers and or highly compensated the reason for that is that risk of forfeiture, the government says we'll let you do what you want in a non qualified plan as long as the people are at a risk that they won't receive it. So that's that unfunded or unsecured benefit and we want to know that the people. Eligible for the the plan. Are high enough within the company within the decision making and management of the business to know they might not receive the money.

We have referenced taxes a couple times here. Let's just kind of briefly talk about understanding that we're not Cpas and we're not giving tax advice. But let's talk about what we know as any sort of requirements or potential requirements with regard to reporting to the IRS if these plans are out there or do we? Have to do that.

We have to do a one time filing with the Department of Labor and at this point it's so simple to do because there's a link to it so it can be done electronically and that has to happen within 120 days of the effective days of plan. And it says, who's in the plan, not not naming people, but for example. That it could say that there's 15 people eligible for the plan. And it might, in the name of the plan, and indicate, you know, confirmation that it is a select group, etcetera. That's it. That's the requirement from the filing standpoint. Any other reporting that happens is not for say purposes of specific to the plan, it's really. Specific to regular tax returns of a business, in other words, was there a an expense associated with it? Administration record keeping is a deductible expense, for example, but if there is an obligation that exceeds what the asset is, in other words, an expense associated with the funding of the plan, those are reported just the same way every every other expense or operational expense of the. Business is reported but not separately because it's a non qualified plan.

And I'm going to take us back to the beginning. Here and we started. Off talking about the great resignation, the Great migration and the great renegotiation, let's just kind of talk about how these sort of plans can benefit both companies and employees or executives, and how they may circle back and and help with solving the great resignation. Create migration and create renegotiation.

There is no doubt in my mind that the great resignation is real, but more importantly, that the the great migration is real. So. You know, unemployment in March of 2022 to 3.6% as opposed to the high during COVID April 2020, I think it was 15% at that point. I know for myself I could name people who have decided they've had enough and retired on their own, you know. Arguably, it's early is earlier than either they expected or business expected. But also there is that whole group of people that decided they didn't want to return to the office and they're demanding a permanent remote career. My own company developed a hybrid workplace, so when people go back to the Home Office, they don't even have a permanent work spot. In other words, it's sort of a rotating. Work environment. So I would say that that great migration is what took businesses from competing either regionally or locally for talent to now competing nationally. So how do they do that now? I mentioned saying, you know, breaking down peers within companies, if you're say a bio business or pharma business, but you're not publicly traded, then you're going to compete against people that are. And so how do you separate yourself when you're competing nationally against the big guys and it's through retention plans? Such as a defined contribution SERP plan. I think more than anything it's trying to keep. It's trying to figure out how to keep good people. Without giving away things you don't want to, for example the ownership or the equity you know not ready to do an ESOP. For example, in helping businesses either growing towards succession or selling to private equity or whatever their long term objective is it's locking in the people that help. And help get them there.

I think that's a great summary and a great overall help for us to understand and the advisor community that's likely listening to this podcast, what they should be looking. For so I'm. Just gonna throw it back to you for one last question, Joanne, is there anything that we missed? Is there anything that you want to make sure that we we hear from you with all of your great experience in this marketplace that would be helpful.

You asked about industries and I think what's interesting is it can be all the way across the board. You know, I've had people ask for what are other businesses in landstreet. You and a lot of the studies out there don't actually separate by industry and it's because they are so prevalent in, say, the large market, which is across all industries. So what I tend to tell people to look for are businesses where either you have a highly compensated census in general, maybe it's a. Technology company and so they are maxing out on qualified plans and might want to contribute more or the other end of the spectrum is those service type businesses you know can be restaurant chains, it can be construction business. Where there's large numbers of rank and file, and because of it the plans are top heavy and the executive team can't do more. So it's across the board, it's more looking for the specific elements of the business. Does the business owner want to provide something else to incentivize their employees?

Wonderful, Joanne, thanks for being with us today. We really appreciate you spending time and helping educate our community and we look forward to continuing to work with you.

Sounds great. Thanks, mark. Thanks, Steve. Have a great day.

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