An Invitation to Join a Dialogue

Deferred compensation arrangements today have long been a method to deliver and provide retirement benefits for executives and highly compensated individuals like physicians. Most deferred compensation arrangements, whether they be defined benefit or target-benefit defined contribution plans, are significantly underfunded and stand the chance of haunting the executive all through retirement. All of the long-held expectations as to how one's retirement years will be spent can unravel at a point in time when it is too late to address the shortfall. This underfunding presents a dilemma to be addressed by organizations and individuals due to costs and unfulfilled benefit promises. In addition, public scrutiny of retirement packages for non-profit healthcare executives is at an all time high, and will continue to rise. Ironically, as an industry, we are not delivering the projected benefits, but still getting the blame for excessive compensation levels.

The answer is not to spend more money ... but less .... and more intelligently. I am beginning a dialogue with my fellow colleagues in the healthcare industry, to explore the causes and potential solutions to these issues. This initial article serves to start that conversation, outlining my experience and observations concerning four broad themes:

Understand and stress test the underlying assumptions – "What You Don't Know Can Hurt You"

All of the various retirement benefit design options, along with their underlying product or investment vehicles, are based on a key set of assumptions that, if not realized, will undermine the viability of the plan under different market circumstances or economic climates. All of the design and product options have historically succeeded or failed based on the management of these key assumptions:

- Rate of Return
    - Pre-Retirement
    - At Retirement (often referred to as the Discount Rate)
    - Post-Retirement
- Volatility
- Life Expectancy
- Deferral Periods

Most deferred compensation plans are significantly underfunded due to the inaccuracy of these assumptions. Other design options are dependent on the accuracy of these assumptions as well. Your Compensation Committee and Board should be educated concerning each assumption, including proactive stress tests detailing the implications of alternative scenarios. They should also be educated on the various methods to hedge many of these assumptions.

Understand the difference between "How Much" and "How" – "Who Can Assist Us In Establishing a Modern Approach to Retirement Benefits?"

We all understand the importance of the rebuttable presumption of reasonableness, and the key role Compensation Consultants play in documenting appropriate comparability data. They have served us well in determining the "How Much." As an example, it may be determined that it is reasonable for an organization to provide a retirement benefit equal to 2% of final average salary for each year of service, up to a maximum of 60%, or 30 years of service.

But once the "How Much" has been determined, the conversation pivots to "How?" How will the organization provide this benefit? Since Compensation Consultants were key players in determining the "How Much," and have established a relationship with the Compensation Committee and Board, it is convenient and tempting to ask them to answer this question as well. But is this a disciplined approach? Are there experts in the industry who have particular expertise in exploring all the available design options, and are better at recommending products that manage the risk associated with each assumption imbedded in the plan? In my experience, there are a select group of Retirement Benefit Engineers that are uniquely experienced at guiding an organization through the question of "How."

Understand the difference between "Design" and "Product" – "How A Modern Process Should Work"

In my experience, a thorough exploration of "Design" options should precede any discussion concerning "Product," or investment options. A common example of a "Design" option is a 457(f) plan. There are several other options that have been widely adopted by conservative, highly regulated industries. These include Section 162 plans (after-tax plans with tax favorable investment products), Section 83 plans (tax deferral of property transfers), and Section 7872 plans (split dollar). Each has its own set of advantages, disadvantages and risks. Some are simple, and others are more complex but tend to be more consistent with the community mission of a non-profit.

Many Compensation Consultants have adopted a disciplined position that they will not recommend or sell a “Product” option, so as to not create a conflict of interest surrounding their “How Much” recommendation. This Chinese Wall approach should also be adopted concerning “Design” options, since some Compensation Consultants generate revenue designing and re-evaluating a limited number of the “Design” options available to an organization. The Compensation Committee and the Board deserve to be educated on all “Design” options without any underlying conflicts of interest, real or perceived.

Understand the importance of ongoing administration

Helmuth von Moltke famously stated, “No battle plan survives contact with the enemy.” No retirement plan, however designed, can be placed in a file and ignored. Eventually it encounters the real world. The plan must be constantly monitored, and complimented with ongoing communication to the Compensation Committee, Board and participants.

Over the next several weeks I will continue to publish a series of “bite-sized” articles, elaborating on each of these issues in cooperation with other industry experts and based on feedback I receive from the healthcare community. Please join in the discussion!

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