

BUSINESS INSURANCE

SERPs and indexed whole life

Business-owner clients often offer fringe benefits that go above-and-beyond traditional benefits to retain top talent. A Supplemental Executive Retirement Plan (SERP) is a dynamic fringe benefit to do just that: a “top hat” plan designed to supplement qualified retirement plan benefits for a select group of management or highly compensated employees. With AuguStar® Life’s Prestige Indexed whole life policies, employers can benefit from both the guarantees of whole life and indexed-based cash accumulation potential, with 10 or 20 years of stable premiums.

How does it work?

A defined benefit-type SERP is a written agreement offering the employee a certain cash benefit if he or she stays with the company until retirement (or other permissible fixed date or event set by the agreement). The benefit is forfeitable, which means the employee loses the benefit if she leaves early. This is why SERPs are commonly referred to as “golden handcuff” plans.

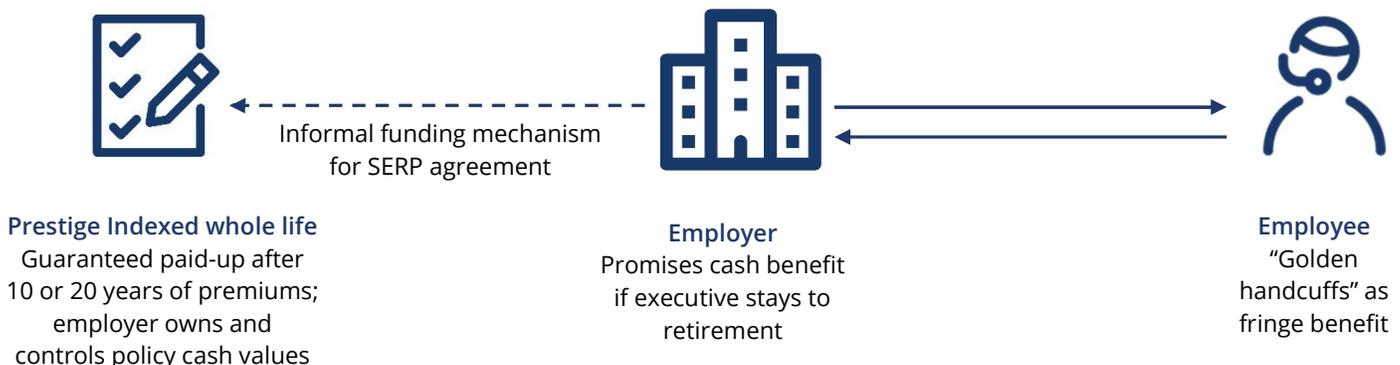
SERPs with indexed whole life

Permanent, cash value life insurance is often the funding mechanism of choice to informally fund a SERP because of the tax benefits afforded to life insurance as well as the death benefit protection should the worst happen. The life insurance policy – through properly structured policy loans and/or withdrawals – helps the company pay benefits promised under the SERP agreement.

Employers offering a SERP are faced with the challenges of finding a product that simultaneously offers both cash accumulation and guarantees. AuguStar Life’s Prestige Indexed 10 and 20 Pay whole life policy can offer the best of both worlds: the stable, guaranteed growth and guaranteed premiums of a whole life policies with indexed-based accumulation potential. And because they are built with just 10 or 20 years of premiums, employers can use a short-term funding period to provide a long-term benefit horizon.

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The benefits

- Prestige Indexed 10 Pay offers the stability and guarantees of whole life insurance.
- As a cash accumulation product, the Prestige Indexed 10 and 20 Pay products features index-based cash accumulation potential to help employers meet promised benefits under the SERP agreement.
- Employers need only pay 10 or 20 years of premiums. This can be particularly useful for business-owner clients unable to commit to a long-term funding horizon.
- The employer owns and controls the life insurance policy informally funding the plan (although in some cases, a trust may be used to prevent a change in management from altering the plan). If the employee leaves the company, he/she forfeits the promised benefits.
- When properly structured, the employee is not currently taxed on SERP benefits. This can delay income taxes on the benefit until it is actually received (typically in retirement).
- SERPs can also be designed to include a pre-retirement or survivor benefit if the employee becomes disabled or passes away.
- Unlike qualified retirement plans, SERPs have only minimal reporting requirements, and there are no IRS contribution limits or discrimination testing rules.

Additional considerations

- For all business-owned life insurance, including policies informally funding a SERP, it is essential for the employer to obtain proper notice and consent from the insured before the policy is issued to help keep death benefits income tax free.
- Because a SERP agreement is a legal document, employers should hire legal counsel to draft the agreement and to help ensure compliance with applicable laws including Internal Revenue Code Section 409A. The Advanced Planning team is happy to provide a sample SERP contract and ERISA statement for the client's attorney.
- SERPs are complex. Employers may need to hire a third-party administrator or specialty CPA to manage the tax and accounting procedures applicable to SERPs.
- SERPs should only be offered to a select group of management or highly compensated employees.
- In order to maintain tax deferral, assets informally funding a SERP agreement – including the life insurance policy – must be subject to the employer's creditors. Additionally, the funding must be informal: the policy must not be earmarked or set aside for any one employee.
- The policy must not be a modified endowment contract ("MEC") to maintain tax-appropriate access to policy cash values.
- Special rules applicable to nonprofits may make SERPs less attractive to nonprofit organizations.

You can learn more about SERPs by contacting the Advanced Planning Team or by consulting the Supplemental Executive Retirement Plan Guide for financial professionals (Form 1488).

This material provides general information that should not be construed as specific legal or tax advice nor the law of any particular state. Clients should seek the advice of a qualified legal or tax professional for their specific situation.

If tax-free loans are taken and the policy lapses, a taxable event may occur. Withdrawals (partial surrenders) and loans from life insurance policies classified as modified endowment contracts may be subject to tax at the time the withdrawal or loan is taken and, if taken prior to age 59½, an additional 10% federal tax may apply. Withdrawals and loans reduce the death benefit and cash surrender value.

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