



ENDSIGHT

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Reconsidering Your Nonqualified Deferred Compensation Plan? Not So Fast.

The economic downturn is causing some credit unions and their executives to reconsider their nonqualified deferred compensation and retirement arrangements. Nonqualified deferred compensation arrangements are merely unfunded and unsecured promises by an employer to pay compensation to the executive in the future. However, Internal Revenue Code 409A ("409A") places significant limitations on an employer's ability to make changes to these plans. Termination of a nonqualified deferred compensation arrangement is generally prohibited by 409A, except in limited circumstances when certain specific conditions are satisfied. These specific conditions may present challenges to an employer when:

1. the employer cannot or does not want to satisfy all the 409A termination provisions, which include a requirement that all arrangements of the same type also be terminated, and no new plan can be added for three years after termination, or
2. there are uncertainties about whether all of the conditions can be satisfied, such as whether a termination or liquidation is not proximate to a downturn in the financial health of the employer.

The failure to meet all specific conditions results in a 409A violation, with significant and immediate adverse tax consequences to the participants (i.e., imposition of ordinary income tax, plus an additional interest tax, plus an additional 20% excise tax).

It is also important to be aware that there is little guidance in the final 409A regulations addressing when a new arrangement may constitute a prohibited substitution of another arrangement. Employers must exercise caution when a new arrangement is established in connection with or proximate to a termination or waiver of an existing arrangement, as the final section 409A regulations generally prohibit the substitution of one nonqualified arrangement for another, and such an action may be viewed as a 409A violation.

So, before any changes are made to your nonqualified deferred compensation plan, be sure to seek qualified advice and proceed with caution.

Life Insurance Carriers in the News

As is true for all financial institutions in the current economic environment, life insurance carriers are facing challenges resulting from the unprecedented shifts in our global economy. As fourth quarter earnings emerged, the impact of the decline in equities on variable annuity guarantees and asset write-downs have resulted in many companies posting

losses. The rating agencies have been reviewing the impact of these losses on carrier capital positions, and such reviews have resulted in some rating downgrades, but have also resulted in some rating affirmations. Because of these recent changes, the financial ratings agencies have placed the entire insurance industry on "negative outlook."

In an attempt to provide some perspective on the recent financial results and rating agency changes, Tom Gallagher, an insurance industry analyst for Credit Suisse, commented, "it's all relative." This means that the insurance industry must be viewed within the broad perspective of the entire financial services industry setting.

"If the yardstick is elastic, the measurement comes out the way you want it," said Alec Berkman, founder of Executive Compensation Solutions (ECS).

It is important to keep in mind that even after these downgrades the industry remains highly rated, especially when compared to most other financial institutions.

Solvency remains the key focus and must be separated from the media's attention on falling stock prices and bailout issues. Some carriers are facing capital challenges due to a weakening capital base, and will continue to be subject to concerns involving commercial real estate and variable annuity guarantee exposure. In general, carriers are focusing on their core operations: issuing policies, servicing policyholders, and paying claims.

Colin Devine, senior life stock analyst for Citigroup, made the following comment in a recent report on the state of the life insurance sector. "Large in-force policy blocks, strong recurring premium cash flows, and generally good capital and liquidity positions should allow all but a few life insurers to avoid the meltdown experienced by their bank and brokerage counterparts."

ECS continues to monitor the insurance carrier industry to assure the best interests of our clients are not compromised in these difficult economic times. Our team is available to answer any questions you may have, and will be happy to discuss any aspect of the financial stability of the carriers we monitor and work with in providing long term funding solutions for our clients.

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 participate in **The Survey** by completing the survey questionnaire, available in May 2009.