Set a Higher *Bar*

MAKE IT HARDER FOR THE COMPETITION TO HIRE AWAY YOUR EXECUTIVES BY TAILORING THEIR COMPENSATION PACKAGES TO MEET INDIVIDUAL NEEDS.

BY PETER SULLIVAN

As we learned in this issue's cover story (beginning on p. 12), credit union executive compensation has continued its steady climb. It's also clear that non-qualified deferred compensation plans represent a significant part of that overall compensation.

According to the 2018 *CUES Executive Compensation Survey (cues.org/ecs)*, base salaries and total compensation increased for each of the 19 executive positions studied. The positions with the highest increase in median total compensation from 2017 to 2018 were information systems/e-commerce, at 8.2 percent, and business lending, at 8 percent.

CEOs were also among the top five in total compensation growth in 2018 (7.6 percent). The most prevalent benefit offered by credit unions to augment CEO total compensation is a 457(b) plan, offered by 44.5 percent of the credit unions surveyed by CUES.

After 457(b) plans and not including 401(k) plans, the most-offered CEO benefits measured by the CUES survey are supplemental life insurance (39.6 percent); a 457(f) plan (34.8 percent); split-dollar life insurance (28.8 percent), and medical insurance premium reimbursement (23.8 percent).

It's worth noting that split-dollar life insurance has gained 14.4 percentage points since 2014. CUNA Mutual Group data also shows growth in the use of split-dollar life insurance. The company reports that its assets under management for collateral assignment split-dollar life insurance increased almost 50 percent from year-end 2014 through 2017.

RETAIN TALENT BY TAILORING BENEFITS

Bonuses and salary increases are certainly strong motivators for executives. They're a fitting means to reward good performance. But they're also easy for a competitor to top.

In contrast, non-qualified deferred compensation and split-dollar insurance plans make it more expensive for competitors to poach your best talent. The agreements for these benefits can specify that recipients receive them only if they stay employed by the credit union for a specified period. So, a competitor has a higher bar to clear than simply offering a higher salary and/or bonus.

Another advantage of non-qualified plans is that they can be tailored to an individual executive's needs. Credit unions can shape plans to executives' specific situations, including:

- **Life stage:** Executives who have young children likely have different needs than those who have college-age children or are nearing retirement.
- **Role in the CU's succession plan**: An executive vice president, COO or CFO you're grooming to replace the CEO within a few years will probably need a different incentive than a lending vice president you're hoping to keep on staff for at least another five years, to provide stability through the CEO transition.
- **Length of service**: A leader who's given you decades of excellent service can be rewarded appropriately, outside of the standard salary and bonus structure. This sends a message to those next in line about how your CU rewards loyalty and success.
- **Likelihood of recruitment from competitors:** If your CU has executives with especially sought-after skills—remember the IS/e-commerce and business lending executives' total compensation increases shown above?—you may need unique solutions to hold onto them.

By adapting deferred compensation programs to these types of circumstances, you're proving to your best executives that you will treat them as individuals, not commodities.

Credit unions use non-qualified deferred compensation and split-dollar plans for three key purposes; I call them the "three Rs."

1. RECRUITMENT

Employment agreements for new execs can include a provision for a deferred compensation or split-dollar insurance plan to be implemented within a specific period—say, 18 to 24 months—with the board's approval. That should help bolster your pitch to prospective hires.

If you're recruiting executives from commercial financial institutions, you may be competing against benefits that, by law, CUs can't offer. You may need to show such candidates some tangible evidence that you can compete in the total compensation arena.

On the other hand, if your candidates are coming from not-for-profit organizations, they may already be familiar with 457 plans and split-dollar arrangements. In fact, as these products become more ubiquitous, highly sought-after candidates may *expect* them to be offered.

2. RETENTION

A 457(f) plan is especially well suited to retention, because it can be designed to pay off at regular intervals, rather than only when an executive retires.

The rules for 457(f) plans can require that recipients remain employed by a CU for a specific amount of time, or they won't receive the 457(f) plan payouts. A 457(f) plan helps CUs manage risk in other ways, too.

For example, CUs can use a variety of investment vehicles to fund 457(f) plans. National Credit Union Administration regulations allow credit unions to fund non-qualified deferred compensation plans with investments that are otherwise non-permissible. Some of these investments offer higher risk for higher projected earnings. Or CUs may choose extremely conservative investments to fund 457(f) plans.

Another risk-management feature of 457(f) plans is that the credit union retains access to the assets within the plans. If the participating executive leaves the credit union or is let go for cause, the 457(f) assets are freed up for other purposes.

The main advantage of 457(f) plans for executives is that, unlike 401(k) or 457(b) plans, 457(f) plans don't have IRS contribution limits. The size of 457(f) plans can be adjusted to suit the priorities of the executive and the CU. Or it can be sized to respond to market conditions.

Of course, it's more than just rules and regulations that make 457(f) and other products effective for retention. It's also the CU's commitment and show of faith in offering them. Those can't be quantified, but they should never be discounted.

3. RETIREMENT

For highly paid credit union employees, replacing any given percentage of their working salary with retirement income is more difficult than it is for lower-paid employees.

A CU's 401(k) and/or defined benefit pension plan, plus Social Security, could easily replace 60 percent to 80 percent of a modestly paid employee's working income. But IRS and ERISA rules, among other restrictions, mean that these benefits can only replace a far lower percentage of a highly paid executive's working income.

A 457(b) plan acts basically like an addition to a 401(k) plan. Although the credit union owns the assets in the plan, the executive is fully vested from the beginning. The credit union and the executive can contribute to a 457(b), but the contributions have an annual maximum (which is $18,500 in 2018).

A split-dollar life insurance arrangement can also augment an executive's retirement income. In the collateral assignment split-dollar form of this arrangement (also called "loan regime split-dollar"), the CU issues a loan to the executive to cover the insurance premiums. The death benefit is split between the credit union and the executive to ensure repayment of the loan.

The executive can take distributions from the policy's cash value for supplemental retirement income, and the remaining death benefit proceeds (after any necessary repayment to the credit union) go to the executive's beneficiaries.

ALIGN WITH STRATEGY

As important as it is to align executive benefits with the executive's needs, it's just as important that these benefits align with your credit union's long-term strategy.

The average credit union size continues to increase, reflecting mergers and growing overall membership. With greater size comes greater responsibility throughout the C-suite, and greater demand for top executive talent.

Credit union boards and executives should consider more than simply ratcheting up overall executive compensation. They should continually review how each executive or recruit serves its overall goals, and design compensation packages accordingly.

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