**CLEARPOINT ADVISORS, LLC**

*Providing Clarity and Confidence in Insurance, Investment and Benefit Solutions*

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# News in Brief: Market Update

## Group Carve-Out Plan (Deferred Compensation Alternatives)

**Special points of interest:**

- **Design as a co-pay with the corporation and executives**
- **Flexibility in design options including defined death benefits or targeted growth of cash value**
- **10 participants can create guaranteed issue underwriting for selected groups**

The primary reason for the popularity of term life insurance with employers is that it's viewed as a fairly inexpensive benefit. For the most part it can be, especially if there are a number of younger, lower-paid workers. However, when the business includes its older, higher-paid executives, including the owners themselves, the result can be a "so-so" benefit at an "oh-no" price.

As a business owner, you may want to consider what could be a more cost-effective alternative: group carve-out insurance. This insurance is so called because older, higher-paid employees are "carved out" of the group plan and are instead provided with permanent, cash value life insurance.

If you are providing across-the-board group term coverage for your employees, group carve-out can provide a valuable, win-win alternative; one that provides employees and the business with a bigger bang for the benefit bucks you spend.

There is nothing wrong with traditional group term life insurance. However, with the group carve-out insurance there is also a very nice tax break. The cost of providing up to $50,000 of death benefit is 100% deductible to the employer.

Group term life insurance accounts for more than 40% of the existing life insurance in the U.S. and represents the ***only*** life insurance on the life of many breadwinners. Group carve-out plans augment this important employee benefit by purchasing additional coverage, usually in the form of universal life policies, on the lives of key personnel.

**Weaknesses of Group Term Life Insurance**

Unfortunately, group term life insurance has several serious weaknesses. This is especially true for businesses with older, higher-paid employees and owner-employees. Among the problems:

1. Costs rise with age.
2. Costs rise with income.
3. The tax break disappears for benefit amounts above $50,000.

Some of the significant limitations of group term life insurance also include:

- Coverage must be provided on a nondiscriminatory basis.
- Coverage is adversely affected, i.e., reduced or terminated at retirement.
- Coverage is lost upon termination.

**Group Carve-outs Can Offset Disadvantages of Group Term**

Each of these limitations inherent in group term life insurance can be offset through the use of a group carve-out plan.

In a group carve-out plan, the employer replaces existing group term life insurance coverage in excess of $50,000 with individual universal life insurance coverage on selected executives. The universal life insurance may be declared rate, equity-indexed or variable, depending upon the wishes of the individual executive. The employer continues to make premium payments for the group term life insurance coverage that remains and also

# Group Carve-Out Plan (Deferred Compensation Alternative)

**Create restrictive bonus and/or vesting schedules on contract values.**

**Utilize as long-term incentive tool.**

**Design with institutionally priced products can provide efficient long-term incentive (LTI) program.**

makes premium payments on the universal life insurance policy. If the executive were to leave the employer's service, the group term life insurance would cease. However, the universal life insurance would continue and the executive, as policy owner, would take it with him or her. The subsequent premiums would be the policy owner's responsibility.

The group carve-out plan solves the problems inherent in group term life insurance by offering several benefits, including selectivity, portability, an avoidance of additional imputed income and the opportunity to maintain coverage beyond retirement.

Similar to other nonqualified plans, the employer may select an executive or class of executives to participate in the group carve-out plan. Ordinarily, an entire class of executives, for example, all VPs, is selected to participate. This selectivity enables the employer to provide more meaningful recognition and rewards to chosen executives.

It would be more than a little unusual if an executive's life insurance needs changed radically between the day before and the day after retirement. The executive's ownership of the universal life insurance policy that replaced the group term insurance in excess of $50,000 means that the executive can continue the coverage beyond retirement, possibly without additional premium payments.

Similar to the maintenance of coverage beyond retirement, the executive's universal life insurance policy provides coverage that is portable. Coverage continues even after the executive's service with the employer terminates.

**Employer Advantages**

There are five principal advantages when the employer installs a group carve-out plan:

- Reduction in group term life insurance discrimination concerns;
- No cost increase;
- Ability to limit participation;
- Current employer tax deduction; and
- Encouragement of executives' active participation.

**Advantages for the Executive**

The advantages to the employer, however substantial, are not as significant as the advantages to the executive under a group carve-out plan. They include:

- An opportunity to maintain death benefits beyond retirement;
- The tax-deferred accumulation of voluntary contributions;
- Portability; and
- The ability to use cash values to supplement retirement income.

***Let Clearpoint Advisors be a compensation benefit resource to you or your client to explore alternative designs.***

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*Source:* New York Life *The Carve-Out Alternative;* Wall Street Journal; *Nonqualified Plans Module 4 Group Carve-Out Plans*