

COMPONENTS OF COMPENSATION

Annuity

A retirement plan that provides periodic payments, usually monthly. A straight-life annuity provides payments during the retiree's life. A joint-and-survivor annuity provides payments to the retiree during his or her life and, at the retiree's death, to the surviving spouse.

Benefits

An employee's non-wage compensation. The U.S. Department of Labor lists group benefits into five categories:

- paid leave (holidays, vacations, sick leave)
- supplementary pay (e.g., overtime or holiday pay)
- retirement benefits
- insurance benefits
- legally required benefits (Medicare, Social Security, workers' compensation, etc.)

Bonus

The U.S. Dept. of Labor's National Compensation Survey considers production bonuses to be part of an employee's wages and nonproduction bonuses to be part of the benefits component.

- **Production Bonus:** Extra payment based on exceeding a quota or completing a project in less time than scheduled.
- **Nonproduction Bonus:** A cash payment not directly related to an employee or group's output.

Cafeteria Plan or Flexible Benefit Plan

A plan that provides a number of options for several different benefits. They often consist of core benefits that an employee must choose (such as vacations, low-option health insurance) and additional benefits that they desire (such as additional vacation days or high-option health insurance).

Deferred Compensation

Earnings that an employer deducts from an employee's earnings and places in a qualified retirement plan, such as a 401(k). The money is distributed at a future date, usually at retirement, because of IRS rules. The money is not taxed until the employee receives the distribution from the plan.

ESOPs

In an employees stock ownership plan (ESOPs), the employer contributes to a fund that invests primarily in company stock and makes distributions in stock or cash. Employees who exercise a stock option under an ESOP do not pay tax on any gains until the stock is sold.

Golden Parachute

A severance agreement that protects the executive financially in the event of a sudden dismissal.

Grantor Trust (or Rabbi Trust)

A trust established by an employer to pay future benefits to executives and employees. It's often called a "rabbi trust" because of an IRS letter ruling in the early 1980s that let a rabbi receive retirement benefits from a trust established for that purpose.

Money Purchase Pension Plan

A retirement plan with fixed employer contributions that are allocated to individual accounts established for each employee. This money is used to purchase an annuity or provide some other kind of retirement income.

Noncompetition Agreement

An agreement made by the employee that he or she will not compete with the employer once the employee terminates employment. It is usually not considered a part of compensation, but could greatly affect compensation if the agreement is broken. The terms usually require that the executive keep certain information confidential, as defined by the employer, and not compete with the company in certain specified ways within a certain geographic area for a set time period.

Noncontributory Plan

A plan that is funded by the employer. The employee cannot make contributions.

Nonqualified Deferred Compensation Plan

A deferred compensation plan that does not receive favored tax treatment, usually because it does not meet the IRS rules concerning who is allowed to participate in the plan or because they offer more benefits than allowed by the IRS rules.

Restricted Stock

Stock that is not owned outright, in that the employee could be asked to forfeit the stock. There are also restrictions on whom the stock can be transferred to until the restrictions are lifted. Once the restrictions are lifted, the owner of the stock is taxed on the stock's value above what he or she paid for it at the ordinary income tax rate.

Stock Bonus Plan

A defined contribution plan with contributions by the employer only or by the employer and employee. Contributions are put into a separate trust fund. Once the employee retires or leaves the company, eligible employees receive distributions in the form of company stock or cash.

Stock Option Plan

Stock options are an employer's promise that the employee may buy at a future date a set number of shares at the price set today.

- **Discounted Stock Options.** Options in which the strike price is less than the market price.
Incentive Stock Options (ISOs). Stock grants that have more tax advantages than the NSO: ISOs are not taxed either when granted or exercised.
- **Nonqualified Stock Options (NSOs).** Stock grants that do not have favored tax treatment. Unlike with ISOs, the employee pays taxes at the ordinary income rate if the NSOs are sold for a profit (a price higher than the strike price).
- **Exercise an Option.** Exercising an option means paying the company the strike price, at which point the option is traded as a stock. For example, an employee buys the stock at the strike price and then sells it at the market price. An employee can exercise only vested options.
- **Strike Price.** The price that the employer guarantees to the employee when the options were first granted. Once a strike price is set, the employee can buy any of the vested options at that price, regardless of the market price for those shares.



Stock Purchase Plan

A plan that lets employees buy shares of the company stock, usually for less than the market price.

Supplemental Executive Retirement Plans (SERPs)

A defined benefit plan that supplements an executive's other retirement benefits according to a set formula determined by the employer. The employer makes the contributions to the SERP for the executive.

Total Compensation

"Compensation" is a concept that is sometimes used to encompass the entire range of wages and benefits, both current and deferred, that employees receive from their employment. "Total compensation" includes all types of employee compensation combined: wages and salary, non-wage cash payments (such as bonuses), and benefits.

Vesting

The amount of time it takes for an employee to own the employer's contribution to the employee's plan. Generally the employee does not own 100% of the contribution immediately; instead, the employee vests (or acquires ownership) of portions according to a vesting schedule set by the employer.

- **Graded Vesting.** The employee vests over a set number of years (not to exceed seven years). For example, an employee who is on a four-year vesting schedule would own 25% of the employer contribution after one year, 50% after two years, etc.
- **Cliff Vesting.** An employee receives 100% of the contribution after a set number of years, but receives nothing if the employee quits before that term. For example, in a four-year cliff vesting arrangement, an employee would receive 100% after four years, but 0% if the employee leaves the company any time before the four-year anniversary date.
- **Accelerated Vesting.** Some events will generally cause contributions to vest 100%: - Retirement - Disability - Death - A merger or acquisition of the company
- **Other vesting.** Some contributions might vest after a performance goal, as defined by the employer, has been met.