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Types of Incentive Packages

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What is meant by "types of incentive packages?"

Employers generally wish to attract, motivate, and retain qualified executives and other key employees. To do so, employers design compensation packages to serve these purposes. There exists a myriad of different incentive arrangements. For an employer to make its business more attractive (to executives) than a competitor's business, the employer often provides perks and special benefits to only its key employees. This discrimination in favor of the highly compensated employees can sometimes cause an employer to run afoul of the Employee Retirement Income Security Act of 1974 (ERISA). To sidestep ERISA's cumbersome rules, employers often use nonqualified deferred compensation plans, rather than qualified plans. Such nonqualified plans allow employers to cover a select few employees rather than mandate that all employees be covered.

What is a nonqualified deferred compensation plan?

A nonqualified deferred compensation plan is a contractual commitment by an employer to an employee to pay currently earned compensation in a future year. These plans do not have the tax-favored benefits of qualified plans.

Nonqualified plans, however, are advantageous because they generally need not comply with complex ERISA rules. Unlike qualified plans, nonqualified plans can be offered by an employer to selected employees only, such as executives and other highly compensated key employees.

What are some other types of incentive arrangements?

There exist many different ways to provide incentives for executives. These include the following:

Golden parachutes

Golden parachutes are severance agreements that protect key employees from the effects of a corporate takeover or change in control. They provide key employees who are terminated (or who have resigned) as a result of a takeover or change in control with either continued compensation for a specified period following their departure or with a lump-sum payment.

Incentive stock options

An incentive stock option is a right or option granted by the sponsoring corporation that allows its employees to purchase shares of the corporation's stock at a certain price for a specified period of time, notwithstanding an increase in the value of the stock after the option is granted.

Phantom stock

Phantom stock arrangements are based on hypothetical investments in company stock. More specifically, phantom stock is the right to receive a cash or property bonus at a specified date in the future based upon the performance of phantom (rather than real) shares of a corporation's common stock over a specified period of time.

Below-market executive loans

Below-market executive loans are loans an employer makes available to its executives as a supplement to their regular compensation. ERISA requirements do not apply to these loan programs. Typically, such loans are interest-free or made at favorable interest rates.

In certain cases, however, interest will be imputed to the executive.

Executive bonus plans

An executive bonus plan involves an addition to regular salary or compensation that is provided, usually near year-end, to enable employees to share in profits resulting from a successful year. Bonuses are often used for executives as an incentive-oriented form of compensation, based on the attainment of profits or other goals during the year. Bonus plans are not subject to ERISA.

Split dollar life insurance plans

Split dollar life insurance is an arrangement between an employer and an employee in which there is a sharing of the costs and benefits of the life insurance policy. Split dollar is a method of premium payment for the life insurance; it is not a type of policy. The coverage, amounts, and terms of the split dollar arrangement need not meet ERISA nondiscrimination rules.

Fringe benefits

Fringe benefits may be defined as noncash compensation benefits provided by employers to their employees. Fringe benefits may take a variety of forms, including employee discounts, company cafeteria or meal plans, free parking, and free gym/club memberships. Although executives normally participate in a company's broad-based fringe benefit programs such as group medical plans, many executives also receive fringe benefits that are available only to the executive group.

Executive business expense reimbursements

Executives often incur business-related expenses when furthering the company's interests off-premises. For instance, an executive might be required to take a client out to lunch or might be required to drive his or her own car somewhere for business purposes. Companies will often reimburse executives subsequently for these business expenses. This can be viewed as one incentive or benefit to working for the company.

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