2016 NAFCU-BFB Gallagher Executive Compensation and Benefits Survey

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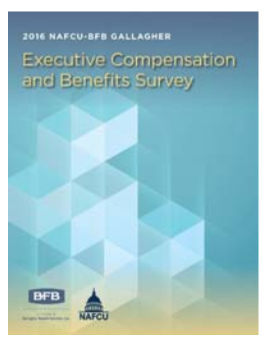
BFB A DIVISION OF Gallagher Benefit Services, Inc.

Agenda

- Survey respondents
- How to read the data
- Asset size and region
- Trends in benefit plans
- Best compensation practices
- Q & A



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Survey Participants

- All Federal and State Credit Unions invited
- 594 Credit Unions
- Includes both NAFCU members and non-members
- Completed Survey from March 2 to April 1, 2016
- 1,726 Executives
  - 594 Top Executives
  - 440 #2 Executives
  - 309 #3 Executives
  - 227 #4 Executives
  - 156 #5 Executives

Population vs Sample by Charter Type

	Total Credit Unions	Survey Credit Unions
N =	6,021	594
Federal	63%	74%
State	37%	26%

Population vs Sample by Region

	Total Credit Unions	Survey Credit Unions
N =	6,021	594
Northeast	25%	21%
Southeast	19%	21%
Midwest	41%	38%
West	15%	20%

48 states represented plus the District of Columbia, Puerto Rico, U.S. Virgin Islands

Population vs Sample by Asset Size

	All Credit Unions = 6,021 *	Survey = 594
< $10M	30%	9%
$10M – $20M	14%	12%
$20M – $40M	15%	15%
$40M – $75M	12%	16%
$75M – $150M	11%	15%
$150M – $400M	10%	14%
$400M – $1B	5%	11%
$1B +	4%	8%
Average	$200M	$334M
Median	$27M	$70M

* NCUA Call Report, December 2015

Data Adjustment

Weight the data based on

- Total Assets
- Region
- Type (Federal/State)

Result: Sample is representative of Federal and State Credit Unions

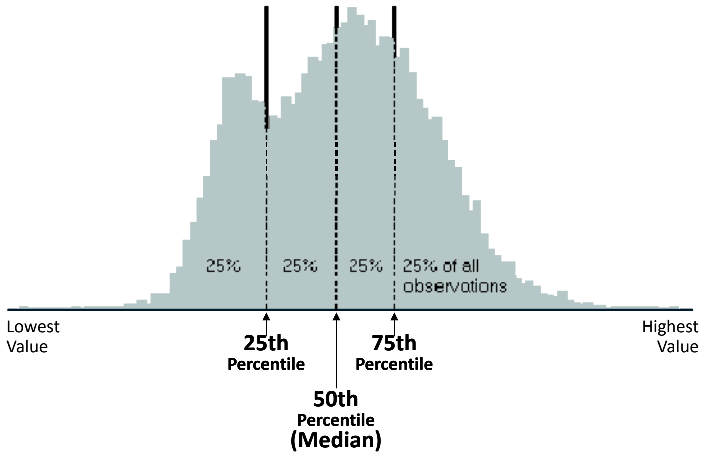
Sample Table – Top Executive (CEO)

Credit Unions with Total Assets of $400 Million to Less Than $1 Billion

Percentile	2016 Potential Total Compensation (Base + Bonus)	2016 Base Salary	Target Bonus % of Base	Target Bonus $ Dollar Amount	Comparison Credit Unions: Total Assets (M)	Loans/ Leases (M)	Number of Members	Employees	Branches
10th	$259,116	$235,560	0%	$0	$422	$242	38,464	108	6
25th	$312,000	$280,000	8%	$23,428	$495	$310	44,027	137	8
40th	$350,000	$309,830	15%	$48,570	$540	$361	52,775	159	9
50th	$385,000	$316,855	20%	$58,500	$603	$394	57,894	195	11
60th	$400,000	$340,000	20%	$70,000	$649	$442	61,526	212	12
75th	$444,000	$370,000	25%	$82,500	$765	$493	70,838	231	14
90th	$562,500	$450,000	30%	$121,200	$930	$610	87,290	258	18

Results based upon surveying 63 top executives in this asset group

What Is a Percentile?



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Relationship between Asset Size and Total Compensation

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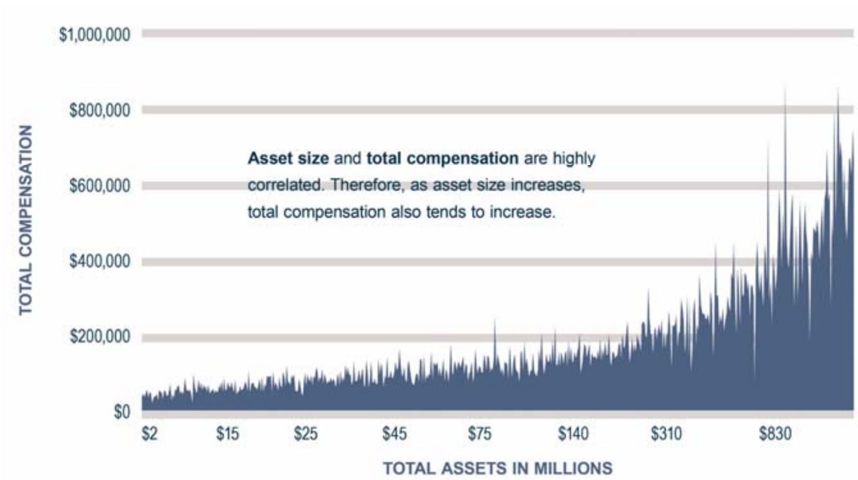
Total Compensation by Asset Size



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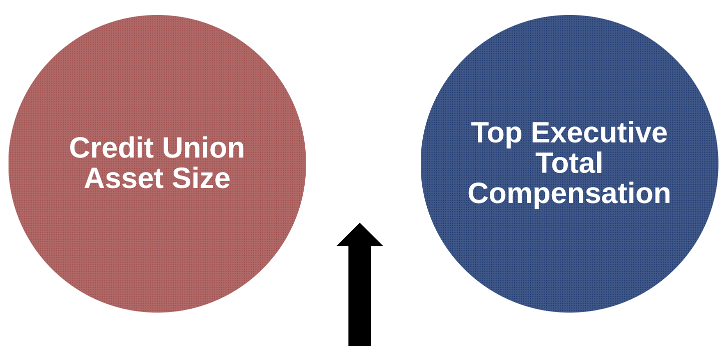
Relationship of Asset Size and Total Compensation



60% of the total variance in Compensation can be explained by Asset Size

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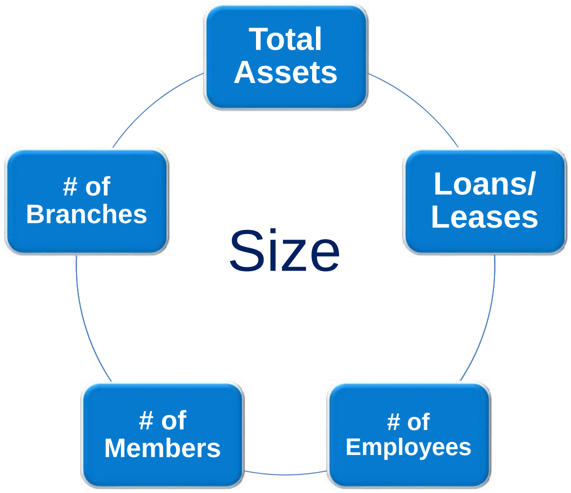

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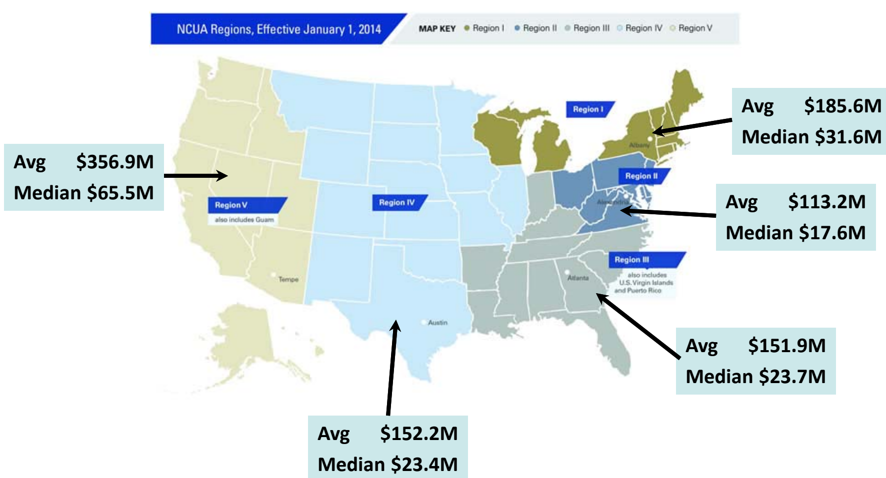
Results based upon surveying 63 top executives in this asset group

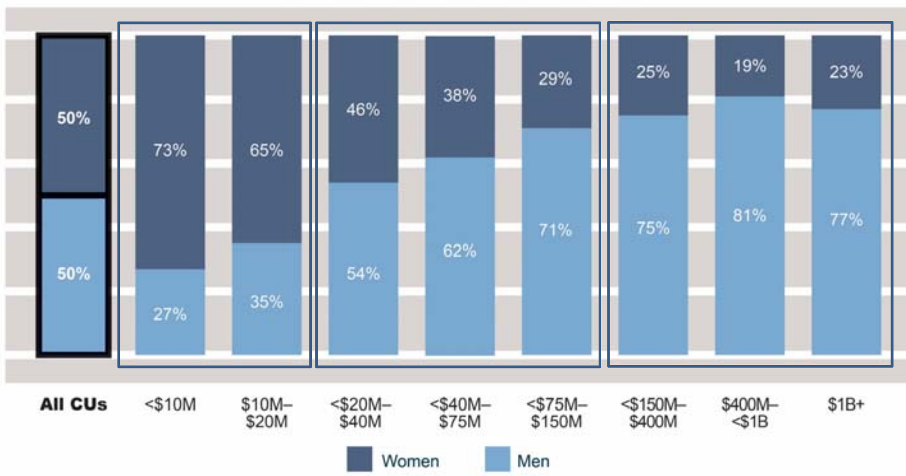
How valuable is it to compare compensation by region?

Total Assets by Region



Note: Region 8 - Navy FCU, State Employees CU, Pentagon FCU, Boeing Employees CU, and Schools First CU – are excluded from this analysis
Source: Query of December, 2015 NCUA 5300 Call Reports

Top Executive: Gender



Source: 2016 NAFCU-BFB Gallagher Executive Compensation and Benefits Survey

Trend – Nonqualified Benefits

Percent of credit unions with Nonqualified Benefit Plans has increased

- Across all 6,000+ credit unions, estimate 6% increase since 2010 *
- The larger the credit union, the more likely they are to have these plans
- Increase mostly attributed to credit unions with $150M + in Total Assets

*Estimate based on comparing 2010 and 2016 survey results for Federal Credit Unions

Executive Benefit Plan Types

Deferred Compensation	Welfare Benefit – Split Dollar	Section 83 Bonus
• Promise to Pay • 457(b) – limited contributions, vesting, **taxation** • 457(f) – Employer-funded benefit, cliff vesting date, **taxation** • Cost mitigation allowed under 701.19	• Loan to Executive • **Tax-free** income to participant • Vesting at BOD discretion • Cost mitigation to institution	• Promise to Buy • Hybrid 457 and Split Dollar • Vests proportionally • **Tax-free** income to participant

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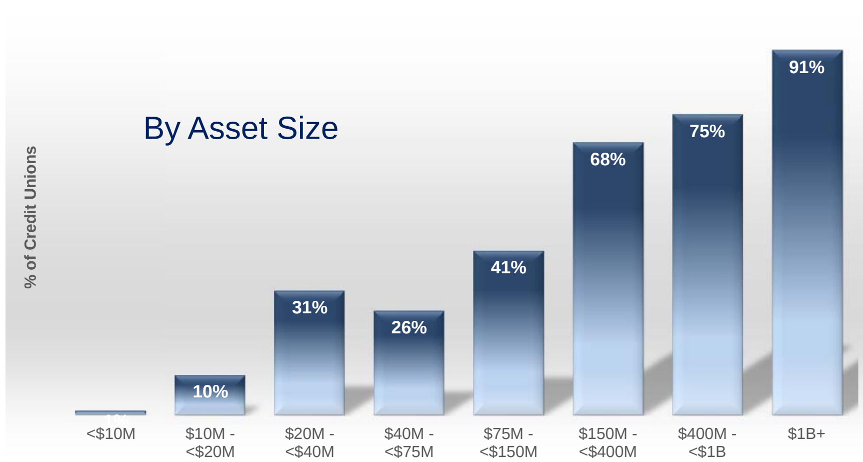
Credit Unions with Nonqualified Plans

(excluding severance)



Source: 2016 NAFCU-BFB Gallagher Executive Compensation and Benefits Survey

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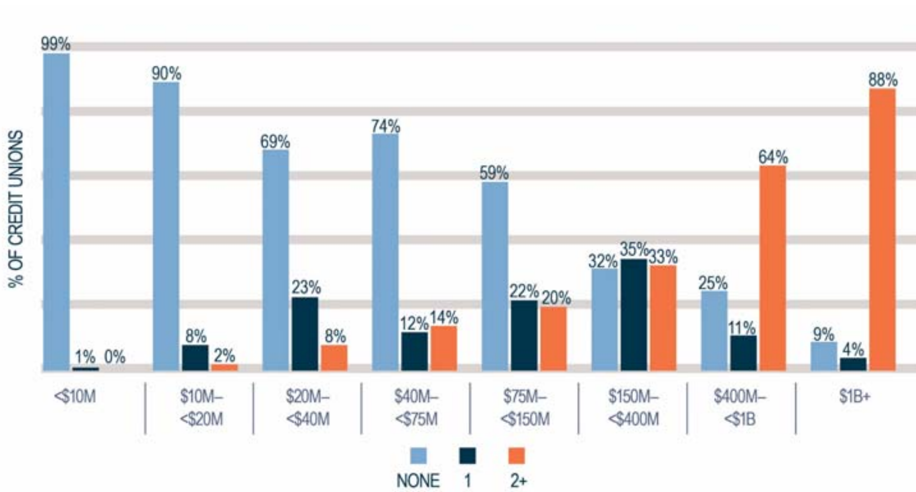
Number of Executives with NQ Plans
(excluding severance)



Trend #1

Executive benefits are growing in usage

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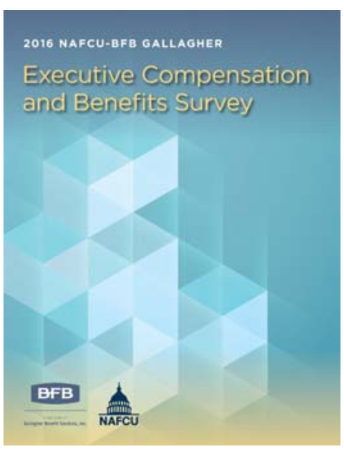
NAFCU-BFB Gallagher Survey



2010
22% of credit unions

2016
28% of credit unions

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Why Is This Happening?

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Trend #2

Boards are increasingly using compensation studies to ensure fair and reasonable compensation

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Compensation Study

- Responsibilities / duties
- Credit union size
- Location
- Complexity

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Compensation Study

- Related industries
- Alignment with compensation philosophy
- Regulatory compliance

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Sample: Multiple Survey Sources Used in CEO Compensation Review

Survey Source	Survey Job Title	Survey Scope	Market 25th Salary	Market Median Salary	Market 75th Salary	Market 25th Total Cash	Market Median Total Cash	Market 75th Total Cash
Kenexa	CEO	Financial Services/ 25-50 FTEs	$192,300	**$249,200**	$313,000	$236,700	$341,800	$494,200
ERI-CA	CEO	Credit Unions/ $200 million assets	$172,046	$227,657	$327,665	$206,455	$273,188	$393,198
NAFCU	Top Executive	US $150-$400 million assets	$166,072	$210,000	$243,300	$187,845	$233,132	$274,331
CUNA	CEO	US $100-$200 million assets	$131,955	**$154,790**	$171,600	$135,200	$161,593	$187,200
CUES	President and CEO	US $150-$300 million assets	$192,632	$218,462	$247,716	$202,511	$230,341	$267,698
		Average of all Sources	$171,001	**$212,021**	$260,656	$193,742	$248,010	$323,325

Trend #3

Executive benefit plans are customized to each individual credit union and executive

One Size Does Not Fit All

Variables

- Compensation philosophy
- Strategic needs
- Performance measures
- Experience
- Payment/retirement time horizon
- Credit union profile

Best Compensation Practices

- Develop a Compensation Philosophy
- Benefits of a Documented Compensation Philosophy
- Seek Compatibility Data
- Require Regulatory and Tax Compliance
- Review Compensation Annually
- Consider the Multiplier Effect
- Establish a Subcommittee for Executive Compensation

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Best Compensation Practices

- Committees Must Communicate Effectively with the Board
- Engage Consultants Who Report Directly to the Board
- No Screening or Filtering by the CEO
- Inspect Plan Modifications
- Ensure Plan Documentation Is Compliant and Terms Understood
- Associate with Professionals to Monitor Legal Developments

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More Info in Summary Report

- Surveyed the top five executives
  - Executive Compensation Plans
  - Fringe Benefits
  - Health & Welfare Benefits
  - Qualified Plans – 401(k), Defined Benefit, etc.
  - Executive Demographics
- Board Benefits

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Thank you!

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Best Compensation Practices

Originally published in the February 2013 issue of Credit Union Business Magazine

Written by James S. Patterson and C. Daniel Sherman of the law firm Sherman & Patterson, Ltd; and Tom Telford, Area Senior Vice President at BFB Gallagher

By carefully managing executive compensation, a credit union's board of directors can minimize the risk that executives, members, the public, or regulators will complain about or challenge how they compensate top management.

We have discovered what does and doesn't work after years of working on executive benefits for tax-exempt organizations. Here are some ideas your organization should consider adopting.

Develop a Compensation Philosophy

A compensation philosophy is a formal document that codifies the credit union's guiding compensation principles and objectives and establishes performance targets. It should be signed by the board chair and added to board minutes. The philosophy should:

1. Identify a peer group of employers
2. Target positioning within the peer group
3. Specify the balance between guaranteed and incentive compensation
4. Define the mix of cash compensation and benefits

Once approved, the board should regularly review their compensation philosophy document to ensure that compensation practices continue to conform to its guidelines. The board should not set the compensation philosophy aside and ignore it.

Benefits of a Documented Compensation Philosophy

Having a documented compensation philosophy helps to establish consistency in compensation levels that can be especially helpful as positions open up and new executives are hired to fill those slots. It also creates a measure of fairness that reduces the risk of a disgruntled executive suing the organization for employment discrimination. The philosophy is helpful when board members change as it gives them a strong basis on which to continue the status quo or to make necessary changes in compensation.

Seek Comparability Data

Knowing the compensation levels and practices of a peer group is critical for setting executive compensation to achieve the objectives stated in the philosophy. The board should not rely on just one source of data. Instead, it should review two or three reputable sources and compare the data it receives. A board's analysis of compensation levels may involve averaging, or sometimes eliminating an outlier if results seem skewed. It is important to compare similarly sized credit unions, and comparable positions within those credit unions. If the board uses a consultant to find the comparability data, it should verify that the consultant is providing reliable data. The board should not rely solely on comparability data provided by the executive team.

Require Regulatory and Tax Compliance

Boards should ask legal staff or consultants to confirm that the plans and their funding vehicles comply with all applicable regulations. An audit is the wrong time to find out that regulatory review or approval was required before the plan was implemented and the funding assets acquired, or that benefits were taxable earlier than expected or subject to penalties. The 46 states that have state credit union charters each have their own set of credit union laws and regulations that must be followed and federally insured state-chartered credit unions must understand and comply with all federal regulations and standards as well. On the other hand, federal credit unions do not need to comply with the state credit union laws in the states where they are headquartered; they are covered only by federal law and regulations.

Review Compensation Annually

Although a compensation package may be fair and consistent with the standards set forth in the compensation philosophy document, some executives will still perceive they are underpaid or have inferior benefits. Annual reviews can help avoid the surprise and disappointment of an executive resigning to accept a better offer, or discovering that after many years a plan is woefully over or under-funded. Executives should be given an opportunity to ask questions or raise concerns. With all of its various compensation components—salary, incentive compensation, benefits, and perquisites—an annual review is a good opportunity to look at the big picture and see how all of the components interrelate.

Consider the Multiplier Effect

An executive's benefits are often tied to base salary. A defined benefit SERP, for example, may specify that the executive receive payments of 1.5 times base salary on a certain date. If base salary increases, this will directly increase the SERP payments. SERP benefits may also be based on total compensation (i.e. base salary plus incentive compensation), which significantly increases the complexity of managing the changes in the projected SERP benefit. Incentive compensation plans can be designed with large variances in possible awards, creating an even greater impact on the executive's SERP benefit. A board needs to be aware of these multiplier effects as it analyzes appropriate levels of base salary and incentive compensation for its SERP participants.

Establish a Subcommittee for Executive Compensation

Compensation issues are complicated. As credit unions increase in size and complexity, the board should consider establishing a compensation committee or executive committee to oversee compensation issues for the board. The board should choose committee members based on their experience with and interest in compensation issues. A committee can dig more deeply into and address more knowledgeably compensation details that are too tedious to be addressed in a typical full board meeting. The committee members should receive materials well in advance of the meeting so they have adequate time for analysis and are prepared for discussion.

Committees Must Communicate Effectively with the Board

Although such committees can add significant value to the board, their role is to administer the board's policy, not to create the policy itself. Effective communication between the compensation committee and the board is critical. Benefit levels can get out of control and create division when compensation committees fail to communicate effectively with other board members. At the end of each year, the committee should give the board a full report that reminds the board of the compensation philosophy it approved; that clearly and accurately discloses compensation levels of its executive team and relates that compensation to peer data; and provide minutes that summarize the committee's discussions throughout the year.

Engage Consultants Who Report Directly to the Board

Consultants live and breathe compensation and benefits, whereas most board members have only a general understanding. A specialist's review can ensure the credit union's compensation dollars are being used efficiently and that plans are fulfilling board and executive expectations. Consultants retained by, and reporting directly to the board, help ensure that the board is receiving accurate, unbiased and unfiltered information. Consultants help boards understand complicated concepts, such as the nuances of comparability data.

No Screening or Filtering by the CEO

Boards received clear direction through NCUA's Rule 701.4 in January of 2011 that the NCUA is concerned about senior executives, especially chief executive officers, having too much influence over the executive compensation set by the board. The NCUA clarified that the board must set executive compensation without any "screening" or "filtering" from the CEO. In most areas of credit union governance, boards appropriately follow the CEO's direction. With executive compensation, however, board members need to analyze consultants' recommendations, lead out and make decisions without any pressure from the CEO. In the past, many boards allowed the CEO to set compensation for the other executives, but more and more boards are realizing that they need to take a more active hand in setting compensation for the other senior executives as well.

Inspect Plan Modifications

Before approving a plan modification, the board should understand the reasons for the change, their costs and the impact of the changes to benefits. As it reviews suggested changes, the board should meet in an executive session to ensure that executives and any board members with a personal stake in the outcome do not participate in the final decision. The board should also document its intent as it approves changes to plans, so it is clear to future board members and executives why the board approved the change.

Ensure Plan Documentation Is Compliant and Terms Understood

A plan sponsored by a credit union is subject to state and federal regulations, as well as a number of provisions under the Internal Revenue Code—Section 457(f) and Section 409A to name two. Since 409A's inception in late 2004, the Internal Revenue Service has issued more than 1,000 pages of guidance under that section alone. Having plan documentation prepared by a benefits attorney minimizes chances for regulatory or tax violations or for disagreements with executives or beneficiaries. Periodic professional review ensures that law changes are incorporated into the documents in a timely manner.

In a recent review of a SERP designed with annual payments following termination, we discovered that the board and executive believed that the SERP benefit would be taxed as the credit union paid the benefit each year. We explained that taxation under Section 457(f) occurs when the substantial risk of forfeiture lapses (e.g. retirement date attained during employment), regardless of when the credit union pays the benefit. This resulted in a significantly lower projected net benefit than previously anticipated, and required some difficult discussions for all parties involved.

Associate with Professionals to Monitor Legal Developments

The legal environment is fluid. Regular consultation with compensation professionals helps keep boards informed and prepared for the changing landscape. For example, the Internal Revenue Service in 2007 indicated it would issue guidance under Section 457(f) of the Code, but despite some occasional rumblings, the IRS has yet to issue any guidance. If and when the IRS does issue guidance, boards will need to review their plans to ensure compliance with the new rules.

Summary

Compensation best practices bring comfort to boards and executives in knowing that their executive compensation is competitive, compliant and an appropriate use of credit union resources.

Jim Patterson is an attorney with Sherman & Patterson, Ltd., a law firm focusing on executive compensation in credit union and other tax-exempt entities. Jim has worked closely with state regulators in the 46 states that have state credit union charters, as well as with regulators at the National Credit Union Administration. www.SPLawFirm.net.

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