SERPS — ONE SIZE DOES NOT FIT ALL

Employers have long struggled with the ability to attract, retain and reward key talent. Government limits and restrictions on the amount that employees and employers may contribute toward qualified retirement plans, such as IRAs and 401(k) and 403(b) plans, leave many highly compensated executives – usually key executives – without enough retirement income to sustain their current standard of living.

A supplemental executive retirement plan (SERP) is a great way to solve both the issue of governmental limits and the ability to attract, retain and reward key talent.

SERPs are typically designed to make up for the retirement income shortfall caused by limits and restrictions in qualified retirement plans, though there are more ways to use SERPs than for retirement income. The executive benefits planning industry has long focused solely on retirement income, because that's how most consultants were trained and introduced to SERPs. Executives at most companies tend to be in their late 40s and 50s, which is where the focus on retirement income originated.

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CASE STUDY

Executive A is 57 years old. He's married and has adult children who live on their own. A is maxing out his deferrals into the company 401(k) plan but still hasn't saved enough for retirement. His employer wants to reward him for his 15 years of service and keep him around another 10 years until he plans on retiring. Putting a SERP in place that promises to pay him 40 percent of his final pay for life will accomplish the employer's goal, because 10 years and retirement are foremost on the executive's mind.

Now let's take a look at his successor in training: Executive B is 40 years old. He's married with three children, ages 4, 6 and 8. B's wife stays at home to care for the children and doesn't have formal employment. B is contributing to his 401(k) but is nowhere near maxing out contributions. His employer wants to retain him long term to succeed Executive A. The employer offers B the same SERP that will pay him 40 percent of final pay at retirement. Three years go by, and Executive B leaves the company for a higher-paying job. The plan did not achieve the employer's goal. Why did it fail?

To most 40 year olds in his situation, short-term incentives are king. To promise a benefit 27 years down the road does little to retain an executive, as retirement isn't on their radar.

That's where many consultants and employers make mistakes in the plan design process. They don't put themselves in the shoes of their executives; they don't ask themselves if they were in a similar stage in life what would matter most to them. They fail to ask each executive being considered if the plan would be valuable to them. Many employers may feel awkward asking their executives, and some executives may be reluctant to answer honestly. That's where a consultant can be invaluable during the planning process. A consultant can ask questions about what stage in life prospective executives are at, their family dynamics, and short- and long-term goals. Once a consultant and employer have a good understanding of what's important to their top talent, a plan can be designed to accomplish the goals. SERPs can be designed to pay out benefits at certain pre-set dates or life events while an executive is still employed. And benefits can be paid to accomplish goals other than retirement. Here are a few examples:

- Lump sum in 5 years for mission work
- Four annual payments starting in 10 years to pay for a child's college
- At age 50 to buy a boat

A BETTER OPTION

Would this plan have been better for retaining him both short and long term?

Executive B is 40 years old. Again, he's married with three young children ages. After an interview, a consultant finds that paying for college is one of the executive's main concerns. B's employer wants to retain him long term to succeed Executive A. The employer offers him the same SERP that will pay him 40 percent of pay. However, this plan allows for half of that amount (20 percent of pay) to be paid out over a six-year period starting in 10 years. This will be beneficial as a source of additional income to help pay for B's children's college tuition. He vests in that benefit over a 10-year period. The remaining 20 percent of pay will be paid out at age 67 when he plans on retiring.

Will this accomplish the employer's goal? It definitely has a better chance. There's now a benefit that entices Executive B to stay with the company short to mid-term. Once he receives those payments and his children are out of the house, retirement becomes a greater concern, as it's then only nine years away.

THE BOTTOM LINE

Over the past several years we've seen an increase in older executives retiring as the baby boomers age. Younger executives taking over have different needs than their predecessors.

Taking an alternative approach to the traditional design of simply focusing on retirement is needed more now than ever. This approach has been well received by our clients over the past several years, and non-traditional designs are becoming more common.

Employer goals of recruiting, retaining and rewarding executives can be accomplished with a SERP as long as we remember that "one size does not always fit all".

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