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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

Beyond Deferred Compensation

In our last issue we discussed deferred compensation plans and why it still makes sense to contribute to them even if federal income tax rates increase.

Deferred compensation is very popular at companies, because it is a voluntary contribution that executives make. A few companies have even gone so far as to require executives to participate in deferred compensation plans in case they need to "clawback" funds under Dodd-Frank.

Deferred compensation has become an extension of 401(k) contributions, which currently cap out at $17,000 annually for executives under age 50, and $22,500 for those over 50[1]. Tax-deferred growth -- on both the pre-tax contribution and the earnings -- means participants realize significantly higher returns over time compared to an identical investment with after-tax funds.

Other executive benefits play an essential role in protecting executives and their families.

Supplemental executive retirement plans (SERPs) – Modeled after defined benefit pension plans, SERPs provide a fixed, determined benefit to eligible executives. The plans provide stability and assurance in retirement planning, important considerations as executives have a good deal of at-risk compensation. SERP plans are not universally accepted by shareholders so it may be prudent to conduct a peer group analysis as part of the evaluation process. SERPs are commonly found in industries such as healthcare, financial services, manufacturing, and banking.

Supplemental disability insurance – One of the major protections that many executives enjoy is disability coverage. It is not uncommon for a group policy to have a $10,000 per month maximum benefit limit. Another common feature is to have group long-term disability plans replace 60 percent of salary and bonus, with a maximum annual payout of $72,000, or 60 percent of $120,000. Often, though, highly-paid employees mistakenly believe that if their employer provides group long-term disability coverage, it applies to all types of income.

The reality for many executives is that their company-sponsored group disability plan will provide less than 25 percent of compensation, particularly if the executive is heavily incentivized with commissions, stock options, and other forms of merit pay.

[1] Annual contribution limits for 2012; limits are indexed to cost of living adjustments.

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To address this, companies can offer supplemental disability coverage. One option is for companies to facilitate supplemental disability coverage through individual policies that can be obtained at group rates because of the large number of interested executives.

Long-term care insurance – As baby boomers age, the potential need to pay for long-term care -- that can easily cost more than $70,000 annually -- is quite a concern for many highly compensated professionals. In addition to the employee, long-term care insurance can cover a spouse, partner, parents, or parents-in-law.

Long-term care insurance plans are attractive to companies because the employer-paid premiums on behalf of employees are not included as income to the employee and are tax deductible to the company. The benefits received usually are not taxable to the employee. Companies can also carve out a select group of highly-valued employees when implementing long-term care insurance.

Death benefit plans – In death benefit plans, the employer makes a legally binding promise to pay a set amount for a set period of time if the executive dies during employment or retirement. The company typically purchases a life insurance policy on the life of the employee. The growth in the policy's value and death proceeds enable the company to recover its costs.

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