Changing of CEO Guard Could Transform Benefits

By Scott Tauschek

In the “good old days” hiring a new CEO was a lot simpler. You hired from within, agreed on a salary, shook hands and the person stayed at the CU for 20 years.

But today, it’s an eye-opening experience for most CU boards. They probably haven’t hired a CEO in at least a decade or more. In addition to being eye-opening, hiring a CEO can be costly. Consider both the tangible costs of going through the process of hiring a new person, plus such intangibles as lost productivity while the job is vacant or as a new hire learns the ropes. What will it take to attract your next CEO?

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There are employment contracts, and CEOs want a guaranteed position for three years, a car, exceptional insurance, and a deferred compensation plan. You need a comprehensive benefits package to attract top talent and restrictions in place to avoid losing them. Headhunters call every day. Most boards likely don’t know what it will take to be competitive in their marketplace and it’s critical to find out. Look at the compensation studies put out by CUES and CUNA or hire a compensation consultant to do a study for you.

Who’s likely to occupy the top spot next? Historically, the CFO (chief financial officer) was the go-to candidate. Now, depending on the CU’s needs and strategic vision, the board might choose a CEO from HR, operations, marketing, or IT. The board might also choose an outsider from another CU or even from the world of banking.

Deferred Benefits Programs

Top talent is in demand and these executives know exactly what's being offered in the compensation marketplace. CUs quickly realize it can be hard to compete—especially if their candidate is from banking. If it were simply a matter of salaries, the research shows CUs are pretty competitive. But we struggle with the complete benefits package. Banks can offer stock options and other perks that CUs cannot. And that's where Supplemental Executive Retirement Plans (SERPs) can help.

SERPs are deferred benefits plans that help address both retirement and retention challenges. These plans are non-qualified, which means they can be made available to an individual (rather than equally to a complete employee class). They can be an affordable way for CUs to beef up their compensation packages and can be tailored specifically for the situation and individual(s).

How Knowledge Helps

Your board may wish to gain more knowledge and experience with deferred compensation. Without enough knowledge, some boards worry that executive benefits plans will be expensive to fund. Your board could also be concerned that these "extra" benefits don't align with CU philosophy—or that having a SERP could open the CU up to compliance and regulatory issues.

Education is the answer to all these worries. First, boards need to understand that CEOs face a retirement parity gap and what top talent—especially talent from outside the CU industry—is demanding. Then, it's critical to show how a properly structured SERP can align with a CU's goals, the role pre-funding the SERP can play, and that the right benefits partner will minimize the regulatory risk.

The CEO Retirement Funding Gap

Retirement-related benefits are especially popular because highly compensated individuals can find themselves in a tricky position come retirement. The Employee Retirement Income Security Act of 1974 has restrictions that limit tax-free contributions to a 401(K) and limit Social Security benefits. These restrictions create a gap in retirement income for highly compensated individuals.

Lower-paid employees can typically expect to receive 60 percent to 80 percent of their salary in retirement through these two sources. Due to restrictions, more highly paid employees can typically receive roughly 30 percent to 40 percent of their salary through these channels, according to internal CUNA Mutual Group data.[1] Once your CU has a plan in mind, look at the NCUA Examiner's Guide for due diligence recommendations. Your board and senior executives must be able to demonstrate to the examiner that they understand the value of these plans and the risks associated with having them and not having them. You must also understand your legal authority to create a deferred compensation program and make sure the plan is set up under the correct tax code. Work with a qualified advisor, attorney, and CPA.

[1] *Non-Qualified Executive Benefits: A Guide for Credit Union Leadership*

Other C-Level Staff

As your CU navigates the challenges of finding and bringing a new CEO, be aware that this will impact the rest of the CU's staff. Generally, what happens, is several staff members appear to be good prospects for the role with one being chosen or there are multiple good internal prospects with no one being chosen. Those who weren't chosen end up looking for opportunities outside your CU, however their presence during the transition is critical to your success. Deferred benefit plans should be structured to help retain key executives through the desired transition and retention periods and can be tailored to each individual. Be sure these are in place before the CEO selection process begins.

Pre-funding Relieves Benefits Cost Pressure

CUs are rightly concerned about how they'll fund compensation and benefits. According to June 2018 National CU Administration call report data, compensation and benefits account for more than 50% of the average CU's operating expense and most CUs struggle to cover these costs.[2]

[2]*June 2018 National Credit Union Administration call report data*

Since 2003, through an amendment to Regulation 701.19, NCUA has allowed federally chartered CUs to address this challenge through benefits pre-funding. This means CUs can fund their benefits via potentially higher-yielding investments (such as business-owned life insurance, mutual funds, stocks, annuities, bonds and institutionally managed portfolios) that wouldn't be permissible in other situations. CUs have historically been reluctant to take advantage of this amendment—both because of their naturally conservative investment approach and because they were waiting to see how the back-and-forth between NCUA, CUs, and investment services firms would play out.

Benefits pre-funding lets you repurpose investment assets and shift them to these potentially higher-yielding investments. Too many CUs have investment portfolios with depressingly low yields not much over one percent. It's possible to double, triple that or more, while still using relatively conservative tools. A growing number of CUs are coming to understand the benefits of this option.

Reeling in the Right SERP

Supplemental executive retirement plan features can be mixed and matched to meet a CU's goals. Consider the following options:

1 457(b) retirement-only

These plans let executives make tax-deferred retirement contributions up to $18,500 (2018) a year and are a good supplement to a 401(k).

Pros: The money is vested immediately; employees can choose investment vehicles; and funds may be received without penalty at a younger age than those in a 401(k). There's no cost to the CU, other than the program's administrative expenses. The CU can choose to match funds (up to the allowed limit).

Cons: Money is held by the CU, with a risk of forfeiture if the CU liquidated. CU HR departments tend to be less familiar with these. The plan amount shows up on the CU's books as a liability.

2 457(f): retirement and retention

These plans are funded by the CU and have no dollar limit. They can be funded as a defined contribution (a specified dollar amount is invested into the plan) or a defined benefit (a specified dollar amount is invested into the plan) or a defined benefit (a specified payout regardless of the performance of underlying funds).

Pros: Employees like the employer-funding, while the CU can create "golden handcuffs" by linking payout to such criteria as job performance or time on the job.

Cons: Benefits to the employees are subject to taxation at vesting. There is also a risk they may not receive benefits if they don't meet plan-defined criteria (such as performance expectations). CUs can struggle to fund defined benefit plans.

3 Bonused life insurance

Through this type of plan, the CU "bonuses" some or all of the premiums needed to maintain an active life insurance policy that is owned by the executive. These plans don't have a limit and the CU or the employee can pay the premium.

Pros: Creates a tax-free income flow for the employee. The plan can be structured to allow for cost recovery by the CU.

Cons: Employees in poor health might not meet the insurer's underwriting standards and will face an increased tax burden if the policy is paid for with a bonus. The downside for CUs: The employee can walk away with the policy once it's paid for.

4 Split-dollar life insurance retirement and retention

No dollar limit. Premiums, ownership rights and death benefits are split between the CU and the employee. Typically, the CU pays the cost of the premium via a loan to the employee. The employee owns the policy, but the CU becomes a lien holder on it.

Pros: Can provide a tax-free income stream and death benefit for the employee. If the CU charges interest on the loan used to pay for the policy, it becomes an income source.

Cons: Insurance amount is locked in and therefore can't reflect large changes in CEO salary. The employee must meet underwriting standards to qualify. CU might struggle to recapture its cost of funds, especially if the agreement ends upon retirement, not death.

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