

# Long-term Executive Benefits at Credit Unions

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# What is a long-term executive benefit?

Long-term executive benefits are a component of total compensation. The long-term benefit's primary purpose is to attract, retain and/or reward an executive.

While this benefit can take a variety of forms, it is fundamentally an agreement between the credit union and the executive. The credit union agrees to pay the executive at some time in the future and in return the executive agrees to continue working diligently at the credit union until a specified date. The benefit can be structured so that some or all of the benefits are forfeited if the executive leaves the credit union prior to fulfilling his/her part of the agreement.



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# Why should a credit union provide this benefit?

Whether you're looking to attract, reward, or retain an executive, the long-term benefit will help you obtain or maintain good leaders.

Consider these points:

- The demand for credit union talent remains very high
- The competition for leadership in the credit union movement has created a lot of movement within the leadership ranks
- Replacing a CEO, a CFO, a COO or other officers can be very expensive and a drag on production
- Maintaining quality C-level officers and having a succession plan will provide financial, morale and quality efficiencies
- The competition will likely be offering a compensation package that includes a long-term benefit



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# How do we determine how large the benefit should be?

This determination is part science and part art. It is paramount that plan provisions (i.e., amount, delivery dates, ancillary benefits and more) provide an affordable, reasonable and effective benefit. Survey information on benefit provisions is unreliable and sketchy. Expertise and credit union movement knowledge is more valuable in understanding what to provide. While “replacement percentage” is the most commonly compared provision, there are many other factors that are integral to the value and effectiveness of the benefit, such as:

- How many annual payments are considered?
- What is the discount rate used to determine the lump sum equivalence?
- How are the other employer-provided benefits valued and what are they (401(k), social security, defined benefit, other)?
- What is the definition of final average compensation? How many years are averaged?
- Are bonuses considered in the final definition of compensation?
- What are the ancillary benefits?
- Should there be vesting prior to payment date? What are the consequences?
- And more!



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# Methods

In the credit union movement, there are two methods that are most common. A third will also be presented.

- 457(f)
  - The executive agrees to work for a period of time. Once the service and any performance requirements are met, the executive is entitled to receive the benefit. Once the benefit is “vested” (i.e., owned by the executive), the executive is taxed on the value of the benefit.
- Collateral Assignment Split Dollar (CASD)
  - A specially designed life insurance policy is purchased by the executive with funds loaned to her/him by the credit union. The policy is an “all-in-one” vehicle which provides benefits, funding and collateral for the loan made to the executive.
- BOLI multi-use
  - A BOLI (Bank Owned Life Insurance) policy is purchased by the credit union. This policy generates annual gains. These gains are split into two uses: (1) earnings to the credit union, and (2) funds used to pay for a benefit to the executive. This benefit can take various forms and have various provisions.



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# 457(f)

## How it works:

- Offers many ways to define the amounts and dates of payments
- Can be tied to performance
- The benefit should be payable when vested because the benefit is taxable when vested
- The benefit is forfeited if the executive voluntarily terminates employment prior to vesting
- There are options on how to vest in the event of involuntary termination, disability, death, termination for cause and sale/merger/acquisition
- Can provide young executives with early payments to make them feel “real”
- The benefit can be grossed up for tax purposes
- The benefit is expensed in full by the time the benefit is paid
- The benefit can be funded
  - Helps mitigate the expense
  - Provides cost recovery to the credit union



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# Collateral Assignment Split Dollar (CASD)

## How it works:

- The credit union lends the executive funds that are used to pay premiums on a life insurance policy
  - The loan accrues interest at the AFR rate in effect at the time of the loan
  - The policy is collateral for the loan
  - The policy builds cash values and at a specified age (per agreement) the executive commences periodic withdrawals from the cash values of the policy (the benefits)
  - The policy must continue to in force every year as long as the insured is alive
  - The policy is designed to pay a death benefit large enough to pay off the loan and interest and also may have some additional death benefit that can be shared between the credit union and executive's beneficiaries
  - This plan works when the AFR rate (the loan's interest rate) is substantially lower than the cash value's earnings rate
  - This plan works only when the policy is consistently maintained as a "life insurance policy"



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# BOLI Multi-use

## How it works:

- In this strategy, an institutionally designed BOLI product is purchased by the credit union. Each year the BOLI is designed to increase in value.
  - Provides an instant return to the credit union; and
  - Pays for a long-term benefit plan for the executive.
- The long-term benefit plan can be designed as either a 457(f) or a bonus plan.
- Funding with a brokerage account, life insurance, annuities, or other can be selected to be appropriate with respect to the benefit amount, delivery dates and cost recovery requirements.
- Plan provisions can also be tailored, including vesting, payment dates and amounts, ancillary provisions and more.



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# The what ifs

In implementing a long-term executive benefit, directors need to know the answers and implications of the answers to these questions:

- Is there is a need for the benefit?
- What could happen if there is no long-term executive benefit for the executive?
- Do we want to keep our executive?
- What are his/her ties to the community and extenuating circumstances that may cause the executive to stay or leave?
- What is the competition doing in the way of total compensation and long-term benefits?
- What are the regulations controlling the benefit amounts?
- What does this benefit cost? How is cost measured?
- What are the regulations controlling the funding thresholds?
- Who will provide the documentation, administration and oversight of such a program?
- What will such a program do to our credit union culture?
- What will happen to the benefit if the executive leaves voluntarily, leaves involuntarily, becomes disabled, is terminated for cause, or has a change of desk due to a sale/merger/acquisition or dies?

**Directors are responsible for understanding the questions and answers posed above. Only once a benefit plan is understood and its risk/reward is fully investigated by the director can they vote knowledgeably on this issue.**



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# About Kevin

- Kevin Mahan is a graduate of University of California at Santa Barbara in Mathematics and has earned the designation of Enrolled Actuary (EA) by the Joint Board for the Enrollment of Actuaries. He is a member of the American Society of Pension Professionals and Actuaries (MSPA). Commencing an actuarial career in 1977, Kevin continues to study and practice in both qualified plans and non-qualified plans. His work within the non-qualified area has been exclusively with credit unions for the past eleven years.
- Kevin is married to Connie and they have a daughter. His hobbies are golf and music. He is an accomplished dobro player and saxophonist. Currently he is a member of The Slick City Pickers, an Americana band that plays in Southern California. Kevin is also on the Board of Trustees of Sound Art, a Los Angeles based not-for-profit mobile music school that provides guitar, bass, drums, recording and song-writing skills to child throughout the underserved areas in Los Angeles.



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