THE CEO Report

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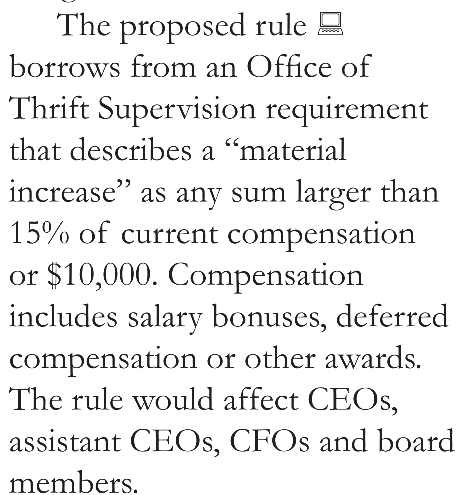
Into the sunlight with credit union merger compensation

A new rule proposed by NCUA would require the CEOs of merging credit unions to disclose merger-related compensation to the agency. Federal credit unions would have to make the same information available to members before a merger vote.



The proposed rule 💻 borrows from an Office of Thrift Supervision requirement that describes a "material increase" as any sum larger than 15% of current compensation or $10,000. Compensation includes salary bonuses, deferred compensation or other awards. The rule would affect CEOs, assistant CEOs, CFOs and board members.

By submitting a request in writing, members would be entitled to review the compensation disclosures at a credit union branch office during regular business hours. If reviewing the documents in person is difficult or expensive, NCUA would expect credit unions to make reasonable arrangements with their members.

Banking agencies, such as the OTS, FDIC and the Federal Reserve, all have transparency rules, so credit union managers should not balk at disclosure, says Alec Berkman, CEO of Executive Compensation Solutions. He is concerned, however, that the threshold could be too low, especially without any protocols for review. "These rules get written in stone, and nobody looks back at them," he says.

CEOs at credit unions larger than $100 million, and even many at smaller CUs, often have compensation plans that would trigger disclosure, even though the plan's original purpose had nothing to do with a merger incentive, Berkman says. Too often, the continuing credit union gets a big surprise when it realizes the size of the payout to a terminated CEO, he says. Even if the credit union plans to retain the CEO in a different capacity, his or her contract could contain a "diminution clause" tailored to compensate the CEO in case of a demotion. The board of the continuing credit union must consider the payout to an acquired CEO early in the due diligence process, Berkman says.

Payout as retention

NCUA realizes that credit unions might have to pay more than $10,000 to keep a senior executive on the payroll. "Credit unions should be able to [justify] these types of increases in compensation, bonuses, or retention agreements in … disclosures," NCUA says in the summary. "The proposed rule would simply require a description of these arrangements in the merger plan."

Unless they're willing to lose talented managers, merging CUs have to put together attractive retention packages, says Dan Kampen, partner in the Rochdale Group. Under the $10,000 or 15% threshold, he thinks most merging credit unions will have to start unveiling compensation packages. "As long as NCUA is making sure it's about disclosure, not value judgments, then [the

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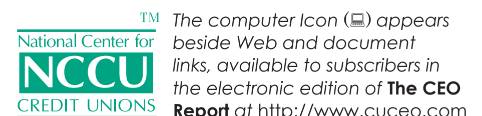

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rule] is fine," he adds.

Speaking of retention bonuses, the proposal says "the Board does not intend to substitute its business judgment for that of the boards of the merging and continuing credit unions on marketplace demands and reasonable compensation arrangements." In another part of its description of the proposed rule, however, the agency leaves open the possibility that it could rule against a proposed merger based on the compensation disclosure: "The proposed changes ensure that NCUA has sufficient information to determine whether to approve a proposed merger."

Justify merger payouts

The rule calls on credit unions to support bonuses, raises or deferred compensation associated with a merger. "Inappropriate justifications are self-defining," Berkman says. "If you can't immediately define why [increased] compensation is needed, it's probably inappropriate." But there are a host of valid reasons to point to, he adds. They include:

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- relocating for a new position;
- changing titles, especially if the new credit union has a defined band of compensation for the position the old CEO will take;
- an increase in responsibility, number of direct reports or working hours; or
- different patterns or mechanisms of compensation at the new credit union.

In some cases, payouts can be in the millions, especially for retirement-bound CEOs, Berkman says. But it's important to note that such compensation often has to come in a lump sum, because CUs are limited in how they can fund pension benefits. While "$1.7 million may make a good headline, that doesn't mean it's inappropriate," he says.

The intent seems to be to forestall a worst-case scenario, a behind-the-scenes deal where senior managers are paid to champion a particular merger partner, regardless of the other merits. But Berkman says he has yet to see that kind of deal. ☐

Contract tips

Your contract should protect you from unforeseen circumstances. CEOs with 457(f) plans are particularly vulnerable in a merger because the plan only vests once, and if the new credit union doesn't want to fund it, you could be out of luck. Follow these tips from compensation expert Alec Berkman, CEO of Executive Compensation Solutions:

- Hire your own counsel. Regardless of how well you get along with your board, CEOs should have their own attorneys for compensation negotiations.
- Include contingency thresholds. If a merger does come to your credit union, you could lose your title and your job, too. Berkman suggests clauses that allow you to walk away with some compensation if you experience reduced responsibility, diminution of title or even a drop in pay.
- Define 'involuntary' for yourself. Reduced responsibility or a diminution of title should be contractual grounds for involuntary severance, which should trigger an appropriate benefit, Berkman says. You can still negotiate a better deal with the new credit union, but you can't afford to count on its charity.

Explain to the board that these positions are not demands, but protections. Now that "unsolicited merger bid" is part of the CU vocabulary, you never know when you'll need that protection. ☐

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