



Severance and Change-in-Control Plans 2003-04

**A survey of WorldatWork members,
conducted jointly by WorldatWork and Aon Consulting**

February 2004

Introduction and Methodology

This report summarizes the results of a WorldatWork member survey, conducted jointly by WorldatWork and Aon Consulting in October 2003. The purpose of this survey was to analyze and better understand the changing landscape of severance and change-in-control (CIC) practices.

A random, representative sample of 5,530 WorldatWork members received an e-mail invitation October 9, 2003 containing a link to the online survey. When the survey closed October 17, a total of 704 responses were received, a 13 percent response rate.

The demographics of the survey sample and the respondents are similar to the WorldatWork membership as a whole. Therefore, the survey results can be considered statistically representative of the membership. The typical WorldatWork member works at the managerial level or higher in the headquarters of a large company in North America.

“Margin of error” is a common summary of sampling error that quantifies uncertainty about a survey result. A survey’s margin of error is affected by type of sampling, sample size and the size of the total population. Because this survey employed a random sampling method, the total number of respondents exceeds 600, and the total population is the WorldatWork membership of approximately 25,000, the survey’s margin of error should not exceed +/- 4.5 percent.

Executive Summary

The October 2003 survey of 704 WorldatWork members about severance plans reveals that the three-year recession has caused these plans to have widespread practical application — more than three-quarters of respondents (76%) have experienced a reduction in force in the past 24 months. In addition, the current severance environment for companies include numerous shareholder proposals putting limits on severance packages for departing executives and/or permitting shareholders to vote on severance packages before they are paid.

One potentially interesting “call to action” for companies is that 56 percent of surveyed respondents have not reviewed their severance plan within the past year or since it was established (15% have not reviewed it since it was established). Similarly, a fairly high percentage of respondents (44%) have not conducted a formal review of their change-in-control (CIC) policies and almost double that number (86%) have no schedule for reviewing their CIC policies. Finally, while more than half of respondents (51%) have reviewed their top executive’s severance plan within the last 12 months or upon hire, a surprising number (78%) do not have a schedule for review of the top executive’s severance plan.

Changes in the business environment, highly visible pay packages of top executives and increasing governance requirements (imposed or recommended by Sarbanes-Oxley, and NACD, SEC, NYSE, NASDAQ) indicate that a review of the severance and CIC policies should be part of a regular schedule of formal review by compensation committees. Regular review is also a good idea because severance and CIC policies can represent sizeable amounts of corporate assets. Finally, the recently “quiet” M&A market may be heating up again and severance and CIC policies may be more in the spotlight in the near future in certain sectors of the economy.

The survey’s other findings include:

- Many companies’ severance structures are different for the CEO, executives and all other employees (36%). Nearly two in 10 companies (18%) have no severance plan at all.
- One week’s pay per year of service is the most common formula for severance payouts for plans covering the largest number of employees (not the CEO); however, two in 10 companies use two weeks’ pay per year of service
- Ninety-five percent of the respondents have indicated that “years of service” is the primary basis for calculating the severance benefits.
- The anecdotal trend of employers offering outplacement is evidenced in the survey results: 75 percent of responding organizations provide outplacement benefits to all affected employees.
- Most companies rely on years of service as the basis for calculating the severance benefit (94%) for plans covering the largest number of employees (except the CEO).

- About half of surveyed organizations do not offer a COBRA subsidy to severed employees, but three in 10 provide a complete subsidy and two in 10 provide a partial subsidy.
- Executives commonly receive a lump sum payment of severance that equals at least 12 months of their monthly salary.

Survey Results

Basic Severance Plan Structure

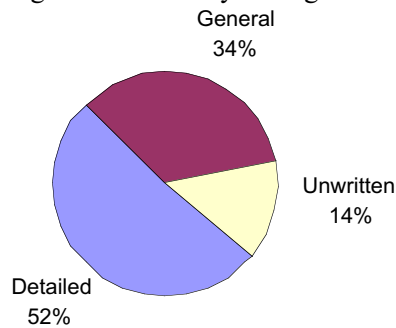
Although it varies fairly considerably, the most common (36%) severance structure at organizations at the end of 2003 was to have one severance plan for the top executive, a different plan for officers and executives, and a third plan for all other employees. An additional 13 percent reported a similar two-tiered structure of one plan for the top executive and one plan for the rest of the employees. Another way of stating this is that a fairly sizeable percentage (49%) of companies have a separate severance plan for CEOs. Almost one out of five in the survey (18%) does not have a severance plan.

Figure 1: “Which of the following best describes the coverage of your organization’s severance plan or plans?”

One plan for CEO, one for executives, one for all other employees	36%
No severance plan	18%
One plan for CEO, one for all other employees	13%
One plan for all employees	11%
Other	22%

Among those with a severance plan or plans, slightly more than half (52%) described their plan or plans as “detailed.” About a third (34%) said their plan or plans were mostly “general” in nature, in other words, not detailed. Finally, 14 percent said their plan or plans were unwritten or undocumented.

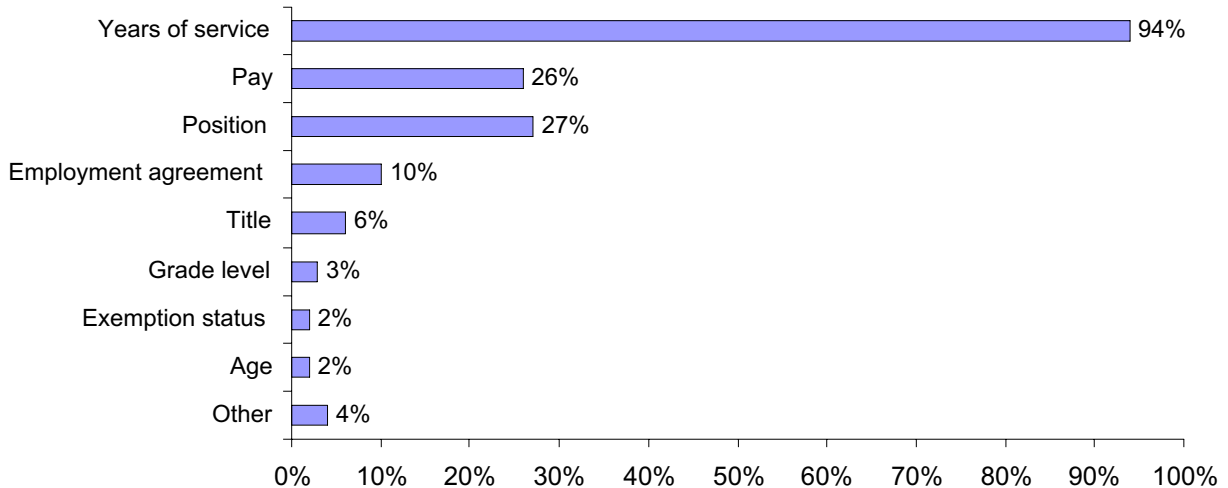
Figure 2: “Which of the following best describes your organization’s severance plan or plans?”



Calculation of the Severance Benefit

Most companies (94%) use “years of service” as a determinant for the severance benefit for plans that cover the largest number of employees (not the CEO). Position and pay levels were the next most common factors for determining severance, but they trailed far behind at 27 percent and 26 percent, respectively.

Figure 3: “Regarding the severance plan that covers the largest number of employees (not the CEO plan), what is/are the basis for calculation of severance benefit? (Check all that apply.)”



The most common formula employed (37%) is one week of salary for every year of service the employee has provided to the employer. But there is considerable variation regarding formulas for severance – the second most common answer was “other” at 33 percent and answers ranged considerably, from simply “two weeks’ pay” to complicated formulas and scaled payouts. Twenty-two percent of employers indicated a more generous two weeks of salary per year employed formula. A small minority of employers uses a generous calculation of a month of salary per year of service as the formula.

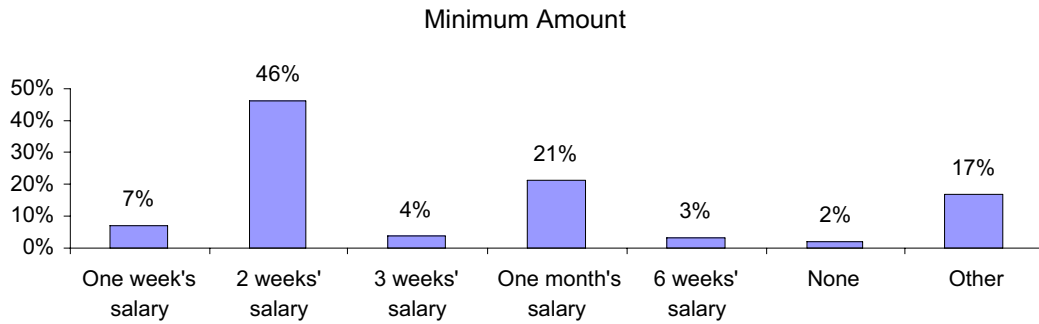
Figure 4: “Regarding the severance plan that covers the largest number of employees, what is your current formula for determining the amount of cash severance?”

One week/year service	37%
Two weeks/year service	22%
One month/year service	2%
No formula	5%
Other	33%

Minimum and Maximum Amounts of Cash Severance

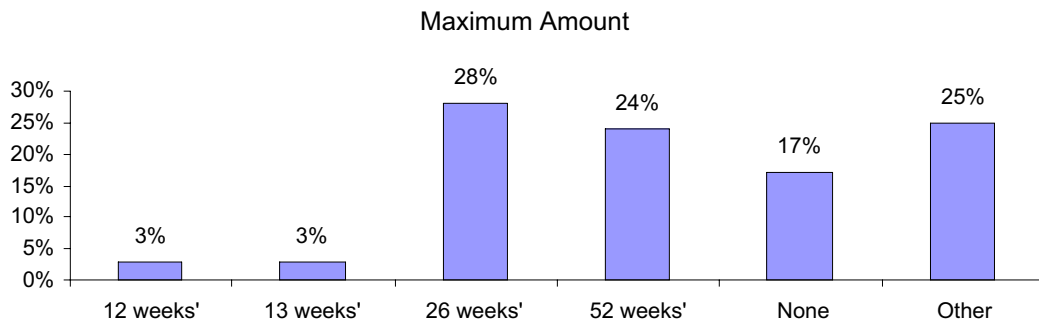
Two weeks' salary (46%) or one month of salary (21%) were the most common minimum amounts of cash severance; 26 weeks (28%) and 52 weeks (24%) were the most common maximum amounts of cash severance for the non-CEO plan.

Figure 5: "What is the minimum amount of cash severance that can be provided to an employee covered by the severance plan (not the CEO plan)?"



As noted above, the most common maximums were either 52 weeks or 26 weeks, but a fairly high percentage (25%) chose "other."

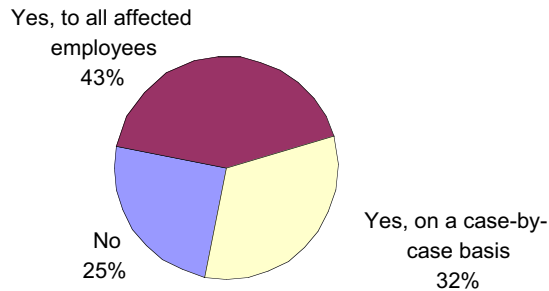
Figure 6: "What is the maximum amount of cash severance that can be provided to an employee (not the CEO plan)?"



Outplacement Benefits

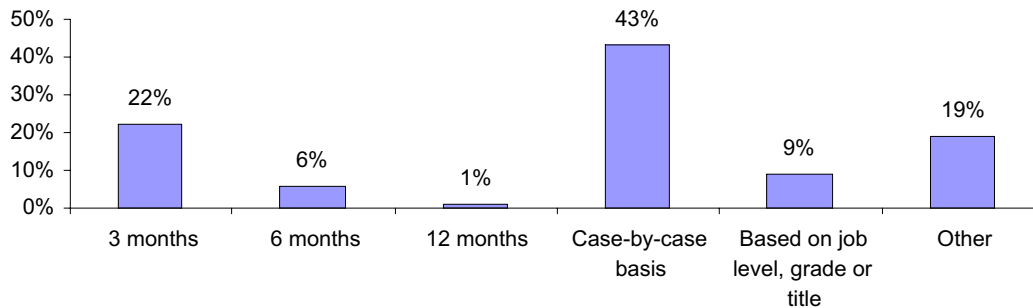
The anecdotal evidence of employers offering outplacement seems to be supported by the survey. Only 25% of responding employers offer no outplacement benefit to employees below the CEO who are severed from the organization. The largest percentage of employers (43%) provides outplacement service to all affected employees; about 32 percent say they provide it on a case-by-case basis.

Figure 7: “Regarding the severance plan that covers the largest number of employees (not the CEO plan), do you provide outplacement benefits to those affected by a reduction in force/layoff?”



Among those who offer outplacement, three months (22%) is the most common length of outplacement benefits.

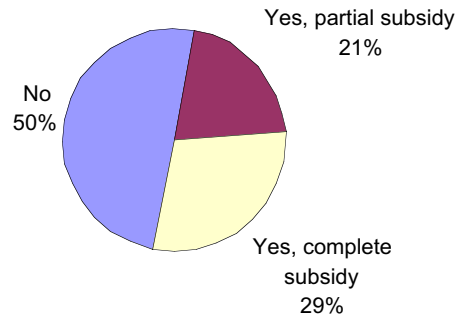
Figure 8: “If you provide outplacement benefits, what is the duration of the benefit?”



COBRA Subsidy

While about half of all organizations do not provide any – even partial – COBRA subsidy for employees who are severed from service, the other half provide either partial or complete subsidy. Twenty-nine percent provide a complete subsidy for a certain period of time, while an additional 21 percent provide a partial subsidy for a time.

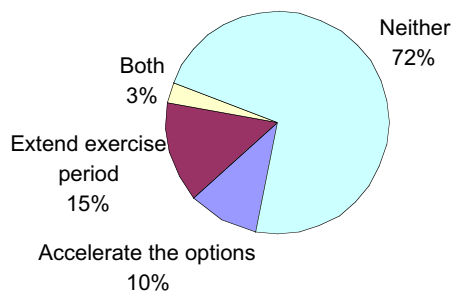
Figure 9: “Regarding the severance plan that covers the largest number of employees, does your organization subsidize any portion of COBRA coverage?”



Handling of Stock Options

Among those companies that issue stock options, when faced with a severance situation, the vast majority (72%) neither accelerate the options nor extend the exercise period. Extending the exercise period could have obvious financial implications to the company in an option-expensing environment.

Figure 10: “If your organization issues stock options, do you either accelerate the options or extend the exercise period in a severance situation?”



Review of Severance Plan

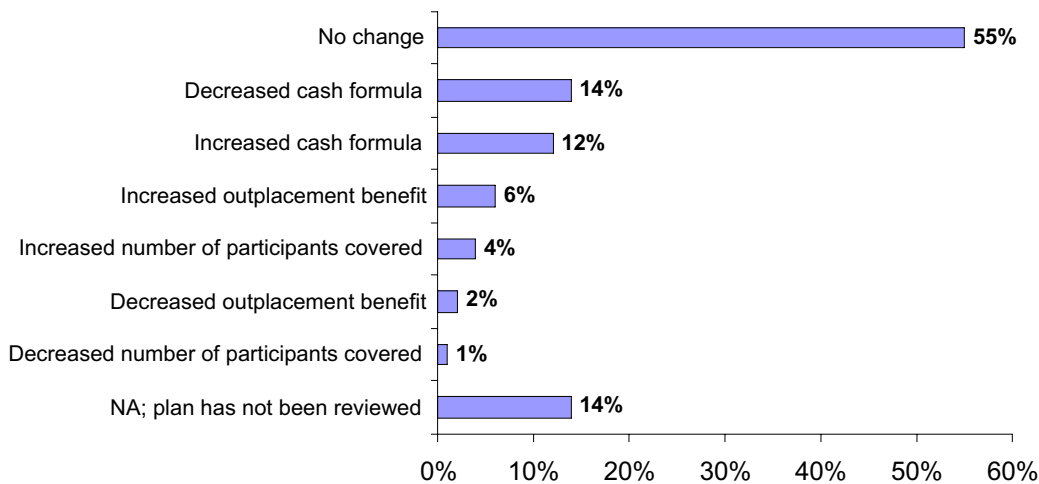
A potential “call to action” in the data is that 56 percent of the respondents have not reviewed their severance plan, either within the past year or since it was established.

Figure 11: “When was the last time your organization conducted a formal review of severance plan/policy that covers the largest number of employees?”

Within last 12 months	44%
Between 12 and 24 months	23%
More than 24 months ago	18%
Not since it was established	15%

Among those who have reviewed their severance plan since it was established, more than half (55%) indicated that they made no change.

Figure 12: “During the most recent review of the severance plan that covers the largest number of employees, what (if anything) was changed? (Check all that apply.)”



Similarly, 79 percent of respondents reported that they do not have a regular schedule of severance plan review, that it occurs when needed. This might be a risky practice for some companies, given the recent signs that the M&A market may begin to heat up in earnest again.

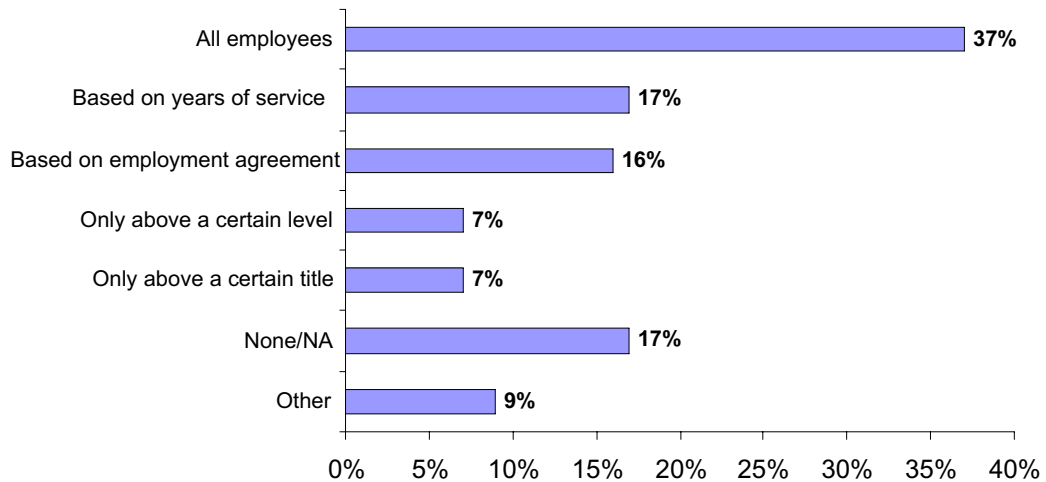
Figure 13: “Which of the following best describes how often your organization reviews the severance plan and policies for the largest number of employees?”

No schedule, as needed	79%
Every year	8%
Every other year	6%
Every three years	5%
Every five years	2%

Change-in-Control (CIC)

CIC policies are generally based on title, years of service, employment agreement (presumably top executives only) or above a certain level or title. More than a third in the survey (37%) indicate that all employees are eligible for severance in the event of a CIC.

Figure 14: “In a CIC situation in your organization, who is eligible for severance? (Check all that apply.)”



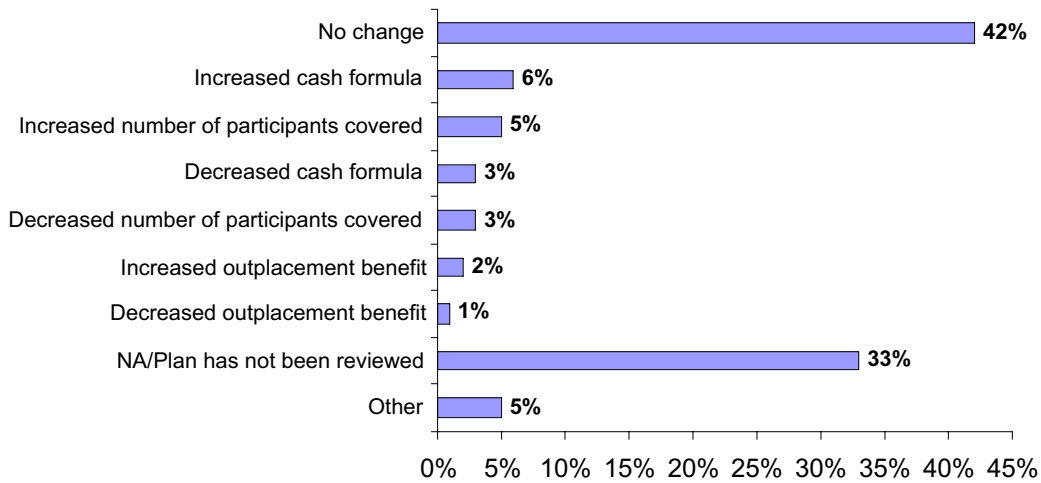
In addition, almost half of all respondents (44%) have not reviewed their CIC policy since it was first established. Like the lack of review of severance, this too might be a risky situation for some companies, given the rapid, varied and sweeping changes in business over the past few years.

Figure 15: “When was the last time your organization conducted a formal review of your CIC policy?”

Within last 12 months	27%
Between 12 and 24 months	14%
More than 24 months ago	16%
Not since it was established	44%

A fairly high number of respondents (42%) made no change to the CIC policy when it was most recently reviewed.

Figure 16: “When the most recent CIC policy review was conducted, what (if anything) was changed regarding severance? (Check all that apply.)”



Almost nine out of ten respondents (86%) have no schedule for reviewing their CIC policies. Again, this might be a risky situation because the covered executives may be more at risk when the M&A environment begins to heat up again.

Figure 17: “Which of the following best describes how often your organization reviews CIC policies?”

No schedule, as needed	86%
Every year	6%
Every other year	4%
Every three years	3%
Every five years	1%

Executive Severance Plans

When asked whether or not their organization “grosses-up” (that is, increases the amount of payment to provide a net amount which, in effect, offsets the tax), a 72 percent majority indicated that they do not “gross-up.” Twenty-three percent, however, provide a full “gross-up.”

Figure 18: “Do you gross-up any executives for the Golden Parachute excise tax if it occurs?”

Yes	23%
No, cut back compensation to level that excise tax does not apply	5%
No	72%

Although practices vary widely, the single largest percentage of companies (25%) provide their top executive with 12 months of pay in the event of severance. The second largest percentage (15%) provides their top executive with 24 months of salary in the event of a severance that does not result from a CIC situation.

Figure 19: “How many months of salary would your top executive receive in the event of a non-CIC severance?”

6 months	8%
12 months	25%
18 months	4%
24 months	15%
36 months	12%
Per agreement/case-by-case basis/no plan	16%
Other	20%

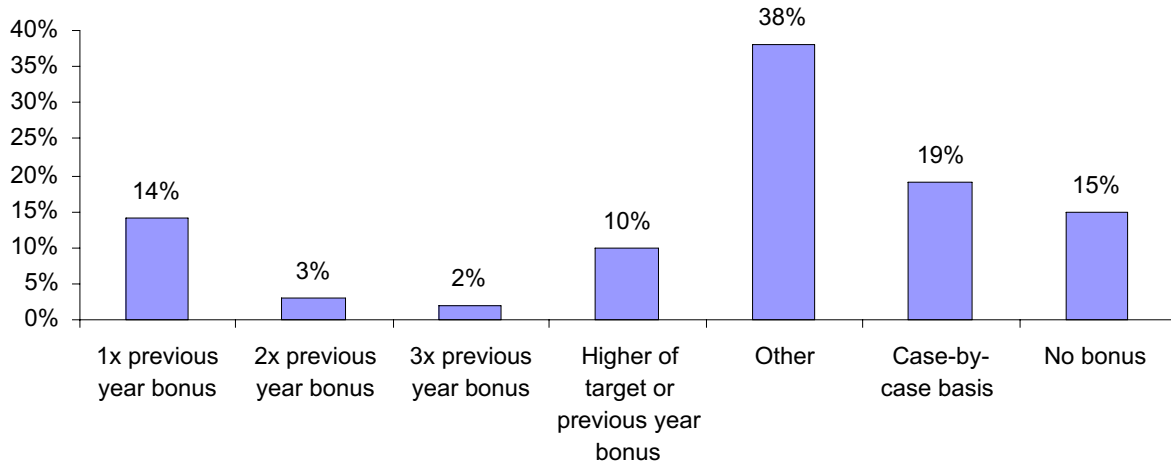
Forty-three percent of employers pay severance to their top executive in a lump sum in the event of a severance that is not from a CIC situation. This supports the notion that many top executives are interested in a fairly quick withdrawal of funds upon their departure even though the tax burden is substantial.

Figure 20: “How would the top executive's severance be paid out in a non-CIC situation?”

Lump sum	43%
_ upon severance, _ upon meeting terms of severance agreement	3%
Two annual installments	1%
Three annual installments	1%
More than three installments	3%
None/per agreement/case-by-case basis	12%
Normal payroll cycle	21%
Other	15%

Nearly three-quarters (72%) in the survey indicate that they do not make payouts of bonus payments as part of the severance in a non-CIC situation based all or in part on the previous year's bonus.

Figure 21: “How would the top executive's bonus be calculated as part of the severance in a non-CIC situation?”



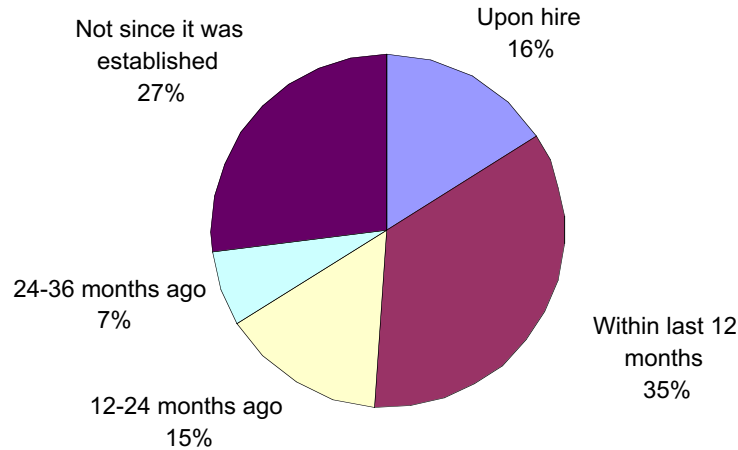
Finally, 65 percent of respondents said that their organization provides a continuation of at least some duration for both health and dental coverage for their top executive in the case of severance (non-CIC situations).

Figure 22: “In the event of a non-CIC severance of the top executive, which of the following would be continued for any period of time?”

Both health and dental coverage	65%
Neither	15%
Health coverage only	8%
Unsure	11%

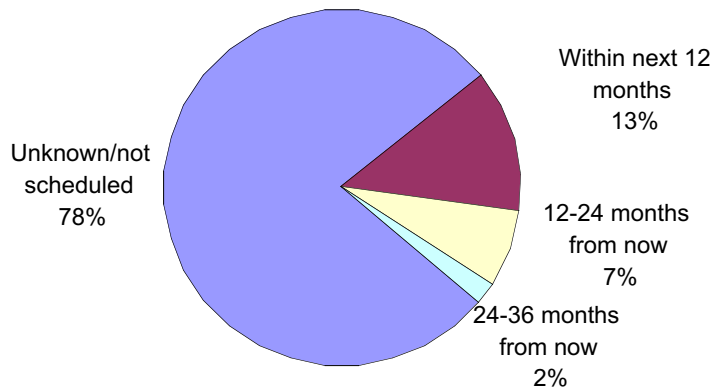
While only 22 percent have reviewed the top executive’s severance plan within the past one to three years, more than a quarter of respondents (27%) have not reviewed their top executive’s severance plan since it was established (although in some cases, it may have been established during the past three years).

Figure 23: “When was the top executive's severance plan last reviewed?”



More than three-quarters of respondents (78%) do not have a schedule for review of the top executive’s severance plan.

Figure 24: “When will the top executive's severance plan next be reviewed?”



Respondent Demographics

Reduction in Force

Although it is not a demographic question per se, the survey asked respondents about recent reductions in force to gain an insight into how many in the survey had recently dealt with severance issues. Seventy-six percent of respondents reported experiencing a reduction in force (layoff) in the past 24 months. The more typical demographic data are presented below.

Organization Type

Publicly-traded	48%
Privately-held	33%
Non-profit, charitable or educational	13%
Public sector/government	6%

Organization Size

Fewer than 100 employees	8%
100 to 499	14%
500 to 999	8%
1,000 to 2,499	17%
2,500 to 4,999	16%
5,000 to 9,999	12%
10,000 to 19,999	8%
20,000 and over	17%

Industry

Manufacturing	25%
Professional, scientific and technical services	11%
Finance and insurance	14%
Utilities	7%
Health care and social assistance	6%
Information (includes publishing – electronic and print, IT, etc.)	6%
Public administration	5%
Other services (except public administration)	4%
Educational services	3%
Retail trade	3%
Accommodation and food services	1%
Arts, entertainment and recreation	1%
Management of companies and enterprises	1%
Real estate, rental and leasing	1%
Transportation and warehousing	1%
Wholesale trade	1%
Other	10%

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