Putting Stock in Benefits: How Prevalent Is It?

Benefits that provide workers with stock or that invest in stock are becoming more prevalent; BLS captures data on some of these plans and is conducting research on those plans not currently captured.

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The BLS National Compensation Survey (NCS) provides a diverse set of measures of employee compensation.[1] Many factors go into the computation of these statistics, including wage rates, hours worked, number of workers receiving certain benefits, and the cost of those benefits. Employers provide a variety of benefits, such as insurances, time off arrangements, and retirement plans. Recently, analysts have been especially interested in one particular class of compensation—plans that invest in or provide workers with company stock. [2]

Such "equity compensation" plans are not new, although the variety of plans that use stock has expanded in recent years, especially since the introduction of section 401(k) of the Internal Revenue Code in 1978. The National Compensation Survey (NCS)—an integrated program designed to estimate local, regional, and national wage rates, the cost of wages and benefits to employers, the share of workers receiving various benefits, and the details of benefit provisions—currently collects some data on stock-related benefit plans, if such plans are qualified defined contribution plans as specified by the Internal Revenue Code.

The remaining discussion in this article details the current treatment of stock-related plans. (See table 1.) Of particular interest is the treatment of these plans in employer cost estimates. The article also explores the concern that the exclusion of certain types of stock plans may result in incomplete compensation data, and outlines the research the Bureau of Labor Statistics has sponsored to include additional forms of stock-related compensation in its data.[3]

Stocks and the Employment Cost Index

The Employment Cost Index (ECI), one of the components of the National Compensation Survey, was first published in 1975, reporting on changes in employer cost for wages and salaries in private industries. Throughout its 25-year history, the index has been expanded and revised in an effort to capture current compensation practices. Benefits were added to the index in 1980, and State and local government workers were added in 1981. In addition, benefit definitions have been refined and updated throughout the period. For example, in the early 1990s, changes to the retirement definition were made to ensure that the rapidly

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TABLE 1. **Benefit plans that provide for or invest in stock, and their treatment in various compensation measures by the National Compensation Survey**

Type of plan	Included in measures of employer compensation costs	Data available on percent of workers eligible for or participating in the plan	Data available on detailed plan provisions
Savings and thrift	X	X	X
Money purchase pension	X	X	
Deferred profit sharing	X	X	X
Employee stock ownership plan	X	X	
Stock bonus	X	X	
Simplified employee pension	X	X	
Stock purchase		X	
Stock option		X	
Defined benefit pension	X	X	X

growing incidence of defined contribution plans was properly recorded.

Defined contribution plans. Currently, only those plans involving stock that are qualified as defined contribution plans for Federal tax purposes are included in the ECI. For example, 401(k) plans in which the employer matching contributions are invested in company stock are included in the ECI; such plans are qualified defined contribution plans.

For purposes of computing the ECI, the cost of defined contribution plans typically is determined by obtaining the employer's contribution, without regard to the potential investment of these funds in company stock or some other investment vehicle. For example, consider a plan that allows employees to contribute up to 10 percent of earnings, with the employer matching one-half of the first 6 percent of earnings contributed by the employee. In such a plan, the maximum contribution by the employer is 3 percent of employee earnings (one-half of the 6-percent employee contribution) or about $1,200 in the case of a worker earning $40,000 per year. As wages change, the change in employer contribution would be captured by the survey. Similarly, if the plan provisions change, any resulting change in employer cost would be captured. These data are recorded for the ECI and the estimates of employee compensation cost, regardless of how the employer funds are invested. (See table 2.) As discussed below, such employer funds often are invested in employer stock.

TABLE 2. **Employer costs per hour worked for employee compensation, and costs as a percent of total compensation, civilian workers, March 2000**

Compensation component	Employer cost	Percent of total compensation
Total compensation	$21.16	100.0
Wages and salaries	15.36	72.6
Total benefits	5.80	27.4
Paid leave	1.42	6.7
Vacation	.65	3.1
Holiday	.48	2.3
Sick leave	.21	1.0
Other leave	.07	.3
Supplemental pay	.55	2.6
Premium pay for overtime	.22	1.0
Shift differential	.05	.2
Nonproduction bonuses	.28	1.3
Insurance	1.36	6.4
Life insurance	.05	.2
Health insurance	1.25	5.9
Short-term disability	.04	.2
Long-term disability	.03	.1
Retirement	.77	3.6
Defined benefit	.43	2.0
Defined contribution	.34	1.6
Legally-required benefits	1.67	7.9
Social Security	.98	4.6
Medicare	.25	1.2
Federal unemployment insurance	.03	.1
State unemployment insurance	.09	.4
Workers' compensation	.33	1.6
Other benefits	.03	.1

The defined contribution plans described in the preceding discussion are considered savings and thrift plans by the National Compensation Survey. Other types of defined contribution plans are deferred profit-sharing plans, money purchase plans, employee stock ownership plans (ESOPs), stock bonus plans, and simplified employee pensions (SEPs). (See box for definitions of these plans.) Regardless of how funds are invested, the employer's contributions to these plans are included in the ECI. Use of the company's own stock is almost universal in ESOPs and stock bonus plans but is also found in other defined contribution arrangements.

Defined benefit plans. Investment in employer stock also may occur indirectly through a defined benefit pension plan; such plans are also included in the ECI. Defined benefit plans

TABLE 3. **Percent of full-time employees participating in selected retirement programs, by size of establishment, private industry, 1996-97**

Benefit	Total	Small establishments, 1996[1]	Medium and large establishments, 1997[2]
All retirement plans	62	46	79
Defined benefit pension	32	15	50
Defined contribution	47	38	57
Savings and thrift	31	23	39
Deferred profit sharing	13	12	13
Employee stock ownership	3	1	5
Money purchase pension	6	4	8
Simplified employee pension	1	1	([3])

[1] Small private establishments are those employing fewer than 100 workers.

[2] Medium and large private establishments are those employing 100 workers or more.

[3] Less than 0.5 percent.

NOTE: The sum of items may not equal the totals because some employees participate in more than one type of plan.

specify a formula for computing retirement benefits, typically based on earnings and service. The cost of such plans is the amount that must be contributed to the plan in a given period to meet the actuarial standards imposed by law. The ECI typically captures the employer contribution to the plan (to meet the actuarial standards) plus any administrative cost of operating the plan (including Pension Benefit Guaranty Corporation premiums).[4] The plan sponsor (typically the employer) bears the burden of providing sufficient funds to pay future benefits; the plan sponsor invests plan assets to increase plan funds. Defined benefit plan assets may be invested in part in employer securities, but all of the investment activities are subject to strict fiduciary standards. Among the limits imposed on the investment of defined benefit plan assets is a restriction that no more than 10 percent of such assets may be invested in employer assets, such as employer stock.[5] As was the case for defined contribution plans, the ECI captures plan costs regardless of how plan assets are invested.

Excluded plans. Some types of stock-related plans are not currently included in the ECI because they are not tax-qualified defined contribution plans. Stock-option plans grant employees the right to purchase stock at a fixed price some time in the future. Stock options come in a variety of forms (see box). Also excluded from the ECI are stock purchase plans, which provide employees the opportunity to purchase company stock at a discount. The Bureau's continuing research into these plans is discussed at the conclusion of this article.

Stocks and benefits

The National Compensation Survey also measures the percent of workers who receive a range of benefits, including several types of defined contribution plans and other equity-related plans. (See table 3.) In 1997, nearly half (47 percent) of full-time workers in private industry participated in a defined contribution plan. Most prevalent were savings and thrift plans, with 31 percent of full-time workers participating. As noted earlier, such plans require an employee contribution, typically on a pretax basis under the provisions of Internal Revenue Code section 401(k). Employers then match some or all of the employee contributions. The combined employee and employer funds are placed in an individual account for the employee, and can be invested in a variety of ways.

Of the workers participating in savings and thrift plans,[6] 87 percent could choose how their funds were invested and 65 percent could choose how the employer's matching funds were invested. The employee usually was given four or five investment choices. About half of those who could invest their own contributions had the option of investing in company stock. The other choices included common stock funds, bond funds, government securities, and guaranteed investment contracts. Typically, plan participants who were allowed to choose their own investments could divide those investments in any manner. About half of them could make changes to the investment mix at any time; the remainder were restricted to making changes at certain times of the year. (See table 4.)

Employees were less likely to have investment choices for employer matching contributions. If workers did not have a choice, the employer contributions typically were invested in employer stock; if workers had a choice, company stock was available less often as an option. Other options for investment of employer matching contributions were similar to the options for employee contributions, such as common stock funds and guaranteed investment contracts.

There are some legal limits on the use of employer equity for defined contribution plan investment. For defined contribution plans that do not allow employees to invest their own contributions—these involve only a small percent of plan participants—there is a 10 percent limit on investment in employer securities, as required by the Taypayer Relief Act of 1997. However, this restriction does not apply if all of the assets in the account do not exceed 10 percent of the combined assets of all employer-sponsored pension plans. Thus, if the plan does not repre-

TABLE 4. **Percent of full-time employees participating in savings and thrift plans, by details of investment provisions, medium and large private establishments, 1997**

Provision	Employee contributions	Employer contributions
Permitted to choose investments	87	65
Number of investment choices:		
Two or three	13	10
Four	21	14
Five	14	10
Six	8	5
Seven	8	6
Eight	7	5
Nine or more	10	8
Not determinable	6	6
Method of allocating investment choices:		
Any multiple	42	34
Specified multiples	37	23
Other or not determinable	9	8
Frequency of change of investments:		
At any time	47	36
Specified times	32	22
Other or not determinable	8	7

TABLE 5. **Percent of full-time employees participating in savings and thrift plans, by ability to choose investments, medium and large private establishments, selected years, 1985-97**

Provision	1985	1989	1993	1997
Employee contributions:				
Investment choice	90	90	86	87
Choice of company stock	70	60	48	42
Employer contributions:				
Investment choice	48	53	58	65
Choice of company stock	61	50	38	25

sent more than 10 percent of total pension assets, there is no restriction on investment in employer stock.[7]

If a plan allows the employee a choice of investments, the law requires the plan's sponsor to "provide a participant or beneficiary an opportunity to choose from a broad range of investment alternatives." According to the U.S. Department of Labor regulations derived from this law, a plan is in compliance with the "broad range" clause if the participant has a reasonable opportunity to:

- materially affect the potential return
- choose from at least three investment alternatives
- diversify the investment[8]

An example of the risk associated with investing defined contribution plan assets in employer stock came to the public's attention in 1996, when the Color Tile Company filed for bankruptcy. The company's 401(k) plan was invested largely in company stock, which lost much of its value when the company had financial trouble. In such cases, risk of investment performance is borne by the employees.[9] As noted by the U.S. Department of Labor advisory committee on pension plans, "Gains and losses are borne by participants regardless of whether the participants have a choice in the investment of their holdings."[10]

NCS data on savings and thrift plan investment options reveal an increase in the percent of plan participants who can direct the investment of employer matching funds, and a decrease in the availability of employer stock as an investment option. While the ability to choose investments of employee contributions remained widespread, the percent of participants who could choose the investment vehicles for employer contributions rose from 48 percent in 1985 to 65 percent in 1997. The availability of employer stock as an investment option for both employee and employer funds declined throughout the same period. (See table 5.)

Less common plans. Other types of defined contribution plans are less prevalent and are often more restrictive regarding investment choices. In 1997, only 13 percent of full-time employees in larger private establishments participated in *deferred profit sharing plans*; in these plans, employer profits typically are shared with employees without regard to employee contribution (although the employee may be allowed to make a voluntary contribution). About two-thirds of workers covered by this type of plans were given a choice of investments, which included employer stock.

Money purchase pension plans. Participants in these plans totaled 8 percent of full-time employees in larger private establishments. In this type of plan, the employer contributes a fixed percent of employee earnings (such as 2 percent or 3 percent), which is placed in an individual employee account. Often employees do not have the option of contributing their own funds to these accounts. Typically, employers make the investment decisions, although if that is the case, the plan would be subject to the investment restrictions of the Taxpayer Relief Act, as noted above.

Employee Stock Ownership Plans (ESOP). Participants in ESOPs totaled 4 percent of full-time employees in large private establishments. These plans are designed for investment in employer stock, although specific diversification rules apply to older workers.

Definitions of Benefit Plans that Provide or Invest in Stock

Defined contribution. A general category of plan that is qualified by the Internal Revenue Service. These plans are characterized by individual accounts, with the contribution typically determined by some formula. The resulting benefit to the employee is based on the contribution and the earnings on that contribution. In the National Compensation Survey, such plans are classified as one of the following types: Savings and thrift, money purchase pension, deferred profit sharing, employee stock ownership, stock bonus, or simplified employee pension.

Savings and thrift plans. An employee chooses to contribute an amount, typically a percent of earnings. Employee contributions are often pretax, under provisions of section 401(k) of the Internal Revenue Code. The employer matches some or all of the employee contribution.

Money purchase pension. An employer contributes an amount based on a stated formula, typically a percent of earnings. Employee contributions are not required, but voluntary contributions may be allowed. At retirement, the value of the employee's account may be paid in a lump sum or used to purchase an annuity.

Deferred profit sharing. A portion of employer profits is designated to be placed in the plan. Those profits are then allocated to employees based on a predetermined formula, often based on earnings. Employee contributions are not required, but voluntary contributions may be allowed.

Employee stock ownership plans (ESOPs). The employer pays a designated amount to a fund that is primarily invested in company stock. There are periodic distributions from this fund to individual accounts, often based on a formula. These plans may be related to money borrowed to purchase a company.

Stock bonus plans. The employer pays into a trust that invests in securities, including those of the company. Proceeds are distributed to each employee's account, in the form of company stock.

Simplified employee pensions (SEPs). The employer invests funds in an account at a financial institution in the name of each employee. The employee can control the investment of the funds, much like an individual retirement account. The employee may be allowed to make voluntary contributions to the account. Access to the account follows the rules for individual retirement accounts, imposing tax penalties for receipt of funds prior to retirement age.

Stock purchase plans. Employees can purchase shares of company stock at below-market price. Employees receive the stock immediately. The employer does not set up an account, nor does the employer control the stock.

Stock option plans. The employer grants the employee the right to purchase shares of company stock at a given price over a given time period. A Non-Qualified Stock Option is taxable as wages when exercised by the employee; an Incentive Stock Option is not taxable to the employee or deductible by the employer either when granted or exercised. A taxable event occurs when the stock acquired under the option is sold, exchanged, or transferred by bequest or inheritance. Stock Appreciation Rights provide employees with the gain between the grant price and the market price of an option, without requiring employees to purchase the stock.

Defined benefit pension. The employer guarantees a periodic benefit at retirement, typically based on salary and years of service. Employers contribute sufficient funds into the plan to pay future benefits.

For example, participants aged 55 with at least 10 years of service are allowed to diversify the investments of 25 percent of the value of their ESOP account.[11]

BLS data from 1993 indicated that stock options were offered to fewer than 1 percent of full-time workers in larger establishments. The same survey also indicated that 2 percent of full-time workers were offered a plan allowing them to purchase employer stock at a discount (stock purchase plan).

Over the 1996-97 period, 32 percent of full-time workers in private industry participated in defined benefit plans. As noted, these plans specify the formula for computing retirement benefits, such as 1.5 percent of final-year earnings times years of service. The investment of defined benefit plan assets typically is the responsibility of the plan sponsor, subject to restrictions on investments in employer assets.

Ongoing research

Because of the heightened interest in stock options, brought on in part by rises in the stock market, the tight labor market, and the increased use of variable pay,[12] BLS is conducting a number of tests regarding the treatment of stock options in its measures of compensation. The first was a feasibility test of 100 employers selected because they offered stock options. The test was intended to gauge the design and content of the survey questionnaire and to determine if a mail survey was appropriate for collecting data on stock options. The results indicated that such data typically are available, and that there are different types of stock option plans and different criteria for granting stock options. Also, the test provided information about where details on stock options could be found within a company (typically, they are available from the finance or accounting department). This information will be useful in further testing of this topic.[13]

The second test was a survey of a statistically valid national sample of about 2,000 establishments, the results of which were published in October

2000. Its purpose was to determine the *incidence* of stock options and related plans, and to identify the groups of workers to whom these plans are offered. Current data on the availability of stock options will help BLS to determine the potential impact of these plans on the National Compensation Survey. This test also collected limited information on other equity-related compensation. Test results may be found on the Internet at **http://stats.bls.gov/comhome.htm**.

The existing procedures for determining employer costs for compensation may be difficult to apply to stock options. As noted above, the ECI typically determines the cost of a benefit by capturing the amount of money the employer paid for that benefit during a given period. For example, the cost of a defined benefit pension plan is the amount the employer is required to contribute to meet future benefit obligations, plus any related administrative costs. This cost may fluctuate over time, depending on investment returns and other factors. It may, however, be more difficult to make a similar determination of the cost to the employer at the time a stock option is offered to employees. Furthermore, the future price of the stock and the point at which the employee may exercise the option are unknown. BLS is examining these issues, in consultation with experts in compensation and financial accounting. The Financial Accounting Standards Board, for example, has issued standards for incorporating the cost of stock options into employer financial statements.

After a method for calculating the cost of a stock option is determined, BLS must ascertain that such data will be available from employers and that the data can be updated periodically. The results of ongoing tests and research will be reported regularly in this periodical.

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[1] Detailed data and descriptions of the National Compensation Survey may be found in the following sources: "Employment Cost Index—December 1999," USDL 00-27 (Bureau of Labor Statistics, January 2000); *Employee Benefits in Medium and Large Private Establishments, 1997*, Bulletin 2517 (Bureau of Labor Statistics, September 1999); "Employer Cost for Employee Compensation—March 2000," USDL 00-186 (Bureau of Labor Statistics, June 2000); and *National Compensation Survey Occupational Wages in the United States*, Bulletin 2519 (Bureau of Labor Statistics, September 1999). All of these items are available on the BLS Internet site at **http://stats.bls.gov/comhome.htm**.

[2] See, for example, Justin Fox, "The Next Best Thing to Free Money," *Fortune*, July 7, 1997, pp. 52-62.

[3] See, for example, David Lebow and others, "Recent Trends in Compensation Practices," (Washington, Board of Governors of the Federal Reserve System, July 15, 1999).

[4] The Pension Benefit Guaranty Corporation is a Federal government agency charged with overseeing the financial solvency of defined benefit plans.

[5] See U.S. Department of Labor, Advisory Council on Employee Welfare and Pension Benefits Plans, *Report of the Working Group on Employer Assets in ERISA Employer-Sponsored Plans*, Nov. 13, 1997, p. 7, on the Internet at **http://www.dol.gov/pwba/public/adcoun/acemer.htm**, visited April 5, 2000.

[6] Detailed provisions of savings and thrift plans are based on data for full-time workers in medium and large private establishments (those with 100 workers or more).

[7] See *Report of the Working Group on Employer Assets in ERISA Employer-Sponsored Plans*, p. 7.

[8] See U.S. Code of Federal Regulations, 29 CFR 2550.404c-1.

[9] See *Report of the Working Group on Employer Assets in ERISA Employer-Sponsored Plans*, p. 2.

[10] Ibid, p. 3.

[11] See Internal Revenue Code section 401(a)28.

[12] Variable pay is a general term that refers to a variety of forms of compensation based on a worker's performance, such as bonuses and commissions.

[13] Beth Levin Crimmel and Jeffrey L. Schildkraut, "National Compensation Survey Collects Test Data on Stock Options," *Compensation and Working Conditions*, winter 1999, pp. 17-20.