A Perspective on BOLI and Executive Benefit Plans for 2018

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Agenda

- BOLI in the current market
- Update on the BOLI market
- Community bank compensation challenges
- Strategies to retain key employees using executive benefit plans
- Deferred compensation plans tailored for millennials
- Q&A
- Closing comments

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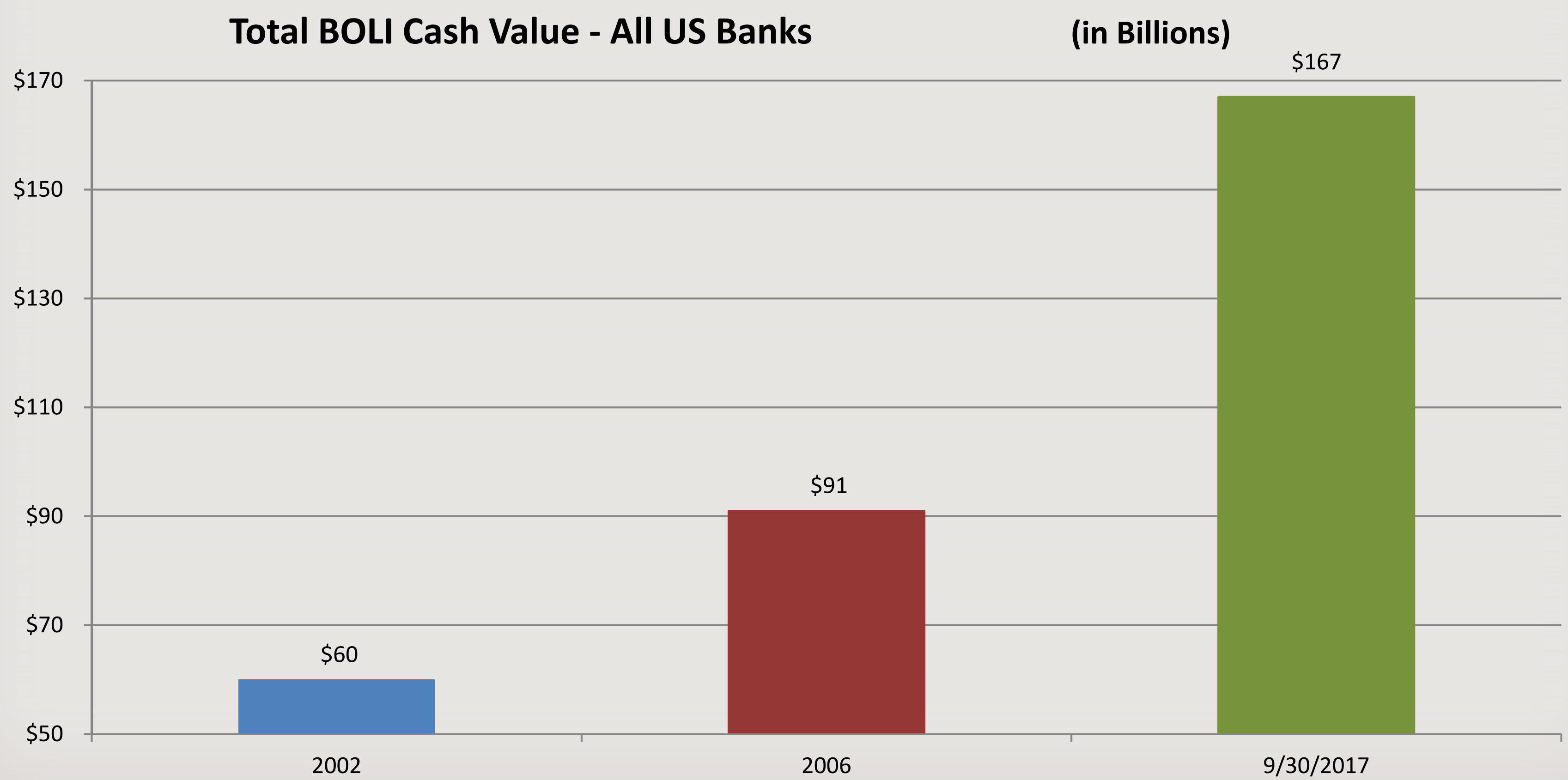
BOLI in the Current Market

BOLI Trend



Source: FDIC

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2017 Tax Cuts and Jobs Act Affect on BOLI

- Corporate Tax lowered to 21%. Combined with Florida state tax of 5.5% for total of 26.5% (24.85% net)
- TCJA also had a provision in it aimed at the STOLI market that inadvertently brought in the potential of transfer for value ("TFV") issues for banks owning BOLI on employees no longer employed by the bank.
- If applicable, TFV results in taxation of the death proceeds received above premiums paid on life contracts that are acquired where no "family, business or financial relationship" with the insured exists.
- As a result, BOLI on insured employees no longer at the bank that is transferred to another bank in an acquisition *could* become taxable for proceeds above the banks basis (premiums paid). Benefit programs, such as SERPs, DCPs and split-dollar on former employees should be considered in evaluating the existence of a "financial relationship" with the insured.
- Industry discussions with the various congressional committees and leaders re this topic indicate it was inadvertent and unintended for BOLI/COLI. We expect it will be clarified, but at this time, are uncertain of the timing. Until it is, we know that some accounting firms are having their bank clients record a deferred tax liability.

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Reasons Cited by Banks for Purchasing BOLI

- Generates tax-advantaged income to help offset and recover a portion of the costs of employee benefit plans
- Provides informal funding for nonqualified officer and director benefit plans
- Generates stable revenue from non-loan sources and enhances the "Other Non-Interest Income" component of the Income Statement
- Strong credit quality

Reasons Cited by Banks for Purchasing BOLI

- Book value accounting treatment
- Increases earnings per share and shareholder value
- Current BOLI net yields are in the 3.00% to 3.75% range
- Tax equivalent net yields of 4.00% to 5.00% (25% tax rate)
- BOLI is the most common method of financing the cost of employee and director benefits, including nonqualified benefit plans.

Market Trends

- BOLI Cash Surrender Value grows by $5 billion to $6 billion per year

- BOLI held by:
  - 63% of all banks
  - 70% of banks over $100 million in assets
  - 78% of banks over $300 million in assets

Source: FDIC

BOLI vs. Traditional Bank Investment

Traditional Bank Investment		BOLI	
Bank Invests	$5,000,000	BOLI Purchase	$5,000,000
5 Yr. Agency Bullet @ 2.58%	129,000	Yield @ 3.50%	175,000
Tax on Earnings @ 25.00%	32,250	Tax on Earnings	0
Net After-Tax Income	96,750	Net After-Tax Income	175,000
Net Yield from BOLI Investment	3.50%	Net Income - BOLI Investment	$175,000
Bank Investment After-Tax Yield	1.94%	Net Income - Bank Investment	$96,750
Spread advantage using BOLI	1.57%	BOLI Net Income Advantage	$78,250

This example depicts adding 157 bps for a bottom line improvement of $78,250 from BOLI vs. alternative investments.

The 5 Yr. Agency Bullet rate is as of 2/9/18. The BOLI Yield is a composite yield among multiple BOLI carriers as of 2/1/18.

Example is a hypothetical illustration to be used strictly as an educational tool. It is not intended as offering specific investment advice or recommendations.

BOLI Overview

Pro Forma Balance Sheet

	December 31, 2017 Actual (1)	BOLI Purchase Debit	BOLI Purchase Credit	December 31, 2017 Pro Forma (2)
Assets				
Cash & Due From Bank	19,650,000			19,650,000
Securities	140,657,000		5,000,000 [1]	135,657,000
Loans	854,237,000			854,237,000
Less: Reserve	7,502,000			7,502,000
Net Loans	846,735,000			846,735,000
Other Assets	38,689,000	5,000,000 [2]		43,689,000
Total Assets	**1,045,731,000**			**1,045,731,000**
Liabilities And Capital				
Deposits	909,137,000			909,137,000
Federal Funds Purchased	20,152,000			20,152,000
Other Liabilities	18,427,000			18,427,000
Total Liabilities	**947,716,000**			**947,716,000**
Stock	24,537,000			24,537,000
Surplus	48,914,000			48,914,000
Undivided Profits	24,564,000	0 [3]		24,564,000
Total Equity Capital	**98,015,000**			**98,015,000**
Total Liabilities & Capital	**1,045,731,000**			**1,045,731,000**

This pro forma balance sheet illustrates changes that may result from implementation of the recommended financing strategy. Please note that this schedule is based upon the bank's call report data as of December 31, 2017.

Column 1 represents actual balance sheet data before the BOLI investment.

Column 2 reflects a pro forma balance sheet with the BOLI investment.

[1] Allocation of current investment.

[2] Recognition of BOLI asset cash values.

[3] Loads or surrender charges, if any.

Equias Alliance does not provide legal, tax or accounting services or advice. We recommend that you consult with appropriate counsel before making an investment decision.

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BOLI Overview

- BOLI Plan Mechanics
  - The bank pays a single premium
  - The bank is the owner and beneficiary of the policies
  - Insure a group of employees (must be in the top 35% by compensation)
  - Hold policies until maturity (death)

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BOLI Overview

- Regulatory
  - BOLI is an allowable transaction under Interagency Guidance 2004-56 (FIL 127-2004)
  - The business purpose is defined as financing employee benefit liabilities
  - The general guidelines is that BOLI should not exceed 25% of regulatory capital in total and not more than 15% to any one carrier

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BOLI Overview

- Tax & Accounting
  - Growth in cash value is recorded as "Other Non-Interest Income"
  - The policy's death benefit proceeds are received tax-free by the bank

BOLI Overview

- General Account
  - In a general account insurance product, the policy premium goes into the general account investments of the insurance carrier. The bank's return is based on the performance of a specified pool of assets in the general account or on the return of the entire general account portfolio. Default risk and price risk remain with the carrier. However, if the carrier experiences financial difficulties, the bank's investment with the carrier may be vulnerable to other creditors.
- Hybrid Separate Account
  - In a hybrid separate account (HSA), the BOLI assets are owned by the carrier but are protected by a separate account legal entity. In the event the carrier becomes insolvent, the assets in the separate account are only available to the separate account policyholders, not to other policyholders or general creditors of the carrier. In effect, the separate account assets serve as collateral for the cash value. Like general account policies, default risk and price risk remain with the carrier.
- Variable Separate Account
  - This is a legal entity which holds invested assets strictly for the benefit of specific policyholders. These assets are typically outside the reach of general creditors of the insurance company and are available only to separate account policyholders. However, default risk and price risk rest with the policyholder, not the carrier. In most cases where separate account policies are purchased by a bank, a "stable value wrap" or similar arrangement is used to smooth out the impact of changes in market value.
  - **Variable life insurance is sold by prospectus only which can be obtained by calling an insurance representative. Investors should carefully consider the information in the prospectuses about the contract's features, risks, charges and expenses, and the investment objectives, risks and policies of the underlying portfolios, as well as other information about the underlying funding choices. Please read the prospectuses and consider this information carefully before investing.**

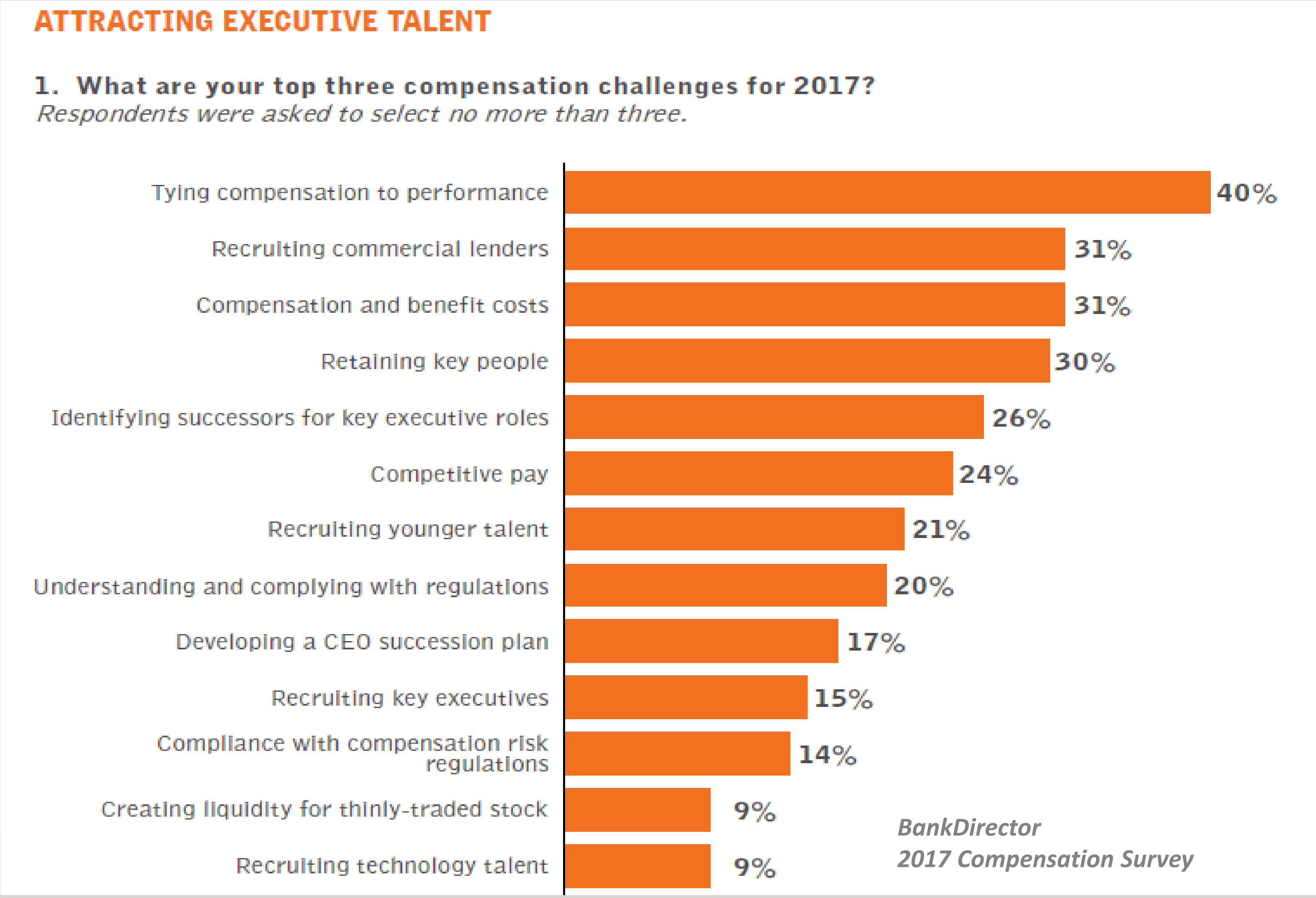
BOLI Types

- BOLI asset allocation (as of 9/30/2017)
  - 45% General Account
  - 44% Variable Separate Account
  - 11% Hybrid Separate Account

- New purchases over the past few years are almost 90% General Account

Source: IBIS Associates, Inc.

Top Compensation Challenges



Five Elements of Compensation

Total Executive Compensation

Cash Compensation

- Base Salary
- Annual Bonus

Qualified Plans

- Pension
- 401(k)
- ESOP
- Profit Sharing

Nonqualified Benefit Plans/Perks

- **SERP/Salary Continuation Plan**
- **Performance Driven Deferred Compensation Plan**
- **Split Dollar Plans**
- **Supplemental Disability**
- **Long-Term Care**
- **Employment Agreement**
- **Change-in-Control Agreement**

Equity Plans

- Stock Options
- Restricted Stock
- Phantom Stock
- Stock Appreciation Rights
- Book Value Appreciation Rights

Group Benefits

- Medical Insurance
- Group Disability
- Group Term Life

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Purpose of Nonqualified Plans

- Attract and retain key officers
- Align compensation to performance
- Cover the gap created by ERISA and IRS limitations on qualified plans
- Develop a compensation plan that includes more than salary and bonus

Overview of Nonqualified Plans

- Unsecured promise to pay future cash compensation
- Purpose is to help attract, retain and/or reward key people
- Documented in a legal agreement
  - Terms include normal retirement, early termination, disability, change in control and death
- Limited to select management, highly compensated officers and directors when set up as a retirement age benefit
- Plans include:
  - account balance plans (Incentive Retirement, Deferred Compensation), also known as "defined contribution"
  - non-account balance plans (Supplemental Executive Retirement Plans (SERP's), Salary Continuation Plans and Director Retirement Plans), also known as "defined benefit"

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NQ Benefit Plan Agreement Provisions

- Payout events
  - Normal Retirement
  - Early Retirement
  - Change in Control
  - Disability
  - Death
- Terms of payout
  - Accrued liability, PV of full benefit, or full payout
  - Paid immediately or at normal retirement age
  - Paid in a lump sum or over time

Defined Benefit SERP

- DB SERPs (also called Salary Continuation Plans) help overcome retirement shortfalls

- The benefit is a fixed amount or percentage of final salary paid at retirement
  - Examples:
    a) $75,000 per year for 15 years
    b) 35% of final salary for 15 years
    c) 70% of final salary minus social security and 401k plan benefit payments

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SERP/SCP Example

- **Assumptions**
  - Officer — Age 37
  - Current Salary — $125,000
  - Projected Age 65 Salary — $286,000
  - Annual SERP Benefit Formula — 35% of final salary
  - Annual SERP Amount — $100,000 per year for 15 years

This is a hypothetical illustration and is for informational purposes only.

SERP/SCP Vesting Example

Age	Annual Benefit
50	$30,800
55	$48,800
60	$72,000
65	$100,000

The plan can provide that the vested annual benefit is forfeited if the officer competes with the bank.

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Defined Contribution
Incentive Deferred Compensation Plan

- Bank contributes a specific dollar amount or percentage of salary each year
- Bank contributions are discretionary or dependent on meeting budget or other goals
- The contributions may vest over 3 to 10 years
- Participant deferrals allow further tax-deferral
- Interest is credited to the account balance (rate could be tied to an external index or an internal index such as bank ROE)

The Value of Customized Deferred Compensation Plans

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The Millennial Generation

- What do 'they' value? Diversity, inclusion, flexibility, culture
- What is their perception of business environment?
  - Heavy focus on bottom-line results
- How do firms attract and retain millennials?
  - Financial Rewards (say 63% of those surveyed*)
  - Cultural Alignment – perception of similar priorities
  - Flexibility – where and when
- Do 'they' have a mismatch in their priorities?
- Community Banks have a unique opportunity

**Source: 2018 Deloitte Millennial Survey: Millennials Disappointed in Business, unprepared for Industry 4.0*

The Value of Customized DC

- Millennial and younger generations may not value traditional SERP or long-term benefit plans
- Can be customized to meet individual needs and tied to performance (student loan repayment or future college tuition)
- Interest rates can be tied to an index of choice or bank performance
- Does not need to meet Top-Hat guidelines if it is not a retirement plan
- CIC, disability, normal retirement accelerates vesting to 100%
- Most terms and conditions for nonqualified retirement plan also apply

Customized DC Plan Examples

- Traditional DC Plan – Annual performance awards build account balance to be paid at retirement
- Rolling DC Plan – Annual performance awards cliff vested after 5 years and paid thereafter
- Traditional DC /Education Hybrid – Annual performance awards accrued with interest and paid at retirement and at tuition intervals.

Example 1: Traditional DC Plan

- **Assumptions**

– Officer	Age 37
– Incentive Contribution	8% of salary
– Current Salary	$125,000
– Crediting Rate	ROE
– Planned Retirement Age	65

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Example 1: Traditional DC Plan

Age	Projected Account Balance
50	$274,000
55	$515,000
60	$898,000
65	$1,469,000

Projected Annual Benefit (for 15 years)	$130,000
Total Benefits	$1,950,000

The plan can provide that the account balance is forfeited if the officer competes with the bank.

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Example 2: Rolling DC Plan

- Goal: Provide incentive, retention, short/mid-term cash
- Who: Mid-level management or young officers
- Design Features:
  - Annual performance awards for meeting or exceeding goals
  - Each award will earn a pre-set interest rate and will cliff-vest after 5 years (ie: 2018 award pays in 2023)
  - After 5 years, the first award, plus interest, will pay in cash
  - Subsequent earned awards will pay 5 years from earn date.
  - At retirement, the account balance will pay out the balance

Example 2: Rolling DC Plan

- **Assumptions**

– Officer	Age 32
– Incentive Contribution	10% of salary
– Current Salary	$125,000
– Crediting Rate	5%
– Planned Retirement Age	65

This is a hypothetical illustration and is for informational purposes only.

Example 2: Rolling DC Plan

	Award	Payment
2018	$12,500	$0
2019	$12,885	$0
2020	$13,272	$0
2021	$13,670	$0
2022	$14,080	$0
2023	$14,503	$16,055
2024	$14,937	$16,537
2025	$15,386	$17,033
2026	$15,847	$17,543
2027	$16,322	$18,070
	Continued Until Retirement	
2051	Balance Paid at Retirement	$169,186

Total Benefit Paid: $858,434

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Example 3: DC/Education Hybrid

- Goal: Mid-term and long-term retention, mid-term cash, retirement income
- Who: High-level and/or executive management
- Design Features: Employee with kids ages 3 and 7
  - The plan will make 8 consecutive payments starting in year 11
  - At retirement age, the remaining account balance will pay out in a monthly stream of payments for 15 years
  - Vesting could be structured differently for both the mid-term payments and retirement payments.
    - ie: Cliff-vesting for mid-term payments and retirement balance vesting over 5 years

Example 3: DC/Education Hybrid

- **Assumptions**

– Officer	Age 37
– Incentive Contribution	8% of salary
– Current Salary	$125,000
– Crediting Rate	ROE
– Withdrawals for College	$25,000/year for 4 years for each Child
– Planned Retirement Age	65

This is a hypothetical illustration and is for informational purposes only.

Example 3: DC/Education Hybrid

Withdrawals of $25,000 per year for 8 years (Ages 49-56)

Age	Projected Account Balance
50	$213,000
55	$281,000
60	$505,000
65	$877,000

Projected Annual Benefit (for 15 years)	$78,000
Total Benefits	$1,370,000

The plan can provide that the account balance is forfeited if the officer competes with the bank.

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Key Takeaways

- Cash is still king – millennials are motivated by financial rewards
- Align your goals/culture to promote diversity, flexibility and community focus.
- Take care of your employees – professional development, reassurance, empowerment.
- Population shift – millennials will outnumber baby boomers in 2019

Death Benefit Plans

- **Split-Dollar Plans**
  - Arrangement between parties to share the benefits of a BOLI policy upon the death of the insured
  - Typically the bank pays the premium while allowing the executive or director to name a beneficiary to receive a portion of the death benefit (insured participant is taxed on the value of the economic benefit)
  - Agreement may state that the benefit is retained after separation from service if certain requirements are met
  - Death benefits to the beneficiary are not subject to federal income tax

Death Benefit Plans (cont.)

- **Survivor Income/Death Benefit Only Plans**
  - The bank agrees to pay a benefit to the beneficiaries of a director or executive
  - The benefits are typically paid from the general assets of the bank.
  - The amounts paid to the beneficiaries are taxed as ordinary income
  - Payments can be “grossed up” to cover taxes
  - Contingent liability is normally offset by the bank’s ownership of BOLI

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Equias Alliance Experience & Endorsements

- Nationwide, Equias consultants have implemented 1,750 benefit plans for 800 banks and made 2,500 BOLI placements
- Extensive experience in the marketplace – have worked with hundreds of banks on BOLI and all types of nonqualified benefit plans
- **Exclusive endorsement of the American Bankers Association** (ABA) for BOLI and nonqualified benefit services
- **Exclusive endorsement of 9 state banking associations (including Florida Bankers Association)**
- Equias Alliance, when combined with its parent company, NFP Corp., has 1,250 bank clients (including clients in all 50 states), making it the largest provider of BOLI services in the country.

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