

Beyond Equity

Executive Wealth-building Alternatives For Private Companies



Attracting, motivating, and retaining talent are critical to any organization's long-term success. For-profit, privately held companies might struggle to compete against public companies that can more easily offer freely tradeable equity-based awards as significant incentives to join and stay with the organization. Although the private company executive compensation toolbox is somewhat different than that of public companies, it can still support talent and retention objectives.

To link rewards to long-term performance, retention, or capital accumulation, private companies often focus on long-term cash plans instead of equity.

However, there are alternatives that could be worth considering, including:

- ▶ Split-dollar life insurance;
- ▶ Cash balance plans;
- ▶ Nonqualified deferred compensation (NQDC);
- ▶ Long-term cash incentive plans (LTIP); and
- ▶ Phantom stock.

It is important to identify the plan that aligns with the business and talent strategy and clearly communicate the opportunity to participants.



Choosing A Plan

The first question to answer is what the company is trying to accomplish with the executive compensation plan.

Goals may focus on one or more of the following:

- ▶ Providing a supplemental executive retirement plan (SERP) beyond the tax-qualified retirement plan that is available to most employees and is subject to annual IRS limits.
- ▶ Retaining the key executive or manager through to a significant milestone (e.g., project milestone, product launch, completion of a new plant, merger, or acquisition).
- ▶ Retaining the key executive or manager for a predetermined number of years: There may be a need to preserve institutional knowledge, a specific skill set, or external relationships.
- ▶ Rewarding long-term performance.

The table on the right provides a quick at-a-glance view of how private companies often use those alternative executive wealth-building tools. That can help narrow plan design discussions to focus on the options most aligned with the company's objectives.

SUMMARY OF HOW PLANS TYPICALLY ARE USED TO SUPPORT EXECUTIVE COMPENSATION GOALS

Plan Type	SERP/Retirement Wealth Accumulation	Retention/Golden Handcuffs	Performance Incentive
Split-Dollar	X*	X	
Cash Balance	X**		
NQDC	X**	X	
LTIP		X	X
Phantom Equity		X	X

* Also includes survivor protection.

** Beneficiaries are eligible to receive the participant's vested benefit.

The balance of this article provides a deeper dive into how to use those plans for:

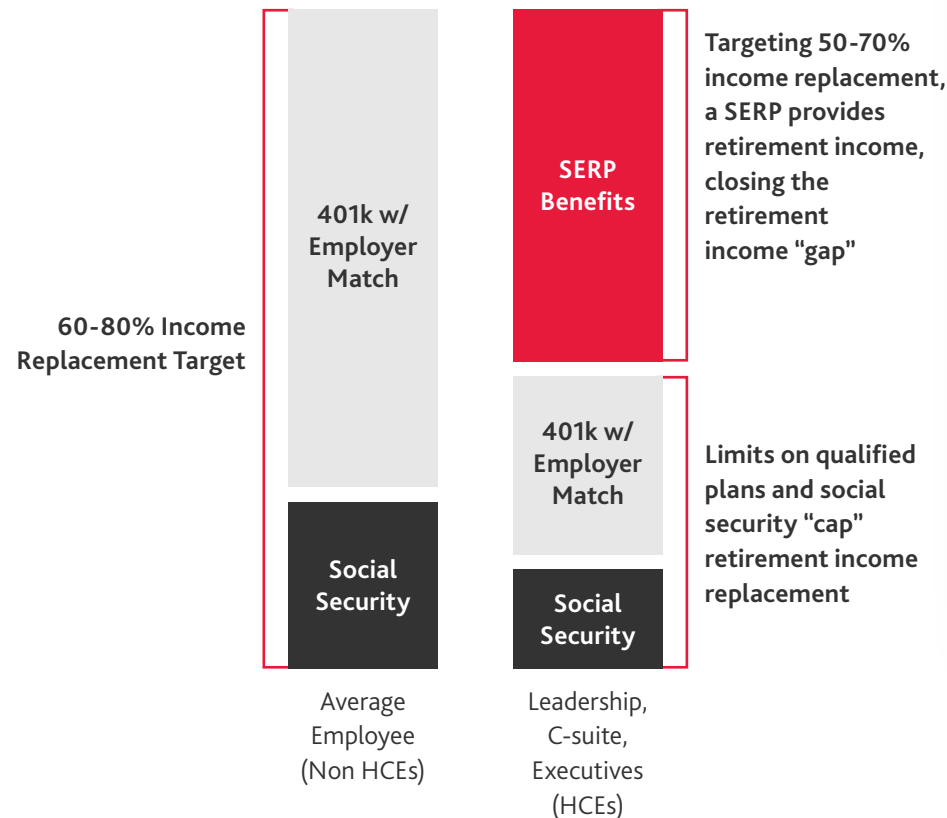
- ▶ Executive retirement;
- ▶ Retention; and
- ▶ Long-term performance rewards.

It is important for each company to evaluate its facts and circumstances; information provided herein may or may not align with specific needs or fact patterns. BDO recommends consulting with tax, accounting, and legal advisors to determine which approach may be most appropriate based on facts and circumstances.

Executive Retirement Plan Alternatives

A SERP is one tool companies can use to help close the retirement-benefit gap created by qualified plan limits for highly compensated employees and could support recruiting competitiveness and long-term retention. When designed with clear vesting and payout terms, a SERP can support succession planning and planned retirement timing while giving the company flexibility to target benefits by role and align funding, tax, and administrative requirements with the company's broader compensation strategy.

WHY A SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP) IS NEEDED



Leadership, C-suite and other Executives are "capped" by qualified plan (401 (k)) and Social Security benefit maximum limits.

A properly designed nonqualified SERP usually targets 50-70% income replacement for the executive at their retirement.

Offsets are typically applied for Social Security and other retirement (such as a 401 (k))

The three plans below are often considered for that purpose.

- ▶ **Cash balance plan (a type of defined benefit plan):** A tax-qualified retirement plan in which the employer promises a pay credit (e.g., 5% of pay) plus an interest credit (either a fixed or linked rate). Although cash balance plans must cover most employees, they can be designed so that the most significant benefits are allocated to the intended recipients within the confines of IRS nondiscrimination rules.
- ▶ **NQDC plan:** An arrangement limited to a select group of management or highly compensated employees in which the participant agrees to defer current compensation and/or receives company credits to be paid in the future, commonly at retirement, on a fixed date, or on separation from service. These plans are commonly called “top hat” plans that are generally exempt from most of ERISA, the federal pension law. NQDC plans can also be structured as non-ERISA deferred bonus plans. Pass-through entity owners may decide not to take advantage of NQDC plans because NQDC is tax deductible only when paid to the participants, so any increase in taxable income due to owner deferrals at the entity level flows through directly to the owners (so any decrease in personal income for the owners is offset by the increase in business income). Also, with multiple owners of a pass-through entity, NQDC can cause a disproportionate taxable effect if owners defer amounts not proportionate to their ownership interest.
- ▶ **Split-dollar life insurance:** A life insurance arrangement in which the company and executive share premiums and/or policy benefits under a written agreement.

The most effective time to address any needs is generally at least 10 years before retirement. Unfortunately, many organizations fail to identify that missing compensation component until executives are nearing retirement; at that point, addressing the shortfall can be more difficult.



RETIREMENT PACKAGE ALTERNATIVES – OVERVIEW

A **cash balance plan** is a defined benefit retirement plan that defines the promised benefit in terms of a stated account balance.

Features include:

- ▶ **Defined benefit structure with a defined contribution feel:** While technically a defined benefit plan, a cash balance plan presents benefits as a hypothetical account balance, similar to a 401(k)
- ▶ **Employer funded:** The employer typically makes contributions to the plan and the account grows with employer contributions plus interest credits
- ▶ **Interest credit:** Participants receive an interest credit, often at a fixed rate or linked to an index, regardless of the plan's investment performance
- ▶ **Investment risk:** The employer typically bears the investment risk in a cash balance plan unlike in a 401(k) where the employee takes on the investment risk
- ▶ **Potential benefits:** The plan can allow for larger contributions than traditional 401(k) plans, especially for older workers, and can be a useful tool for tax planning and retirement savings
- ▶ A key consideration is that the plan must cover most employees, not just the targeted executives

An **NQDC plan** allows highly compensated employees to accumulate supplemental retirement benefits outside qualified plan limits.

Features include:

- ▶ **Nonqualified:** Not subject to qualified plan contribution limits or nondiscrimination rules
- ▶ **Employer contributions:** Contributions are made by the employer (although employee deferrals can also be made)
- ▶ **Substantial risk of forfeiture:** To avoid immediate taxation, benefits generally vest only on meeting service or performance conditions
- ▶ **Taxation at payment:** Benefits are taxed when actually or constructively paid, which is usually when the employee retires
- ▶ **No statutory contribution limits:** Allows for large, targeted benefits for a select group of management or highly compensated employees. Because there are no mandatory rules about treating all participants the same, contributions can vary among participants

Split-dollar life insurance is an arrangement in which an employer and employee share the costs and benefits of at least one life insurance policy.

Key aspects of split-dollar life insurance are:

- ▶ **Employee consideration:** Employees can receive additional life insurance coverage, access to cash value growth, and potentially tax-advantaged income after the agreement terminates
- ▶ **Employer considerations:** Companies can use these arrangements to support efforts to attract and retain key employees, potentially recover their costs from the policy proceeds, and customize the agreement to meet specific needs
- ▶ **Cost and benefit sharing:** The agreement specifies how the costs of the policy (premiums) and the benefits (cash value and death benefit) are divided between the employer and employee
- ▶ **Ownership:** Ownership of the policy can be structured such that either the employer or employee owns the policy. If the employer owns the policy, it is an "economic benefit regime" split-dollar life insurance arrangement and is taxed under IRC Section 61. If the employee owns the policy, it is a "loan regime" split-dollar life insurance arrangement and taxed under IRC Section 7872 (often called "collateral assignment split dollar" (CASD))
- ▶ **Tax implications:** There are tax implications for both the employer and employee that vary depending on the specific arrangement and tax regime (economic benefit or loan regime)

Each plan type has appealing features. However, all features need to be considered in the context of the organization's needs, structure, financials, and timing.

RETIREMENT PACKAGE ALTERNATIVES – OVERVIEW

Retirement Plan Type	Features	Considerations
Cash Balance (Tax-qualified retirement plan)	▶ Significant amounts can be contributed within IRS limits — potentially more than under a 401(k) plan — for senior staff with smaller contributions for other employees ▶ A 401(k) plan can remain in place, which may help with testing for the cash balance plan ▶ Benefits are generally not taxed at vesting	▶ The organization needs sufficient cash flow to fund the plan ▶ Most employees must be included, although that may be less of a concern for smaller companies ▶ Administrative requirements apply (e.g. actuary, annual Form 5500 filing, nondiscrimination tests)
NQDC	▶ There is no statutory limit, so the company, employee, or both can make large contributions ▶ Offers significant design flexibility	▶ The organization needs sufficient cash flow to fund the plan unless employee funds are used ▶ Income tax applies when benefits are paid, but Social Security and Medicare taxes may be paid earlier ▶ Deferred amounts and related earnings are considered employer assets and are subject to the claims of general creditors ▶ The plan should be designed to reduce the risk of Section 409A issues and generally must include a substantial risk of forfeiture where applicable
Split-dollar loan regime	▶ The employee owns the policy ▶ The employer loans money to the employee to pay premiums ▶ To repay the loan, the employer receives a portion of the cash value and/or death benefit	▶ Adequate lead time before retirement is typically needed to accumulate cash value ▶ Health conditions may affect insurability and plan availability ▶ Administrative complexity is a factor, and companies often use specialists to help design draft documents and administer the arrangement
Split-dollar economic benefit	▶ The employer owns the life insurance policy and pays the premiums, while the employee receives specific benefits from the policy, typically a portion of the death benefit and a portion of the cash value ▶ The organization recoups cost when cash value is paid out or from death benefit	▶ Adequate lead time before retirement is typically needed to accumulate cash value ▶ The employee is taxed each year on the value of the economic benefit received based on the cost of the life insurance protection ▶ Health conditions may affect insurability and plan availability ▶ Administrative complexity is a factor, and companies often use specialists to help design draft documents and administer the arrangement

Retention Plan Alternatives

Executive retention in private companies is typically more effective when the amount is (1) meaningfully wealth-building; (2) tied to a liquidity path that does not require an IPO; and (3) structured with multiyear golden handcuffs plus competitive cash.

The nonequity compensation plan types that tend to retain executives well are:

- ▶ Retention bonuses paid out at predetermined milestones;
- ▶ NQDC plans; and
- ▶ Long-term cash plans/phantom equity.

RETENTION APPROACHES - OVERVIEW

Retention/Stay Bonuses

- ▶ Bonuses to be paid on a predefined future date. Typically linked to a specific time in the future but can also be linked to a milestone event
- ▶ Best at retention for a defined period of six months to a few years
- ▶ These are particularly effective for acquisitions, major integrations, turnaround plans, enterprise resource planning implementations, and leadership transitions

NQDC Plans/LTIP

- ▶ These can be structured in many ways; for example, an annual bonus earned now but paid out over two to four years (often with a continued-service condition)
- ▶ Can also be an employee or company-funded annual contribution
- ▶ The inclusion of performance measures (such as for a cash-based LTIP) makes the plan useful for both retention and as a performance incentive
- ▶ Best for long-term retention, even until retirement, but could be laddered as rolling retention over a period of three to five years, with new tranches and related vesting issued annually, so that individuals always have skin in the game and would have to leave money on the table if they leave before the end of the vesting period for that tranche
- ▶ The retention hook is the creation of a bank of funds that grows each year

Phantom Equity

- ▶ These plans mimic equity upside without giving actual ownership/control
- ▶ Best for owners who do not want dilution or additional shareholders
- ▶ **Key retention lever:** Payout at change of control and/or scheduled internal liquidity events; strong vesting/forfeiture provisions
- ▶ **Risk:** Design should be reviewed to be sure the executive is not required to leave the organization to trigger a distribution (the term "double trigger" means two things must happen for the executive to get paid, typically an event like a change in control coupled with a termination of employment, so a "single trigger" may be preferred)

The table below summarizes several retention approaches commonly used in private companies and highlights how each plan works, how the plans tend to be most effective as a retention tool, and the key design and governance considerations to address before implementation.

RETENTION PLAN ALTERNATIVES – FEATURES AND CONSIDERATIONS

Plan type	Features	Key considerations
Retention bonuses paid out at predetermined milestones	▶ Simple, immediate-stay incentive; can be effective for short-to-medium horizon and critical projects or transactions ▶ Can combine retention and performance through the achievement of defined milestones	▶ May be perceived as pay-to-stay ▶ Payout size should be meaningful ▶ Milestones should be clearly defined ▶ Retention risk may increase after payout ▶ Payroll and tax timing should be considered ▶ Cash obligations should be planned for
NQDC plan	▶ Can create golden handcuffs through growing account balances ▶ Can supplement retirement planning ▶ Does not require equity dilution ▶ Offers flexibility in design, including eligibility, credits or deferrals, vesting, and payout timing ▶ Often used with a retention focus	▶ Technical tax and compliance requirements apply (e.g., Section 409A in the U.S.) ▶ Election and distribution rules are strict ▶ Benefits are generally subject to unsecured creditor status, creating credit risk ▶ Accounting impact should be considered ▶ Recordkeeping and participant communications are important ▶ A rabbi trust may be considered ▶ Change-in-control terms should be clearly defined
Phantom equity	▶ Can align leaders with long-term value creation ▶ Provides equity-like upside without issuing actual equity ▶ Can fit private-company liquidity constraints ▶ Combines retention and performance objectives	▶ Valuation methods and metrics should be clearly defined and documented ▶ Accounting implications should be considered ▶ Payouts can create significant cash obligations, so plan liquidity should be evaluated ▶ Vesting and termination-of-employment provisions should be addressed ▶ Rolling grants may help reduce unwanted turnover at vesting ▶ Section 409A compliance should be considered

One key consideration is what happens after payout or vesting occurs: There can be a lot of pressure to create a new award to retain talent once a payout is received. That can also create challenges if multiple key leaders receive payouts at the same time. While retention awards can be useful, it is important to consider what happens after the initial program concludes.

Long-term Performance Plan Alternatives

Often, private companies seek approaches to align their executives' goals with those of the company owners. In some cases, owners do not want the dilution associated with granting equity or adding shareholders.

In such situations, those plans provide alternatives worthy of consideration:

- ▶ LTIPs, which are performance-triggered NQDC plans, settled in cash; and
- ▶ Phantom equity
- ▶ The table on the next page provides an overview of the features of each of these tools

SUPPLEMENTAL RETENTION APPROACHES - OVERVIEW

LTIP

- ▶ Cash bonuses that are based on long-term company performance, typically over a period of about three to five years
- ▶ Best at retaining executives over a defined three to five-year window with clear and controllable performance goals
- ▶ Especially relevant when design priorities include simplicity, no dilution, and predictable plan mechanics (although the company must have cash available for payout)
- ▶ New grants may be made on a rolling basis, as often as annually, creating a "ladder" where each award has a three- to five-year performance horizon so that employees always have "skin in the game" if they leave

Phantom Equity

- ▶ These create equity-like alignment and retention without giving actual ownership, with value typically determined by formula or periodic valuation
- ▶ Can use time- or performance-based vesting or both
- ▶ Best for owners who do not want dilution or additional shareholders but want to motivate key, non-owner employees for enterprise value growth
- ▶ Can issue stock appreciation right (SAR) grants that provide only cash based on appreciation after the grant date or restricted stock unit (RSU) grants under which the employee gets the full value of the share plus appreciation

The following table compares those two long-term performance vehicles, which can be used by private companies to create owner-aligned incentives without relying on traditional stock-based awards used by publicly traded companies. It highlights how each approach is structured, what it does best (for example, simplicity and cash-based performance pay versus equity-like value tracking), and the key trade-offs to evaluate—particularly liquidity funding, valuation/governance requirements, and tax complexity.

LONG-TERM INCENTIVE PLAN ALTERNATIVES – FEATURES AND CONSIDERATIONS

Plan type	Features	Key considerations
Long-Term Cash Bonus Plans	▶ Multiyear (often three to five years) cash incentives tied to performance e.g., EBITDA, revenue, return on invested capital) ▶ Simple to explain ▶ No dilution or impact on the company's capitalization table ▶ Typically a fit for companies with steady cash flow ▶ Supports retention through payout timing	▶ Cash funding is required at payout ▶ Section 409A considerations ▶ Payments generally are treated as ordinary income and are subject to Social Security and Medicare taxes
Phantom Equity	▶ Equity-like alignment without issuing actual equity ▶ Can issue SAR grants that provide only cash based on appreciation after the grant date or RSU grants, under which the employee gets the full value of the share plus appreciation ▶ Typically time-vested ▶ Typically works well when owners want to retain control and a clean cap table ▶ Can align with enterprise value growth ▶ Can support performance and retention through vesting design	▶ Requires valuation support and careful governance ▶ Can create large cash obligation at exit or redemption ▶ Section 409A considerations ▶ Accounting remeasurement might increase earnings volatility

One key consideration regarding performance-based awards is how much information owners are willing to share with participants. For participants to value those awards and respond to them as intended, they need to fully understand the company's key performance drivers and performance expectations. Private companies could face tensions when owners seek to encourage performance without sharing enough information for participants to clearly evaluate the awards. When that happens, participants might discount or undervalue the awards, which in turn could limit the awards' effectiveness.

Value Proposition Comparison

The table below is intended to help stakeholders align plan choice with the organization's objectives, cash-flow capacity, and desired level of ownership alignment by comparing the value proposition of the executive-benefit and long-term incentive alternatives discussed above. It highlights what the executive receives; whether potential value creation is tied to company growth; the primary retention mechanism; and when liquidity is typically delivered, which may help inform plan selection based on the organization's objectives, cash-flow capacity, and desired level of ownership alignment.

Feature	Split-Dollar Life	Cash Balance Plan	NQDC Plan	Retention Bonuses	LTIP/Phantom Equity
What the executive "gets"	Cash value and/or death benefit	A promised retirement account balance	A contractual right to future payments	A cash bonus payment if the executive remains through a specified milestone	Cash payout tied to multiyear performance and/or company value/appreciation
Upside tied to company growth	No	No	No, assuming deferred amount is a predefined value	No (unless bonus is explicitly tied to growth metrics)	Yes, if payout is tied to multiyear performance and/or company value
Retention hook	Strong (typically through vesting or repayment triggers)	Moderate (generally through vesting, subject to qualified plan rules)	Strong (typically through vesting and payout timing)	Strong (typically through payout timing)	Strong (typically through vesting and payout timing)
Liquidity timing	Often at retirement/termination or death	At retirement/separation under plan rules	According to the future payout schedule	At the specified date(s) or on a milestone/event	Based on the payout schedule

How BDO Can Help

Designing executive retirement, retention, and long-term incentive arrangements requires organizations to weigh a range of business, tax, accounting, legal, and administrative considerations. BDO's Compensation & Benefits professionals work with companies to evaluate plan alternatives, assess trade-offs, and align design choices with compensation objectives, ownership priorities, and liquidity considerations.

BDO can also help organizations model plan design scenarios, evaluate tax and accounting implications, support implementation planning, and develop communication approaches for participants.

By bringing together professionals across tax, accounting, advisory, and other relevant disciplines, BDO helps companies assess executive compensation strategies in light of their specific facts and circumstances.

Learn more about BDO's Private Company Compensation Survey

BDO's survey encompasses detailed analysis of executive pay, including salaries, bonuses, long-term incentives, and other arrangements for key positions, such as:

- ▶ CEO;
- ▶ COO/Head of Operations; and
- ▶ Head of Sales Marketing
- ▶ CFO;

The survey also covers employee stock ownership plan (ESOP) arrangements and the use of fiduciary or advisory boards.

By participating, you will be eligible to receive the complete report with the included pay analysis tool for compensation benchmarking. Only organizations that complete the survey are eligible to receive the complimentary results report.

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All data is held in complete confidence and no individual company data will be shared or identifiable.



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