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Nonqualified Plan Funding Alternatives: When to Transition Mutual Funds to COLI

Utilizing mutual funds as the vehicle to informally fund a nonqualified plan is a popular choice for many plan sponsors. When a new plan is initially implemented, informally funding the plan with corporate owned life insurance (COLI) does not always make financial sense. The number of participants and/or the amount of annual plan contributions could make COLI unattractive. However, as a plan grows those factors are likely to change and companies should consider a transition to COLI.

When mutual fund balances grow, the annual taxation cost and future tax liability to the plan sponsor grow along with it. COLI offers an alternative to mutual funds with significant additional benefits.

COLI Includes

- Tax deferred cash value appreciation
- Cash surrender value increases flow through the P&L statement as income
- Tax-free life insurance death benefits
- Participant investment options similar to mutual funds

COLI Removes

- Tax liability of realized gains and rebalancing of investments

While there is a cost to insurance, in many cases this cost is far below the tax liability of a plan with a large mutual fund balance. With a large group of executives, guaranteed issue underwriting simplifies insurance enrollment without any medical exams. Additionally, tax-free death benefits will provide significant cash inflows to the plan sponsor which help reduce the overall cost of the nonqualified plan. To learn more about informal funding alternatives, visit NolanFinancial.com.

If you have questions regarding nonqualified deferred compensation plans, please reach out to Michael Nolan, NolanM@nolanfinancial.com, or Kenton Quick, QuickK@nolanfinancial.com, or by phone at (888) 886-9128.