



ENDSIGHT

ALERT
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FINANCIAL REGULATORY REFORM ON THE HORIZON

Treasury Secretary Timothy Geithner testified before the House Financial Services Committee on March 26, 2009 to discuss financial services regulatory reform. His four-part plan includes mitigating systemic risk, improving consumer and investor protection, eliminating gaps in the overall regulatory system, and promoting international coordination among regulatory agencies. While Secretary Geithner will provide a more detailed outline in the coming weeks, the guidelines for executive compensation practices center on standardizing practices to encourage prudent risk-taking with a focus on long-term performance rather than short-term gains.

NCUA REPUDIATION OF SEVERANCE AGREEMENTS

After the NCUA's recent Update on the Corporate Stabilization Plan, there is some concern that the NCUA will take a broad interpretation of its right to repudiate the severance agreements of dismissed corporate executives.

"While ECS works for the credit union and not the executives, I have concerns about what they said regarding the repudiation of severance packages, and how broad that might be," said Alec Berkman, founder of Executive Compensation Solutions.

Specific concerns include whether the NCUA intends to deny severance pay from contracts signed in the early 1990s that are cumulative in structure, or even 457(f) deferred compensation plans. Given the unprecedented actions of the NCUA, it is unclear whether it has had time yet to be able to distinguish between severance packages, deferred compensation programs and retirement benefits earned over many years. Without an understanding of the underlying programs, it is imprudent to treat all such programs as subject to repudiation, as they serve different purposes and long-term credit union objectives.

THROUGH GOOD TIMES AND BAD, FOCUS ON YOUR LONG-TERM STRATEGY

Credit union boards must balance the short-term needs of their credit unions with executive long-term continuity programs by aligning the interests of the credit union leadership team with the overall goals of the credit union and its members. Through good times and bad, the executive team is accountable for a credit union's performance; therefore, it makes sense that incentive awards should reflect the performance of the organization and the performance of the individuals responsible for achieving a credit union's goals.

The most effective executive compensation and benefit systems use objective, outcome-based evaluations of performance to align executive total compensation with the organization's business strategy and financial goals. In some situations, a performance-based compensation strategy may align the interests of the executive team, the organization, and its members. To be successful, such a strategy must provide that:

- (1) Performance goals and measures are relevant and reasonable;
- (2) Executives are involved and understand the program and evaluation process;
- (3) Performance is evaluated in an open, fair, and consistent manner.

In a performance based compensation system, both short-term and long-term incentive compensation components can be linked to strategic performance benchmarks and achievement goals. Due to a set of unique (and disadvantageous) IRS rules, credit unions have to balance between deferring the reward and managing the executive's risk of losing compensation that they have earned, but is not yet vested. There are specific design features that can be used to achieve this balance. The long-term component of a performance-based compensation system usually takes the form of a 457(f) plan for executives of credit unions. With periodic and scheduled distributions prior to retirement, credit unions can keep the reward for strong performance proximate to the time that it was measured, and allow for accumulations of supplemental retirement income.

While it is important to keep an eye to current financial conditions and economic environment, the history of the Credit Union Movement demonstrates that long-term strategy trumps short-term tactics. Making long-range people decisions and keeping the short-term diversions in perspective is key to leadership and organizational success.

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

COMING SOON: The Survey 2009. Help us to keep you informed. We invite you to participant in ***The Survey*** by completing the survey questionnaire, available in May 2009.