STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association CUNA

CREDIT UNION
Directors
NEWSLETTER

MAY 2019
VOLUME 45
ISSUE 5

The 'No Surprises' Model of Executive Benefits

Answer three questions about the current health of deferred compensation plans.

If you have deferred compensation plans in place for one or more of your top executives, consider these recent developments that might impact those plans:

- **Federal Accounting Standards Board** (FASB) **changes** can affect some non-703 compliant investments on your income statements.
- **The excise tax** on executive annual income above $1 million, which began in 2018.
- **A prolonged low-interest environment** that has been a drag on permanent life insurance crediting rates.

Given these developments, review deferred compensation plans you have in place. If the board's investment and/or executive compensation committees haven't reviewed the potential impact of these three factors on deferred compensation plans recently, they should.

Three questions to answer about the plans:

Will the FASB accounting change regarding equities add significant volatility to your net income?

FASB now requires credit unions to categorize certain non-703 compliant equities—for example, stocks or mutual funds—as "trading securities" on annual income statements for fiscal years beginning after Dec. 15, 2018. This will also be required for interim income statements for fiscal years beginning after Dec. 15, 2019.

A common use for this type of non-703 compliant investment is to fund an executive's nonqualified deferred compensation plan, such as a 457(f). Previously, credit unions could book these investments as "available for sale." For investments in this category, changes in value from one year to the next don't affect the income statement. They're considered an "unrealized gain/loss."

Now that these investments are categorized as trading securities, however, credit unions must assign fair market value to them and record changes in value as an income or an expense.

The takeaway: If you have one or more executives with this type of deferred compensation plan—or if you use non-703 qualified investments for general employee benefits prefunding or charitable donation accounts—follow the new FASB accounting procedure and understand the potential for market-driven income swings. Be prepared to shift to more stable investments if necessary.

Will income from any of your executives' plans trigger the new 21% excise tax?

The Tax Reform and Jobs Act that took effect in 2018 created a 21% excise tax for credit unions on annual executive compensation in excess of $1 million, plus any excess parachute payments, to any one of a credit union's five highest-paid executives.

Even if you don't pay any executive an annual salary more than $1 million, a nonqualified deferred compensation plan could trigger the tax. In particular, 457(f) plans may activate the tax because these plans typically vest periodically, resulting in lump-sum vesting and payouts.

The takeaway: Review deferred compensation plan vesting dates and projected payouts. You may need to adjust these vesting intervals and amounts to avoid the excise tax.

Are life-insurance-based supplemental executive income plans still on target to produce the originally projected benefit goals?

Cash-value life insurance products are common funding instruments for deferred compensation plans because these products tend to produce more steady, predictable earnings than stock portfolios. But when bond rates remain low for many years—as they have since the Great Recession—these earnings are often affected.

Periodically review the accumulated cash value of life insurance policies and the current crediting rates.

The takeaway: If insurance-based plans underperform—or if the executive's circumstances have changed—you should be able to adjust the plan to achieve the new goals. You can make adjustments to rebalance executive deferred compensation or supplemental retirement plans. You'll want to act quickly, however, if the plan is due to vest within a few years rather than within a decade or more.

Make an executive deferred compensation plan progress report part of the board's annual review process—call it the "surprise aversion initiative."

ANDY ROQUET *is senior executive benefits specialist at CUNA Mutual Group. Contact him at* andy.roquet@cunamutual.com.