



Compensation Dictionary
A Compilation of Key Compensation Terms



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Compensation Dictionary

In an effort to provide our readers with valuable resources, we have put together this dictionary of key compensation terms that will be helpful to anyone in the compensation field. Here you will find all the terms you need to know to have a good grasp on the language of compensation.

280g	3	Non-Exempt Employee	5
409a	3	Non-Qualified Deferred Compensation	5
Actual Bonus	3	Overhang/Dilution	5
Base Pay Or Base Salary	3	Pay Grade	5
Benchmark Job	3	Pay-For-Performance	6
Black-Scholes Method	3	Peer Group Analysis	6
Bonus	3	Performance Share	6
Bonus Target	3	Performance Vesting	6
Broad Band	3	Perquisites	6
Burn Rate/Run Rate	3	Phantom Stock Plan	6
Ceo Pay Ratio	3	Reasonable Compensation	6
Change In Control Payment Or Golden Parachute Payment	3	Recognition Plan	6
Clawback Policy	4	Restricted Stock	6
Compensation	4	Restricted Stock Unit	6
Compensation Consultant	4	Retention Plan	6
Compensation Discussion and Analysis (CD&A)	4	Retention Ratio	7
Deferred Compensation	4	Salary Grade Structure	7
Employee Stock Ownership Plan (ESOP)	4	Stock Appreciation Right	7
Employee Stock Purchase Plan (ESPP)	4	Stock Option	7
Equity Compensation Plan	4	Stock Ownership Guidelines	7
Executive Benefits	4	Summary Compensation Table	7
Exempt Employee	5	Supplemental Executive Retirement Plan (SERP)	7
Grant Date Fair Market Value	5	Top Hat Plan	7
Incentive Plan	5	Total Cash Compensation (TCC)	7
IRC 162 (Internal Revenue Code Section 162)	5	Variable Pay	7
Long-Term Incentive Plan	5	Waterfall Structure	7
Market Study	5		
Monte Carlo Method	5		
Net Profits Interest	5		

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Compensation Dictionary

280G

Outlines the rules of the “golden parachute” payments/benefits from a company to certain executives when there is a “change in control,” and it imposes special tax penalties on employer by stating no deduction shall be allowed for any excess parachute payment.

409A

Regulation which applies to compensation that workers earn in one year but is not paid until a future year, which is referred to as non-qualified deferred compensation.

ACTUAL BONUS

The bonus value earned with respect to Company’s management incentive plan, assuming continued employment through the performance period.

BASE PAY OR BASE SALARY

The initial rate of fixed compensation an employee receives in exchange for work performed and excludes benefits, bonuses and overtime.

BENCHMARK JOB

A position or job that is common in the market across various companies and industries and serves as a shared point of comparison in evaluating compensation levels.

BLACK-SCHOLES METHOD

A model used for calculating the theoretical value and determining the fair price of European style options based on six variables: time, strike price, type of option, underlying stock price, volatility, and risk-free rate.

BONUS

An amount of money paid to an employee in addition to their base pay as a reward for performance.

BONUS TARGET

A percentage of base salary that an executive is eligible for on annual basis if the Company achieves certain results and/or the employee achieves certain personal goals.

BROAD BAND

The broadest salary grouping in a compensation system that encompasses several pay levels, ranges or grades.

BURN RATE/RUN RATE

Measures how fast a company’s cash holdings are decreasing or the rate at which their cash pool is depleted (negative cash flow); typically calculated monthly.

CEO PAY RATIO

The ratio between the CEO’s total annual compensation and the median employee’s pay. Public companies are required to disclose this figure in any annual report, proxy or information statement.

CHANGE IN CONTROL PAYMENT OR GOLDEN PARACHUTE PAYMENT

An agreement to pay a large sum and/or benefits to a company executive who is terminated from his position following a sale, merger, consolidation or acquisition of a company.

Compensation Dictionary

CLAWBACK POLICY

A special clause typically included in employment contracts, by which money already dispersed must be paid back under certain conditions, possibly with added penalty.

COMPENSATION

The total cash and non-cash payments given to an employee in exchange for services performed and includes base pay, commissions, bonuses, benefits, stock options and other forms of non-cash benefits.

COMPENSATION CONSULTANT

Experts in the design and implementation of compensation plans, the creation of proper incentives for employees, and advising companies on compensation trends and the current pay rates for given job positions.

COMPENSATION DISCUSSION AND ANALYSIS (CD&A)

The CD&A is a required part of a company's annual proxy statement that provides narrative disclosure explaining all material elements of the company's executive compensation objectives and policies, and puts it into perspectives for shareholders.

DEFERRED COMPENSATION

Payments that are made to an employee at a later date after which the income was earned and, in most cases, includes a deferment of taxes on said income. Examples of deferred compensation include retirement plans, pensions, deferred savings and stock-option plans.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP)

A benefit offered to employees that allows them to own stock in the company without having to buy shares. The plan is funded by employer contributions that are held in a trust and are tax-deferred until the employee retires or leaves the company. Distributions are tied to vesting, meaning employees earn shares for each year of service and compliance with certain covenants.

EMPLOYEE STOCK PURCHASE PLAN (ESPP)

A program offered by a company which allows employees the option to purchase company shares at a discounted price through after-tax payroll deductions and includes four phases: grant, offering period, transfer and disposition. The grant phase grants employees the option to purchase stock at a predetermined cost. The offering period is the time during which the employee's payroll deductions accumulate for the future purchase of shares. Following the offering period, in the transfer phase, the employer uses the money saved by the employee to purchase company shares and transfers ownership of those shares to the employee. The disposition phase is when the employee sells, trades, exchanges or transfers the shares.

EQUITY COMPENSATION PLAN

A form of non-cash pay an organization can offer its employees to encourage retention by allowing them to partake in ownership of the company through various plans such as stock options, performance shares and restricted stock. Participating employees can share in the organization's profits through appreciation.

EXECUTIVE BENEFITS

Beyond salary and cash compensation, these benefits provide an additional way to reward and retain key executives and employees. Examples include: 401k, SERPs, stock options, golden parachutes, etc.

Compensation Dictionary

EXEMPT EMPLOYEE

An employee exempt from the Fair Labor Standards Act (FLSA) regulations and therefore excluded from minimum wage and overtime requirements. Exempt employees are paid a yearly salary rather than an hourly wage.

GRANT DATE FAIR MARKET VALUE

Equal to the volume-weighted average trading price of the Company Stock occurring on the NYSE on the Grant Date.

INCENTIVE PLAN

A system or method put in place to motivate employees of all levels and boost performance to achieve certain goals and objectives.

IRC 162 (INTERNAL REVENUE CODE SECTION 162)

Provides guidance related to factors which the IRS views as determinants of establishing reasonable compensation levels.

LONG-TERM INCENTIVE PLAN

A company's reward system designed to improve employee's long-term performance and reward employees for achievement of strategic objectives that will maximize shareholder value.

MARKET STUDY

An analysis that compares similar companies with similar jobs to determine competitive salary and compensation levels.

MONTE CARLO METHOD

A special option-based valuation simulation that takes into consideration the terms of the plan, payout rates, potential future returns, and other factors to estimate a fair value of the award.

NET PROFITS INTEREST

The proportion of net profits paid out to particular investors or employees according to their percentage stake in the company.

NON-EXEMPT EMPLOYEE

An employee that is not exempt from the Fair Labor Standards Act (FLSA) requirements and is entitled to receive overtime pay of at least one-and-a-half times their hourly rate when for any hours worked beyond 40 in a given week.

NON-QUALIFIED DEFERRED COMPENSATION

A type of deferred compensation also called an NQDC plan or a 409A plan that is not protected by the Employee Retirement Income Security Act (ERISA) and could, therefore, put the funds at risk if the company holding the employee's NQDC declares bankruptcy or is sued.

OVERHANG/DILUTION

The calculation to determine the dilutive effect on existing shareholders when allocating additional shares to a share-based incentive plan.

PAY GRADE

A level within a pay range in which multiple roles with similar internal and market value can be grouped into.

Compensation Dictionary

PAY-FOR-PERFORMANCE

A compensation structure based on individual or company performance during a given time frame.

PEER GROUP ANALYSIS

The process in which a group of companies of similar size, industry, revenue and geographical location are analyzed to compare and establish reasonable and competitive compensation levels.

PERFORMANCE SHARE

A share of company stock vested upon achievement of company-wide, previously-defined performance objectives over a multi-year period (typically three years).

PERFORMANCE VESTING

Refers to plans in which vesting only occurs once performance-related goals and specified conditions are met.

PERQUISITES

Rights, privileges, benefits, or advantages outside of regular salary or wages (ex. health insurance, automotive allowance); also referred to as “perks.”

PHANTOM STOCK PLAN

A benefit plan offered to employees (upper level executives) that provides stock ownership benefits without giving them any actual company stock. Phantom stock follows the fluctuations of the company’s actual stock and results in higher or lower payouts as stock prices rise or fall. Phantom stock plans may be tied to performance metrics and only pay out if certain targets are met. Like other forms of stock-based compensation, phantom stock plans serve to align employee and shareholder interests while incentivizing and retaining key employees.

REASONABLE COMPENSATION

That which is consistent with the normal compensation for similar employees performing similar duties for similar companies under similar circumstances.

RECOGNITION PLAN

An employer’s effort to motivate employees by recognizing their achievements (length of service, exemplary one-time achievement, etc.) in the organization through methods of rewarding these achievements (ex. written or spoken thank you notes, cash “spot” bonuses, gift cards, etc.).

RESTRICTED STOCK

Compensation to employees in the form of company shares that cannot be issued until certain requirements have been met, such as years of service or achievement of performance goals.

RESTRICTED STOCK UNIT

Stock that is not fully transferrable until certain restrictions/conditions have been met. Upon satisfaction of those restrictions, the stock becomes transferrable to the person. They are often used as a form of employee compensation, and can be settled in actual shares or cash.

RETENTION PLAN

A plan put in place with the purpose of retaining key employees in an organization by offering certain incentives to reduce turnover and ensure employees are motivated to stay with the company long-term. A good retention plan aligns with business performance goals to allow for maximum return on investment.

Compensation Dictionary

RETENTION RATIO

An arrangement whereby a certain number or percentage of shares are required to be retained toward the satisfaction of stock ownership guidelines.

SALARY GRADE STRUCTURE

An organized compensation structure that includes various pay grades with a maximum, a midpoint and a minimum pay rate for a given job.

STOCK APPRECIATION RIGHT

A cash-settled long-term incentive given to an employee that is equivalent to the appreciation of company stock over a specified period, so that the holder/employee benefits from an increase in stock price.

STOCK OPTION

A benefit given by a company to an employee in the form of an option to buy stock in the company at a stated fixed price or at a discount.

STOCK OWNERSHIP GUIDELINES

A method for measuring the annual usage of shares for incentive purposes.

SUMMARY COMPENSATION TABLE

The Summary Compensation Table is included in a company's proxy statement and provides a comprehensive overview of pay levels for top-paid executive officers (typically over the last three years).

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP)

A type of non-qualified deferred compensation plan for key executives that provides supplemental income to the basic retirement benefits to which the executive is otherwise entitled. SERP benefits are payable only if vesting conditions and other requirements are met by the executive and become taxable upon distribution.

TOP HAT PLAN

A type of employer-sponsored plan that is unfunded and provides deferred compensation to the eligible employee group - typically high-ranking executives and directors. These are not meant to be tax-qualified so they don't offer the same tax benefits of an opt-in employer-sponsored plan.

TOTAL CASH COMPENSATION TCC

The sum of all cash payments made to an individual for services during a year of employment including base pay and variable pay such as commissions, bonuses and incentives.

VARIABLE PAY

Non-fixed compensation that is dependent upon performance, such as commissions, bonuses or incentives. Also referred to as pay-for-performance or at-risk pay.

WATERFALL STRUCTURE

The order in which a private equity fund pays out distributions after investments have been liquidated. Typically, higher-tiered creditors receive payments first, while the lower-tiered creditors receive payments only after the higher-tiered creditors are paid back in full, in an effort to prioritize the highest-principal loans first because they are also likely the most expensive.