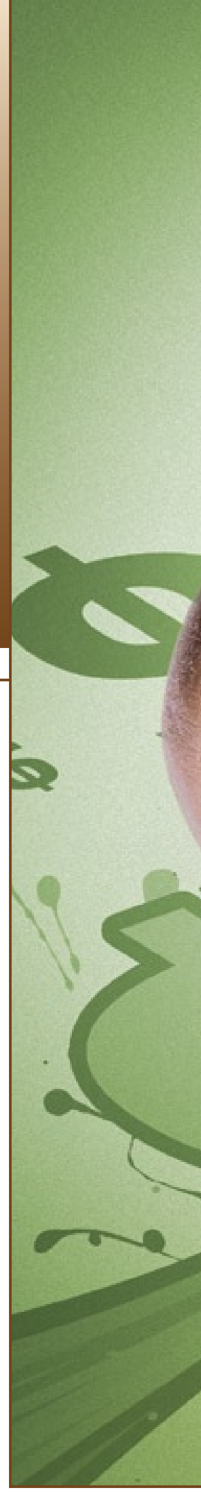

ROUGH ROAD TO RETIREMENT?

BY KAREN BANKSTON

Unpredictable economy throws a monkey wrench in long-term compensation planning.

As if planning a long-term compensation program for the CEO isn't hard enough already, the economic downturn and unpredictable market swings have added new complexities to the board's work. But it's too soon to tell if directors are facing a pothole or a bridge collapse as they chart a path for the credit union's—and its chief executive's—future.

Along with the rest of the financial services industry, credit unions will likely need to weather the financial doldrums, "but at least they're not caught up in the mortgage debacle," says Scott Dettmann, vice president and principal in Carlson Dettmann Consulting *(www.carlsondettmann.com)*, an operating division of ene-trix, Middleton, Wis., which administers CUES' annual compensation surveys.

In the boardroom, directors and executives are continuing their discussions on the best way to structure long-term compensation plans. "There might have been a momentary pause to consider how to get through all this, but I think most boards have an underlying belief that we'll work past it," Dettmann says.

There is potential for credit unions to come out ahead, as consumers turn to the one segment of the financial sector that hasn't been in the news over scandals, shutdowns and emergency buyouts, notes Joe Tripalin, president of Preferred Partners Consulting, LLC *(www.preferredbenefitpartners.com)*, McFarland, Wis. But in the short term, credit unions will share the pain of worried members who put off buying new homes and cars or taking out loans for home improvement projects and other discretionary expenses.

REPEAT NONPERFORMANCE

This is not the first time in recent years that boards and CEOs have been reminded of the dangers of basing a long-term compensation plan primarily on the vagaries of the stock market, Tripalin says. The market free-fall in the aftermath of the Sept. 11, 2001, terrorist attacks disrupted many retirement programs and sent executives in search of a safer alternative.

"That's one reason why insurance-based programs that create a supplemental benefit are becoming more common than funding mechanisms that rely on market gains," Tripalin says.

Even with insurance giant AIG making headlines, well-established, financially strong insurance companies tend to provide steady dividends, especially in comparison to stock-based plans in recent years, he suggests.

The need to stay the course through the recent financially stormy waters to accomplish long-term strategic objectives underscores the challenges facing boards in designing an effective executive compensation program. There is no doubt that CEOs are earning their pay these days as they look for ways to weather the catastrophes in the mortgage market and financial services sector and turn those setbacks into opportunities for their credit unions and members. They must position their organizations to respond to trends of industry consolidation; expansion of products and delivery channels; and the upward spiral of members' expectations for instant access, convenient infrastructure and high-quality service. At the same time, they face the daily grind of managing increasingly

complex operations and complying with ever-expanding regulations.

Charter expansions, mergers, and new product lines such as business services present new possibilities, while compliance concerns and the need to guide members through the current financial morass require a steady and skilled executive at the helm. The bottom line for compensation planning is recognizing the leadership accomplishments of a CEO who successfully navigates today's new challenges. Failure to do so puts the credit union at risk for losing its chief executive during a time when it can least afford to do so.

It's not just about executives earning a reward for leading in these uncertain times, Tripalin says. "In a lot of credit unions, executives' retirement benefits are not nearly adequate for what their needs are, and that's not going to go away. The board needs to find ways to respond to that gap and put together a plan to allow the CEO to retire with an adequate retirement program."

Thus, the board's most essential work is, first, to agree on the credit union's strategic course and then identify the long-term performance measures to evaluate whether the CEO is steering the organization in the right direction. That requires looking beyond short-term financial performance. For many credit unions, those evaluations are based on both objective, quantitative

criteria and more subjective assessments, such as annual board reviews.

THE FAIRNESS FACTOR

Settling on a long-term compensation formula also comes down to offering the CEO a fair deal, both internally and externally, Dettmann suggests. Executives look for assurances that their retirement plan and other long-term benefits reflect industry standards, which can be difficult to do because extensive survey data on these benefits is not readily available. Boards may need to do some custom surveys to get a clear picture of current market practices.

"External data remain rather cryptic because these practices are very diverse," he notes. "But the main question for CEOs remains, 'What are our competitors doing?' When we work with credit unions and other nonprofits, we stress the need to agree on a common ground for why the organization should extend these benefits. Typically, the need to retain executive talent is the main reason."

Within the credit union, the compensation planning quandary is the ability to extend to highly paid executives opportunities for proportional retirement savings as compared to non-exec employees. "The board needs to consider if the CEO is treated fairly in comparison to the typical employee when it comes to retirement benefits," Dettmann says. "The truth is that tax laws and the ceiling on Social Security benefits works to the disfavor of executives. It's hard to maintain parity."

Several sections of the IRS Code, including parts of sections 401, 404 and 408, set a ceiling on income that can be a factor in calculating annual retirement savings that qualify for special tax treatment. The compensation limit for 2009 for employer-sponsored retirement plans, such as 401(k) and defined benefit plans, is $245,000, up from $230,000 in 2008. Executives with higher salary and bonus compensation begin to fall behind in the rate of retirement savings, especially when factoring in limits on Social Security benefits.

Let's consider some examples. Dettmann employs an actuarial projection model developed by John Frederick, an actuarial consultant based in Shorewood, Wis. The model focuses on "career employees," or those who work at least 20 years for the same company. The model calculates the estimated differences in projected income at retirement from Social Security and a fully funded 401(k) plan. Our comparison is based on an average 4 percent annual salary increase, 6 percent annual 401(k) contribution, and 7 percent average return on the retirement savings (which may seem a bit optimistic, given market performance in recent months) for employees who are 45 years old in 2008. When they retire in 20 years, employees and executives at various salary levels can count on the accumulated retirement savings and Social Security benefits outlined in Figure 1.

Obviously, highly paid executives can amass a significant nest egg through traditional retirement vehicles. According to this projection model, for example, the CEO of a $1 billion credit union could accumulate $711,933 by the year 2027 in a 401(k) plan, compared to $117,499 for an

FIGURE 1

	2008 Salary *(Base + Bonus)*	Equivalent Annuity Payable Beginning at Age 65 *(as a percentage of final pay)*	Total Annual Retirement Income, Including Social Security *(as a percentage of final pay)*
Credit union employee	$35,000	14.4%	48.3%
CEO of credit union with $10 million to $19 million in assets*	$79,400	14.4%	38%
CEO of $100-199 million credit union	$156,801	14.4%	27.6%
CEO of $200-399 million credit union	$208,247	14.2%	24.1%
CEO of $400-599 million credit union	$282,659	10.8%	18.1%
CEO of $600-999 million credit union	$320,000	9.6%	16%
CEO of $1 billion+ credit union	$446,499	6.9%	11.5%

**CEO salaries are based on the median base plus bonus salaries reported in the 2008 CUES Executive Compensation Survey.*

employee earning $35,000 this year. However, because she can't sock away the same proportion of income as employees earning less than the maximum, the CEO's 401(k) balance at retirement would be less than her final annual pay, estimated at $940,706.

In response to those restrictions, the board may offer a high-performing CEO a supplemental executive retirement plan (SERP), carefully designed to comply with Internal Revenue Service standards. Many credit unions that go this route offer a 457(b) plan, a retirement plan that is eligible for tax deferment until retirement. It may be offered as an extension of the 401(k) retirement account and may even be managed by the same administrator, Dettmann notes. The 2008 limit for contributions to a 457(b) plan is $15,500.

If a wide gap in proportional retirement savings remains, the board may also decide to create a 457(f) plan for the CEO. Regulations guiding the design of a 457(f) plan require that there be a "substantial risk of forfeiture," typically satisfied by the executive's continued service to a set date. Technically, these plans cannot be formally funded like 401(k) and 457(b) plans, so they tend to be "informally" funded through a variety of means, including insurance vehicles, Dettmann explains.

According to a Clark Consulting (*www.clark consulting.com*) survey, *Executive Benefits: A Survey of Current Trends 2007 Results*, about two-thirds of responding companies, including 82 percent of the financial institutions surveyed, created SERPs for their highly paid executives. Among the primary reasons for those plans was to replace benefits lost by the cap on traditional retirement contributions, to provide incentives to recruit high-level execs, and to create "golden handcuffs" to tie a high-performing CEO to the organization.

Benefit formulas vary among survey respondents, but many use some percentage of final compensation to calculate benefits. More than half of the respondents fund their SERPs informally and, among those that do, three-fourths depend on corporate-owned life insurance as a funding vehicle.

It's true credit unions have to weather yet another storm with their executive retirement planning. The good news is the market always recovers. As Dettmann notes, most credit union boards understand that they have to work past it. He says: "Despite all the angst, it should be business as usual for credit unions again soon."

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RESOURCES

For more articles on executive benefits, go to *cumanagement.org*. Click on "Article Archives," then select "Boards" and "Executive Benefits."

Learn more about CUES Executive Benefits presented by Preferred Benefit Partners Consulting, LLC at *cues.org/executivebenefits/*.

Read more from the *2008 CUES Executive Compensation Survey* at *cues.org/repository/708feelingthe squeeze.pdf.* Or, you can visit *survey.cues.org* for more information.