The New Executive Bonanza: Retirement

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By Eric Dash
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WHEN Vance D. Coffman retired as chief executive of Lockheed Martin last August, the company wanted to show a little gratitude. So the board endowed a $1.5 million professorship at Iowa State University, Mr. Coffman's alma mater, to honor his steady leadership over 37 years. It also agreed to foot the bill for various expenses, like his country club membership and use of company aircraft, until he steps down as chairman this month at the age of 61.

Those perks, however, are pocket change compared with the pension that Lockheed, the military contractor, bestowed upon Mr. Coffman a few weeks ago: a $31.5 million lump-sum payment.

Everyone knows that chief executives are paid huge amounts of money while they are working. Less known is just how much they make in retirement. At many of America's biggest corporations, it is not uncommon for retired executives who were paid tens or even hundreds of millions of dollars during their tenures to receive $1 million or more in pension benefits every year - for as long as they live.

Some will take home much more. Henry A. McKinnell Jr., the chairman and chief executive of Pfizer, will be paid about $6.5 million a year after he retires, according to the company's annual proxy statement filed last month. Lee R. Raymond, Exxon Mobil's chief executive, can expect $5.9 million a year.

At a time when millions of American workers have seen their pension plans pared back or shut down, and millions more are being asked to bear the risk of managing their own retirement savings, departing chief executives are making out better than ever. A total of 113 chief executives can anticipate retirement benefits worth more than $1 million a year; at least 31 may get twice that amount, or more.

Those findings are based on a review of the 2004 proxy statements of 500 large companies done for Sunday Business by the Corporate Library, an independent corporate-governance research firm. More than two-thirds of those companies - 339 - have separate retirement plans for executives only. These special plans, called supplemental executive retirement plans, or SERP's, usually offer better benefits than traditional pension plans and are sometimes guaranteed regardless of the fate of the company itself. And these executive pension plans are often in addition to the subsidized 401(k) and defined-benefit plans available to other employees.

Unlike a chief executive's salary or stock options, the cost of these executive pension plans is rarely laid out for shareholders. Instead, the information is usually so deep in a company's regulatory filings that it is difficult to find, let alone calculate. Critics call it "stealth wealth" or "camouflage compensation." Many ordinary investors don't have a clue about its cost.

"The fact is, we don't have good economic reasons for channeling dollars for this form," said Lucian A. Bebchuk, a Harvard Law School professor and co-author with Jesse Fried of a recent book, "Pay Without Performance." "There is a clear benefit in terms of making the amount of pay less transparent."

As Michael Kenser, an executive compensation consultant at Deloitte & Touche, put it: "If you wanted to deliver extra compensation and you wanted to do it below the radar screen, you did it through the SERP."

WHETHER or not the goal is to hide extra compensation, though, the amounts can be large. Consider Mr. McKinnell, 62, the chief executive of Pfizer and the chairman of the Business Roundtable, an organization of chief executives from prominent companies. If he steps down from Pfizer in three years, as expected, his supplementary pension benefits have an estimated lump-sum value of $80 million, Professor Bebchuk said. The typical executive retirement plan is based on average salary and bonus, as well as years of service; Pfizer's plan is based on certain long-term incentive awards and grants of restricted stock, too.

Of course, it's hard to decipher that from information in the proxy. But when those performance payouts and one-time awards of restricted stock are treated as annual pay, they greatly inflate the value of the pension. Without them, Mr. McKinnell would be entitled to only about $37 million in retirement.

"It goes against the logic of why a retirement plan is there at all," said Shekhar Purohit, an executive compensation consultant at the Delves Group in Chicago. "A retirement plan helps replace income. It's not wealth-creation replacement."

Pfizer's compensation committee discontinued the practice of counting long-term incentives and restricted stock at the end of 2000; the company no longer found it appropriate, a company spokesman said. Nonetheless, veteran Pfizer employees, including Mr. McKinnell, still fall under the company's old rules.

Certainly, compensation consultants say, chief executives are entitled to maintain their standard of living in retirement. In most cases, Social Security benefits and regular retirement plans would cover only a small fraction of their pay. That is one reason that supplementary retirement benefits have become such an important tool for recruiting a new executive in midcareer.

But many of the companies that offer supplementary plans are the same ones that pay executives so handsomely. William W. McGuire of the UnitedHealth Group took home more than $210 million in salary, bonus and stock-options gains in five years; Edward E. Whitacre Jr. of SBC Communications made nearly $104 million in the last decade. Each can expect retirement benefits worth more than $5 million a year.

"Given their compensation during their working life, it would seem that they, even more than the rest of us, would be able to provide for their retirement by deferring their income into savings," said Paul Hodgson, an executive compensation analyst at the Corporate Library, in Portland, Me.

UnitedHealth declined to comment. An SBC spokeswoman said Mr. Whitacre's pension reflects his long service and accomplishments.

The Corporate Library's analysis of executives' retirement benefits assumes that an executive's recent earnings remain the same. Because pay generally increases later in one's career, as do the years of service, it is likely that those benefits could be worth more.

Based on the latest available proxy information, at least eight executives are eligible to retire with annual benefits worth $3 million or more. They include Reuben Mark of Colgate-Palmolive, Robert L. Nardelli of Home Depot, Samuel J. Palmisano of I.B.M. and Kenneth D. Lewis of Bank of America. I.B.M. and Bank of America have recently been sued by workers over changes to their employee pension plans.

Not every chief executive can expect a pension quite that large. Of the 339 who will receive most of their retirement income from a supplementary employee retirement plan, roughly a quarter will become eligible for an annual pension worth $367,000 or less.

About a third of the 500 surveyed companies said senior managers were eligible to participate only in a defined-contribution plan like a 401(k), the same as any other employee. Those include many companies in the technology sector, like Cisco Systems, Microsoft and eBay, that have generously compensated top executives with stock options; those three offer no special executive retirement plans at all.

"We are by nature a very egalitarian company," said Hani Durzy, an eBay spokesman. "By and large, the benefits available to executives, while not the same amounts, are the same type available to everyone else."

Forty years ago, most corporate pension plans worked that way. Upon retirement, everybody from the lowest-paid worker to the highest-paid manager was covered by a pension that would provide guaranteed benefits. Typically, those were half the employee's final average salary for the rest of his or her life.

But in 1974, Congress passed legislation that required companies to adequately fund pensions they promised their employees, and to keep executive pensions roughly proportional to what the rank and file received, if they wanted a tax deduction for the plan. Congress had hoped to discourage companies from giving executives exorbitant retirement amounts.

Instead, the new rules encouraged companies to set up separate plans for their workers and their top executives, letting the employee plan keep its tax deduction - but opening the way for executives to ask for more in their supplemental plans, which did not qualify for the deduction. And because these nonqualified benefits did not have to be granted to all employees, it was easy for boards to allow bonuses and sometimes stock options and other incentives to creep into pension calculations.

As executive compensation soared in the 1980's and 1990's, so did such payouts. More companies started offering them, and because disclosure was so poor, the amounts went largely unchecked.

Only recently, amid fallout from the $139.5 million retirement package of Richard A. Grasso, the former New York Stock Exchange chairman, have boards started tallying all elements of a pay package.

"Compensation committees want to look at SERP's now because of the Grasso effect," said Ira T. Kay, an executive compensation consultant at Watson Wyatt in New York. "It used to be nonexistent. Now I have roughly half my companies doing it."

The results are often so startling, other compensation advisers say, that they have invented a term - the "holy cow" moment - to describe the look on directors' faces when they discover the payouts.

"Things pile up and it creeps up on you, and boom, there it goes: holy cow!" said Michael S. Melbinger, a compensation lawyer at Winston & Strawn in Chicago who advises many boards. "You don't realize when so many things, when added up, produce an outrageous total.

"There have been a lot of holy cow moments during this year's proxy season from compensation committees," he added. "Sometimes, they even use more colorful language."

Some of the surprises come from tweaks that may not initially appear to have significant costs. The employment contract of Franklin D. Raines, the Fannie Mae chief executive who was ousted last year, stipulated that his entire $1.4 million annual pension could be passed down to his wife, if she survives him. That provision alone accounts for $5 million of the pension's estimated value of about $25 million, Professor Bebchuk said.

At some companies, executives are allowed to retire at 60 rather than 65, or they are credited with more time at the company than they actually serve. Each of these tweaks can add considerably to an executive's lifelong retirement benefit.

E. Linn Draper Jr., the chief executive of the American Electric Power Company, was awarded 36 years pension credit when he stepped down in February 2004, which was enough time to almost triple the value of his annual pension, to about $850,000. Problem is, Mr. Draper had been a company employee for only 12 years.

A company spokesman said that awarding extra credit for years served is consistent with industry practice and necessary for recruitment and retention.

STILL, changes are afoot. United Airlines, which has said it must terminate its defined-benefit plan for regular employees if it is to emerge from bankruptcy, recently ended its special plan for executives. Nonetheless, the $4.5 million worth of retirement benefits for Glenn F. Tilton, UAL's chairman and chief executive, who was ineligible for the main executive plan, has remained safe in a special, fully funded trust. And Bank of America has stopped contributing to its supplementary plan for most executives, though Mr. Lewis, its chief executive, will still receive at least a $3.5 million pension.

Since at least last fall, the Securities and Exchange Commission has been reviewing its disclosure policies related to SERP's, though it has set no timetable for deciding whether to rewrite the rules. Some shareholder rights advocates, like the A.F.L.-C.I.O. and the Council of Institutional Investors, are not waiting; they have placed the issue high on their corporate governance agendas. In anticipation, several companies, like the credit card giant MBNA, have added tables to their proxies that make identifying the cost of an executive's retirement benefits as easy as finding his salary or bonus.

But for now, the retirement years for many of today's executives look like they will be as green as they are golden. Consider Mr. Coffman, the Lockheed Martin chief executive. Should his $31.5 million nest egg become depleted, he has another source of income to fall back on: Under the company's ordinary retirement plan, he is eligible to receive $87,187 a year.