Recruiting and retaining highly compensated employees

Supplemental benefits are critical

Attracting and retaining key executives and other highly compensated employees can go beyond pay. Many companies are adding "restorative" benefits like carve-out retirement plans, specialized insurance and other perks to compensate their executives sufficiently—and avoid losing them to other employers.

Supplemental life insurance

The Society for Human Resource Management (SHRM) *2017 Employee Benefits Report* shows that 76% of employers offer supplemental life insurance. Group life insurance is often capped so that highly compensated employees (HCEs) will not receive the financial protection as a percentage of their incomes like other employees. To correct that, employers can offer their executive team supplemental life insurance in addition to the group plan.

A typical employer plan provides life insurance coverage equal to one to two times the employee's annual salary. For example, an employee making $120,000 annually may receive $240,000 in life insurance coverage. For a single employee or an employee with one dependent, this may be adequate. However, a highly compensated employee may require several times that amount to align with his or her financial situation in order to take care of a spouse or children.

Supplemental insurance allows you to offer more life insurance coverage to your HCEs while not increasing the limits or premiums of your group plan.

Supplemental short-term and long-term disability insurance

According to the SHRM report, 55% of employers offer supplemental short-term disability insurance and 49% offer supplemental long-term disability insurance. Most group disability plans provide 60% income replacement with a maximum benefit, often as little as $5,000 to $6,000 per month. For executives, depending on their incomes, that maximum group benefit will not provide a full 60% income replacement. It could wind up closer to 30%.

Most highly compensated employees would not be able to cut expenses by 70% if they were out of work due to a disability. By offering a supplemental disability insurance plan to your HCEs, they have the option to insure income beyond the group maximum. Depending on the policy, they could receive up to 70% or more of their gross income from the combined plans. Since the premiums are usually grossed up if employer paid or paid voluntarily by the employee, the benefits paid are tax-free. That produces a full income replacement for the executive on an after tax basis.

Supplemental executive retirement plans

Qualified retirement plan rules impose limits on the amounts employees and employers may contribute toward tax-favored qualified plans such as a 401(k), 457(b), or 403(b). Additionally, executives with compensation in excess of $120,000 per year can have

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their 401(k) contributions significantly reduced in order to ensure the qualified plan passes discrimination testing. Highly compensated employees can only contribute 2% more than the average deferral rate of non-highly compensated employees. This often prevents HCEs from contributing the maximum allowed by the IRS ($18,500 in 2018). A safe harbor fully vested matching contribution would allow HCEs to contribute the IRS elective contribution maximums, but even this may not provide them enough retirement savings.

The “retirement gap” is a major concern for many top executives. While the SHRM study states that only 9% of employers are offering supplemental executive retirement plans, they can be a great way to provide financial security to your top executives and differentiate yourself from other employers.

There are various forms of non-qualified plan that can wrap the core employer-sponsored qualified plan.

A Supplemental Executive Retirement Plan (SERP) is a non-qualified retirement plan for key employees, such as executives, that is an employer-funded benefit. It can be funded on a defined contribution basis with an assumed earnings credit added annually. It can also be structured to provide a specific level of monthly benefit for a specified period of years. It is typically a non-funded plan that is retained on the balance sheet of an employer with the employer tax deducting the cost of the benefit at the time of distribution.

A deferred compensation plan allows employees to defer taking a portion of their current income and leave it on deposit with the employer for future distribution when they retire. Since this is income the employee could have taken currently as taxable income and invested on their own, most plans allow the employee to self-direct the investment of their deferred income. This is usually an option preserved for public companies since employees may be hesitant to leave otherwise current income on the balance sheet of a privately held company that may not be payable for 20 or 30 years in the future.

A more popular approach to funding as supplemental plan for privately held employers is the use of what we refer to as a 401(k) Restoration Plan. It allows employees to contribute a total of 15% of compensation to the combination of their qualified 401(k) plan and a supplemental funding arrangement owned by the employee. To make the plan feel like a 401(k) contribution to the employee, the employer provides a current taxable bonus as a percent of the employee's contribution to the supplemental plan designed to cover the tax liability on both the bonus and the employee’s contribution. This provides an immediate tax deduction for the employer, deferred earnings to the employee when invested in designated insurance products, and extremely easy administration.

Employers can set themselves apart and win the battle for executive talent by offering their highly compensated employees the benefits they need to protect their incomes and lifestyles.

For more information, contact us.

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