What 2017 Proxy Statements Reveal About Executive Perquisites

Executive perquisites – or “perks” – remain a relatively small portion of the total compensation provided to key executives. Their value generally ranges between 0.5%-1.5% of total pay. Yet with executive pay practices constantly being scrutinized in the current Say-on-Pay era, each element of compensation is being compared to what peers are providing. We have just completed our own review of select executive perquisites provided to the Named Executive Officers (“NEOs”) at public companies in the S&P 100 and S&P 500 Index as disclosed in 2017 or their most recently filed proxy statements. We have been conducting a similar review for the past 12 years. Over the past several years, we have seen greater stability in the executive perks being offered, compared to a marked decrease in perks a decade ago when enhanced proxy disclosure rules were put in place. In most cases today, any executive perks must have a legitimate corporate purpose and not be deemed excessive. But they also can play a role in attracting, protecting and retaining key executives.

For purposes of the following review of disclosed executive perks, we will be reporting only certain relatively common perquisites and not other executive benefits, such as top-hat nonqualified deferred compensation plans, SERPs, long-term incentive plan awards, executive severance, special retention awards or similar executive benefits.

Below is an overview of the executive perquisites provided to the NEOs within two overlapping groups of companies - the S&P 100 and 496 companies in the S&P 500. On the next page, we will illustrate the most common ones (full disclosure - Ayco financial planning services paid for by the employer are considered an executive perquisite).
What Executive Perquisites Are Being Provided

Here are the most common executive perquisites provided to the CEO or one or more of the other NEOs at the S&P 100 and S&P 500 companies, as indicated in the company’s most recent proxy statement. This analysis is without regard to any perquisite allowance offered – which is in place at approximately 5% of the S&P 500.

**S&P 100 Companies**

**S&P 500 Companies**

*These include executive life, executive disability, and/or executive medical benefits*
During the past 12 years, many of the companies that make up the S&P 500 Index have changed. The most common reason for removing companies from the Index is a merger or acquisition. The components of the S&P 100 change much less often than the S&P 500. During the past 11 years, the average number of annual replacements in the S&P 100 was six. During the decade from 2005 thru the end of 2015, there were 239 changes in the S&P 500 Index, with over 20 companies replaced in 2016. Thus, 50% of the Index has changed over the past 12 years.

➢ **Other Reported Executive Benefits** - Relocation expenses were paid or reimbursed for one or more NEO at 15% of the S&P 100 and approximately 13% of S&P 500 companies during 2016. In addition, 8% of the S&P 100 and 7% of the S&P 500 disclosed paying or reimbursing for foreign taxes, housing or other expat-related expenses of internationally mobile NEOs. A small number of companies reimbursed NEOs for non-resident state income taxes incurred or for the Hart Scott Rodino fees paid by their CEO (this is a fee generally associated with mergers, but also payable by an individual who owns or controls a significant amount of company stock – $78.2M in 2016 increasing to $80.8M in 2017).

➢ **What Is A Reportable Perquisite?** - To be reportable in a proxy, a perquisite should provide to a NEO a direct or indirect benefit with a personal aspect, not be directly related to the performance of the executive's duties, and not offered to all employees. But, there is not consistent disclosure of executive benefits. A perfect example is an executive physical exam. Some companies disclose this in their proxy while others consider it similar to a benefit available to all employees. Therefore, this is one benefit that likely is under-reported in proxy statements.

Examples of items directly related to the performance of an executive's duties which should not be reported include: reserved parking, travel to and from business meetings, reimbursement of business entertainment expenses, and clerical or secretarial services. Examples of what generally will be a reportable perquisite include: personal use of company aircraft or automobile, security provided during personal travel or at a personal residence, financial planning or tax advice, payment of club dues or memberships not used exclusively for business, personal use of property owned or leased by the company, payment of housing and other living expenses, discounts on company products or services not generally available to all employees.

➢ **Proxy Reporting Rules** - Under SEC Regulation S-K, the value of perquisites and personal benefits received by NEOs must be disclosed in the All Other Compensation column of the Summary Compensation Table (“SCT”) unless the aggregate value is less than $10,000. If this threshold is exceeded, each perquisite utilized must be itemized in a footnote disclosure and the individual value reported for those that have a value greater than $25,000 or 10% of the total value of all perquisites. In addition, there must be a separate disclosure of perquisites provided following termination of employment of a NEO or upon a change-in-control. Some companies utilize a chart to illustrate the value of perquisites provided to their NEOs, while others report the value in a footnote to the SCT. The value reported should be the cost to the company (which is not necessarily the same value as the amount reported as taxable income to the executive).

➢ **SEC Action** - Earlier this year, the SEC settled charges against a New York marketing company, MDC Partners, that it failed to disclose certain perquisites provided to its then CEO. While the company did report an annual $500,000 perquisite allowance for Miles Nadal, it failed to disclose additional personal benefits paid on his behalf, including private aircraft use, club memberships, cosmetic surgery expenses, yacht and sports car costs, pet care, jewelry and personal travel expenses.

The company agreed to a $1.5 million penalty and Nadal agreed to pay $1.85 million in disgorgement, plus $150,000 in interest and a $3.5 million penalty to settle charges that the perks were not properly disclosed to shareholders over several years. He also returned $11.285 million to the company and resigned as CEO.

The SEC has indicated that even if a perquisite has no incremental cost, it must be separately identified (i.e., spousal travel). But any item for which the NEO fully reimburses the company need not be reported. There is no requirement that the names of service providers be reported. Any tax reimbursements or gross-ups provided by the company must be separately disclosed. Almost all companies include a narrative in their Compensation Discussion & Analysis (“CD&A”) describing current policy with regard to any executive benefits. In most cases, this is a paragraph or two (some companies provide details of the rationale supporting the benefits). Similar disclosure is required for perquisites provided to corporate directors in the Directors' Compensation Table.
**Personal Use of Corporate Jet** - This continues to be the largest reported value of all executive perquisites. In Equilar’s CEO Executive Benefits & Perquisite Report on Fortune 100 companies, the median value of the CEO’s personal use of corporate aircraft was reported to be approximately $95,000 in 2015 and the average value was just under $109,000. We counted 18% of the S&P 100 disclosing CEO aircraft personal use with a value of over $150,000. This is due to the calculation under the Standard Industry Fare Level (SIFL) commonly used to value this benefit. A number of companies, (we counted 9% of the S&P 100) have dollar limits on the personal use of leased or corporate aircraft, after which the NEO must reimburse the company. Many companies justify this benefit as providing a level of security for executives and their family and as a means to increase travel efficiency. But this does not eliminate the requirement to report the value of personal use in the proxy.

**Tax Gross-Ups** - Tax gross-ups for most executive perquisites at U.S. public companies have largely disappeared. This can be attributed, in part, to the Conference Board’s Task Force on Executive Compensation recommendation that gross-ups not be provided absent special justification. ISS warned that they would consider a tax gross-up for certain executive perquisites to be a “poor pay practice.” They did clarify that a tax gross-up would not result in their recommendation of a “withhold vote” for the compensation committee, but that such practice would be reviewed on a case-by-case basis. They want to see an explanation to shareholders of the rationale for any such reimbursement. In our recent review, we saw only 2% of the S&P 100 and 3% of the S&P 500 disclosing a tax gross-up, with spouse travel and relocation being the most common basis for the gross-up.

**Broad-Based Financial Education** - Many companies offer financial education to a broader group than only executives, including companies with an egalitarian culture that offer no executive-only benefits. Companies are finding that offering a financial education program helps meet employees’ personal needs, while achieving corporate objectives. This includes helping employees to better understand and take advantage of benefits offered, which helps in retention. Plus, a successful program can help employees of all ages better prepare for their eventual retirement. A recent survey by the LIMRA Secure Retirement Institute found that 27% of U.S. workers age 55-65 (those closest to retirement) stated they did not know how they will use their 401(k) plan savings after they retire. Employees who experience a financial wellness program usually are more productive and happier.

According to a recent study from the International Foundation of Employee Benefit Plans (IFEBP), 66% of the 406 organizations in their survey currently offer some kind of financial education and over two-thirds rate their program successful. More than one-third started offering financial education within the past five years.

Many employees wish their employers would do more to educate them on how to achieve their retirement savings goals. The 2017 Workplace Benefits Report from Bank of America Merrill Lynch reported that 86% of employees surveyed would gladly participate in a financial education program provided by their employer. In a MetLife Study of Employee Benefit Trends, 57% of employers agreed that offering financial education had a positive effect on employee productivity. In Aon Hewitt’s “2017 Hot Topics in Retirement and Financial Well-Being”, 60% of employers reported that the importance of employees’ financial well-being increased within the past 24 months, at 38% it remained the same, and it decreased at 2%.

**Rationale For Providing Perquisites** - While many executive benefits are under increased scrutiny, Compensation Committees are distinguishing those executive perquisites which can be justified as being in the best interests of shareholders. Clearly, the health and safety of senior officers is important to any organization. The same can be said of helping make certain that key executives meet all regulatory and compliance requirements while achieving personal planning goals. These can help minimize risk to the company – one of the key objectives in today’s environment.

Companies offering perquisites often describe in the CD&A their rationale for these programs. We have paraphrased some of these below. Identified perquisites –

- Facilitate a more productive use of an executive’s time and allow for a greater focus on corporate activities;
- Are part of a competitive compensation package to attract and retain executive talent;
- Protect the health and safety of executives;
- Help executives better understand and make appropriate decisions for benefit and compensation programs creating "peace of mind";
- Help ensure compliance with tax and regulatory requirements, as well as corporate policies;
- Are an efficient use of corporate resources. The value of perquisites represents a very small percentage of overall compensation.
Could Wellness Rewards or Other Benefits Paid from Self-Funded Health Plan or Other Arrangement be Taxable?

Under IRC §105(b), employees generally are not taxed on amounts received through employer-provided accident or health insurance if such amounts are paid for expenses incurred for the medical care provided to the employee, their spouse or dependents, as well as children of the employee who are not dependent but have not attained age 27 by the end of the taxable year. Another Internal Revenue Code provision, §104(a)(3) provides that amounts received through accident or health insurance, or through an arrangement having the effect of “insurance”, for personal injuries or sickness are not taxable. But this exclusion from income does not apply in all instances. In order for amounts to be excludible from income there must be adequate “risk shifting” or insurance involved. The IRS recently issued Chief Counsel Advice 20170313 describing a situation in which the benefits paid under an employer’s self-funded health plan would result in tax consequences to employees.

This guidance was issued in response to a request from an employer interested in the IRS position regarding a scheme being marketed by certain promoters and insurance brokers referred to as a “fixed indemnity health plan.” The promoters suggest that the arrangements could provide certain medical benefits at little or no cost to the employer and little or no cost to employees, net of what they otherwise would have received as after-tax income. This is how the proposed arrangement would work:

Employees participating in the arrangement would make pre-tax contributions to a wellness program and also make relatively small after-tax contributions to a self-funded health plan. The employee’s pre-tax contributions would avoid being subject to FICA taxes – saving dollars for both employer and employee. A large portion of the pre-tax contribution amount would later be returned to the employee either through a wellness rewards program or as cash payments which would not be reported as taxable income. The employer would pay a fee to the promoter for administering the plan. The question to the IRS was whether any of the benefits received by employees participating in this scheme should be considered taxable.

The IRS answered this with a resounding “Yes”. To the extent that the average amounts received by employees for participating in a health-related activity predictably exceed the employee’s after-tax contributions, any excess should be reported as taxable.

This position is based on the legislative history of IRC §104, as well as Rev. Rul. 69-154. While neither the Internal Revenue Code nor IRS regulations define the term “insurance”, the Supreme Court ruled in 1941 that in order for an arrangement to constitute insurance for federal income tax purposes, there must be both risk shifting and risk distribution. In the scheme being described, the average benefits paid or predicted to be paid greatly exceeded the after-tax contribution by each participating employee – primarily due to the relatively large pre-tax contributions later largely returned to the employee supposedly on a tax-free basis, and the relatively small employee after-tax contributions to the self-funded health plan. Thus, the IRS concluded that amounts received in excess of an employee’s after-tax contributions should be income taxable and subject to FICA tax. Rev. Rul. 2002-3 provides that employee pre-tax contributions used to pay for a portion or all of a health insurance premium may not also be reimbursed to an employee on a tax-free basis. This is known as “double dipping” since the same dollars would be excluded from income twice.

Earlier this year, the IRS addressed a question posed as to whether an employer may exclude from an employee’s income payments made under a fixed indemnity health plan if the employee’s share of premiums were made by salary reduction under a §125 cafeteria plan. (A fixed indemnity plan pays a set amount – e.g., $100 – for each medical visit or hospital stay without regard to the amount actually incurred). While reimbursements or payments for qualified medical care may be excluded from an employee’s wages, cash or non-cash incentive awards paid should be included in the employee’s compensation, unless it qualifies as an excludible fringe benefit under IRC §132. This can apply to wellness program rewards or incentives. The IRS concluded in Chief Counsel Advice Memorandum 20170313 that amounts paid under a fixed indemnity plan should generally...
be included in taxable wages (subject to FICA withholding) if
the cost for coverage was treated as pre-tax and excludible
from the employee’s income (CCA Memo 201622031
addresses the general tax rules for such wellness rewards).

Are you treating wellness cash and non-cash incentives as
taxable? How about if they are contributed to an
employee’s HSA?

Do RSUs Have Any Preference Over
General Creditors in Bankruptcy?
The bankruptcy of Lehman Brothers in 2008 remains the
largest corporate bankruptcy to date. It has been nearly a
decade since their bankruptcy filing, yet there continues to
be ongoing consequences. Last month, for example, a
federal appeals court upheld a Bankruptcy Court decision
regarding claims by three subgroups of former Lehman
employees as to whether restricted stock units they
received as compensation should have priority over claims
by general creditors of the company in any ultimate
distribution of remaining cash (In Re: Lehman Brothers
Holdings Inc.).

The employees had received restricted stock units (RSUs)
under the Lehman Brothers Equity Award Program. This
authorized the company to pay certain employees a portion
of their compensation in equity-based awards, including
RSUs. Under the terms of the plan, there was a five-year
holding period before shares of common stock would be
issued to recipients who remained employed. During this
period, RSU recipients were not considered shareholders,
although were entitled to dividend rights associated with
the awards. A provision in the plan confirmed that
recipients were general creditors of the company with
respect to the awards until payment.

When Lehman Brothers filed for Chapter 11 bankruptcy on
September 15, 2008, thousands of Lehman employees were
holding RSUs that were granted for services performed
between 2003-2008, but not fully vested. Many, but not all,
of the RSU holders filed a claim in the bankruptcy
proceeding seeking a cash payment equal to the face value
of the RSUs. In response, the company sought to
subordinate these to the claims of general creditors of the
company. Just over 200 of the former employees opposed
this position by the company and it took the Bankruptcy
Court nearly three years to issue a decision. The court
followed the reasoning of a similar argument made during
the earlier bankruptcy of Enron Corp. It found that the
claims of RSU holders must be subordinated to claims by
general creditors of the company. The former employees
appealed this decision and a U.S. District Court judge upheld
that position last year. They continued to appeal and the 2nd
Circuit Federal Court of Appeals has now upheld the earlier
decisions. It ruled that the RSUs that the individuals
received as compensation met the legal definition of
securities and that, therefore, employees holding them
must be treated similar to other holders of Lehman
Brothers equity. That is, any general creditors of the
company will have priority over them in any bankruptcy-
related payment.

One of the subgroups were former directors of Neuberger
Berman who had joined Lehman Brothers when the
companies merged. They had argued that because they
were subject to non-compete agreements that should be a
factor in giving them some priority over general creditors.
However, the federal court disagreed with this position and
found that they should be treated no differently than any
other employees who had received RSUs as compensation.

2018 Limits for Health Savings
Accounts Announced
Health savings accounts (“HSAs”) have now been available
for over a decade and the number of individuals with HSAs
continues to grow – up over 25% from 2015 and nearly
140% from five years ago according to a survey by United
Benefit Advisors. According to a report from Devenir
Research, the number of HSAs rose to over 20 million as of
the end of 2016 with employer-sponsored HSAs being the
largest driver of new accounts. One of the requirements to
fund an HSA is that an individual must be covered only by a
“high deductible health plan” (HDHP).

The IRS recently released an Information Letter explaining
why not all medical plans, including some in the healthcare
Marketplace (state and federal Exchanges), with large
deductibles, would qualify as HDHPs (IRS Info Letter 2017-
0005). A HDHP must satisfy minimum deductible and
maximum out-of-pocket requirements (which will be
illustrated below). The plan may provide certain preventive
care benefits, but may not provide any other benefits below
the deductible limit. For example, if a plan pays for
prescription drug benefits below the minimum deductible,
or provides first dollar coverage for a number of office visits
before the deductible is reached, it will not be considered a
HDHP that could allow for funding an HSA.
In our analysis of the 2017 open enrollment at Ayco client companies, nearly 95% now offer a HDHP as a coverage choice. To encourage selecting this choice, approximately 85% of our survey group contributed to the HSA of any employee who elected the HDHP.

Having an HSA does not guarantee it will be regularly or fully funded. In fact, few fund their HSAs to the maximum allowed each year. Devenir reported an average HSA balance as of the end of 2016 of nearly $15,000 which is a significant increase from average balances they saw a few years ago. Fidelity recently reported that assets in Fidelity HSAs rose 50% during 2016. They also found that individuals with both a 401(k) and HSA saved on average more – average of 10.7% of wages – than those with only a 401(k) plan. Contributions to a HSA can be a better savings vehicle than contributions to a 401(k) plan or IRA (See October 2016 Digest for our analysis explaining this).

There are no minimum contributions required to be made to an HSA, but there are annual maximums. Proposals have been floated to increase significantly the current annual contribution maximums – but nothing appears imminent. The IRS releases annually, by June 1 prior to the year to which they apply, the inflation driven cost-of-living adjustments for HDHPs and HSAs. The 2018 HSA limits (reported in IRS Rev. Proc. 2017-37) are now available well in advance of this fall’s annual enrollment period. Here are the HSA limits for 2017 and 2018. Unlike for this year, there will be changes in most limits next year.

<table>
<thead>
<tr>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HSA Maximum Annual Contribution Amount</strong></td>
<td></td>
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<tr>
<td>Individual Coverage</td>
<td>$3,450</td>
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<tr>
<td>Family Coverage</td>
<td>$6,900</td>
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<tr>
<td><strong>Catch-Up Contributions (age 55 or older)</strong></td>
<td>$1,000</td>
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<tr>
<td><strong>HDHP Minimum Deductible Amount</strong></td>
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<tr>
<td>Individual Coverage</td>
<td>$1,350</td>
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<tr>
<td>Family Coverage</td>
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<tr>
<td><strong>HDHP Maximum Out-of-Pocket Amount</strong></td>
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</tr>
<tr>
<td>Individual Coverage</td>
<td>$6,650</td>
</tr>
<tr>
<td>Family Coverage</td>
<td>$13,300</td>
</tr>
</tbody>
</table>

According to Healthview Services, “2016 Retirement Health Care Costs Data Report” (using data from 50 million individual cases), a 65-year old couple retiring last year can expect health care costs to average around $288,400 in current dollars (estimated at about $425,500 in future dollars). This figure does not include the cost of dental, vision, hearing or co-pays. Fidelity reported a similar estimate of $260,000 for a 65-year old couple. Yet, a large majority of retirement-eligible Americans have not assessed how much they will need to save for retiree healthcare. A recent study by Voya Financial reported 81% of those surveyed had not done so.

While an HSA represents a valuable means and perhaps the most tax efficient means to save for future medical expenses, it appears unlikely that it will play more than a minor part in funding retiree healthcare expenses for most. That doesn’t mean they should be ignored and HSAs can be an integral part of an individual’s retirement savings. Distributions made to pay or reimburse for qualified medical expenses are received income tax-free. They can even be taken in the same year the HSA funding occurs or any subsequent year, even if Medicare eligible. A retiree can use distributions to pay for Medicare premiums, COBRA coverage, or long-term care insurance.

Like IRAs, HSAs are in an individual’s name and cannot be jointly held. When an employee and spouse are both HSA-eligible (both covered only by a HDHP, even if at separate employers), they need to coordinate contribution maximums. For example, if one has self-only coverage and the other elects family coverage, their combined contribution amount cannot exceed the family contribution limit. But, they can allocate this between their separate HSAs and they should consider any company contributions in setting up and funding their separate accounts.

An individual’s HSA can be used to pay for qualified medical expenses for themselves, a spouse, and any dependent children. This is the case even if the spouse and dependents are not covered under the employee’s HDHP.

An HSA may be transferred tax-free to a surviving spouse following the owner’s death and then will be treated as the spouse’s HSA. It also can be transferred to a former spouse pursuant to a divorce decree. An individual’s HSA can be passed to a non-spouse beneficiary – although, in that case, there could be certain tax ramifications.

The cost of employer-provided healthcare is reported on a Form W-2; however, employer contributions to an employee’s HSA are not included in this amount due to the fact that employer contributions are separately reported in box 12 of the W-2 with a code W, along with any employee pre-tax contributions to the HSA.
Did You Know…

- The ten largest corporate bankruptcies include:
  1. Lehman Brothers Holdings (2008);
  2. Washington Mutual (2008);
  3. WorldCom (2002);
  4. General Motors (2009);
  5. CIT Group (2009);
  6. Enron (2001);
  7. Conseco (2002);
  8. Energy Future Holdings (2014);
  9. MF Global Holdings (2009);

  During 2016, the largest bankruptcies were among energy, oil and gas, and coal companies.

- The Pension Benefit Guarantee Corporation (“PBGC”) paid out $5.6 billion in pension benefits during 2016 to nearly 861,000 retirees in failed single-employer pension plans. The states with the most retirees receiving PBGC benefits include Pennsylvania, Ohio, and Florida.

- The cost of healthcare for a family of four covered by an employer-sponsored PPO plan is just under $27,000, according to the Milliman Medical Index. Employees pay about 43% of total expenses.

- As of April 2017, 19% of Americans age 65 and older were still working – the highest percentage since 1962, according to government data.