Key Employee/Veterinarian retention program with a possible option for ownership

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Retention is a top issue

- WSJ – Jobless rate lowest in 50 years.
- "failure to attract and retain top talent" is now the No. 1 issue on the minds of CEOs.
- Glassdoor: Nearly half (45%) note that salary is the top reason for employees changing jobs.
- Technology has made it easier to look.

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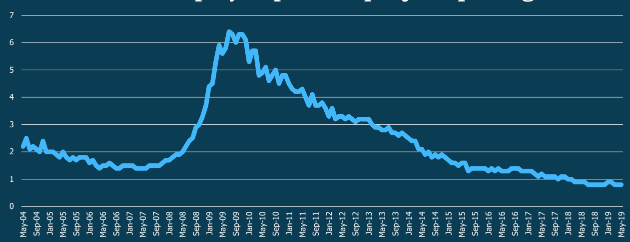
Employment ratios are changing

Number of unemployed persons per job opening



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Why do we care?

- This is critical to business owners who want to:
  - Sustain the business.
  - Grow the business.
  - Sell the business.
  - Pass the business along to a child or other family member.
  - Protect the family in the event of premature death.

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Key concerns

Key employee's primary concerns:

- Employment security.
- Ability to earn additional rewards for real economic advancement.
- Ability to afford retirement.

Employer's primary concerns:

- Attract key people to grow the business.
- Reward key people for growth they drive.
- Retain key people to unlock the value.

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Cost of losing

- Distraction costs
- Recruitment costs
- Inefficiency costs
- Ramp-up costs

And after all of these expenses, there's no guarantee the new person will be "right."

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People – Appreciating assets

- And most importantly of all, we have to remember that people are what we call an "appreciating asset."
- The longer we stay with an organization, the more productive we get:
  - We learn the systems;
  - We learn the products; and
  - We learn how to work together.

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Retention factors

- Fair compensation.
- Feeling valuable to and appreciated by the organization.
- Enjoying the work.
- Career opportunities to continue growth and development.

"Money isn't usually what attracts people to a job, but it can be very useful for retention."

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Benefits of long-term incentives

- Employee retention.
- Focus on desired results.
- Balance short-term and long-term decision making.
- Sharing in the company's growth.

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Benefits of long-term incentives

- Not additional comp – it's a targeted incentive.
  - If you could guarantee that your key employee would stay and work to help you achieve your goals, the additional comp would be a great investment.
  - But no one can guarantee they will stay and work.
  - But you can guarantee that you will not pay them <u>unless</u> they stay and work.

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What Is A SERP?

- <u>S</u>upplemental <u>E</u>xecutive <u>R</u>etirement <u>P</u>lan.
- A customized fringe benefit providing
  - additional retirement income,
  - supplemental disability income,
  - severance pay and/or
  - survivor income.

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What Is A SERP?

- A benefit which can be provided on a selective basis.
  - only to select members of management and/or those employees who are "highly compensated."
- A plan with minimal government regulation, which is
  - extremely flexible,
  - easy to understand and
  - easy to administer.

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How do these plans work?

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Key Concerns

Employer's primary concerns:

- Attract KEY PEOPLE to grow the business
- Reward KEY PEOPLE for growth they drive
- Retain KEY PEOPLE to unlock the value

Key employee's primary concerns:

- Employment security,
- Ability to earn additional rewards for real economic advancement
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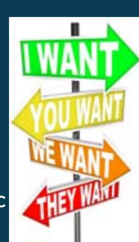

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Plan Advantages to the Executive

- Provides an opportunity for supplemental retirement income without current tax to the executive.
- Can provide survivorship benefit to executive's family without any addition to current taxable compensation.
- The plan can be custom designed to meet the executive's individual needs.

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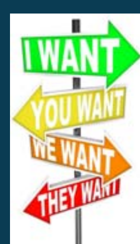
Plan Advantages to the Employer

- An additional benefit employer can offer to attract top talent in a competitive environment.
- Offers more flexibility in design than a qualified plan.
  - Cover a single executive or a group of key executives
  - Without anti-discrimination provisions of qualified plans.
- Provides incentive for long term employee loyalty.
- Benefits, when paid to the executive, are tax deductible.
- Full company cost recovery is available.



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How Do These Plans Work?

Business | Employee

ABC, Inc. ⟷ Agreement

The agreement is a binding legal document designed to protect and balance the interests of both parties.

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Agreement Must Be Written

- Defines the duties and obligations of each party.
- States benefits and how they will be determined.
- Provisions relating to:
  - termination of employment before retirement,
  - benefits payable following a change of control, and
  - the effect on both parties in the event of a merger, sale or acquisition.

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How Do These Plans Work?

Business

ABC, Inc.

Agreement

Employee

Conditions

-- Will pay benefit when due as promised

-- Will continue to work
-- Will fulfill conditions

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How Do These Plans Work?

Business

ABC, Inc.

Agreement

Employee

Employer reserves the funds required to fulfill the contract

Conditions

-- Will pay benefit when due as promised

-- Will continue to work
-- Will fulfill conditions

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How Do These Plans Work?

Non-Qualified Funding

- Cannot be formally funded
  - No assets formally set aside to fund
  - No vesting in specific assets
- Informal funding options:
  - Cash flow
  - Borrow
  - General business assets or cash reserves
  - Cash value life insurance

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How Do These Plans Work?

Many plans use life insurance

- Death Benefit can
  - help the practice cope financially with the key employees loss
  - funds the pre-retirement promise
  - Can allow the practice to recover plan costs.
- Cash value growth can be
  - Predictable (subject to timely payment of required premiums)
  - tax-deferred

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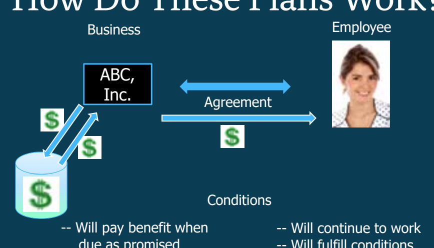
How Do These Plans Work?



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Taxation Of A SERP

The Executive

- No reportable income prior to retirement or termination.
- Benefits paid are taxed as ordinary income in the year of receipt.

The Beneficiary

- Benefits paid are taxed as ordinary income in the year of receipt.

The Employer

- Benefits paid to the executive or to the executive's beneficiary are tax deductible in the year they are made.

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Complying With ERISA Requirements

- A SERP is intended to be exempt from most ERISA requirements.
  - Exemption is limited to "top-hat" plans.
- ERISA requires the Department of Labor be notified by letter within 120 days of the plan's effective date. The letter must include:
  1. Name and address of the employer;
  2. Employer tax identification number;
  3. A declaration that the plan is for a select group of employees;
  4. The number of employees in the plan; and
  5. An agreement to furnish copies of plan documents to the Department of Labor upon request.

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Special Considerations

- Under 409A plan must be in writing
- Must include timing of distributions
- Supplemental Retirement Income cannot be distributed earlier than one of six specified events:
  - Separation from service
  - Disability
  - Death
  - Specified time (or fixed schedule)
  - Change in ownership or effective control of employer
  - Unforeseeable emergency

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How can these plans help?

To the Next Generation: Additional Retirement

Case Study 1

Additional retirement

- Facts:
  - Business owner in his mid-60s.
  - Four key people significant to the business growth and profitability.
  - 36-year-old son working in the business and groomed to take over.

Additional retirement

- Objectives:
  - Owner wants to pass along the business to his son over the next several years.
  - Owner wants to make sure the key people who made him successful stick around to make his son successful.

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Additional retirement

- Problem:
  - How do we create a plan that incentivizes those key people to stay?
  - What's important to them?

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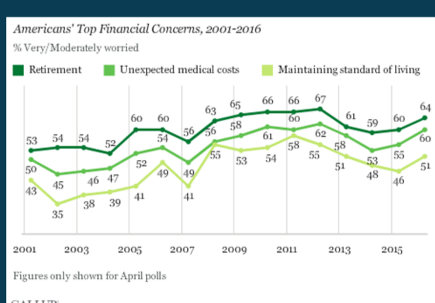
Retirement remains a concern



Top priority for 70% aged 30-64

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Intentions for working after retirement

	2011	2013	2017
	%	%	%
Continue working, and work full time	18	15	11
Continue working, and work part time	63	61	63
Stop working altogether	18	22	25

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Additional retirement

- Solution:
  - Promise key people additional retirement benefit at age 65.
  - Make the benefit subject to vesting.
  - Promise key people a pre-retirement death benefit.

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Additional retirement

- Solution:
  - Purchase a life insurance policy on each key person, which provides:
    - A death benefit
      - To pay the promised pre-retirement death benefit.
      - To provide additional cash to the business to help compensate for the loss of a key person.
    - Cash value
      - To fund the additional promised retirement benefit.*

* Policy loans accrue interest. Loans and withdrawals will decrease the policy cash value and death benefit

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Succession Planning: Find buyer

Case Study 2

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Find a buyer

- Facts:
  - Business owner in his early 50's.
  - Four key people significant to the business growth and profitability.
  - Wants to retain key people.
  - At some point will sell out but not sure who will buy.
  - Thinks one of key people may want to buy but won't have the $.

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Find a buyer

- Objectives:
  - Wants to consider retirement in 10-15 years.
  - Wants to make sure key people stay for that time.
  - Would like to find a way to help a key employee be able to make a down payment to be able to buy the business.

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Additional retirement

- Problem:
  - How do we create a plan that incentivizes those key people to stay?
  - Doesn't know if any of the key people will want to be a buyer.

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Additional retirement

- Solution:
  - Promise key people additional retirement benefit at age 65.
  - Be prepared to allow the key people to use their promised benefit as a down payment to buy the business if one or more of them desire.
    - Doesn't often happen, at inception, that you know who will be a successor.
    - Happens over time, and these agreements help create the option

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Protect the Family: Stay Bonus

Case Study 3

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Keeping the business

- Facts:
  - Business worth $5 million.
  - Generating $800,000 income annually.
  - Owned by 50-year-old male.
  - Wife also works in the business.
  - Most assets still in the business.

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Keeping the business

- Objectives:
  - Wants to consider retirement in 10 years.
  - Business is sellable.
  - If he dies prior to that time, wants his wife to continue the business.
  - She can run it if two key people stay in place.

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Keeping the business

- Problem:
  - How do we know they will stay?
  - Can we create a plan that incentivizes those key people to stay in the event of husband's death?

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Keeping the business

- Solution:
  - Promise key people a stay bonus payable at the end of 10 years.
  - Amount of stay bonus equals $100,000 for each year they stay beyond the owner's death.
    - Example: Husband dies three years from now.
    - Stay bonus of $700,000 would be payable at the end of an additional 7 years to key people.
  - Bonus funded by life insurance policy on the owner.

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Frequently Asked Questions (FAQ)

Implementation

- Does it need to be in writing?
  - If so, do I need to hire a lawyer, or can I just do it myself?
    - 409A, ERISA, unanticipated contingencies.
- How will this be monitored on an ongoing basis?
  - Do we need an administrator?
    - Depends largely on the type of plan, as well as number of participants.

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Modification

- Can we change the agreement later?
  - What if I can't afford to pay the benefit?
    - Unsecured creditor
  - What if I sell the business?
    - Accelerate vesting, payout possibly
  - What if parties wish to modify on a mutual basis?
    - 409A still controls, but further deferral possible

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Vesting and forfeiture

- What's the difference between vesting and payment?
  - Example - $2K per month for 10 years at retirement
  - 10 year vesting – 10% per year
- What does it mean to be subject to a risk of forfeiture?
- Can I recapture benefits already paid out?
- What happens if I fire the employee?

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Other considerations

- Can I tie benefit to value of company, and if so, how?
  - Equity – Stock, stock options
  - Hybrid equity – Stock appreciation rights (SARs) and phantom stock
- Should I include a non-compete?
  - Time, scope and geographic restrictions
- Can I tie the SERP to an Employee buy-out?

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