Floating Leg Payout: 100.000 * 10% = $10,000

Payout to Employee: $9,950

In the example, the employee earns just under the 10% he would have, had he been invested in an actual fund. In reality, the fund would also charge fees, so the employee doesn't notice any material difference in their investment returns. The fees are substituted with the cost of hedging. With the TRS, it is easy for the company to provide the fund exposure to the employee. It happens that the S&P 500 has one of the most liquid TRS markets in the world, so if that is the only fund a company provides, it is easy and inexpensive to offer that exposure to their employees in their NQDC program. It also happens that companies want to offer other types of funds to their employees as well, and this is where it can get challenging to find a deeply liquid hedge.

Index funds like the S&P 500, the Nasdaq 100, and the Russell 2000 are very liquid and can be acquired in a TRS very cheaply. These hedges are extremely effective at mirroring the index funds. Companies also like to offer their own stock and won't typically hedge that exposure, thinking that they don't mind showing a negative P/L if their stock goes up. But companies also like to offer "mutual funds" that aren't necessarily index funds and don't neatly track an index. In this case, they'll have an ineffective hedge and will have a fairly large P/L on the program. This is the norm in deferred compensation.