



ENDSIGHT

ECS has asked one of our valued business partners, Norma Sharara, Partner with Luse Gorman Pomerenk & Schick, P.C.'s Executive Compensation, Employee Benefits and Taxation Group, to share her experience on executive compensation and benefits and the trends she is currently seeing with her credit union clients.

1) What are your credit union clients most concerned about with respect to retaining and rewarding their executive talent in the current economic environment?

Our credit union clients seem most concerned about striking the right balance between fulfilling their fiduciary duties to their members and providing appropriate executive compensation packages to retain and reward their top talent.

2) What do you see as the emerging theme in credit union executive benefits over the next 5 years?

We expect to see greater board oversight of risk-taking behavior that is designed to incent “pay-for-performance”. We also anticipate seeing credit union boards adopt more formalized processes and procedures (i.e., better governance practices) over all elements of executive compensation packages. In the past, there was more of a “piecemeal” approach to executive compensation and now we’re seeing a more holistic approach.

3) What regulatory activities are you keeping an eye on? How might current or pending regulatory action impact your credit union clients?

In credit union mergers, you have to keep in mind the NCUA rules on golden parachute payments. We also expect that the NCUA will soon release final rules implementing Dodd-Frank, regarding safety and soundness of incentive compensation for credit unions with assets of \$1 billion or above. Credit unions below that size should consider implementing similar rules as best practices.

4) Credit unions primarily concern themselves with the impact of 457(f) on their executive benefit programs, but they must also comply with 409A regulations. Where do these two tax provisions intersect? Where do they potentially have different interpretations?

Code Section 409A is *in addition to, not instead of*, Code Section 457(f). Code Section 457(b) plans (which are very similar to 401(k) plans) are exempt from compliance with 409A. We often advise clients to combine a 457(b) and a 457(f) plan so the executive can be vested up to the maximum annual amount permitted by IRS rules under the 457(b) component (i.e., \$17,500 for 2013), with amounts in excess of that limit remaining unvested because those amounts are taxed under Code Section 457(f) when they are vested (even if those amounts are not paid out until later). Code Section 409A primarily focuses on time and form of payment, not amount of benefit, so using a combination plan may be desirable.

5) As credit unions review their long-term executive benefit programs, what due diligence actions would you recommend?

Credit union boards should have a committee that is responsible for creating and maintaining an overall compensation philosophy for the credit union. Each element of executive compensation should be a pillar that

supports the over-arching compensation philosophy. Often, we find credit union boards don't know why they offer certain benefits to executives other than "everyone else does it". By having a compensation philosophy, the committee can clearly articulate to the full board, to members, and to the executive team, why the credit union offers each type of benefit, and at what level. Committee members need training to understand how financial institution compensation differs from other industries so the credit union can attract and retain top talent.

6) When you work with credit unions in advising on executive benefit programs, who is typically your client – the credit union board or the executive?

Typically, we represent the credit union so we can participate in educating the board about their fiduciary duties in the context of executive compensation on a day-to-day basis, as well as in the context of mergers and acquisitions. Occasionally, we represent individual executives, if the credit union already has counsel. We view ourselves as specialists, and are not looking to replace local counsel who advises on other matters. Both the credit union and the executive should have their own lawyers review significant documents like employment agreements, deferred compensation plans, separation packages, etc. Although we generally represent the credit union, we believe in an approach that is fair to both the employer and the employee. After all, the credit union wants an executive who is happy and who will perform well for the members.

7) How do you differentiate between what is reasonable and competitive and what might be seen as excessive?

There is definitely a line where a compensation package is too rich for a particular credit union or for a particular executive based on their contribution to the organization. The IRS may even revoke the tax exempt status of an organization that pays excessive compensation. Peer group analysis is needed to objectively benchmark where the credit union falls with respect to compensation packages for the top executive team. Subjective individual factors are then a necessary overlay to customize the objective peer group data to "right size" the package.

8) What should credit unions be on the lookout for when designing a long-term executive benefit program?

Just because a popular salesperson pitches a product, or many credit unions seem to have a similar product, doesn't mean that you should buy that product for your credit union unless you completely understand what it is supposed to do, and what the long- and short-term risks are to the credit union and the executive. If something sounds too good to be true, it usually is. Similarly, it shouldn't take hundreds of pages to explain how a product works. There are several common strategic planning alternatives for credit unions that work well, when used correctly, and with "eyes wide open" about how the products actually work (and a healthy skepticism for rosy projections). The best time to think about an exit strategy from a comp program is when you are entering into it.

9) Where have you seen credit unions make mistakes during the design, evaluation, and documentation process? How can these be avoided?

The most common mistake that we see is when credit unions say, "We just committed to buying corporate owned life insurance (COLI) because we like the accounting treatment of COLI (or everyone has it and now we do too). Now we need a supplemental executive retirement plan (SERP) to link to that insurance policy, so can you draft something for us?" In my view, buying the insurance first amounts to the tail wagging the dog. Instead, if the credit union has an overall compensation philosophy, the credit union will know whether it needs a SERP, and if so, what kind of SERP is necessary to support that philosophy. Credit unions need an expert advisor to quarterback their compensation program. When used properly, COLI is a powerful tool, but when used improperly, such purchases can lead to "buyer's remorse."

10) Have you ever worked with a credit union client that has had to "unwind" or correct a poorly designed executive benefit program? If so, what steps were taken to correct the situation?

Unfortunately, fixing a broken plan happens a lot. We often work with clients in "clean up mode" to set things right from a legal standpoint, then we switch over to "planning mode" to set up better governance over executive compensation matters. These "guard rails" are intended to result in a compensation structure that doesn't take the credit union over any cliffs when unexpected curves turn up.

11) What closing words of advice would you give a credit union board in the development, design, and implementation of a strategic executive benefit program?

Executive compensation planning is truly an area where "an ounce of prevention is worth a pound of cure". The key

is to work with specialized, experienced advisors who can provide judgment, practical experience, and technical expertise. Involving a specialist early on can save the credit union in the long run and result in fewer sleepless nights for executives and the board.

Norma Sharara has more than 20 years of experience in the executive compensation and employee benefits field. Ms. Sharara regularly counsels management and boards of directors of publicly traded and privately held financial institutions and tax exempt organizations on ERISA fiduciary duties, employment and income tax issues, and corporate, securities and regulatory issues involving 401(k) plans and employee stock ownership plans (ESOPs), 403(b) plans, non-qualified deferred compensation plans (including 457(b) and 457(f) plans for credit unions), supplemental executive retirement plans (SERPs), health and welfare plans, equity incentive plans, split dollar and bank-owned life insurance (BOLI) arrangements, employment and change in control agreements and executive separation packages, both in the context of on-going compliance and in the context of mergers and acquisitions and stock offerings. Ms. Sharara can be reached at 202.274.2035 or nsharara@luselaw.com.

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