



Executive Compensation Plan Evaluation and Resuscitation

By David S. Emery

In years of market growth, the financial instruments sometimes used to fund executive benefit and incentive plans parallel the upward market direction, requiring only annual monitoring to generate success smiles for all concerned.

In turbulent markets as in recent years, plan-funding assets cause furrowed brows, requiring more oversight to assure an executive's benefit will be there at the proper time, as planned.

Several nonqualified retention/reward tools are available to credit unions, but a 457(f) plan is the industry's primary deferred compensation plan, and exemplary of the monitoring and remediation that may be required for such tools. Not all credit unions will elect to use such a plan, but they are commonly seen among institutions wanting to keep or reward senior executives.

Disappointing markets alter program performance and spur credit unions to determine if plans are operationally efficient, effective and current. But, this is not the only reason that plans may change.

Regulations change, and plans must be brought into compliance. Accounting systems or operational processes (including plan documentation) alter, and programs must be adjusted. Lastly, board objectives may change, and plans must be aligned with new goals.

No single authority is responsible for ensuring 457(f) and other programs are up to date. Ultimately the board is responsible for plan results, but monitoring is usually divided among credit union staff, auditors, and the plan provider and/or administrator.

The credit union CEO or CFO receives notice that regulations have changed, and must notify the board. The third party plan administrator or provider may provide performance numbers. The auditing CPA should review the validity of the plan accounting and performance. A credit union can also make its attorney or compliance officer accountable.

An up-to-date plan is one with a review history, with goals and results in alignment with board intentions, compliant with current regulations and properly accounted for. The underlying investments must have a similar review history.

With an effective plan, everyone knows his accountabilities and verification intervals. (Verification must be at least annual, include documentation in board minutes and include updates on each plan design component.) Reports should be archived so results can be compared period over period. A service agreement between all parties and the board is strongly suggested.

If a plan hasn't gone well, there are surprises, usually with associated costs: Off on a regulation or two, the attorney says the plan is not in compliance, the plan can't make the distribution.

If an administrator read documents incorrectly and only accrued \$800,000 of a million-dollar benefit package, the credit union could wind up with a \$200,000 expense. If the board thought the plan would automatically renew for another 5 years, but it doesn't, they now have an obligation for another period with no recourse.

If performance is not what is expected in any area of service, remediation is necessary. The initial steps are to review plan documents, design, funding and accounting. If poor investment performance is involved, evaluation will include options to replace original investments.

If you made a decision under a set of circumstances that changed, the decision may need to be changed. If the market is poor, everyone in it will get beaten up. The best chance for preventing or remedying performance pain is a template for regular monitoring and adjustment. The sooner it's known if things are not going right, the sooner improvements can be made.

For a plan that has functioned poorly, the choices are: keep what you have or change. Options become more limited the closer the plan is to maturity. If results and options have been reviewed regularly, the changes at any point will be small. The more infrequent the evaluation, the bigger the changes may be.

Sometimes the wise option is to cancel an existing program and move to another allocation. If it's too painful to move due to contractual provisions, surrender charges or other specifications, there is often a way to "crawl out" of investments. Gradual movement to a more stable environment is possible, making less money subject to market volatility.

If other matters, such as accounting, need improvement, the plan provider has an ethical and fiduciary responsibility to explain. Plan documents should always be updated with any investment alterations.

It is rarely pleasant to make changes, but credit unions must have a system to regularly review results. Options can be developed and help secured from competent resources, but only if a credit union has systematized monitoring and feedback. 🐼

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