



# ENDSIGHT

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## Aligning Credit Union and Executive Interests

Aligning credit unions' values, interests, and business strategies with those of their executives is the key to developing healthy, long-term relationships with executives who can effectively lead credit unions through changing times. Gone is the homogeneity that once defined the Credit Union Movement. Credit union cultures, focus and needs are changing. Credit unions are competing with banks and other depository institutions and, indeed, with each other. Efficiencies and bottom line performance are the focus today. The composition of a management team that can lead a credit union today is vastly different from the past.

Credit unions need to differentiate themselves to compete in the marketplace, and their compensation programs are central to this differentiation. Traditionally, credit union boards set CEO compensation to compete with financial institutions of similar size. The conventional credit union executive pay package has usually contained two basic components — salary and bonus. This was due, in part, to the relatively lower risk environment in which credit unions operated. They did not need to be as highly leveraged as banks to be competitive, and their members historically did not demand the broader array of services that have now expanded the job expectations for the executive staff. Today, credit unions need to compete with other financial institutions, including other credit unions and banks.

## Differentiated Executive Compensation Programs

The primary compensation objectives of credit union boards using traditional approaches to pay and incentives are to: (1) compensate executives with appropriate levels of base pay and, (2) provide rewards that are sufficient to attract and retain qualified executives. While each credit union will have a different decision path as it evaluates alternative pay structures that promote alignment with strategic goals, many credit unions now integrate pay-for-performance and cost control principles into their executive pay plans.

Bonus, or 'at risk' compensation, is more prevalent in credit unions that aggressively compete for market share with banks and other credit unions. With increased competition comes a requirement to invest heavily in marketing and executive talent. Investing in people is risky business all by itself, but these more market-oriented credit unions also employ business strategies that involve greater risk-taking and, as a result, their executive compensation plans reflect that risk by basing a much higher percentage of the total compensation package on incentive pay. The executives' total cash compensation is more highly leveraged, but there is greater potential to earn more. The amount of pay that is leveraged (put at risk) should be directly related to the degree of control that the executive has over the results. If the desired results are outside his or her control, the leveraged portion of the plan will not act as an incentive to the executive, as the executive's efforts cannot influence the outcome. Board discretion and an element of subjective job

performance review can remain a part of the evaluation process, but objective measures help both the executive and the Board to know what the goals are and what positive outcomes are expected.

Given that there is a limit to the control that executives can exercise in a more sophisticated and competitive operational environment, and recognizing that not all organizational goals can be accomplished in a single fiscal cycle, additional components of the executive compensation package, in the form of longer-term incentive programs, are also important. These long-term incentives include deferred compensation plans and supplemental retirement plans. Long-term performance measures are increasingly factored into the design of long-term incentives that usually take the form of 457(b) and (f) plans. For tax-exempt organizations such as credit unions, few other options are available.

## Fair and Equitable Evaluation: A Starting Point

For any compensation plan to work, there must be a perception of fairness and equity among the participants. However, fairness can be viewed from different vantage points. The down and dirty approach is to compare what one makes with what others who do the same or similar jobs make. If the conclusion is that the compensation for the position does not compare favorably, or the compensation does not equal the value of the work product, action steps might include changing the way one works or changing the employer for whom one works. The point is that people do not compare their jobs and performance to non-like jobs and non-like performance, nor do they compare their jobs to jobs to which they do not aspire. It should be no surprise that credit union executives compare their compensation to other credit union executives. Where do credit union CEOs and boards get comparative data? Typically, they have gotten it anecdotally, and processed it selectively. There is also a tendency for board members to have their own reference points, and usually, somewhere in the process, the comparison drifts to what board members are paid in their own employment. Avoiding anecdotal information and the artificiality of board members' historical or current compensation and benefits is vital. That requires having a realistic alternative for comparison data. **The Survey 2008: Employee and Executive Compensation and Benefits for the Credit Union Movement**, in conjunction with other credit union surveys, and community-bank-based survey data, provides an objective starting point for a fair, equitable, accurate and realistic evaluation process. Knowledge and common sense are the sentinels of good decision-making.

**The Survey 2008: Employee and Executive Compensation and Benefits for the Credit Union Movement** is now available, at no charge, in book or electronic format. To obtain a copy please send an email to [creditunion@ecs-m.com](mailto:creditunion@ecs-m.com) or call Executive Compensation Solutions at (626) 914-2333.