Using Executive Benefit Plans to Attract, Reward and Retain Top Talent

In a competitive employment market, a nonqualified executive benefit plan can be a game changer.

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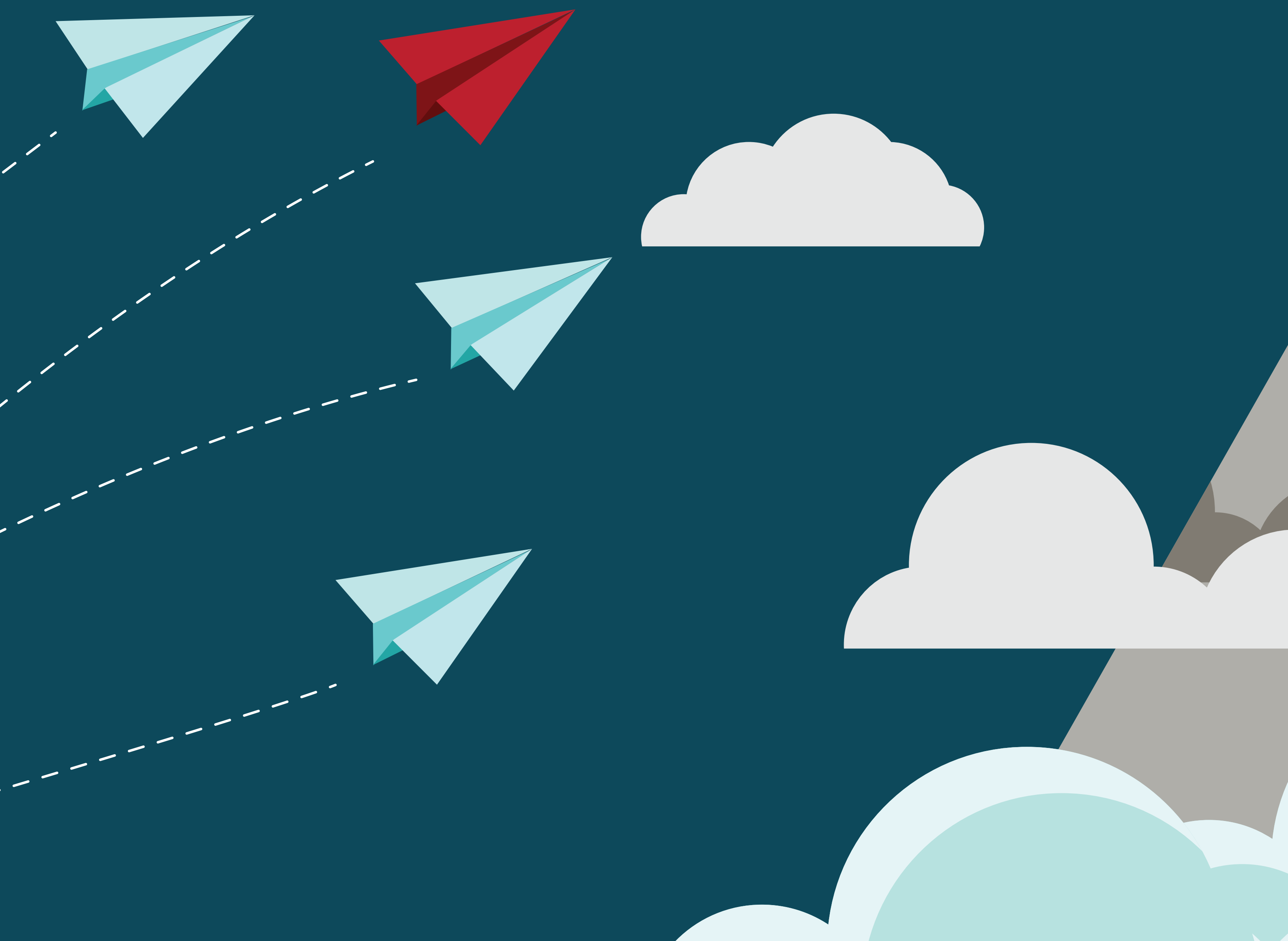

Building a competitive advantage is one of the biggest challenges facing companies today. What is the key to a lasting competitive advantage? Attracting, retaining and rewarding the employees you need in order to ensure your success.

Today, with unemployment trending lower, wage growth is picking up. This is good news for job candidates. Employers have positions to fill, which also means that workers now have leverage, confidence and options. For companies competing for job candidates, a comprehensive benefits package may tip the scales for a candidate who is considering multiple offers. The bottom line: benefits, especially retirement benefits, can be a game changer.

Competitive benefits not only help with recruitment, they can also bolster retention. While a strong benefits package can become expensive, replacing an employee can be even more costly and time consuming if a company experiences regular turnover. Investing in a comprehensive retirement benefits package can help mitigate the cost, time and effort involved in employee turnover and recruitment.

Today, competition for new talent — and the need to retain top talent — is fiercer than ever before. However, qualified plans are only part of the equation. Today, executive benefit plans are an essential component of any corporate benefits strategy.

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ENHANCING YOUR COMPETITIVE POSITION WITH AN EXECUTIVE BENEFIT PLAN

Under the Employee Retirement Income Security Act (ERISA), qualified plans must be offered to all employees at a company. An executive benefit or nonqualified plan, however, is a type of tax-deferred, employer-sponsored retirement plan that falls outside of the ERISA guidelines.

Nonqualified plans can be designed exclusively for key employees and directors, providing an optimal solution to benefit limitation issues. Since nonqualified plans are not subject to the same regulatory requirements that apply to qualified plans, employers can provide benefits through nonqualified plans to recruit and retain key employees who cannot be fully compensated through a combination of salary and qualified plans due to the cost and compliance burdens that arise when similar benefits are provided to all employees.

A nonqualified plan may be offered to a prescribed group of employees. The Department of Labor (DOL) requires that the plan be designed to cover a select group of management and/or highly compensated employees. Certain job titles generally meet this description, such as president, chief executive officer, chief financial officer, senior or executive vice president, general counsel, and treasurer. Other employees may be eligible based on their level of compensation and responsibilities.

Executive benefit plans reward a select group of employees without affecting costs on an employer-wide basis. These plans are often used to address the retirement income shortfalls resulting from qualified benefit plan limitations, while incorporating rewards based on targeted performance or other benchmarks. Executive benefit plans provide flexibility in developing benefit compensation strategies, as they can be used to:

- Provide replacement income at retirement based on total (non-limited) compensation
- Reward, attract and retain key executives
- Replace benefits lost due to IRS limits on qualified plans
- Provide benefits in addition to those under qualified plans
- Defer compensation
- Provide enhanced benefits in the event of an acquisition or other change of control

An executive benefit plan is a contractual commitment by an employer to a select group of employees to provide supplemental retirement benefits at a future date. Since there are no coverage, eligibility or participation requirements, an employer can decide to provide nonqualified deferred compensation benefits only to a select group of executive or highly compensated employees. This allows the employer to provide rewards and incentives based on an employee-by-employee approach, offering maximum design flexibility.

Individual agreements with each employee can specify interest crediting rates, vesting schedules, death benefits, disability benefits and early retirement benefits, as well as change-of-control protection.

PLAN DESIGN OPTIONS

Following is a look at the different plan design options that are available.

Executive and Director Deferred Compensation Plans

Executive and Director Deferred Compensation plans are typically established in order to provide a vehicle for key employees, highly compensated employees and directors to defer compensation until retirement. Deferred compensation arrangements permit designated executives to defer additional compensation to avoid current taxation.

> "What are the organization's business objectives, and how do they translate into a benefits philosophy?"

Arrangements can include deferred salary and bonuses as well as director fees — including board meeting and retainer fees — allowing greater tax deferred dollars than can be made on an individual basis. Each executive has the ability to defer either a percentage of his or her salary or a flat dollar amount annually. Deferred dollars are then credited interest equal to an index such as prime rate. The interest credited on each executive and director's deferral account is adjusted annually (*i.e.*, prime rate); the crediting rate is typically designed with a floor and ceiling rate.

Supplemental Executive Retirement Plans (SERPs)

A Supplemental Executive Retirement Plan (SERP) is an executive benefit program designed to reward officers and/or key employees. Plans may be entirely discretionary and designed to provide rewards arbitrarily or based on specific performance factors. SERPs can be constructed in a variety of ways, including as defined contribution or defined benefit plans. Benefits provided through these arrangements are over and above those provided by qualified plans. SERPs may be used to provide benefits based on a more generous formula than used in a qualified plan, or may credit more years of service than under a DB pension plan, or may even restore retirement plan benefits lost due to the various limits placed on IRS qualified plans. Supplemental executive retirement plans can provide benefits beyond those provided under the qualified plan. Enhanced benefits might include:

- A benefit based on a more generous formula than used in the qualified plan
- Credit for additional years of service under a DB plan
- Enhanced retirement benefits for executives who retire early
- A benefit reflecting compensation excluded under the qualified plan's salary definition, such as bonuses and deferred compensation
- A DC incentive retirement plan that allows an organization to reward their top executives and directors based on the performance of specific benchmarks

Benefit Equalization Plans

Benefit Equalization Plans (BEPs) are a type of SERP typically designed to restore or supplement retirement plan benefits lost due to the various salary and benefit limits placed on IRS qualified plans. BEPs may also be used to restore benefits due to plan "freezes" or formula changes. A BEP can "correct" the plan salary limit, the DB plan maximum benefit limit and various DC plan limits, including maximum 401(k) deferrals.

Executive Incentive Retirement Plans

Executive Incentive Retirement Plans are also a type of SERP.

These plans are designed to provide a reward to a select group of participants if the organization exceeds key performance metrics, such as Return on Equity (ROE), Return on Assets (ROA), Net Income, Quality of Loan Portfolio, Growth in Fee Income or Cross-Selling Achievements.

FUNDING CONSIDERATIONS

The employer has a choice as to whether or not to fund an executive benefit plan. A funded plan generally is more secure than an unfunded plan. Under a funded plan, contributions are made to an independent trust and benefits are paid from the trust. Under an unfunded plan, payments are usually made from the employer's general assets. Most nonqualified plans are unfunded plans or "informally" funded plans. Regardless of which "informal funding" vehicle is used in an unfunded arrangement, the assets belong to the employer, not the employee, and are subject to the claims of the employer's creditors.

TRANSLATING BUSINESS OBJECTIVES TO BENEFITS PHILOSOPHY

Designing an effective retirement benefits program for an organization starts with a review of the firm's management philosophy and compensation strategy, the different types of plans available, an analysis of what the firm's peers offer, and considerations such as demographics and the maturity of the organization. Beyond these factors, what are the organization's business objectives, and how do they translate into a benefits philosophy?

There are two basic approaches that a company should consider in developing a benefits philosophy: objective and competitive.

Objective Approach

Compensation and benefits are offered to fulfill a specific function; benefit adequacy involves an analysis

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of what level of compensation and benefits allow an employee to maintain a certain standard of living.

Competitive Approach

Benefits and compensation packages are offered in order to attract and retain employees; benefit adequacy involves an analysis of wages and the level of benefits offered by competitors.

While these two approaches are different, they are not mutually exclusive; a successful benefits program will reflect a blend of both philosophies.

EXECUTIVE BENEFIT PLAN DESIGN CONSIDERATIONS

Determine the objectives you want to achieve with a nonqualified program by analyzing which employees are being affected by IRS limits and which key employees you might wish to reward with coverage under a nonqualified arrangement. Next, address these key questions in order to better define the organization's benefits philosophy:

- How does the organization want to position its compensation and benefits programs relative to peers as well as competitors?
- What is the most effective way to apportion retirement benefit dollars among the various benefit plans — including qualified programs?
- What is the company's attitude toward allocating benefits based on an overall company performance?
- What are the firm's overall benefit and cost objectives?

No two organizations are alike. Executive benefit plans are highly customized for this reason. As employers deal with an increasingly competitive labor market and a new generation of workers, they face new challenges in the key areas of attracting, retaining, rewarding and motivating talent. Positioning the benefits program competitively can make a critical difference for any organization. PC

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