

Align Nonqualified Deferred Comp to the Needs of Your Key Employees

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There are several forms of nonqualified deferred compensation arrangements. Each company must evaluate its objectives and workforce needs to determine which approach best supports and rewards its key employees. When properly aligned, these arrangements can create meaningful benefits for both the organization and its employees. The following examples illustrate how specific deferred compensation strategies can be matched to the needs and goals of key employees.

Case Study 1

The company has 5 non-family key employees ranging in age from early 40s to late 50s. The owner decided to keep the company in the family. The owner wants 5 key employees to see financial results of their hard work within a short period of time.

Proposed Solution

Short Term and Mid-Term Cash Incentives: (a) cash bonuses at the end of each fiscal year tied up to individualized performance goals, and (b) stock appreciation rights to be vested over 5 years vesting schedule based on the requirement to stay with the company for 5 years while meeting certain annual EBITDA marks.

Case Study 2

The company has 3 family and non-family key employees ranging in age from early 40s to late 50s. The owner decided to keep the company in the family. The owner wants both the family **and** non-family key employees to think and act as owners (i.e. focusing on mid-term/long-term goals rather than short-term benefits). The key employees want tailored tax deferred arrangements.

Proposed Solution

Stock Ownership (Actual and Phantom). Since the family key employees receive actual stock in the company, the non-family key employees receive quasi-ownership. For both groups, the meaningful results will show over the mid-term/long-term period based on company growth and appreciation. As such, family key employees get stock, and non-family key employees receive phantom stock. Both groups get dividends from the company (an ongoing immediate result) and both groups build value based on the underlying stock/phantom stock and its appreciation (long-term results).

Case Study 3

The company has a relatively large management group (e.g. about 10-15 employees) consisting of high-level key employees. The company is owned by a relatively large group of about 30-40 related and unrelated shareholders. The company wants its high-level key employees to see the financial results of their labor

aiming at the company growth and profitability. The key employees want to feel like owners.

Proposed Solution

Temporary Actual Stock Ownership. The company adopts both the Incentive Stock Option Plan and Nonqualified Stock Option Plan. Under each plan, the company grants stock options to key employees. The key employees become shareholders when they exercise the option and stay as shareholders for a period of time until they are required (by the company under the right of first refusal or termination event) to sell stock back to the company. Even temporary stock ownership will give a boost to key employees' confidence and internal drive to contribute to the company's growth and profitability.

Conclusion

As these examples demonstrate, there is no one-size-fits-all approach to nonqualified deferred compensation. Careful evaluation of a company's ownership structure, succession plans, and employee incentives can help create arrangements that deliver lasting value for both employers and key employees.



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