

# The View from Level VII™

## EXECUTIVE COMPENSATION

### *Annual Executive Bonuses*

Business people often refer to “state of the art” whether this relates to a product or service, a design or production method, or access to email, voice messages etc. The same comment also applies to executive compensation design which continues to evolve, both in public and private/closely-held companies. It may surprise you to know that “discretionary” bonuses still exist for senior executives. A “discretionary” bonus is typically one whereby no plan design is developed or communicated to executive participants and bonus payout(s), if any, are determined by subjectively by shareholder(s) or a Board committee.

Obviously one would like to think that the higher the company financial results the larger the bonus payout will be, rather than the bonus being awarded because “Good old Charlie” deserves a bonus for “his long and loyal service” – irrespective of company performance. To motivate the executive team into taking progressive actions in the best interests of the company, and “bust their gut” in so-doing, will almost certainly require a well designed compensation plan – communicated fully, in advance. Among the most frequent financial targets used in annual executive bonus plans are:

- Net profit, Profit before tax or Net Income
- Return on sales
- Return on assets, capital or investment
- Cash flow

Many companies use one Income Statement measure plus one from the Balance Sheet, so as to ensure assets/capital are used wisely. If your company has not yet stepped into the 21<sup>st</sup> century with executive compensation design, you may wish to consider a compensation package, which creatively balances salary, annual bonus and long term incentive plans. Your company profitability and growth depend on this!

**Harman & Associates** with its fortune 500 background, has extensive national and international experience in executive compensation planning for private and public companies.

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## EXECUTIVE BENEFITS

### *IRS Final Word—Split Dollar Arrangements*

On September 11, 2003 the IRS issued final regulations regarding Collateral Assignment Split Dollar Arrangements (Arrangements). In close keeping with the proposed regulations of May 8, 2003, the major changes found in the final regulations are as follows:

**Economic Benefit Regime:** Under the Economic Benefit Regime, the employer owns the insurance policy supporting the Arrangement. The final regulations state that employer deposits into the policy create a taxable economic benefit to the executive. This annual economic benefit is calculated based on the prescribed term cost (IRS 2001 Rate or Carrier Term Rates) of the death benefit provided in the Arrangement, as well as any cash value “currently accessible” by the executive.

**Loan Regime:** Under the Loan Regime the employer owns the insurance policy supporting the Arrangement. The final regulations state that employer deposits into the policy creates a taxable loan to the executive. The annual taxable interest to the executive equals the difference between the interest rate charged by the employer and the Applicable Federal Rate (AFR). Prior to the regulation changes the taxation under Loan Regime was the same as under the Economic Benefit Regime.

**Immediate Action Needed:** Those of you with existing collateral split dollar arrangements beware, as January 1, 2004 is the date upon which the new tax changes go into effect. *WFR welcomes working with you and/or legal advisor to help determine whether your Arrangement is affected, and if so, what is the most effect solution to meet your objectives.*

**Weir Financial Resources, LLC** is a financial advisory firm offering information, ideas and solutions in Executive Benefits, Business Succession and Private Wealth Planning.

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## HUMAN RESOURCES

### *Recent Study in Employee Loyalty*

Only about one-third of employees are committed to their employers, plan to stay for at least two years, and would recommend their company to job seekers, according to a recent survey of 2,400 employees released September 1, 2003.

The remaining percentage of employees either feel “trapped” in their jobs or are actively looking for other opportunities, the study said. This low commitment can be a “silent profit killer,” because customer loyalty increases in direct proportion to employee loyalty, according to the research firm. Happy employees lead to happy customer and, often increased revenue.

According to the study, most employees do not consider financial compensation key to their loyalty or disloyalty, but instead cite care and concern for employees and opportunities for growth and career development as top motivations. You can always buy employee retention by throwing more dollars at the situation, however, just because they stay doesn't mean they're loyal. They're just more trapped.

The study defines “loyal” employees as those who are more than merely “satisfied” with their jobs and the companies they work for, and also are pleased with their relationship with their companies. Such employees tend to recommend their employer as a good company to work for, limit their outside job-searching activities, turn down offers to work elsewhere, contribute “above and beyond the call of duty” at work, and plan to stay at least two more years, the survey said.

“Trapped” employees, on the other hand, are not committed to their employers but plan to stay at least two years, and those “at risk” are neither committed nor planning to stay, the survey said.

**HR Professional Consultants, Inc.** offers human resource services and outsourcing for businesses of various sizes.

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## EMPLOYEE BENEFITS

### *Medical Insurance—Experience Rating*

Lately, it is hard to turn on the television or radio without hearing advertisements for medical insurance carriers. One of the terms that you may hear is experience rating. This term refers to the process of removing the group from the community rated pool, and basing rates on actual claim experience. Experience rating was previously reserved for companies with 500 or more employees, but in recent years that requirement has come down, and is now offered to groups with 50 employees or more. Whether you agree or disagree with this practice, it seems to be gaining ground with a number of local businesses.

Below are some key items to consider regarding Experience Rated Plans.

- Access to accurate claim experience
- Group demographic information
- Out-of-area employees, and their demographics
- Company Risk Tolerance
- Carrier preferences
- Company outlook (stability of current workforce)
- “Failsafe Options” & “What Ifs”

Experience rating is not something to jump into. A thorough look at all available data may show this option as a positive direction for your company, or may give you a new appreciation for community rates. Benefits Advantage, Inc. is licensed with all three local HMOs, and has significant experience in this area. By reviewing specific group information, we can evaluate possibilities for experience rating, or even full self-insurance. Please contact us for any of your group medical insurance needs.

**Benefits Advantage, Inc.** provides consulting and insurance brokerage services for all types of employee benefits programs. Emphasizing *personal service, creative ideas, and positive results*; Benefits Advantage Inc. has 30 years of industry experience in working with clients.

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