Executive Benefit Plans:
Has the Pendulum Swung Too Far?

A Series Examining the Changes and Growing Challenges in Executives' Retirement Plans -- and How to Address Them

In recent years, executive benefits have undergone significant changes and faced intense scrutiny. This has been daunting for executives and companies, a.k.a. plan sponsors, alike. Today, both face enormous challenges and uncertainties.

The Todd Organization will be reviewing these issues through an eight-part series, "Executive Benefits: Has the Pendulum Swung Too Far?" Reports will be issued every two weeks.

These issues extend far beyond the top five or so executives named in the proxy and include most of the senior executives. As such, the series will address issues of concern not only to the CEO and named executives, but all who are defined as highly compensated by the government, i.e., those earning more than $115,000. Many of these executives, including some middle managers, are eligible for non-qualified executive benefits and need such benefits to ensure adequate retirement income.

Indeed, the retirement planning gap is daunting for many executives, particularly those who are affected by the $17,000 annual limit on individual contributions to a qualified 401(k) plan.

The Todd Organization estimates that a typical executive today earning $300,000 who plans to retire in 20 years will be able to receive less than 30 percent of final pay from Social Security and maximum participation in a qualified 401(k) plan.

The "pendulum" refers to several major trends, including the following.

- ***The swing to defined contribution from defined benefit plans.*** The shift in retirement plans from predictable, fixed payment defined benefit plans to the uncertain payouts inherent in defined contribution vehicles. This well-known, decades-long phenomenon is continuing. Companies are looking to reduce not only their compensation costs but also the variable, unpredictable costs that arise from having poorly performing pension and non-qualified defined benefit assets.

continued on next page

- ***The shift of compensation dollars from retirement planning to near-term wealth creation via expanded equity compensation.*** The pay-for-performance movement has led to the widespread use of stock options, restricted stock, and other equity instruments as compensation vehicles. To be sure, this has had many positive effects and at many companies.

For highly compensated executives not named in the proxy who for all intents and purposes cannot influence the company's bottom line, the uncertainty of equity values may be far less desirable than securing greater retirement benefits, especially during volatile markets and as one approaches retirement.

- ***A reduction in retirement compensation dollars.*** At many companies, through either design or unintended consequence, retirement program dollars have been reduced over the years. The rising costs of healthcare, a tight economy, and other factors have led to less money for executive retirement programs. Furthermore, with life expectancies continuing to rise, and more executives approaching retirement age, executive retirement programs are of growing importance.

- ***Shareholder activism in the post Dodd-Frank era.*** Amid today's shareholder activism, it is more important than ever that executive benefits be strategically and effectively structured so they retain and attract quality executives. This applies not only to those executives named in the proxy, but also to key executives throughout the company.

What has been the practical impact of these pendulum shifts?

For executives it has often meant a lower amount of retirement funds and far greater uncertainty over the amount of these funds. A prudent goal is for executives to have retirement income that will replace 80 percent of their final pay, adjusted for inflation, over a 20 year or so period. For "non-proxy" executives, this challenge is now daunting.

Because of fluctuation in stock values and company performance there is also generally greater volatility in annual compensation than in years past. This, too, adds to the planning difficulties and uncertainty.

Companies, a.k.a. plan sponsors also face great challenges in this environment. It is more difficult to retain and attract quality executives who will create maximum shareholder value. The replacement costs and business disruptions from such turnover, as well as lost opportunities for sales and income growth, significantly impacts many companies.

While each company's situation is unique and merits individual analysis, there are several general approaches to ensure the best solutions for executives and shareholders, as follows.

- Ensuring that the right balance is struck in compensation between wealth creation opportunities and meeting known retirement needs. As equity compensation is usually more oriented toward wealth building than retirement planning, executive deferred compensation plans are usually a more efficient way to address retirement needs.

continued on next page

- Retaining and attracting executives with competitive benefit packages and avoiding the high costs of executive recruiting and other business disruptions that can occur.

- Gauging the best ways to issue equity compensation. By moving to restricted stock, for example, companies can avoid the potential of issuing options that will be under water, a situation where a compensation expense is incurred without being able to provide a compensation asset.

- Finding ways to guarantee a larger proportion of executive retirement assets in sought after, predictable returns.

Indeed, executive benefits programs can be designed, financed, and administered so that they create shareholder value, through both direct and indirect measures. We will examine these and related issues in the weeks ahead.

A list of the upcoming next seven topics follows.

Non-qualified benefits lead to prudent long-term management

Regardless of tax rate changes, deferred compensation will remain important

Executive benefits: More than deferred comp

Company matches: Why they usually make compelling sense

A guide to executive benefit technology

Total plan management

Thinking years ahead

For more information, contact your Todd Consultant or visit our website at www.toddorg.com.