



INCENTIVE COMPENSATION: HOW TO STRUCTURE AND AVOID LEGAL PITFALLS IN COMPENSATING EMPLOYEES FROM HOURLY TO EXECUTIVE

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FUNDAMENTAL OF THE WEEK

12. Embrace Diverse Perspectives

Purposefully seek opportunities to learn from others. Be genuinely interested in learning about others' unique strengths, thoughts, suggestions, and life experiences. We recognize the value of empathetically inviting, including, and understanding diverse perspectives. Take deliberate, informed actions to create a culture of belonging where everyone can thrive.



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Overview

- Understand trends about how the executive compensation landscape is evolving in light of COVID-19
- Learn the various forms in which executives may be compensated, including annual and long-term incentive programs, severance agreements
- Review best practices for complying with statutory legal obligations, including deferred compensation, pay equity, and other contractual obligations such as change in control as businesses downsize and restructure

COMPENSATION TRENDS - NATIONAL

- The median raise in 2023 is expected to be around 4%, with 25% of employers responding planning to give increases in the range of 5%-6% in 2023.
 - Salary.com, September 2022
- 75% of employees are reportedly willing to leave their job for a salary increase, but state it would take on average a 16.1% increase to leave.
 - BambooHR, 2022 Guide to Retention
- Compensation costs for civilian workers increased by 5.1% in 2022
 - US Bureau of Labor Statistics, February 2023



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COMPENSATION TRENDS – PAY TRANSPARENCY

- Currently, eight states have enacted, and 11 are considering pay transparency laws which would require postings for jobs, promotions or transfers to include the compensation or a compensation range for the opportunity advertised.
- Michigan has not enacted a pay transparency statute.
- The number of U.S. job postings that include salary information more than doubled from 18.4% to 43.7% between February 2020 and February 2023.
- Indeed Hiring Lab, March 2023
- 63% of employees surveyed said they preferred to work at a company that discloses pay information over one that does not
- Glassdoor Economic Research, March 2022



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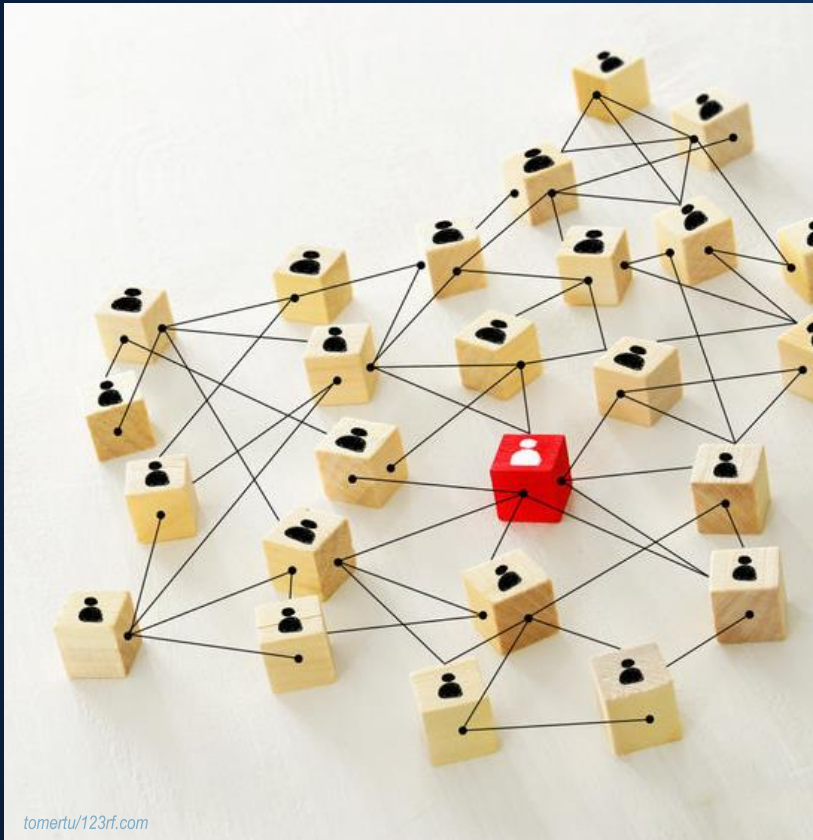
EXECUTIVE COMPENSATION TRENDS - NATIONAL

- Using the realized compensation measure, CEO pay has skyrocketed 1,322% since 1978.
- During the pandemic, CEO's realized compensation rose 18.9%.
 - Economic Policy Institute, August 2021



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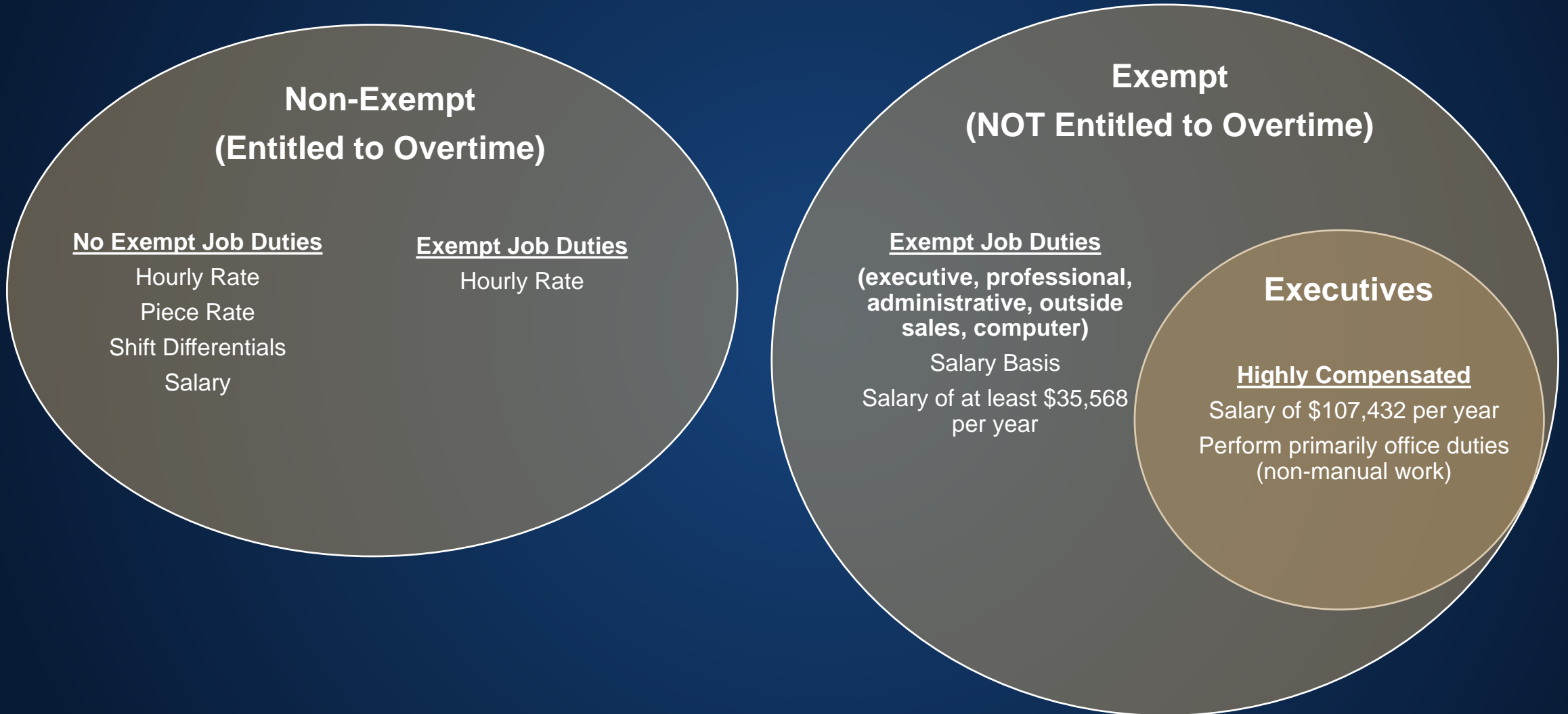
EXECUTIVE COMPENSATION TRENDS - LOCAL



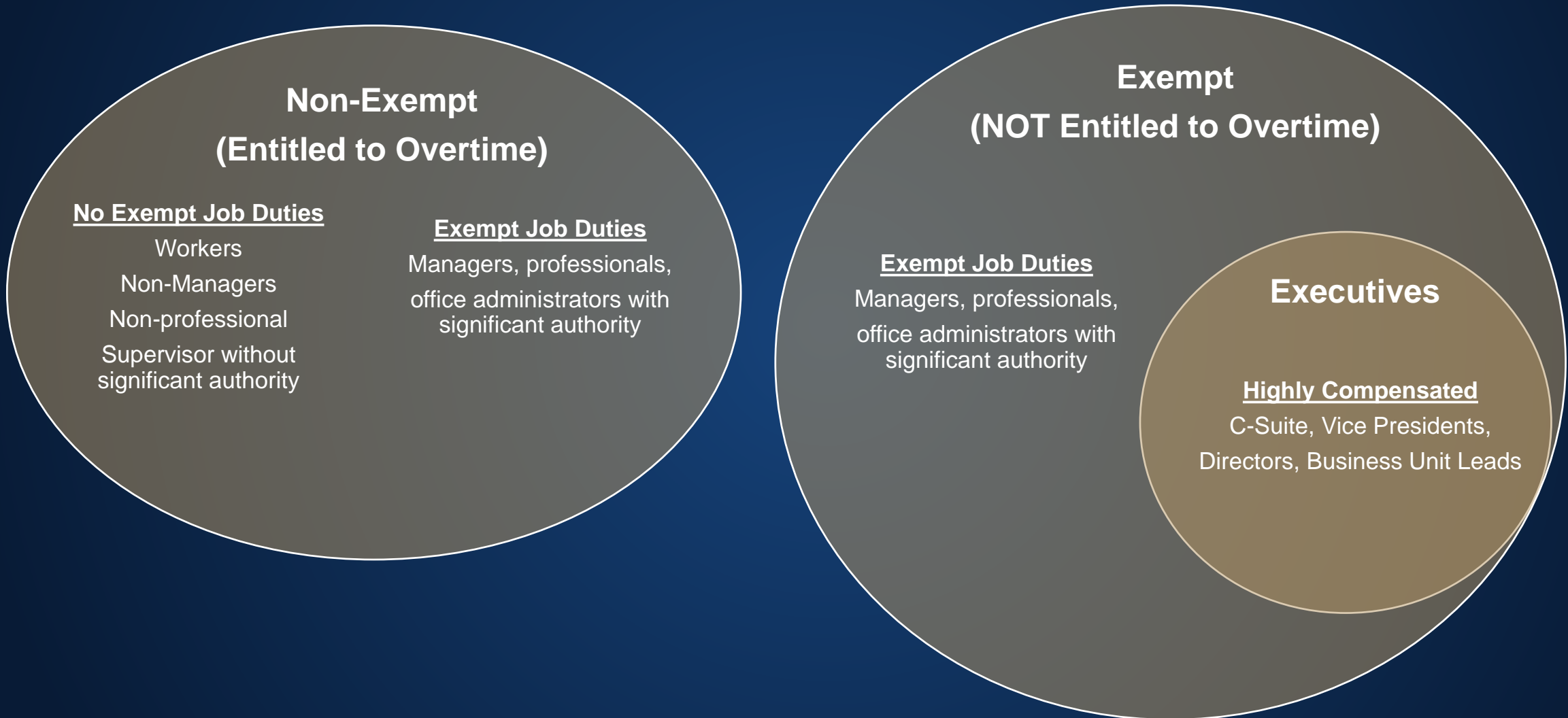
- According to Zip Recruiter, the average CEO salary in Michigan is \$118,290 compared to the national average of \$148,441.
- CEO salaries in Michigan range from the 25th percentile at \$79,035 to the 75th percentile at \$173,878.
- A Michigan Nonprofit Association survey found nonprofit CEO salaries increased almost 30% since their 2010 compensation report.

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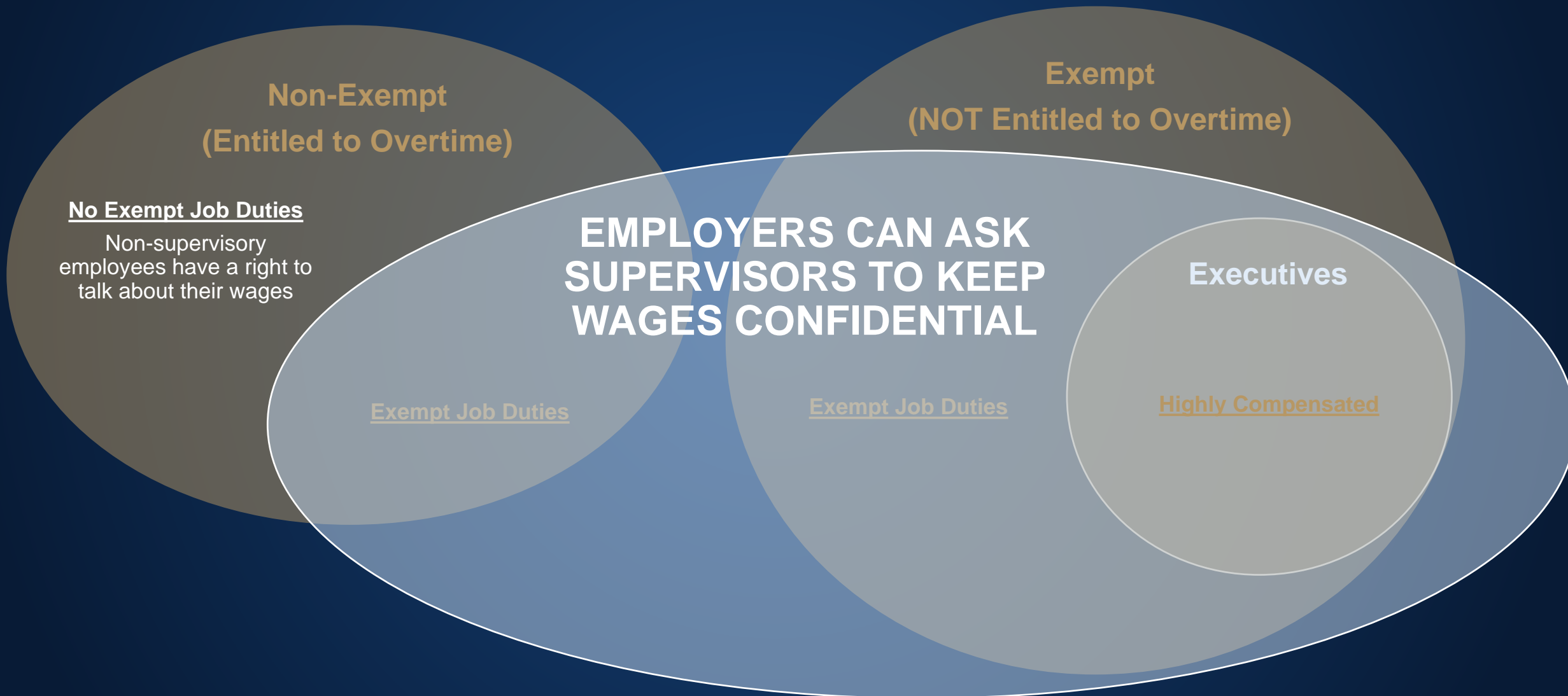
EXECUTIVE COMPENSATION LANDSCAPE - FLSA



EXECUTIVE COMPENSATION LANDSCAPE – BY ROLE



COMPENSATION LANDSCAPE - CONFIDENTIALITY





FORMS OF COMPENSATION

SALARY & SEVERANCE

- Guaranteed for a term or at-will?
- If term, then define:
 - Termination “For Cause”
 - Resignation for “Good Reason”
 - Total Disability
- Severance
 - Typically payable upon termination without cause and resignation for good reason



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BONUSES

WHAT DO YOU WANT TO INCENTIVIZE?

- **When is bonus considered earned?**
 - **Appreciation of value/profit** – earned based on an increase in profit or value of the company
 - Incentivizes success of company/think like an owner
 - **Performance** – earned based on performance attributable to executive
 - Incentivizes success of individual or individual's team
 - **Time** – earned based on duration of service
 - Incentivizes retention
- **When will bonus vest?**
 - Consider short-term versus long-term bonus structures



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BONUSES

- **How will you calculate?**
 - **Discretionary** – Retain freedom to decide whether bonus will be paid; no guarantee as to amount or timing.
 - **Non-discretionary** – when an employer creates an expectation of payment and doesn't control the timing or amount without breaching legal or contractual agreements.
- **Will you disclose the calculation?**
 - Based on EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)?
 - Profitability versus overhead of individual employee?
- **How is it payable?**
 - **Stock** – delivered as shares of company stock
 - **Cash** – delivered in cash
 - **Other benefits** – other fringe benefits or negotiated terms



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BONUSES

- **How does incentive compensation affect exempt and non-exempt employees?**
 - **Exempt Employees** – Since exempt employees are not entitled to overtime, an incentive compensation, whether discretionary or non-discretionary, is paid in addition to the guaranteed base salary.
 - **Non-exempt Employees** – Payment of non-discretionary bonuses (those based on a set of criteria or performance goals) to non-exempt employees increases the regular rate on which overtime is due.



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STOCK BONUSES

- Stock options
 - What kind?
 - Restricted stock
 - Profit sharing (“phantom stock”)
 - Purchase plans
 - Stock appreciation “golden handcuffs”
- Stock options motivate executives to think and act like owners



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DEFERRED COMPENSATION

- Severance
- Purchase of stock
- Pay continuance of benefits
- Profit Sharing Plan
- Retirement/Savings Plans
 - Traditional 401(k) – MOST POPULAR
 - Roth 401(k) – POPULAR
 - Annuity (purchased through life insurance company)
 - Defined contribution retirement savings plan (e.g., 403(b), 457 including “Top Hat plans”, Thrift Savings Plan)
 - Supplemental Executive Retirement Plan
 - Pension Plan – NOT COMMON ANYMORE



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EXPENSES AND PERKS

- Relocation
- Travel
- Car
- Phone
- Professional licenses
- Continuing education
- Conferences
- Country club / gym membership
- Luncheon club membership
- Reserved parking
- Rent



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STATE/CITY FUNDED RESOURCES/BENEFITS

- State/city relocation programs
 - Alaska pays residents appx \$1,000
 - Montana will pay up to \$12,500 to new residents plus 35% to offset taxes
 - Vermont will pay up to \$7,500 to certain workers
 - West Virginia pays \$12,000 to move to certain locations
- State assists with child care
 - Michigan Tri-Share Child Care Pilot Project
 - Reduces cost of child-care; executive must earn less than 300% of Federal Poverty Level; and must be participating employer



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FRINGE BENEFITS

- Benefits are a percent of total compensation. Common benefits include:
 - Vacation / sick time / paid time off
 - Holidays / bereavement / other
 - Medical / dental / vision
 - Life insurance – policy owned by company
 - Disability – short term and long term
 - Pensions



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EMPLOYEE EXPERIENCES AND SUPPORT

- Home / child care
- Housing / rent
- Educational reimbursements
- Payment of student loans



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LEGAL COMPLIANCE

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- Deferred Compensation
- Equal Pay
- Restructuring Considerations
- Contractual Obligations



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DEFERRED COMPENSATION – 409A ISSUES

When does Section 409A apply?

- When there is a **legally binding right** to compensation that has not been actually or constructively received and that is payable in a later year, except for payments within the short-term deferral period.
- “Short-term deferral period” ends two and one-half (2 1/2) months following the later of the calendar year or the employer’s fiscal year in which the employee’s right to receive the payment is no longer subject to a **substantial risk of forfeiture**, with some exceptions
- *some exceptions, including for “grandfathered” deferred amounts and non-collectively bargained involuntary separation pay amounts with some limitations.



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DEFERRED COMPENSATION – 409A ISSUES

Why do we care about complying with 409A?

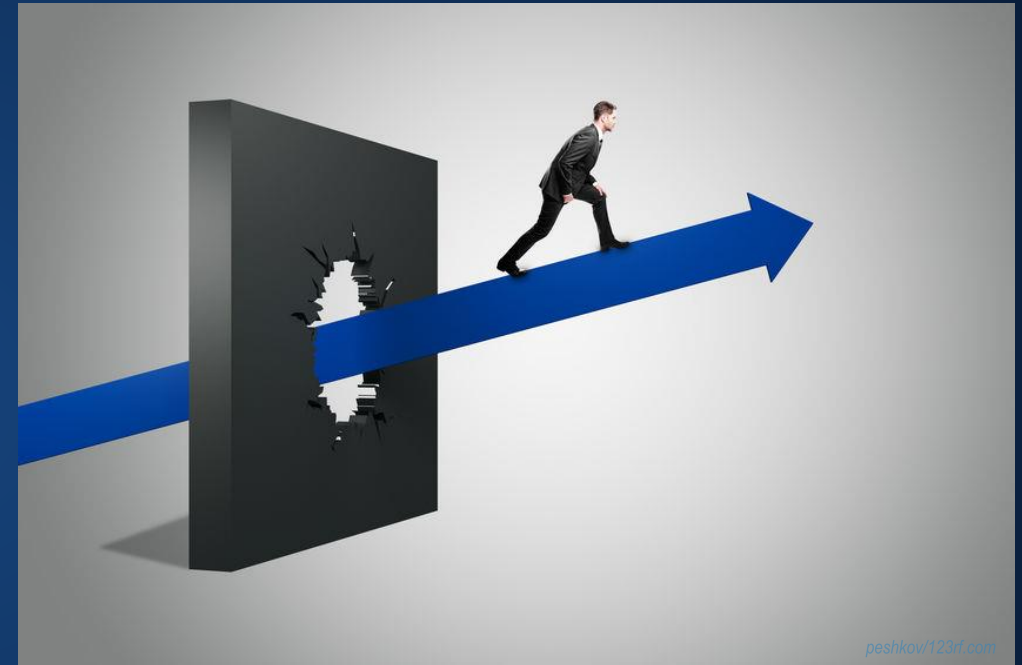
- Failure to comply results in all compensation being included in income **unless subject to a substantial risk of forfeiture**, with additional taxes including:
 - 20% tax applied to the portions paid in violation of 409A .
 - 1% penalty on the amounts underpaid as of the date of the deferral or the date when there is no substantial risk of forfeiture, whichever is later.
- What is Required to comply?
 - Plan must be in writing, describe how much will be paid, when it will be paid, and how. Employer must actually pay the promised amount at an appropriate date (409A defines the permissible times), and such payment may not be accelerated or postponed unless it falls under an exception under 409A.



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EQUAL PAY/TITLE VII OBLIGATIONS

- Importance of conducting audits of compensation
- Consider opportunities for advancement and who is advancing (or not)
 - Equity versus Equality



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RESTRUCTURING CONSIDERATIONS

- Conduct adverse impact study when adjustment in staffing, including executives, upon
 - Change in control
 - Furloughs of employees
 - Re-hiring employees



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CONTRACTUAL OBLIGATIONS

- Review contract to identify:
 - Remedies upon breach
 - Requirement for arbitration
 - Venue for dispute
 - Governing law
- If executive is working remotely, consider whether considered as doing business in new state
 - Registration and tax obligations



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