

Severance and Change-in-Control Practices—2007

A Research Report
by WorldatWork
Innovative Compensation and
Benefits Concepts LLC (ICBC)
November 2007



research



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About Innovative Compensation and Benefits Concepts

Innovative Compensation and Benefits Concepts, LLC (rjones5335@aol.com) is an independent and objective consulting firm that specializes in representing Compensation Committees as an independent and knowledgeable advisor, developing Total Reward retention strategies, achieving better alignment of Human Resources programs with a Company's business strategy, designing more effective and competitive Compensation and Employee Benefit plans and acting as an independent ombudsman and third party opinion source.

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Introduction & Methodology

This report summarizes the results of a June 2007 WorldatWork member survey, conducted jointly by WorldatWork and Robert Jones, *JD, CPA, CEBS*, who is CEO of Innovative Compensation and Benefits Concepts LLC (ICBC), a global HR consulting firm.

This survey was conducted to analyze and enhance our understanding of variances in the change-in-control (CIC) and severance practices across various organizations in multiple industries. A random, representative sample of 4,590 WorldatWork members were asked about their general severance plans, CIC policies and severance for top executives via an e-mail invitation May 17, 2007, which contained a link to the online survey. When the survey closed June 20, 2007, 523 responses were received, an 11-percent response rate, which is considered a good response for detailed surveys of this nature.

This survey has been electronically conducted every two years since 2003 and, aside from some minor variations, questions have remained consistent throughout the three surveys. This report focuses on 2007 survey results and shows comparisons to 2005 and 2003 findings, where appropriate.

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 (523) and the total population is the WorldatWork membership of approximately 23,600, the survey’s margin of error should not exceed +/- 3 percent.

Executive Summary

The need for having severance and CIC plans that are current and the importance of reviewing them periodically has never been greater than it is today. With compensation committees increasingly using tally sheets, the new SEC disclosure requirements still requiring significant effort, investor groups’ initiatives gaining momentum, and the continued drumbeat by all constituents—investors, regulators and interested observers—that pay plans be more closely aligned with executive performance, the environment is creating even more heightened awareness of the governance responsibilities of boards of directors with regard to these types of plans.

“This survey fits in very well with the current enhanced interest of compensation committees in reviewing all aspects of the Total Rewards package for top

executives...and with WorldatWork's innovative research in regard to Total Rewards as well," said Robert Jones, the study's author.

The survey revealed that a greater number of companies than in prior years (42 percent versus 35 percent in 2005) offer a three-tiered structure for severance which includes the top executive, the next level of senior executives, and all other employees.

In addition, the environment for these types of plans continues to be fertile. While a majority, 58 percent, has experienced reductions in force in the past 12 months, a slightly greater number of employers than in the previous survey plan reductions in force for the next 12 months (32 percent compared to 28 percent in 2005), indicating further uncertainty in job security and in the economy.

On the other hand, there is no appreciable change in the number of organizations that have reviewed their plans recently (within the past 12 months)—39 percent to 37 percent for 2005—or have ever reviewed their plans—13 percent report never having reviewed their plans versus 12 percent for 2005's survey.

Years of service continued to be the most common criterion for severance, while one week/year of service continued to be the most common multiplier. The most common minimum amounts of cash severance are two weeks per year of service (42 percent), and one month (17 percent), respectively, while the most common maximums are 26 weeks (25 percent) and 52 weeks (20 percent).

A number of benefits continue to be prevalent in connection with severance and CIC features, including outplacement and COBRA health benefit supplements, to name two of them. For those who answered "yes" on outplacement, these benefits are predominantly composed of individual counseling (40 percent), general office and secretarial services plus individual counseling for a fixed period (37 percent), and general office and secretarial services for a fixed period (5 percent).

In addition, the other most significant finding of the survey is that a smaller number of organizations would offer severance to all their employees—31 percent for the current survey versus 39 percent for 2005 and 37 percent for 2003. This may reflect a general decline in employers offering broad-based employee plans in general as noted by several surveys.

Similarly, an increasing number of organizations have reviewed their CIC policies within the past 12 months—31 percent (compared with 29 percent in 2005 and 27 percent in 2003). Gross-up plans seem to also be declining—21 percent compared to 23 percent for 2005. Also, the top executive's bonus would be calculated using the target bonus by a preponderance of those answering (30 percent compared to 20 percent for using actual bonus).

Also, 57 percent stated that they offer one or more benefits (retirement, health, dental, etc.) for a continued period of time in the event of an involuntary termination non-CIC severance not-for-cause situation for top executives.

Finally, while the number across the three surveys for review prevalence of severance plans (Figure 16) are about the same, there is a marked decline in the percentage who have **never** reviewed their CIC plans since establishment (23 percent in 2007 versus 35

percent for 2005 and 44 percent for 2003). "This shows some progress in this area on the part of compensation committees and their HR liaisons in general," Jones said*.

Perhaps the most unique aspect of the survey (for the most part) is the remarkable consistency of the responses over the years from the first survey to the third.

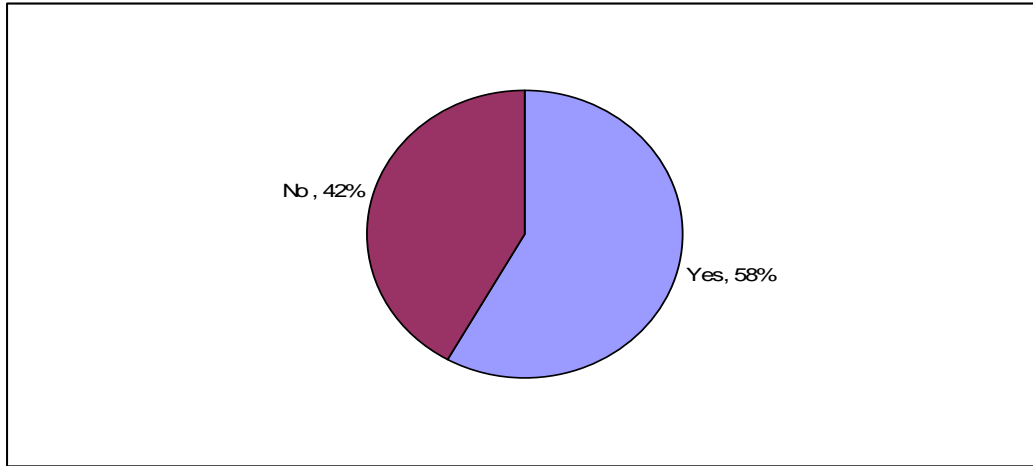
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Detailed Survey Results

General Severance Plan Information

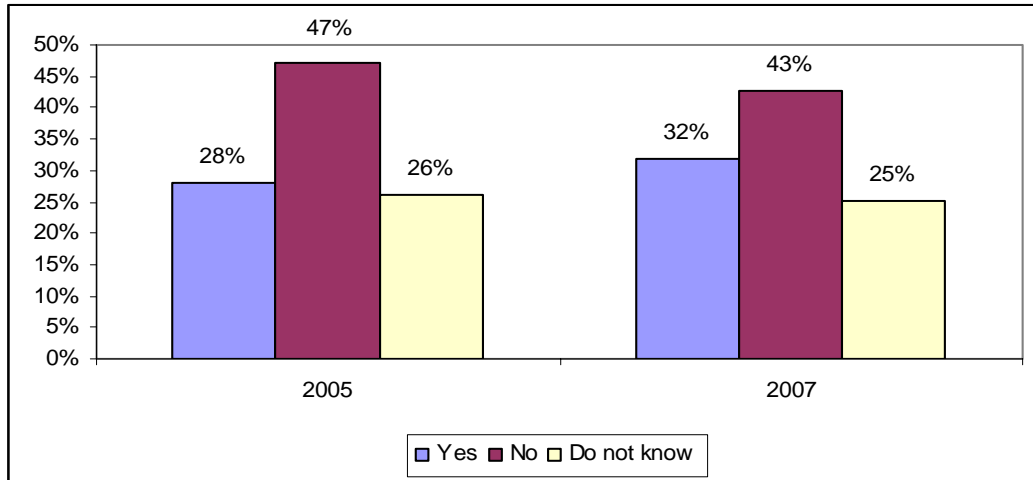
The majority of organizations (58 percent) stated having experienced reductions in force from May 2006 to May 2007.

Figure 1: “Has your organization experienced reductions in force (either incented or nonincented layoffs) over the past 12 months or so? (n=522)”



In addition, 32 percent of the organizations indicated the intention of having a reduction in force during the next 12-month period. As portrayed in Figure 2, the variation between the 2005 and 2007 surveys is minimal. (The question was not asked in the 2003 survey).

Figure 2: “Does your organization plan any reductions in force (either incented or nonincented) over the next 12 months or so? (n=522)”



More than half (53 percent) of the surveyed organizations demonstrate that they have a separate severance plan for CEOs. The most common severance plan approach, depicted by 42 percent, consists of a blend that provides one plan for the CEO, one plan for key officers/executives or direct reports to the CEO, and a separate plan for all other employees. Fourteen percent of organizations do not have a severance plan in place. Of the 33 percent who answered “other,” many reveal that their severance plan coverage is equal for all employees (Figure 3).

Figure 3: “Which of the following best describes the coverage of your organization’s severance plan(s)?”

	2003 (n=696)	2005 (n=605)	2007 (n=522)
One plan for CEO, one for key executives/officers, one for all other employees	36%	35%	42%
No severance plan	18%	19%	14%
One plan for CEO, one for all other employees	13%	8%	8%
CEO plan only	0%	1%	1%
One plan for CEO, one plan for key executives/officers, no other employees covered	1%	2%	3%
Other	31%	35%	33%

Among those organizations that have documented severance plans, 37 percent described their plan as “detailed,” and 24 percent described their plan as being “general.” A small number, 12 percent, do not have written plans or policies (Figure 4).

Figure 4: “Which of the following phrases most accurately describes the documentation for your organization’s severance plan(s)?”

	2003 (n=583)	2005 (n=601)	2007 (n=459)
Detailed plans & policies in writing	52%	45%	37%
General plans & policies in writing	34%	23%	24%
Unwritten or undocumented plans & policies	14%	12%	12%
Employment agreements for top executives only	n/a	2%	6%
Employment agreements and general plans and policies in writing	n/a	14%	15%
Other	n/a	3%	6%

Note: n/a not applicable; not answer options in the 2003 survey.

Calculation of the Severance Benefit

A noteworthy 71 percent of the organizations employ “years of service” as a core factor for the calculation of a severance benefit plan that covers the largest number of employees, excluding the CEO. The second foremost component is “position,” reflected by a significantly lower 21 percent. Other basis for calculation includes “pay,” “title” and “employment agreement,” represented by 17 percent, 5 percent and 4 percent, respectively (Figure 5).

Figure 5: “For the severance plan that covers the largest number of employees (not the CEO plan), what is the basis for calculation of the severance benefit?”

	2003 (n=989)	2005 (n=477)	2007 (n=446)
Years of service	94%	85%	71%
Position	27%	23%	21%
Pay	26%	20%	17%
Title	6%	6%	5%
Employment agreement	10%	6%	4%
Combination of several factors	0%	17%	19%
Other	11%	17%	7%

In relation to the current formula used to determine the amount of cash severance to be allocated as part of a severance plan, the largest occurrence was one week of salary per year of service (31 percent), followed by two weeks of salary per year of service (20 percent). A marginal 7 percent do not utilize any formula (Figure 6). For the majority of those who answered “other” (40 percent), a tiered structure based on years of service and/or age was the determinant for the amount of cash severance offered upon termination.

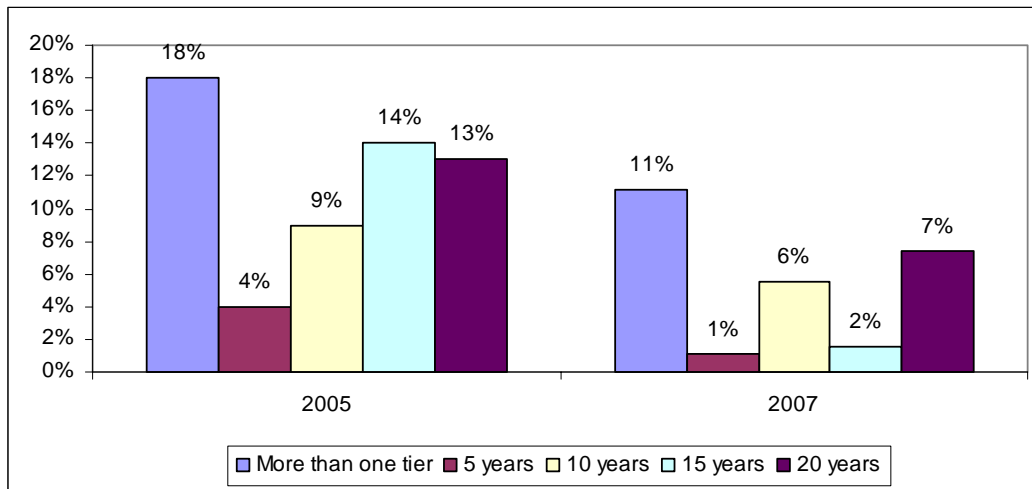
Figure 6: “For the severance plan that covers the largest number of employees, what is your current formula for determining the amount of cash severance?”

	2003 (n=559)	2005 (n=473)	2007 (n=447)
One week/year of service	37%	32%	31%
Two weeks/year of service	22%	23%	20%
One month/year of service	2%	1%	3%
No formula	5%	5%	7%
Other	34%	39%	40%

A considerable number—73 percent—admitted to not having a tiered severance pay plan; however, of the remaining 27 percent that did indicate having one, 11 percent used a plan with more than one tier for different service levels by employees; 7 percent indicated using 20 years as a level of years of service (Figure 7). Those respondents who answered “other,” designated 25 and 26 years of service level as a base, represented by 22 percent and 30 percent, respectively.

The 2005 survey revealed that 42 percent of the respondents answered “other,” a category which represents a severance pay plan of more than 20 years; an option not available in the 2007 survey (Figure 7). Open-ended responses to this question reveal that 52 percent of participating companies set a maximum at 25 to 26 years of service. Compared to 2005 figures, 2007 tiers were fairly consistent. The question was not asked in the 2003 survey.

Figure 7: “If you provide a tiered severance pay plan, i.e., different levels for different employees, is there a level of years of service at which you provide a maximum amount? (n=365)”



Minimum and Maximum Amounts of Cash Severance

The most common minimum amounts of cash severance are two weeks' salary (42 percent) and one month's salary (17 percent). Fourteen percent of respondents indicate having no minimum amount (Figure 8). General practice for the maximum amount is 26 weeks' salary and one year's salary, corresponding to 25 percent and 20 percent, respectively (Figure 9). Of those who responded "other," 43 percent offer one week of coverage, 28 percent offer eight to nine weeks and 20 percent offer four weeks.

Figure 8: "What is the minimum amount of cash severance that can be provided to an employee covered by the severance plan that covers the largest number of employees?"

	2003 (n=566)	2005 (n=482)	2007 (n=448)
2 weeks' salary	46%	44%	42%
3 weeks' salary	4%	3%	3%
One month's salary	21%	19%	17%
6 weeks' salary	3%	3%	3%
3 months' salary	n/a	9%	5%
No minimum	2%	11%	14%
Other	24%	11%	15%

Note: n/a not applicable; not an answer option in the 2003 survey.

Figure 9: "What is the maximum amount of cash severance that can be provided to an employee covered by the severance plan that covers the largest number of employees?"

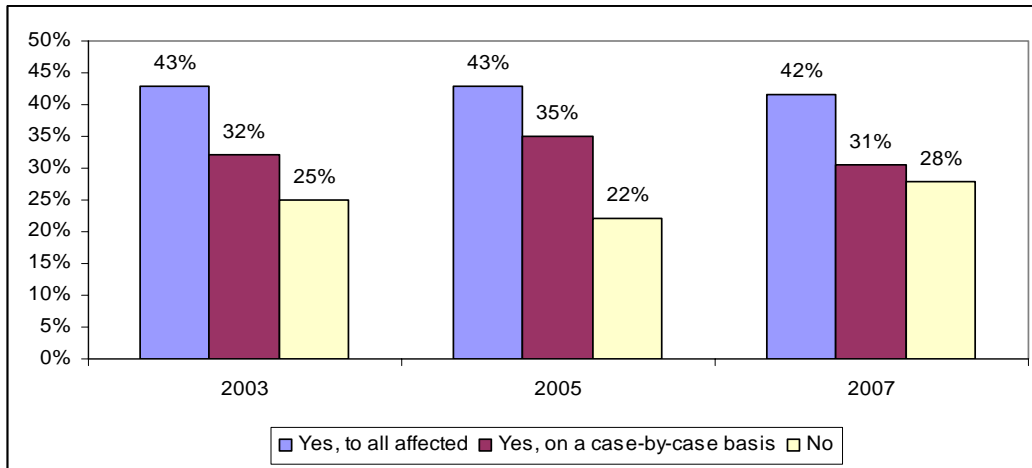
	2003 (n=558)	2005 (n=481)	2007 (n=447)
13 weeks' salary	3%	5%	5%
26 weeks' salary	28%	23%	25%
39 weeks' salary	n/a	1%	2%
52 weeks' salary	24%	22%	20%
Greater than 52 weeks' salary	n/a	5%	3%
No maximum	17%	22%	23%
Other	28%	22%	21%

Note: n/a not applicable; not answers options in the 2003 survey.

Outplacement Benefits

A significant majority of organizations provide some level of outplacement benefits to their employees. In fact, 42 percent offer outplacement support to all affected employees, followed by 31 percent who offer it on a case-by-case basis (total of 73 percent). A total of 28 percent do not offer any outplacement support, which is up slightly from prior years (2005-22 percent and 2003-25 percent) (Figure 10).

Figure 10: “For the severance plan that covers the largest number of employees, do you provide outplacement benefits to those affected by a reduction in force/layoff? (n=455)”



Among those who offer outplacement benefits, one-fourth report having a three-month program. An additional 34 percent reports a duration of benefits evaluated on a case-by-case basis. A marginal 2 percent reflects duration of one year for outplacement benefits support (Figure 11). For 43 percent of the 25 percent who responded “other,” the duration is contingent on salary grade and/or job level.

Figure 11: “If you provide outplacement benefits for the severance plan that covers the largest number of employees, what is the duration of the benefit?”

	2003 (n=518)	2005 (n=381)	2007 (n=335)
3 months	22%	14%	25%
6 months	6%	6%	7%
12 months	1%	2%	2%
Case-by-case	43%	39%	34%
Capped at fixed amount	n/a	9%	8%
Other	28%	30%	25%

Note: n/a not applicable; not an answer option in the 2003 survey.

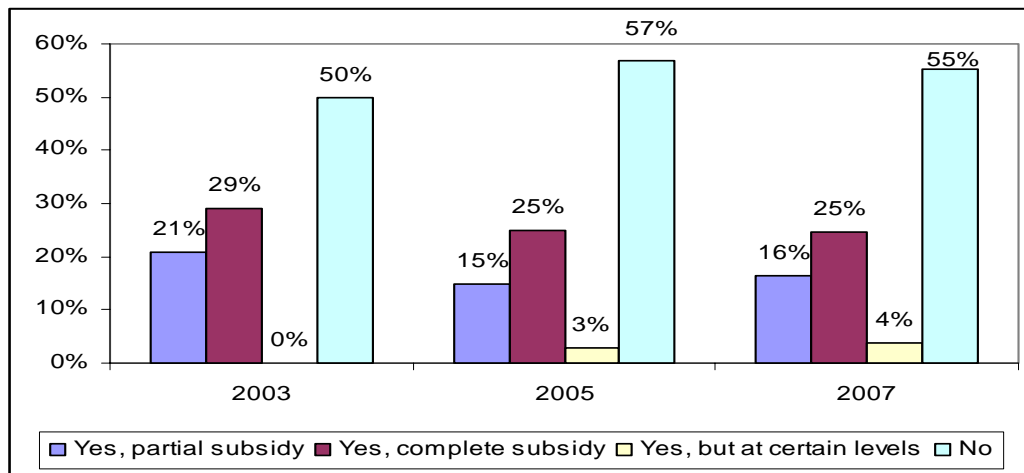
For those who answered yes to the previous question, outplacement benefits are predominantly composed of individual counseling (40 percent), general office and secretarial services plus individual counseling for a fixed period (37 percent), and general

office and secretarial services for a fixed period (5 percent). The remaining 18 percent answered “other.” This question was not available in the prior two surveys.

COBRA Subsidy

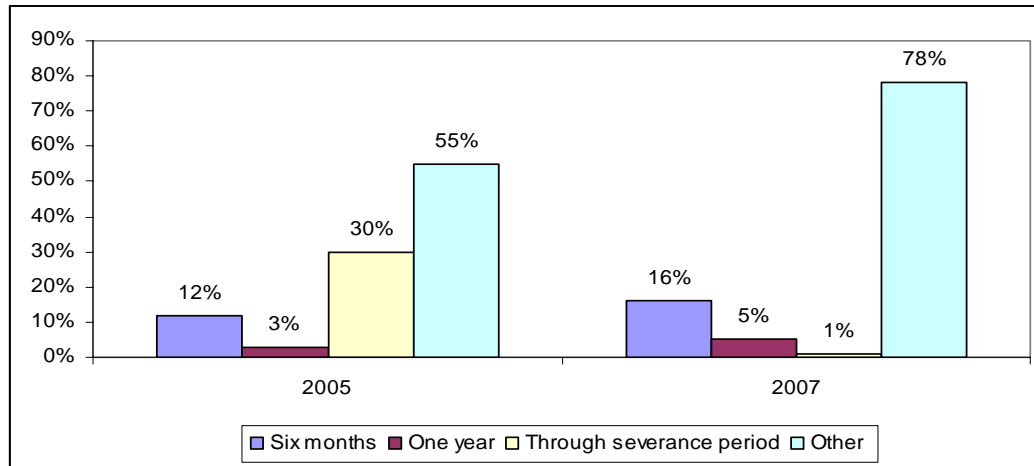
Although more than half (55 percent) of the surveyed organizations do not offer COBRA subsidy or coverage assistance to employees who are severed from service, 45 percent of the respondents do grant partial or complete subsidy. In fact, 16 percent of the organizations provide partial subsidy for a limited period of time, one-fourth offer full subsidy for a limited period of time and 4 percent provide it to people with certain levels of service (Figure 12).

Figure 12: “For the severance plan that covers the largest number of employees, does your organization subsidize any portion of COBRA coverage? (n=451)”



More than three-fourths (78 percent) of the surveyed organizations indicated their period of COBRA subsidy to fall under the “other period of time” category. Within this answer choice, the majority (98 percent) specify a range of one to three months of coverage. It is important to note that one-third of the respondents selected “through severance period” in 2005; however, this was not an answer option in the 2007 survey. (Figure 13.) The question was not posed in the 2003 survey.

Figure 13: “If yes, what is the period of COBRA subsidy/coverage assistance? (n=294)”



As depicted in Figure 14, non-COBRA medical coverage may also be part of the severance package. For the 2007 and 2005 surveys, more than three-fourths (78 percent) did not choose any of the specified number options. The question was not available in the 2003 survey.

Figure 14: “If the organization provides continued medical coverage (non-COBRA) for employees who are involuntarily severed, what is the duration of the assistance?”

	2005 (n=245)	2007 (n=355)
6 months	11%	10%
One year	2%	6%
18 months	9%	4%
Two years	n/a	1%
Through retirement	n/a	1%
Other	78%	78%

Note: n/a not applicable; not answer options in the 2005 survey.

Handling of Stock Options

In addition to health-care benefits, stock options and/or equity awards may also be affected in a severance situation. From May 2006 to May 2007, 45 percent of the organizations did not offer any stock options or equity awards. For those who do offer stock options and/or equity awards, 17 percent neither accelerate the options nor extend the exercise period (Figure 15).

Figure 15: “If your organization issues stock options or other equity award subject to vesting, do you either accelerate the vesting of the options or extend the exercise period in an involuntary severance situation?”

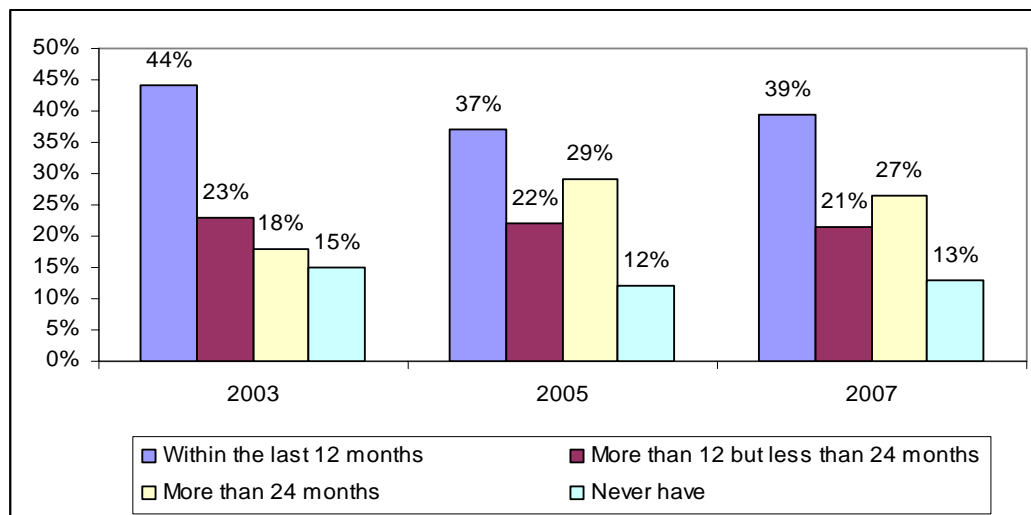
	2003 (n=543)	2005 (n=419)	2007 (n=407)
Not applicable	45%	n/a	45%
Accelerate the options	6%	9%	9%
Extend exercise period	8%	13%	4%
Do not accelerate the options	n/a	n/a	20%
Do not extend the exercise period	n/a	n/a	4%
Both	2%	4%	2%
Neither	40%	73%	17%

Note: n/a not applicable; not answer options in the 2005 and 2003 surveys.

Review of Severance Plan

On a positive note, 39 percent of the respondents have reviewed their severance plan in the past year. The second largest time frame for severance plan review is more than two years, which accounts for 27 percent of the organizations. A total of 13 percent stated that they never reviewed their plan (Figure 16), which was similar to the prior surveys’ responses—12 percent for 2005 and 15 percent for 2003.

Figure 16: “When was the last time your organization conducted a formal review of the severance plan? (n=443)”



Change-in-Control (CIC)

CIC policies are generally based on title, years of service, employment agreements (presumably top executives only) or above a certain level or title. Approximately one-third of the respondents (31 percent) state that all employees are eligible for severance in the event of a CIC. Eighteen percent base their CIC policies on the employment agreement (Figure 17). Of the one-fourth that answered “other,” 59 percent either do not know who would be eligible and/or have no formal plan.

Figure 17: “In a change-in-control situation in your organization, who is eligible for severance?”

	2003 (n=499)	2005 (n=415)	2007 (n=445)
All employees	37%	39%	31%
Only those above a certain line	7%	15%	8%
Only those above a certain level of functional responsibility	7%	13%	6%
Only those above a certain number of years of service	17%	6%	1%
Employment agreement	16%	20%	18%
Other	9%	8%	25%

Furthermore, more than one-third of the organizations (31 percent) have conducted a formal review of CIC policy, while 23 percent stated that they have not reviewed their policy since its establishment (Figure 18).

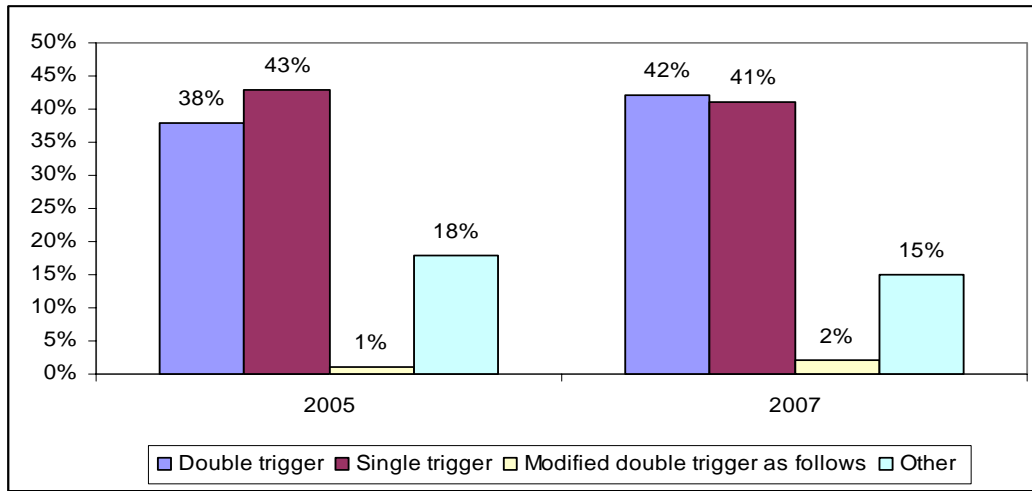
Figure 18: “When was the last time your organization conducted a formal review of your CIC policy?”

	2003 (n=441)	2005 (n=451)	2007 (n=415)
Within the last 12 months	27%	29%	31%
More than 12, but less than 24 months	14%	17%	13%
More than 24 months	16%	14%	10%
More than 5 years	n/a	5%	5%
Never have, but considering	n/a	n/a	18%
Not since its establishment	44%	35%	23%

Note: n/a not applicable; not answer options in the 2005 and 2003 surveys.

As shown in Figure 19, out of the five choices available regarding the issuing of stock options and/or other equity awards, the vast majority (64 percent) revealed that their policy did not fall under any of the categories. An equal 15 percent reflect single and double trigger as the eligibility policy for accelerated vesting in stock option/equity upon a CIC, well down from 2005 levels of 38 percent and 43 percent, respectively. Organizations that selected the “other” category, admit either not having or knowing about an existing policy (62 percent). These options were not available in the 2003 survey.

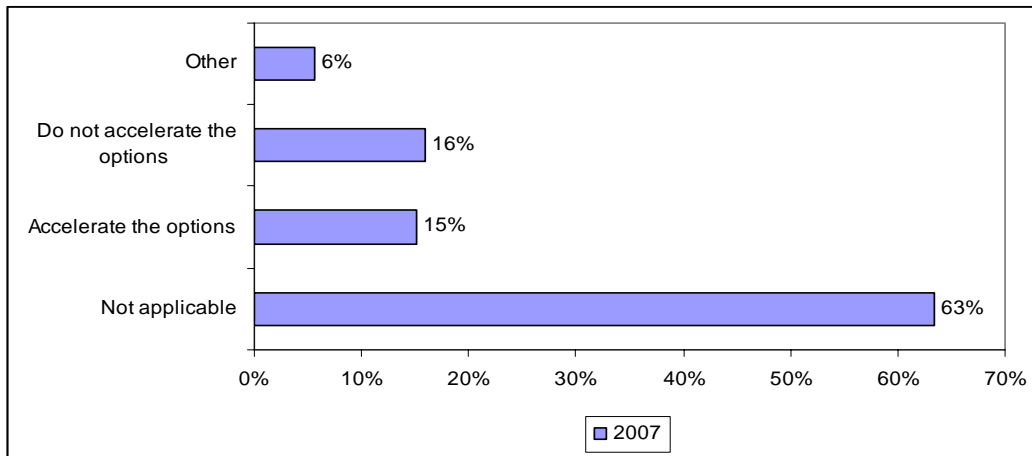
Figure 19: “If your organization issues stock options and/or other equity awards, what is your eligibility policy for accelerated vesting upon a change in control? (n=355)”



Executive Severance Plans

Among those with a SERP plan (31 percent), 15 percent provide accelerated vesting and payout, in a CIC situation, while 16 percent do not. A significant 63 percent of the respondents do not have a SERP plan (Figure 20). In the 2005 survey, the question included a nonqualified deferred compensation (NQDC) answer option, which 7 percent of respondents indicated they would offer and also accelerate in a CIC situation. The question was not included in the 2003 survey.

Figure 20: “If your organization provides Supplemental Executive Retirement Programs (SERPs), do you either accelerate the vesting or accelerate the payout in a change-in-control situation?”



Furthermore, when asked whether or not their organization “grosses up” any executives for the “golden parachute” excise tax, a whopping 79 percent responded that they do not “gross up.” Of that vast majority, 5 percent are considering “grossing up” (Figure 21).

Figure 21: “Do you gross up any executives for the ‘golden parachute’ excise tax if it occurs?”

	2003 (n=431)	2005 (n=417)	2007 (n=385)
Yes	23%	23%	21%
No, cut back compensation to level that excise tax does not apply	5%	4%	2%
No	72%	73%	77%

Although practices vary widely, the prevalent answer was granting top executives with one year of severance pay in the event of an involuntary non-CIC (21 percent). The second largest group (15 percent) stated that they provide their top executives with two years of salary in the event of an involuntary severance that does not result from a CIC situation (Figure 22). For those who answered “other,” almost one-third (28 percent) indicated a lack of awareness with respect to their policy.

Figure 22: “How many months of salary would your top executive receive for an involuntary nonchange-in-control severance not for cause?”

	2003 (n=250)	2005 (n=207)	2007 (n=333)
6 months	8%	11%	6%
12 months	25%	11%	21%
18 months	4%	29%	4%
24 months	15%	25%	15%
36 months	12%	7%	8%
Other	36%	17%	47%

Of the 67 percent of organizations that do provide a certain amount of severance salary to their top executives, 39 percent include salary and bonus in their formula and 29 percent do not. Thirty-two percent “do not know,” if the formula includes salary and bonus. Moreover, 43 percent of those who answered “yes,” stated that the formula applies to target bonuses only, as shown in Figure 23. This question was not included in the prior two surveys.

Figure 23: “How does the formula apply to bonus?”

	2007 (n=308)
Last year's actual bonus	13%
Target bonus	43%
Higher of target or previous year's actual	10%
Average bonus over the past 3-5 years	10%
Highest bonus in the past 3-5 years	1%
Other	23%

Employers pay severance in various ways as depicted in Figure 24. Lump sum is the most popular choice of severance payment, reflected by a 45-percent response rate. The second preferred method is monthly installments, reflected by a 21-percent response rate. Of the 23 percent that selected “other,” 30 percent state either not having or not being aware of a top executive severance pay-out policy.

Figure 24: “How would the top executive’s severance be paid out in an involuntary non-CIC situation, not for cause?”

	2003 (n=233)	2005 (n=263)	2007 (n=266)
Lump sum	43%	43%	45%
Upon severance; after meeting the terms of severance agreement	3%	3%	3%
Two annual installments	1%	1%	1%
Specific number of annual installments	4%	3%	2%
Monthly installments	n/a	22%	21%
Other	49%	28%	27%

Note: n/a not applicable; not an answer option in the 2003 survey.

As seen in Figure 25, the most common method for calculating an executive’s bonus as part of severance in a non-CIC situation is by employing the target bonus as a multiplier, as revealed by 23 percent of the respondents. One times the previous year actual bonus is the second-largest response (17 percent). A significant 46 percent selected “other” as an answer, of which more than half (52 percent) stated not knowing/not having a bonus as part of the calculation.

Figure 25: “How would the top executive’s bonus be calculated as part of the severance in a non-CIC situation?”

	2003 (n=217)	2005 (n=167)	2007 (n=211)
One multiplied by previous year’s actual bonus	14%	16%	17%
Two multiplied by previous year’s actual bonus	3%	3%	1%
Three multiplied by previous year’s actual bonus	2%	3%	2%
Higher of target or previous year bonus	10%	4%	4%
Target bonus as multiplier	n/a	28%	23%
One multiplied by previous year’s target bonus	n/a	7%	4%
Two multiplied by previous year’s target bonus	n/a	1%	2%
Three multiplied by previous year’s target bonus	n/a	3%	1%
Other	71%	35%	46%

Note: n/a not applicable; not answer options in the 2003 survey.

Lastly, while the response varied widely, a majority of the respondents, or 57 percent stated that they offer one or more benefits for a continued period of time in the event of an involuntary termination non-CIC severance not-for-cause situation for top executives. Another 23 percent were unsure of the benefits provided and 19 percent did not offer any of the answer choices (Figure 26).

Figure 26: “In the event of an involuntary termination non-CIC severance not-for-cause of the top executive, which of the following benefits would be continued for any period of time?”

	2003 (n=240)	2005 (n=243)	2007 (n=320)
Health coverage	8%	6%	6%
Dental coverage	n/a	8%	12%
Retirement plan coverage	n/a	1%	3%
All of the above	n/a	10%	13%
Some combination of the above	n/a	8%	23%
None of the above	15%	16%	19%
Unsure	11%	14%	23%
Other	66%	37%	n/a

Note: n/a not applicable; not answer options in the 2003 survey.

Appendix

Demographic Information

Industry

Industry	2007 %	2007 (n = 450)
Agriculture, Forestry, Fishing & Hunting	1%	5
Utilities	5%	21
Construction	1%	4
Manufacturing	20%	90
Wholesale Trade	1%	4
Retail Trade	4%	16
Transportation & Warehousing	2%	9
Information	7%	31
Finance & Insurance	15%	67
Real Estate & Rental & Leasing	1%	4
Professional, Scientific & Technical Services	9%	41
Educational Services	3%	14
Healthcare & Social Assistance	9%	41
Arts, Entertainment & Recreation	2%	10
Accommodations & Food Services	1%	4
Other Services (except Public Administration)	4%	18
Public Administration	2%	8
Other	13%	59

Organization Size

Number of Employees	%	n
Less than 100	6%	27
100 - 499	14%	60
500 - 999	12%	52
1,000 - 2,499	14%	60
2,500 - 4,999	15%	64
5,000 - 9,999	15%	65
10,000 - 19,999	10%	45
20,000 or more	14%	61