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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

Deferred Comp Matches: Why They Make Sense

In our last issue we discussed the prevalence of deferred compensation and other popular executive benefits. While deferred compensation is a widely popular, easy-to-implement and low-cost executive benefit, some companies hesitate to use matching programs.

> Approximately half of the companies offering deferred compensation plans also offer match contributions of some kind.

Not surprisingly, companies with matches have higher executive participation rates, approximately 46 percent, compared with 33 percent participation in plans without a match.

Yet, there are other good reasons why companies implement these matching programs. For example, vesting provisions for matches can serve as incentives and golden handcuffs for highly compensated professionals.

The Need

Executives face many challenges in accruing adequate retirement income. A typical executive today earning $300,000 with plans to retire in 20 years will receive less than 30 percent of final pay from Social Security and maximum participation in a qualified 401(k) plan.

As executives near retirement, they tend to want to save a good deal more. This often happens if college tuitions have just been paid or the executive made a mid-career move to a new company and has to replace forfeited pension benefits from the previous employer.

Many executives anticipate being in a lower tax bracket upon retirement. So, the need to defer and have matching amounts for those deferrals is a very valuable proposition.

Issues of Parity and Fairness

Companies often provide some type of matching contribution on approximately the first six percent of deferrals made into qualified 401(k) plans. This is regarded as a valued form of compensation that helps meet employees' needs while helping the company retain talented professionals and attract new ones.

These same principles should apply to non-qualified 401(k)s and related deferred compensation plans. Actually, the executives who want to participate in these plans typically have a much higher percentage of their annual pay that is not set via salary. It is at risk because of such factors as commissions, individual performance bonuses, and the company's overall performance.

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Furthermore, many highly compensated executives cannot make even the maximum legal contribution into the company's qualified 401(k) because federal testing rules can reduce the amount that may be deferred.

Participating in a deferred compensation plan also can provide balance and diversity to the executives' stock options and related equity programs.

Using the Match as Golden Handcuffs

> With a match program, companies can institute various vesting provisions and requirements. Matches can be tied to individual, group, or company performance.

In general, the plans can be structured to require an executive to stay for a given period before receiving the match. And, for the company's protection, it can be designed so that if an executive is terminated for cause before retirement, some or all of the match will not be granted.

Because it is as a debt instrument that is on the company's books, the deferred compensation matching contribution provides added incentive for executives and participants to manage the company so that it does not take undue risk. This way their interest is aligned with debt holders and shareholders.

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