Episode #324 - A Unique Strategy to Recruit and Retain Key Employees

Hello, my name is Luke Geller, and welcome to another episode of Money Script Monday. Today we're going to be talking about a unique strategy to help recruit and retain employees. Before I jump into it, I want to talk a little bit about my background and more specifically the family I grew up with. I grew up in a family of business owners, more specifically, my dad, Ross Geller. He owned his own business in 1999 when I was 10 years old. It was a trucking company called local freight service, LFS for short. Really what he did was he delivered freight from inside and outside of LA county to San Diego and San Francisco and really, it was a same-day freight delivery service. He owned that company all the way up until I was almost 30 years old, for 20 years.

If you have been a part of a company or have owned your own company during that timeframe from 1999 to almost 2020, you've gone through a lot. In 2000/2001 we hit the ".com" bubble. In 2007/2008 it was the real estate bubble. I remember sitting with him at the table one day and him talking about having to let some of his employees go.

That was a terrible day for him and the reason why, is because these employees were with him and helped him grow his business. Helped him put his kids through school and go on vacations and trips and he never wanted to let them go. He wanted to reward them. From the fear and frustration of letting them go in 2007-2008, to the joy just a few years later when he was able to re-hire some of them back, hire more individuals, and then be able to reward those individuals with the success of his business. Then to be able to see them buy their own homes, be able to take their families on vacations, retire if they wanted to reward those employees with that.

As I was growing up and seeing that, it really had an impact on me and that is why I want to talk about a unique strategy and a unique way to reward employees for what they do to help you and help your business grow. Now this concept of the strategy is going to be an advanced strategy, so we are going to try and keep it as high-level as possible and look at a 1000-foot view and try to make it as simple as possible for something complex.

We are going to talk about today a split-dollar agreement as a retirement plan for key employees. We're going to focus on two aspects of this plan we're going to focus on the business, and we're going to focus on the key employee. Between the business and the key employee, there's a split-dollar arrangement right here, and what's happening is, that the business is loaning premium dollars to the employee every year. That employee is taking those premium dollars, taking the money loaned to him, and purchasing a cash-value life insurance plan that's going to have tax advantages, cash value growth, and a death benefit.

Then that employee is going to collaterally assign that policy back to the business. What collaterally assigned means is the interest and principal on the premium that's loaned are going to be paid back to the business upon termination of the split-dollar arrangement. You're thinking well there's a loan so that means there's interest and principal and the key employee is able to utilize the policy, either the cash value on the policy or something happened to that employee the death benefit from the policy, a portion of that would go to the business to make that business whole.

Another key aspect to think of is each premium payment is treated as a new loan to the key employee and will have certain interest amounts. It's a very low interest rate. It's the applicable federal rate, which is the lowest rate that can be made between a private loan based on the IRS guidelines. It is usually around 3-4%, even in a high-interest rate environment, so that's very advantageous. That's really what the agreement looks like, but what are some of the benefits to the employees and the business themselves?

The employer benefits, the main one is that this is a nonqualified plan and so it’s not subject to ERISA guidelines. ERISA guidelines cover 401k, deferred comp, and pension plans. They all have to follow certain guidelines that are outlined in ERISA and because it’s a nonqualified plan, the employer does not have to do that. That means they don’t have to have it available for every employee and there are other benefits to that as well, so that’s a big benefit to the employer.

The other is it’s a cost recovery for the business. We talked about being a loan and that there is a recovery to the business. The key employee is going to be paying back the loans plus interest to that business. Because of that, it’s treated as an account receivable on the business’s books. It’s an asset to the business on the ledger because this is an account receivable, it’s going to continue to earn interest as well. Obviously, it’s not a large interest number, but that’s a benefit to the business so they keep an asset on their books, they’re rewarding an employee, and then on top of that, all the money that they’re using to reward that employee will eventually come back to them and will have cost recovery for that as well.

Now to the employee benefits, the big one is this is exclusive to only key employees. This does not fit under regular guidelines. It’s exclusive, which is a great way to reward and to help hire new employees as well especially if it’s a key executive that you're trying to bring on to your business. That is something unique. They can’t go to their neighbors, and they can’t go to other companies that will offer that.

On top of that, the employee receives a tax-advantaged retirement plan. What this employee is using these loan premiums to purchase, is a cash-value life insurance policy, usually an index universal life. The key employee is going to be able to have this large, tax-free cash value growth, not be subject to market risk and market loss, and participate in the market upside.

On top of that, they can take loans from this policy as income and that’s completely tax-free as well. The employee has low to no out-of-pocket cost for the huge retirement advantage and tax-free advantage that they’re getting. They’re not paying taxes on the loans because the loan is not coming out of their pocket. The only cost that might come out of their pocket, is if the employee decides to pay the interest to the employer or to the company for that loan premium or they can roll the interest in the policy and pay that back from the cash value at a later date once it grows and exceeds what's loaned on the policy.

Again, this is a complex strategy. It’s not something that can be explained in a short video like this, however, I wanted to make sure we went over the basics. If you do have any questions on this, I would highly recommend talking to a financial advisor about that. I really want you to think back to the story I told you when we started this conversation. If you’re a business owner, if you are an executive in a business, and you’ve been there for a long time, you’ve seen what it’s like to go through some of those hardships. But you’ve also seen what it’s like to be able to reward some of those key employees and with the strategy here, you’re able to give this unique reward that not many other companies can do or have done. It allows you to really see that benefit to that employee, to someone who's worked so hard to help your business grow and become what it's become. Now you're able to give a little back in a great tax-free benefit that is cash value life insurance. Again, thank you for attending today. I hope you have a wonderful day. Until next time, my name is Luke Geller.