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Understanding the Various Types of Executive Deferred Compensation

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The "Nuts and Bolts" of a divorce includes understanding the income and assets of each spouse. When one party is a highly paid executive, income is often more than simply a salary that is reported on a W-2. It is important for the non-working spouse to be familiar with all forms of compensation.

Executive deferred compensation refers to a form of compensation that allows executives to defer a portion of their earnings and receive it at a later time. This provides executives with a range of financial benefits, including tax advantages and retirement planning. It also provides an incentive to stay with the company. This blog will explore the different types of executive deferred compensation and their significance for organizations and executives. A later blog will discuss how these forms of compensation are distributed in a divorce.

Deferred Cash Plans:

Deferred cash plans involve postponing a portion of an executive's salary to a future date. This compensation often accumulates interest or earnings until the deferred amount is paid out. These plans offer flexibility, as executives can choose when they receive their deferred amounts, such as upon retirement or at a specific age. Deferred cash plans allow executives to diversify their income sources, making it easier to manage financial well-being during retirement as well as take advantage of tax savings.

Stock Options:

Stock options are a popular form of deferred compensation that provide executives the right to purchase a company's stock at a predetermined price in the future. When the stock price appreciates, executives can exercise their options and buy stocks at the lower price, turning a profit. This form of deferred compensation aligns the interests of executives with shareholders, as their financial success depends on the company's performance. Stock options often come with vesting periods to incentivize long-term commitment. When the stock price is higher than the price which it can be purchased for, this is known as being "in the money." Even though the executive may not have access to the stock option at the time of a divorce, the asset can still be distributed.

Restricted Stock Units (RSUs):

Restricted stock units grant executives a specific number of company's shares after a predetermined period or the achievement of certain performance goals. Unlike stock options, RSUs have intrinsic value and cannot be purchased at a discounted price. Executives receive the shares when they vest, and they can be subject to certain resale restrictions. RSUs not only reward executive performance but also offer long-term incentives to remain with the organization. RSUs typically vest on a three-year schedule. Like options, although the executive may not have access to the stock at the time of a divorce, the asset can still be distributed.

Phantom Stock Plans:

Phantom stock plans are a type of synthetic equity, where executives are awarded units that correspond to a company's stock price. These units accumulate value over time based on the company's performance. When the executive reaches a specific milestone, they receive a cash payout representing the value of their phantom stock units. Phantom stock plans offer executives the opportunity to benefit from a company's growth without directly owning the shares.

Cash Bonus Deferrals:

Cash bonus deferrals enable executives to defer their annual cash bonuses and receive them at a later date. This allows for tax deferral and potential investment growth. Through such deferrals, executives can align their financial goals with the long-term objectives of the organization. Cash bonus deferral plans often come with various payout options, offering executives flexibility when receiving their deferred bonuses.

Supplemental Executive Retirement Plans (SERPs):

SERPs are designed to provide executives with additional retirement benefits beyond their regular pension or 401(k) plans. These plans allow an executive to defer a portion of their income, which is invested and paid out at retirement or upon reaching a specific age. SERPs often offer attractive features such as competitive investment returns and the possibility of remaining with the organization beyond the normal retirement age.

This list is not exhaustive of the types of compensation an executive may receive. It is meant to demonstrate the importance of obtaining all information in a divorce.

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