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## **It's Time To Deep-Six SERPS**

**by Graef Crystal**

**May 11, 2010**

Supplemental Executive Retirement Plans (SERPs) need to go. They create a class of senior executives akin to British royalty. And in most instances they are, in my view, morally wrong.

Let's go back to before 1974. In those ancient days, the vast majority of major companies had defined benefit pension plans (of the type where the recipient receives a pension, say, of 2 percent of final pay for each year of service). And those plans were all IRS-qualified, meaning that the company was able to deduct immediately its contributions to the pension trust, while the recipient avoided taxation until the monies were paid out.

But to receive the IRS' blessing, the plan had to be non-discriminatory. If the pension for 30 years of service was 60 percent of salary, that percentage could be applied to the CEO as well as the janitor. That the dollar amounts were way different was not controlling; it was the same percentage applied equally to all.

Then came the Employment Retirement Income Security Act – known as ERISA. (A client of mine, Richard Furlaud, then the CEO of Squibb Corp., told me ERISA stood for “Every Rejected Idea Since Adam!”)

That act stipulated that the dollar amount of pension paid from the pension trust could not exceed \$75,000 a year. The \$75,000 figure was linked to inflation. But later on, the inflation –adjusted amount was unilaterally reduced and then re-indexed.

That pension cap threw companies into a quandary. The janitor could receive 60 percent of his final pay as a pension. But a CEO whose final pay was, say, \$300,000, could only receive a pension of \$75,000 -- a grossly-unfair result.

Congress' stupid meddling gave birth to what was at first called an ERISA restoration plan. The CEO was told: "We can only pay you \$75,000 from our pension trust. But you are entitled to 60 percent of your final pay of \$300,000, or a total pension of \$180,000. So you will be getting two checks every month, one from the trust and the other from the company. If the company goes belly-up at some time in the future, you could lose that second set of checks totalling \$105,000 a year. But if not, the only inconvenience to you is that you will have to Hancock two checks each month instead of one."

Had things been left there, that would have been fine. Justice would have been done.

But enter the pension consultants.

In the old days, pensions were predicated on salary only. If a company had tried to define pensionable pay as the sum of salary and bonus, the IRS would have required that the company pay pensions on workers' overtime -- a W-2 view of the world. Companies were singularly unenthusiastic about doing that.

But, the silver-tongued pension consultants declared, there would be nothing illegal about keeping the definition of pay as salary only in the IRS-qualified plan and then using a definition of salary and bonus in the ERISA Restoration Plan -- a plan which the consultants thought might now be better-named a SERP, since their conception would do a lot more than merely restore what ERISA took away.

That thinking spread through corporate America with about the same speed as a forest fire in Southern California. Soon, the great majority of companies were sporting SERPs, which were given out to a handful of senior executives.

But things didn't end there. Once corporate executives were divorced from the masses, all manner of goodies could be loaded into the company's SERP:

- The Chosen were promised a full-sized pension, not after, say, 30 years of service, but after, say, 20 years of service.
- The Chosen could obtain a full pension, with no actuarial discount, as early as age 55.
- The Chosen could be given, say, two years of pension credit for each year of service, a goodie extended to Jamie Dimon when he was hired as CEO of Bank One.
- The Chosen, if there were coming in from the outside, could walk through the door with years and years of pension credit. George Fisher left Motorola to become CEO of Eastman Kodak at the end of 1993. He left seven years later. But he didn't have seven years of pension credit at Kodak; no, he had 28 years.

- The definition of pensionable pay was, in at least a few cases (one of them being Pfizer), expanded to include not just salary and bonus but also what other companies would think of as long-term incentive pay.

In the meantime, the Chosen turned around and gutted the pensions of their workers. Gone were the defined benefit pension plans. Now we had 401(k)s with modest company contributions or so-called cash balance plans.

I just completed an analysis of the pay of 271 CEOs for Bloomberg/News and Bloomberg/Business Week. The selection criteria included:

- The company's 2009 fiscal year had to end on Dec. 31, 2009 or later.
- The company had to be a member of the Standard & Poors 500 Index.
- The CEO had to have been in his or her job for at least two full fiscal years.

Of the 271 CEOs, 189 participated in SERPs in 2009. The total amount of increased pension present value was \$337 million, which averaged to \$1.2 million per head and a higher \$1.8 million for the CEOs who actually received SERPs. (A usually-tiny of these figures included relatively-small amounts of above-market interest on deferred compensation.)

Here is some commentary on five of the six largest SERP winners in 2009 (I have excluded SPX Corp., because it is less well-known):

- Thomas Ryan of CVS Caremark. The increase in his pension present value in 2009 was \$14.2 million. Among other things, he was granted five years of extra pension service. CVS does not have a qualified defined benefit pension plan.
- Donald Felsing of Sempra Energy. His SERP cost shareholders \$12.6 million in 2009. The company does not have a qualified defined benefit pension plan. It offers a cash balance plan with contributions equal to 7.5 percent of the participant's salary and bonus.
- Randall Stephenson of AT&T. The 2009 increase in lump-sum present value was \$9 million. The company's proxy seems to suggest that the defined benefit pension plan for regular employees was replaced by a cash balance plan in 2005.
- James McNerney of Boeing. His pension value increased by \$5.7 million. The company also has a cash balance pension plan in lieu of a defined benefit plan.
- William Weldon of Johnson & Johnson. For him, the increase was \$5.2 million. Alone among the companies cited, only J&J seems to have an old-fashioned defined benefit pension plan for the bulk of its employees.

One of the reasons why SERPs cost so much in 2009 was due to the secular decrease in interest rates. As interest rates drop, the lump-sum present value increases. AT&T declared that lowered interest rates caused Mr. Stephenson's value to increase by 44 percent.

Around the same time as SERPs were invented, companies also put in so-called Supplemental Executive Medical Plans. Under such plans, the participating senior executive was reimbursed under the company's regular group insurance plan for whatever the plan paid. Then he was given a check for any further medical expense.

That saved him deductibles and co-pays – not all that much. But more important, the supplemental plan covered things the main plan didn't, e.g., dental care, psychiatric care, hearing aids, eyeglasses, etc. So if the CEO had six neurotic children, each with bad teeth, the benefit could be sweet indeed.

Supplemental medical plans provoked an immediate outcry. How was it fair, many people asked, for the most well-paid executives to receive the very best medical benefits?

Over time, those supplemental medical plans began to disappear, aided in no small part by much better proxy disclosure.

Now it's time for SERPs to disappear, too. CEOs should have whatever pension benefits they give to their workers – no more and no less.

What is going on today is a disgrace and smells of outright discrimination.

Graef Crystal's is now in his 51<sup>st</sup> year in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. (He still contributes occasional columns to Bloomberg News.) He has written six books and more than 1,600 articles on executive pay.