



Special Benefits and Perquisites – The New Paradigm

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Special Benefits and Perquisites – The New Paradigm

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Why do companies provide supplemental benefits and perquisites to executives? If you look at proxies, you'll find reasons such as:

- To attract and retain the best talent;
- To be competitive;
- To bring on a mid-career hire;
- To make up for what a new recruit has left behind;
- For time efficiency or convenience;
- For security reasons; and
- To allow executives to remain focused on their job without distraction.

While these reasons may be true, the real reason that many companies have provided supplemental benefits, and especially perquisites, has been to confer status and recognition. Most executives can afford to pay for their own financial planning, car, and even private flights, as well as fund their own retirement, often many times over. These special benefits and perquisites, however, send a message to both the executive and others that they have achieved the pinnacle level of success to which many aspire, and few reach. They recognize past hard work, strong performance, and contribution.

Many years ago, when the difference in pay levels between executives and average employees wasn't as great, these little extras were meaningful forms of recognition and often modest in nature. Over time, with the keen competition for top executive talent, these special extras grew. Now, however, the trend is clearly reversing. The paradigm is, appropriately, shifting from one of "status and recognition" to one of "pay for performance." This article explores this shift and provides key considerations for Compensation Committees navigating this new environment.

The Changing Landscape

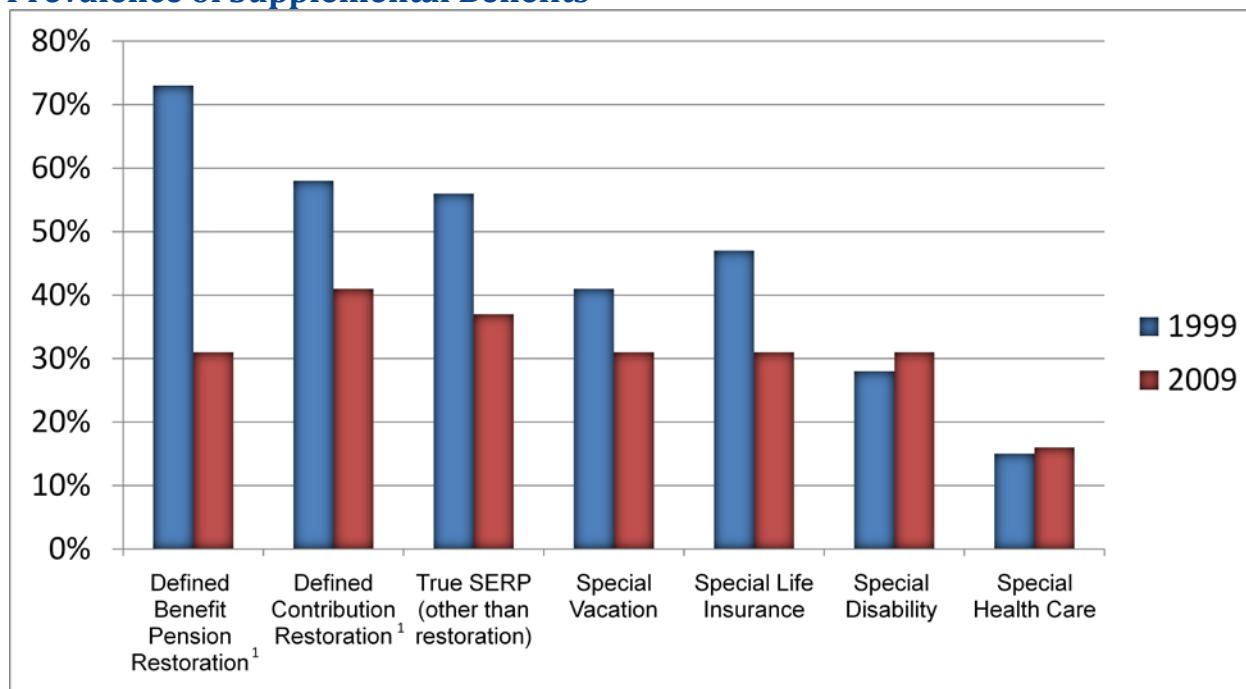
As the following charts indicate, the prevalence of most special benefits and perquisites has declined over the last 10 years. This decline has picked up steam most notably in just the last 2 years. There are a number of reasons for the shift, including public and shareholder pressure following recently enhanced disclosure requirements combined with the growing mantra of pay for performance.

One other contributor specific to the decline in supplement executive retirement plans (or SERPs) is the shift away from defined benefit (DB) retirement plans. Under a DB plan, employees receive a fixed amount at retirement, generally a percentage of their final average pay. Most of the value of these plans accrues during the last few years of a person's career. At that point pay is higher and early retirement subsidies kick in. In order to recruit a tenured executive who had such a plan, a company often needed to provide an special enhanced SERP to make up for the lost benefit value. A "true" SERP does more than just make up for IRS pay limits—it provides a benefit formula that is better than that available to other employees or provides extra years of service credit (i.e., credit for 15 years when an executive only worked 10 years). However, with only about one-third of major companies still offering DB plans,¹ the need to provide this type of special replacement is rapidly declining. In fact, many organizations that have frozen their DB plans and SERPs have **not** made exceptions for senior executive hires.

¹ Source: Hewitt Associates, "Guide to 2009 Economic, Health, Retirement, and Employment Trends."

Another driver has been the influence of proxy advisory services firms such as RiskMetrics Group and Glass Lewis. As the compensation value associated with supplemental benefits and perquisites does not vary based on performance, if excessive, it can lead to pay-for-performance disconnects. These disconnects, in turn, can lead to “withhold” or “against” vote recommendations for individual directors or an against vote recommendation for a management Say on Pay proposal. In addition, some practices viewed as particularly egregious, such as providing extra years of service in DB plans or excessive perquisites, may lead to negative vote recommendations regardless of performance. Disproportionate supplemental pensions may also be viewed as a potentially risky pay practice. If executives have large pension benefits, they can be viewed as insulated from the impact of taking on excessive risk. With the prospect of Say on Pay becoming a reality in the near future, vote recommendations from these proxy advisory service firms take on increased importance.

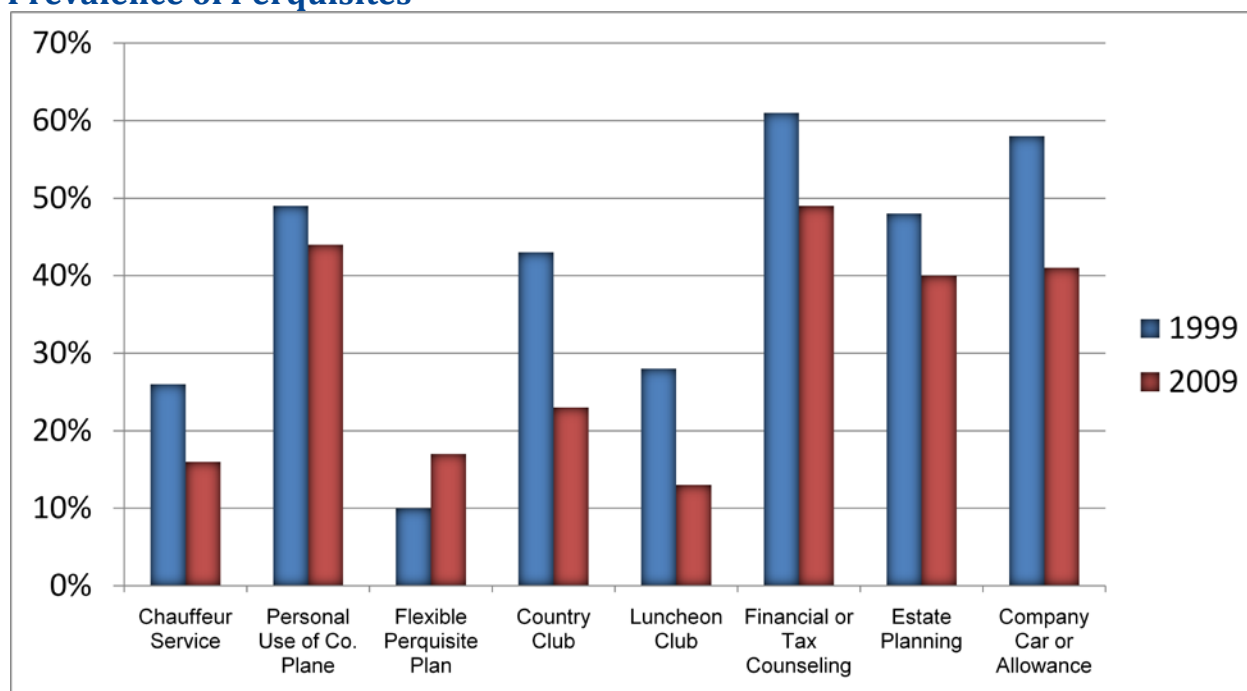
Prevalence of Supplemental Benefits



¹ Restoration benefits only serve to keep employees whole when affected by IRS-imposed pay limits.

Source: Hewitt Associates Executive Compensation Policies and Programs

Prevalence of Perquisites



Source: Hewitt Associates *Executive Compensation Policies and Programs*

Key Considerations for Compensation Committees

As Committees review total compensation programs for companies they serve, following are key questions to ask about special benefits and perquisites.

- Is the special benefit or perquisite serving a real business need? Or is it simply a legacy offering?
- What actions have peer companies taken in recent years regarding these elements of compensation?
 - What was competitive just a few short years ago may now be an outlier practice.
- Have any current perquisites or benefits been noted as a concern by any proxy advisory services firms? Will the level of concern likely lead to withhold or against vote recommendation for directors, or a negative vote recommendation on a management Say on Pay proposal?
- Is the company bound by contract to provide special benefits or perquisites? If so, can the contract be amended without undo cost or impact to executives?
 - Some companies provide a one-time buy-out of perquisites through an increase to salary. However others have simply taken them away in light of evolving market practice and good governance standards.

- Even if current executives have special items locked in, do we need to perpetuate the practice by giving them to new executives? Will we lose a key recruit if we don't provide them? What are new recruits really leaving behind? Are there other, performance-based vehicles we can use instead? And if a new recruit is demanding special considerations, is he or she the only person who can fill the role?
 - While current executives may not be willing to part with current extras, they can be “grandfathered.” New executives may not receive special benefits or perquisites, but they may receive other recognition through higher bonus targets or equity awards.
- Can the company provide a benefit more efficiently than it can be purchased by the executive on a stand alone basis (e.g., through greater purchasing power or through a sharing of resources)? If so, and the committee decides to offer it, should the executive reimburse the company for any incremental cost?

In Summary

There may always be special circumstances and business needs to justify selective use of special benefits and perquisites. However, these circumstances need to be thoroughly vetted by the Compensation Committee and not viewed as a standard offering. These special benefits and perquisites are no longer the right vehicle to signify elite status or recognition of years of outstanding contribution. Rather, earned incentive awards and growth in enterprise value (in which the executive holds a meaningful stake) will convey that message in a more appropriate and shareholder friendly manner in the future.

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