



# 2021/2022 SERP Survey

Latest Findings from  
D. Hilton's Longitudinal Research Initiative  
on Retention and Retirement Issues

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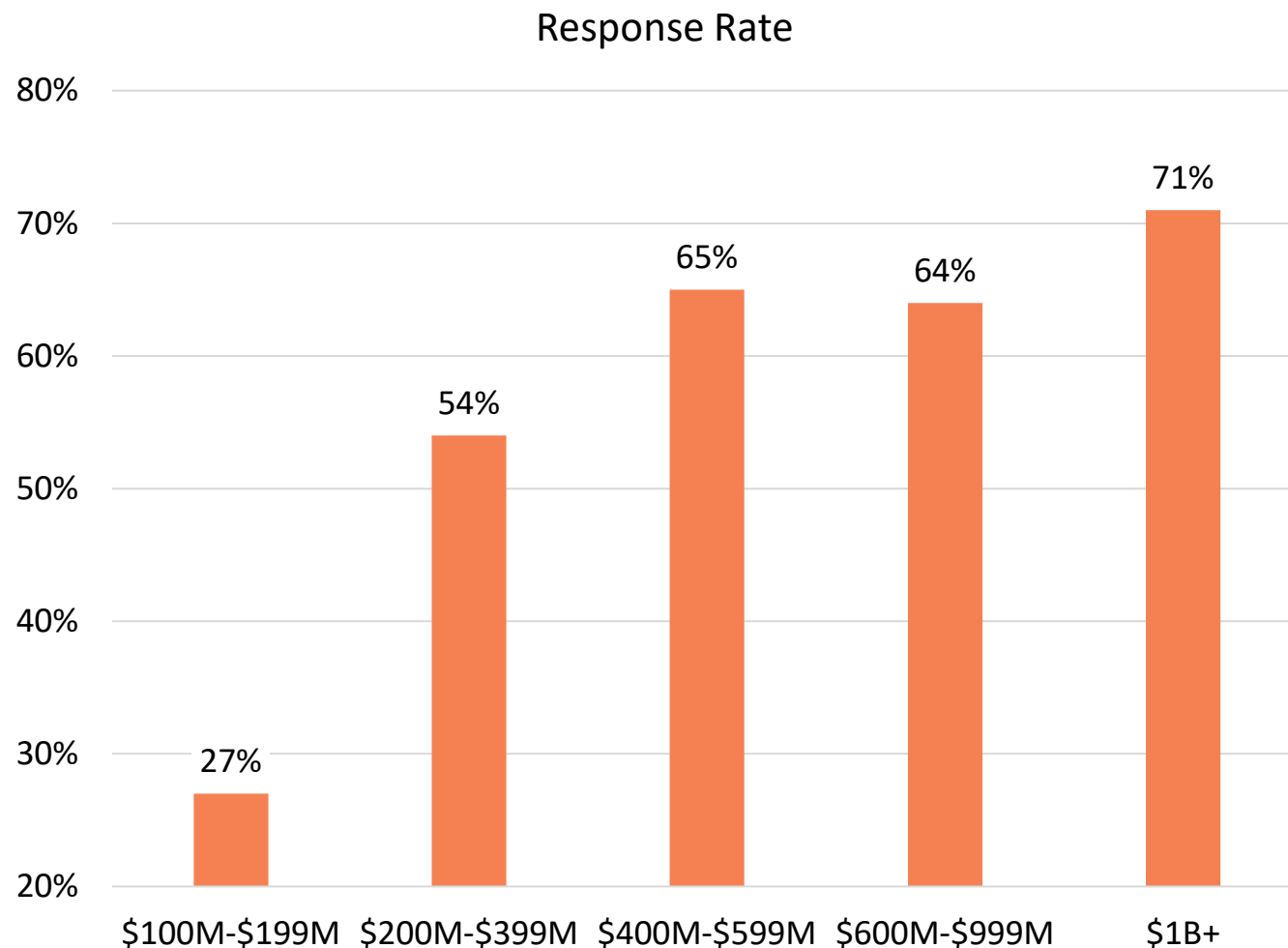
## What is a SERP?

- A tool used to **attract, reward, and retain** executive talent.
- An agreement between **the credit union and selected executives** to provide supplemental income in return for the attainment of agreed upon objectives, typically at specified employment anniversaries and/or at retirement.
- SERPs are **selective and non-qualified**, providing the opportunity to reward key executives without restrictions on contribution amounts or income caps.
- If the credit union terminates the Executive's employment "For Cause" or as a result of the Executive's voluntary resignation, **the Executive's benefit is typically forfeited**, and no payment of any kind is made to the Executive or beneficiaries.



## 2021 D. Hilton SERP Survey Methodology

- ✓ Emailed to 1,799 credit unions (> \$100 million in assets)
- ✓ 926 credit unions responded (52% response rate)
- ✓ 95% confidence level +/- 2.1%



Source: 2021/2022 D. Hilton SERP Survey



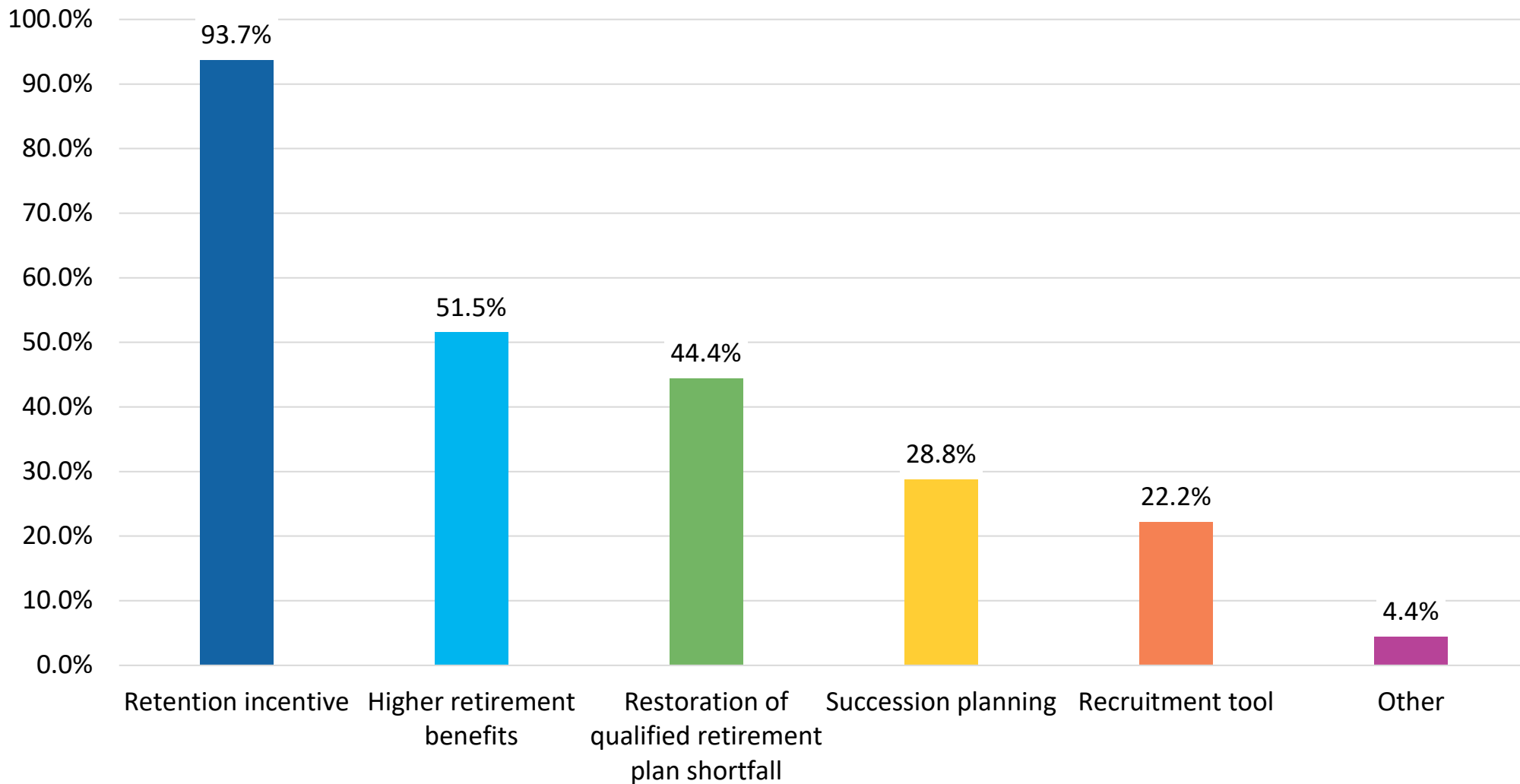
## Typical Plan Objectives for High Performing CUs

- **Attract, retain and motivate** high-performing and service-focused leaders.
- **Best practice design:** simple to understand, sustainable, results-oriented and compliant.
- **Peer competitive:** CUs of similar size/complexity and, when appropriate, the for-profit sector.
- **Enhance succession plan** to retain key executives.
- **Restore retirement plan shortfalls** due to IRS and Treasury mandated income caps (\$290,000 in 2021/\$305,000 in 2022).
- The **terms and specifications** are benchmarked to current non-qualified deferred compensation practices within the credit union industry.
- Commit to a **Pay Philosophy** that focuses on attracting and retaining the most qualified senior executives.



## Retention and Succession are Drivers...

### Reasons for offering the CEO a SERP Plan



Source: 2021/2022 D. Hilton SERP Survey



## Design and Benefits Need to Incorporate Executive Milestones and CU Succession Planning

Example:  
COO Likely  
Successor to  
CEO



|              | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|--------------|------|------|------|------|------|------|------|------|------|
| Pres/<br>CEO | 63   | 64   | 65   | 66   | 67   |      |      |      |      |
| CFO          | 64   | 65   | 66   | 67   |      |      |      |      |      |
| CLO          | 51   | 52   | 53   | 55   | 56   | 56   | 57   | 58   | 59   |
| COO          | 43   | 44   | 45   | 46   | 47   | 48   | 49   | 50   | 51   |
| CTO          | 56   | 57   | 58   | 59   | 60   | 61   | 62   | 63   | 64   |



## Example of IRC 415 Limit Retirement Plan Shortfalls on Employer Contributions to a 401(K)

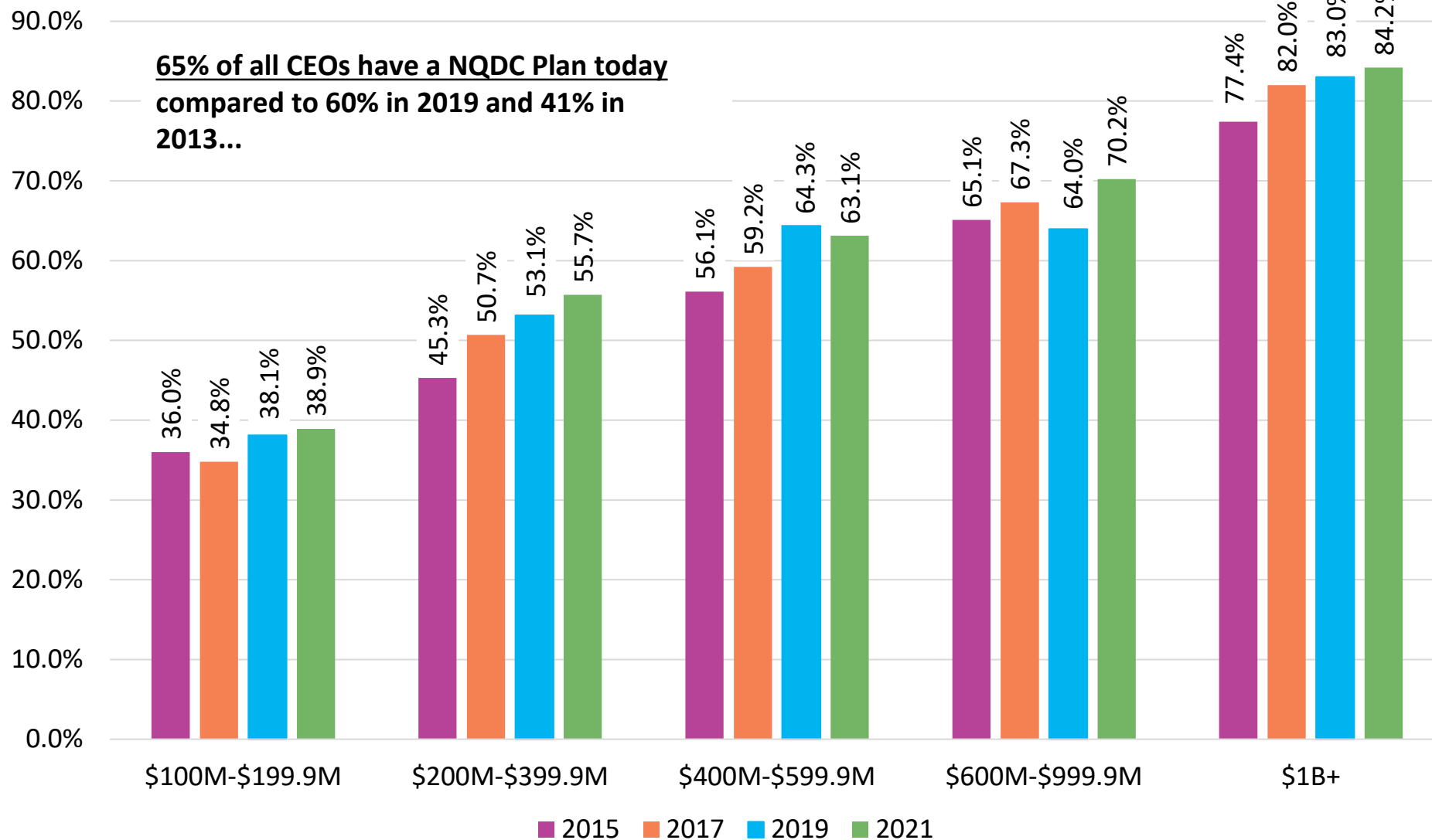
| Year                                                          | Age | Total CEO Comp (Base + Bonus) | Historical IRC 415 Limit | Projected 401(k) <u>WITHOUT</u> IRC 415 Limit (5% Match) | Projected 401(k) <u>WITH</u> IRC 415 Limit (5% of Proj. Limit) | Percentage of Total Comp <u>WITH</u> IRC 415 Limit | Projected Difference <u>With</u> and <u>Without</u> IRC 415 Limit |
|---------------------------------------------------------------|-----|-------------------------------|--------------------------|----------------------------------------------------------|----------------------------------------------------------------|----------------------------------------------------|-------------------------------------------------------------------|
| 2002                                                          | 48  | \$500,000                     | \$200,000                | \$25,000                                                 | \$10,000                                                       | 2.00%                                              | \$15,000                                                          |
| 2003                                                          | 49  | \$525,000                     | \$200,000                | \$26,250                                                 | \$10,000                                                       | 1.90%                                              | \$16,250                                                          |
| 2004                                                          | 50  | \$551,250                     | \$205,000                | \$27,563                                                 | \$10,250                                                       | 1.86%                                              | \$17,313                                                          |
| 2005                                                          | 51  | \$578,813                     | \$210,000                | \$28,941                                                 | \$10,500                                                       | 1.81%                                              | \$18,441                                                          |
| 2006                                                          | 52  | \$607,753                     | \$220,000                | \$30,388                                                 | \$11,000                                                       | 1.81%                                              | \$19,388                                                          |
| 2007                                                          | 53  | \$638,141                     | \$225,000                | \$31,907                                                 | \$11,250                                                       | 1.76%                                              | \$20,657                                                          |
| 2008                                                          | 54  | \$670,048                     | \$230,000                | \$33,502                                                 | \$11,500                                                       | 1.72%                                              | \$22,002                                                          |
| 2009                                                          | 55  | \$703,550                     | \$245,000                | \$35,178                                                 | \$12,250                                                       | 1.74%                                              | \$22,928                                                          |
| 2010                                                          | 56  | \$738,728                     | \$245,000                | \$36,936                                                 | \$12,250                                                       | 1.66%                                              | \$24,686                                                          |
| 2011                                                          | 57  | \$775,664                     | \$245,000                | \$38,783                                                 | \$12,250                                                       | 1.58%                                              | \$26,533                                                          |
| 2012                                                          | 58  | \$814,447                     | \$250,000                | \$40,722                                                 | \$12,500                                                       | 1.53%                                              | \$28,222                                                          |
| 2013                                                          | 59  | \$855,170                     | \$255,000                | \$42,758                                                 | \$12,750                                                       | 1.49%                                              | \$30,008                                                          |
| 2014                                                          | 60  | \$897,928                     | \$260,000                | \$44,896                                                 | \$13,000                                                       | 1.45%                                              | \$31,896                                                          |
| 2015                                                          | 61  | \$942,825                     | \$265,000                | \$47,141                                                 | \$13,250                                                       | 1.41%                                              | \$33,891                                                          |
| 2016                                                          | 62  | \$989,966                     | \$265,000                | \$49,498                                                 | \$13,250                                                       | 1.34%                                              | \$36,248                                                          |
| 2017                                                          | 63  | \$1,039,464                   | \$270,000                | \$51,973                                                 | \$13,500                                                       | 1.30%                                              | \$38,473                                                          |
| 2018                                                          | 64  | \$1,091,437                   | \$275,000                | \$54,572                                                 | \$13,750                                                       | 1.26%                                              | \$40,822                                                          |
| 2019                                                          | 65  | \$1,146,009                   | \$280,000                | \$57,300                                                 | \$14,000                                                       | 1.22%                                              | \$43,300                                                          |
| 2020                                                          | 66  | \$1,203,310                   | \$285,000                | \$60,165                                                 | \$14,250                                                       | 1.18%                                              | \$45,915                                                          |
| 2021                                                          | 67  | \$1,263,475                   | \$290,000                | \$63,174                                                 | \$14,500                                                       | 1.15%                                              | \$48,674                                                          |
| Projected Total Forfeited due to IRC 415 limit from 2002-2021 |     |                               |                          |                                                          |                                                                |                                                    | \$580,649                                                         |

Assuming a 5% investment return on the \$580k forfeited over 20 years, the executive also forfeited \$332k in investment gains.





## SERP Plans Among CEOs

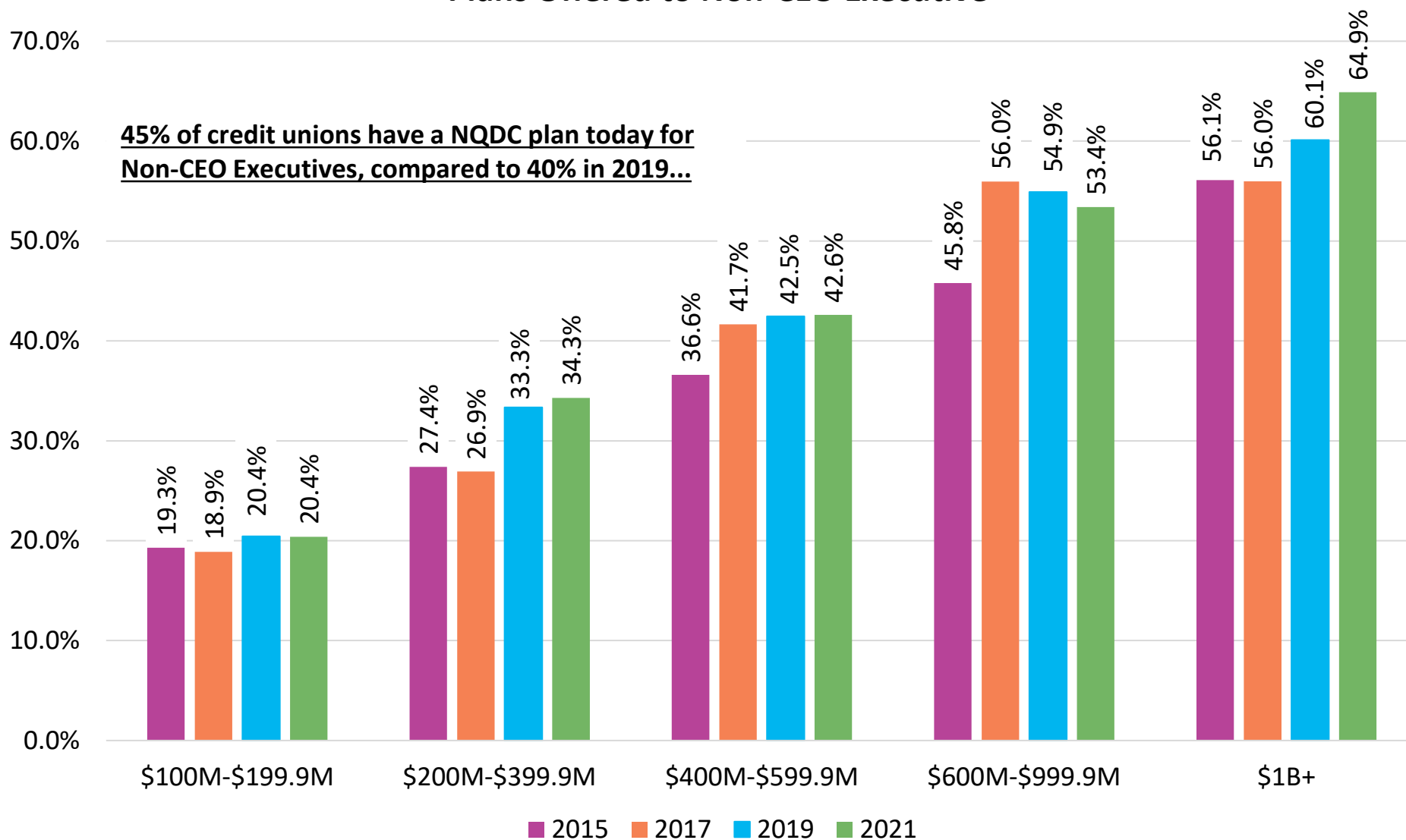


Source: 2021/2022 D. Hilton SERP Survey



## Planned Succession has Become Key...

### Plans Offered to Non-CEO Executive



Source: 2021/2022 D. Hilton SERP Survey

Note. Data represents the percentage of survey respondents who offer a plan to a non-CEO executive.



## SERP Plans for Non-CEO Executives

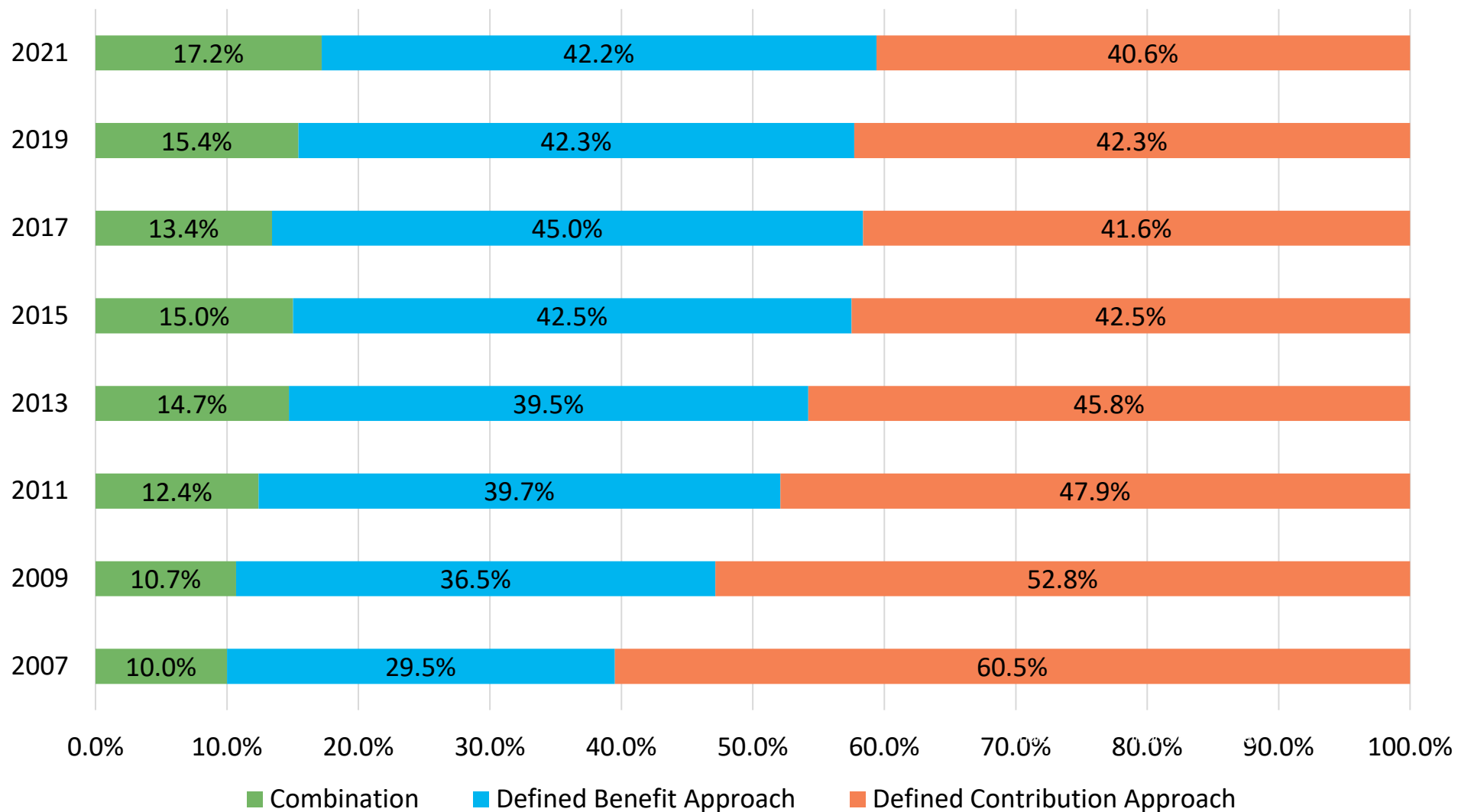


Source: 2021/2022 D. Hilton SERP Survey

Note: Data represents the percentage of survey respondents who offer a plan to a non-CEO executive.



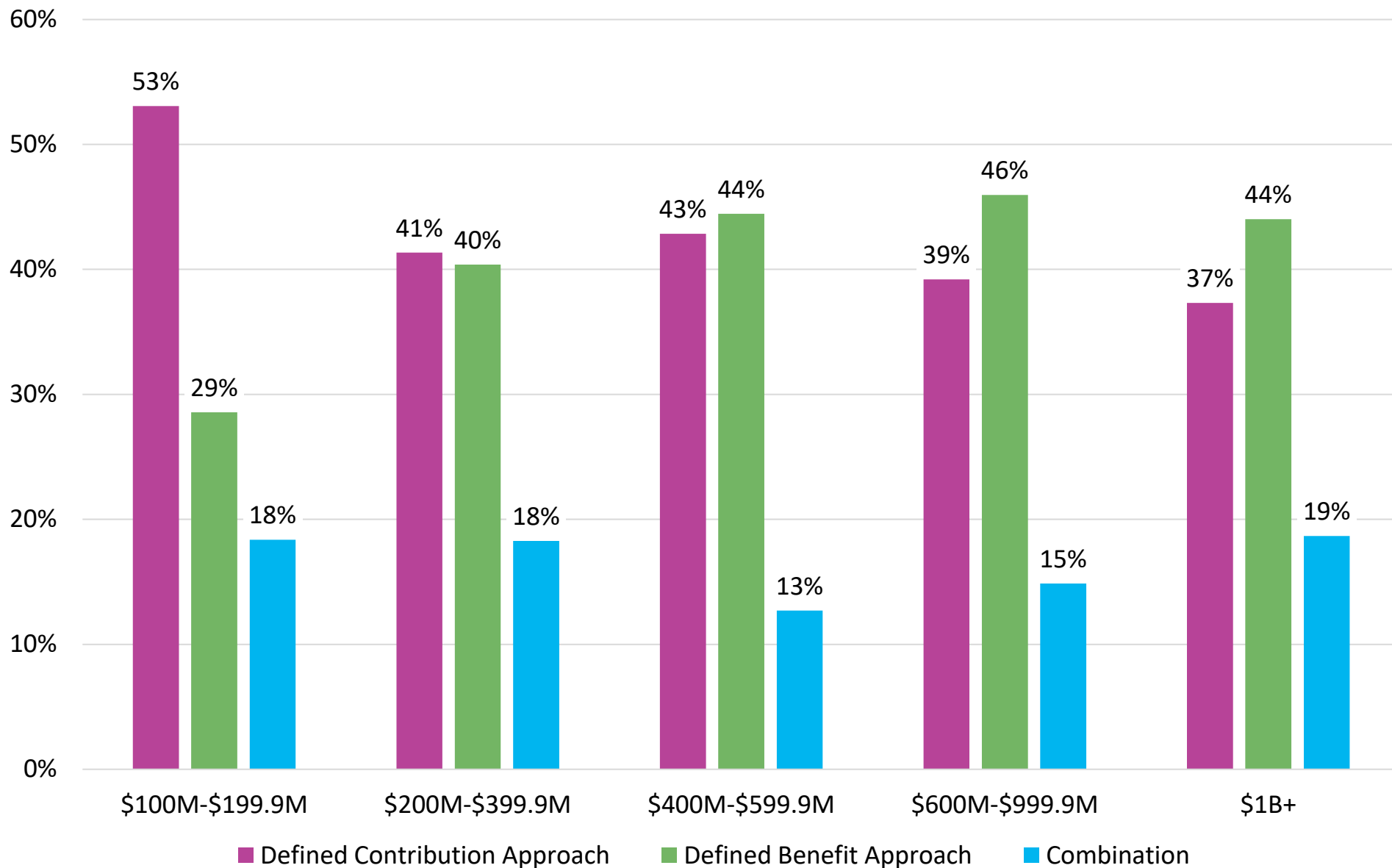
## Plan Design by Year



Source: 2021/2022 D. Hilton SERP Survey



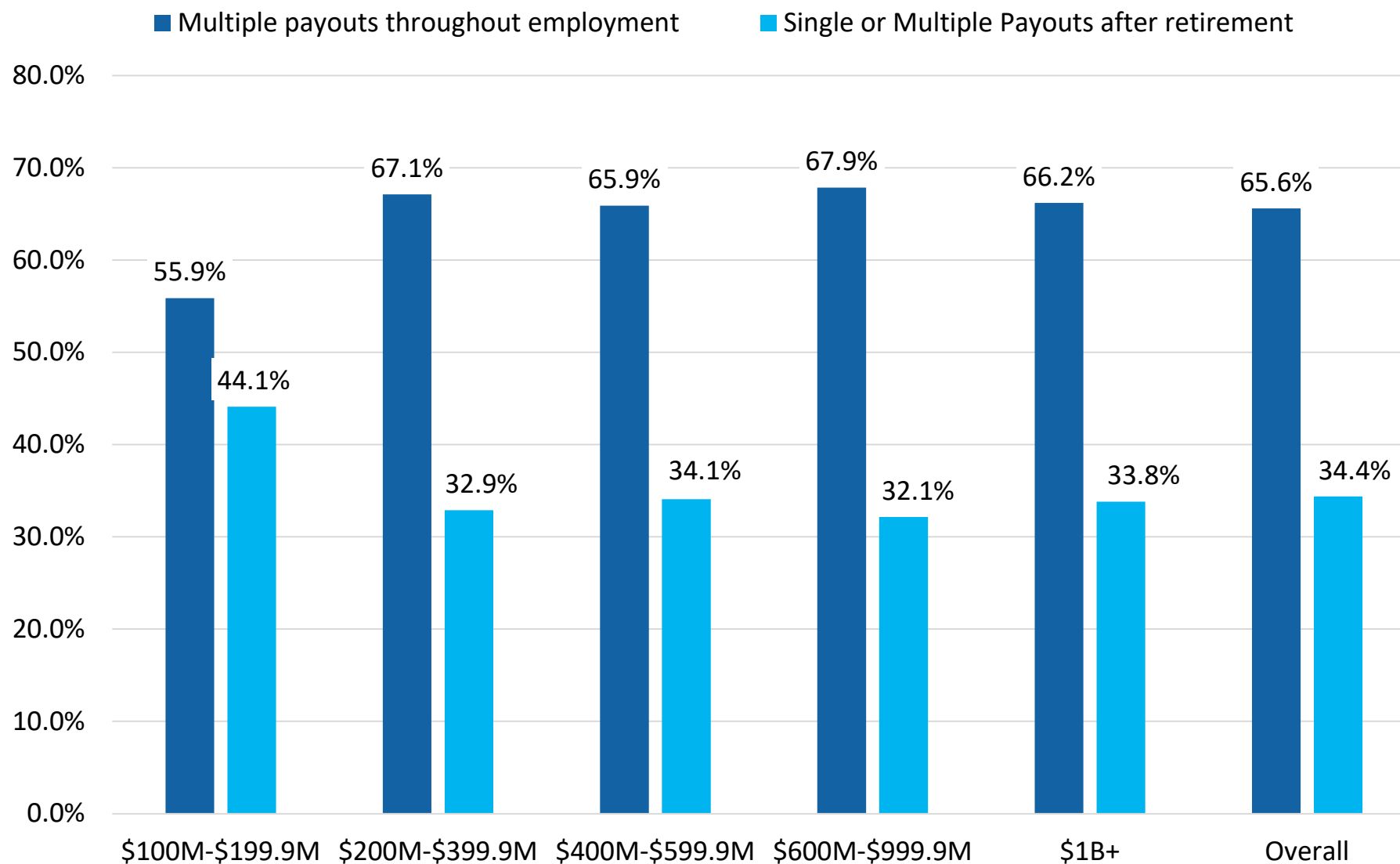
### Plan Design by Assets



Source: 2021/2022 D. Hilton SERP Survey



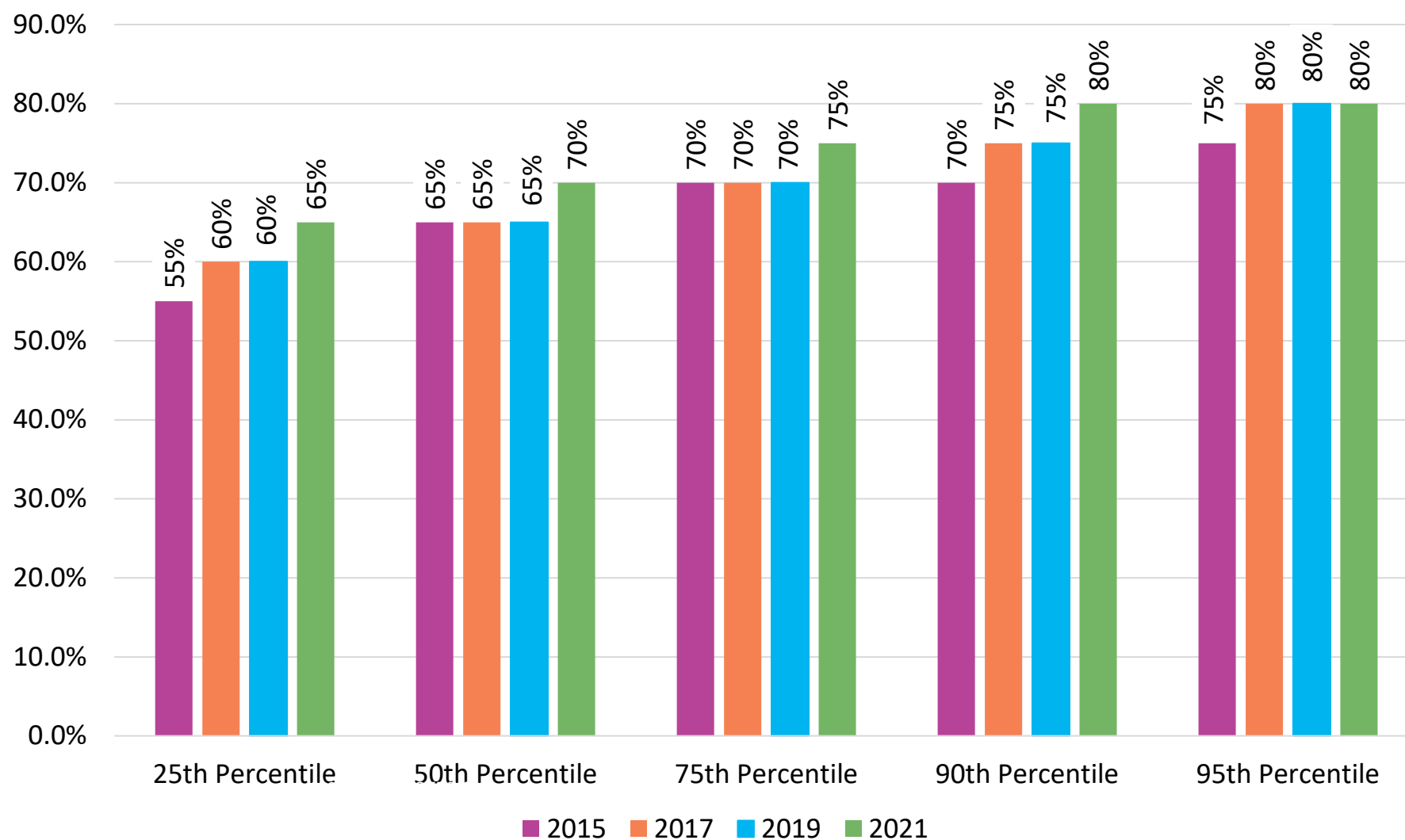
## Distribution Frequency Matters



Source: 2021/2022 D. Hilton SERP Survey



## CEO Target % of Average Final Total Compensation (\$100M+ CUs)



Source: 2021/2022 D. Hilton SERP Survey

Note: Total Compensation = Base Salary + Variable (Bonus) Pay



## Total Compensation vs. Base Compensation

A majority of credit unions utilize a target benefit at retirement of the **last 3 or last 5 years average total compensation.**

Base Compensation = Base Salary Only

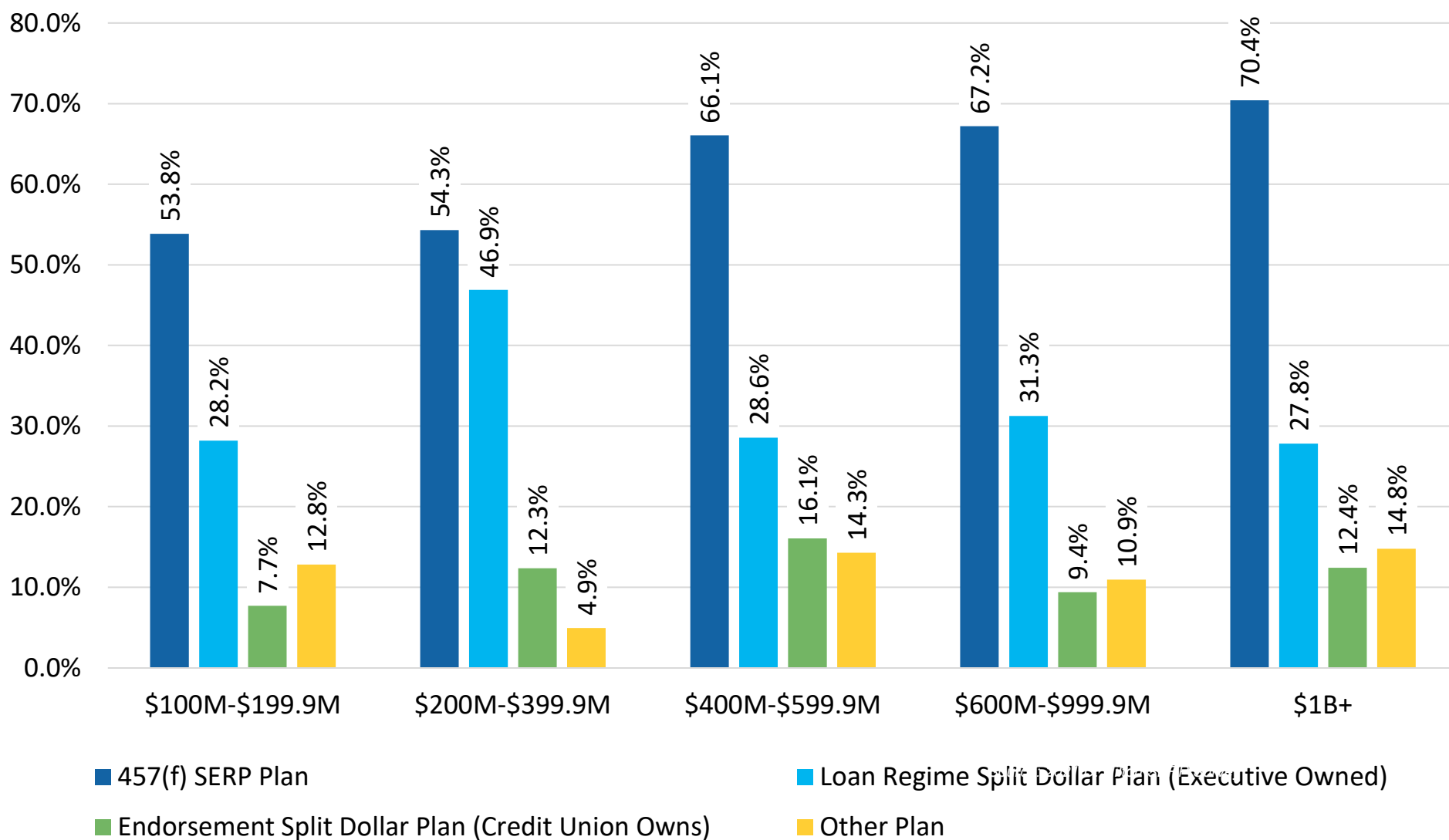
Total Compensation = Base Salary + Variable (Bonus) Pay

*Source: 2021/2022 D. Hilton SERP Survey*





### CEO Plan Type By Asset Size



Source: 2021/2022 D. Hilton SERP Survey



## 457(f) Plan

In a **457(f) Plan**, the credit union has complete ownership and control of the plan. Any returns in excess of the executive's guaranteed benefit typically belongs to the credit union. The plan investments can easily be transferred to another executive or used as "seed money" in the recruitment of another executive. While taxes are typically the responsibility of the executive, the credit union can choose to design a 457(f) Plan where distributions are net of taxes and account for some or all of the tax liability.

### 457(f) Plan Advantages

- **Diversification** – a 457(f) Plan allows the ability to customize each executive's plan based on their unique situation and the credit union's succession plan design.
- **Greater Executive Retention** – because the executive benefit is tied to performance of the credit union and executive, a 457(f) Plan enhances the retention of the executive while encouraging performance. Multiple interim distributions are also easily achieved, further enhancing the executive retention goal of the plan.
- **CU Owned** – a 457(f) Plan is owned and controlled by the credit union, allowing the Board of Directors the ability to make changes to the plan design and plan participants at its discretion.

### 457(f) Plan Challenges

- **Taxation** – while funds grow tax deferred until distribution, upon constructive receipt and once distributed to the executive, the benefit is taxed to the executive as ordinary income.
- **Balance Sheet Impact** – a 457(f) Plan gain or loss typically passes to the balance sheet and can fluctuate based on market conditions. Insurance investments may offer a minimum guarantee of returns on premiums or principal.
- **Excise Tax Potential** – the 457(f) benefit is part of ordinary executive income.



## Loan Regime Split Dollar

In a **Loan Regime Collateral Assignment Split Dollar (CASD) Plan**, the executive owns the life insurance policy, not the credit union. Therefore, the executive has the authority on the policy once it is in place. To pay the premiums on the policy, the credit union makes one or multiple loans to the executive to cover the total cost of the annual premiums on the life insurance plan. Loan(s) to the executive by the credit union will be charged loan interest. The executive signs an agreement giving the credit union collateral assignment of the life insurance until the loans are repaid. Loan repayment is typically paid out of cash values at retirement or tied to the death of the executive.

### Loan Regime CASD Plan Advantages

- **Taxation** – the executive may be able to take policy loans against the life insurance tax free. This is based solely on interpretation of current tax law.
- **Balance Sheet Impact** – because the plan is a collateralized loan, there is no impact to the credit union's balance sheet. The CU's loan policies may need revision to adhere with the plan design.
- **Excise Tax Potential** – there is no income generated to the executive from the plan benefit other than any double bonus provided to the executive as an imputed tax gross up.

### Loan Regime CASD Plan Challenges

- **Plan Performance Risk** – the executive benefit is assumed at inception but all risk regarding the competitiveness of the retirement benefit liability and the investment performance falls on the executive, not the credit union.
- **Weak Executive Retention** – the executive can either walk away from the policy at any time or through a negotiated benefit with another employer, repay the credit union their loans.
- **Potential Lack of Liquidity** – terminating this plan can be costly due to surrender charges, legal expenses and limitations imposed by the insurance company.



## Hybrid Plans (457(f) and Loan Regime CASD) are a Design Option.

| Hybrid SERP Plan Sample Illustration |                                   |                                   |                                   |                                   |                                |                                               |                                               |
|--------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|--------------------------------|-----------------------------------------------|-----------------------------------------------|
| Milestone                            | 5 Year Anniversary                | 10 Year Anniversary               | 15 Year Anniversary               | 17 Year Anniversary               |                                | 20 Year Anniversary                           | 22 Year Anniversary                           |
| Age                                  | 50                                | 55                                | 60                                | 62                                |                                | 65                                            | 67                                            |
| Benefit                              | 457(f)<br>Interim<br>Distribution | 457(f)<br>Interim<br>Distribution | 457(f)<br>Interim<br>Distribution | 457(f)<br>Interim<br>Distribution | Loan Regime<br>CASD<br>Benefit | 457(f)<br>True-up<br>Distribution<br>Equal to | 457(f)<br>True-up<br>Distribution<br>Equal to |
|                                      | \$350,000                         | \$500,000                         | \$500,000                         | Equal to 65%<br>Total Comp        |                                | 70% Total<br>Comp                             | 75% Total<br>Comp                             |

**Redesigning existing plan(s) to ensure they keep up with the success of the credit union and the competitive compensation landscape is key.**



**While 82% of CEOs indicate they would not consider another opportunity unless a SERP was present...**

## **One Size Does Not Fit All!**

**Example:** increase in resumes using single payment loan regime split dollar designs...



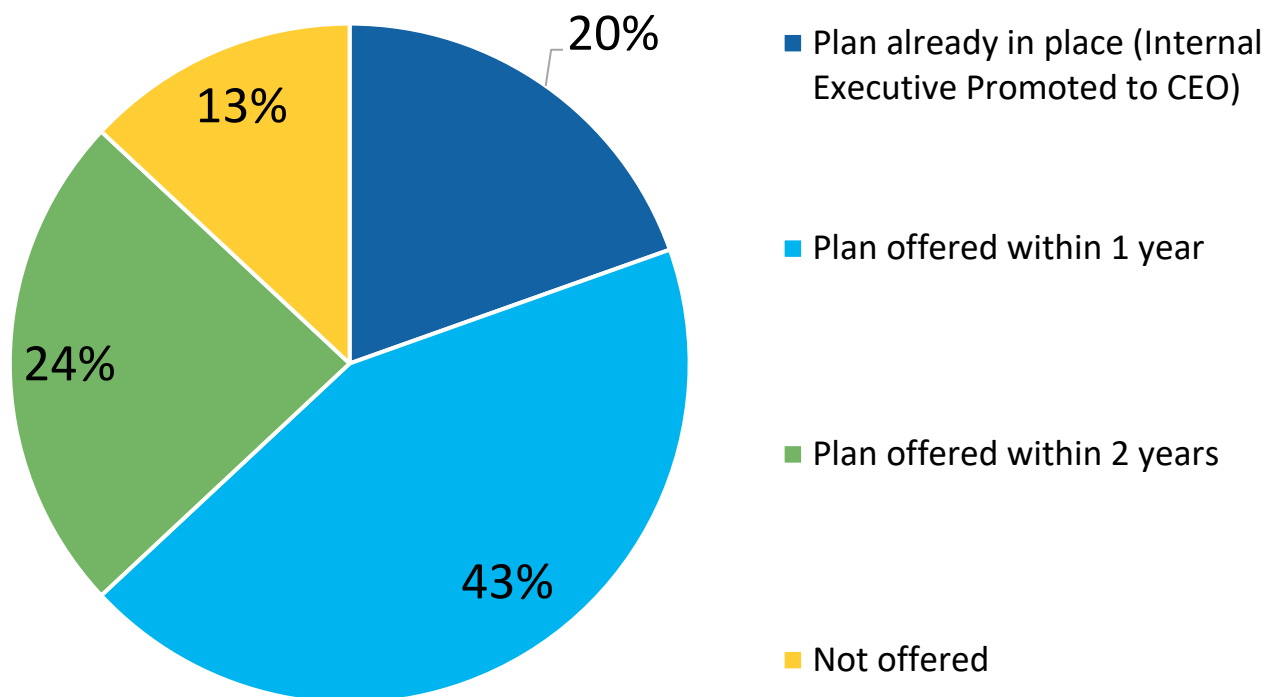
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**Applicants with loan  
regime CASD Plans  
vs.  
457(f) Plans.**



## Across all D. Hilton CEO placements in the last three years...

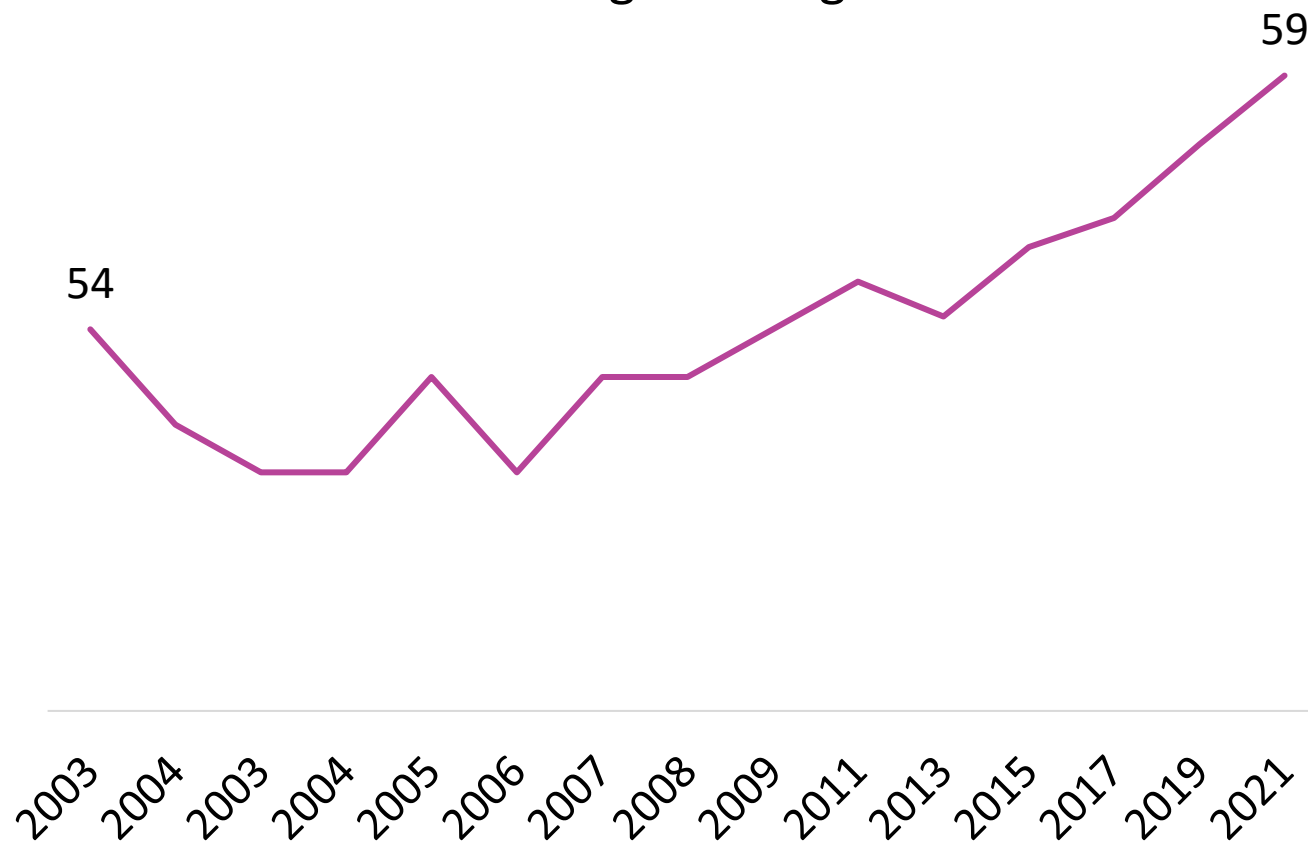
### CEO Searches



**87%**  
of new CEOs  
were offered a  
SERP Plan within  
2 years of hire  
date



### Average CEO Age



**The target retirement age of 34% of CEOs is within the next 5 years**

Source: 2021/2022 D. Hilton SERP Survey





## SERP Plan Revisions can be Expected

- **Revised target retirement date** (extend an executive commitment to the organization).
- **Growth and mergers** modifying peer group and **growth and sophistication** of the business.
- **Succession plan design.**
- **Promotion or transition** of a key executive.
- **Revision in original design assumptions** (i.e., compensation projections, rate-of-return modifications, asset management modifications, longevity increases, social security estimates).
- **Greater tenure and value** to the organization.
- **Excise tax** minimization.



## Excise Tax

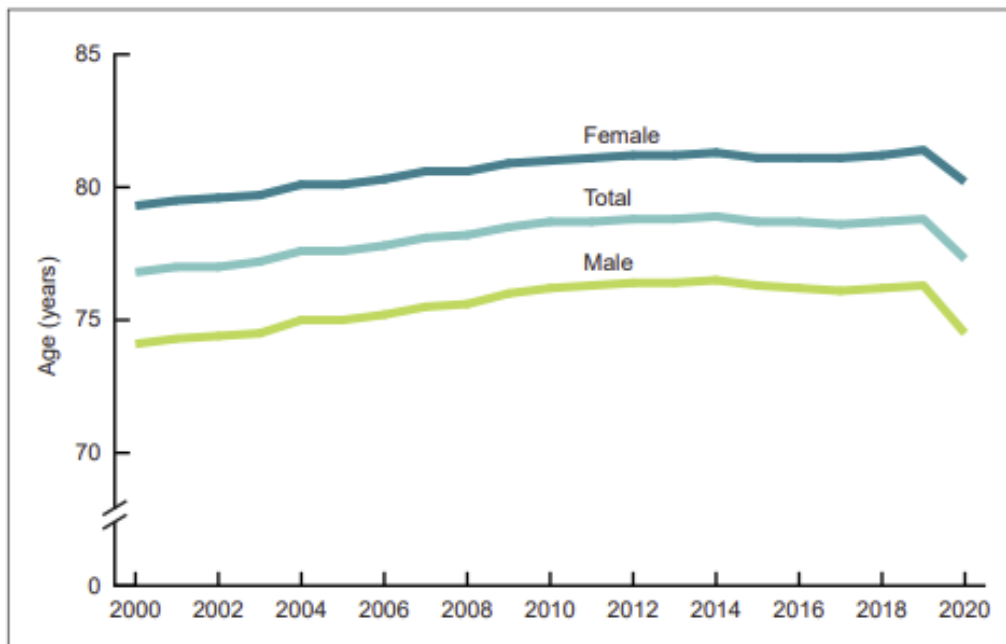
- The 2017 Tax Cuts and Jobs Act that passed on December 22, 2017 includes a section (Section 13602) related to executive compensation for all applicable tax-exempt organizations. The Act states that an **excise tax of 21% will be imposed on all applicable tax-exempt organizations for any withholdable compensation greater than \$1,000,000 in a single year.**
- On January 19, 2021, the Federal Register published IRS guidance that states that 501(c)(1) organizations are exempt from the excise tax. Federal credit unions are 501(c)(1) organizations.
- <https://www.federalregister.gov/documents/2021/01/19/2021-00772/tax-on-excess-tax-exempt-organization-executive-compensation>
- State chartered credit unions are 501(c)(14) organizations so technically are not exempt. However, state-chartered credit unions are federal instrumentalities in that they have federal insurance and are regulated by both the state and NCUA. Because there is typically parity between federal and state regulations, there will likely be further revision or elimination all together to provide parity between federal and state charters regarding this issue. Trade associations both in the CU industry and other not-for-profit industries (e.g., public and private universities, etc.) are already lobbying on this lack of parity. Given the administration's intention to further overhaul the 2017 tax regulation, we could see this become a moot point if the entire bill is eliminated or significantly gutted.
- On February 11, 2021, NAFCU flagged that while all credit unions are considered applicable tax-exempt organizations under the final rule, federal credit unions exempt under Section 501(a) of the IRC are exempt from paying tax owed under Section 4960, until further guidance.
- Ogletree Deakins agrees that federal credit unions are excluded from the excise tax under Section 4960 of the Internal Revenue Code under the final Treasury Regulations. Further guidance from the IRS regarding state-chartered credit unions will be needed.
- The credit union should consult their audit firm for guidance on reversing excise tax accruals and ceasing any future accruals for excise tax.



## Potential Impact of the COVID-19 Pandemic

### Projected Life Expectancy Impacts

Figure 1. Life expectancy at birth, by sex: United States, 2000–2020



NOTES: Life expectancies for 2019 by Hispanic origin and race are not final estimates; see [Technical Notes](#). Estimates are based on provisional data for 2020. Provisional data are subject to change as additional data are received.  
SOURCE: National Center for Health Statistics, National Vital Statistics System, Mortality data.

Source: <https://www.cdc.gov/nchs/data/vsrr/vsrr015-508.pdf>

- According to a July 2021 article from CIDRAP (Center for Infectious Disease Research and Policy) amid the COVID-19 epidemic, life expectancy among American adults dropped by 1.5 years—the biggest dip since World War II, based on new data from the Centers for Disease Control and Prevention (CDC).
- The CDC used the **National Center for Health Statistics (NCHS)**, which collects and disseminates the nation's official vital statistics, to show life expectancy estimates based on provisional death counts for January through December 2020.
- In 2020, life expectancy at birth for the total US population was 77.3 years, declining by 1.5 years from 78.8 in 2019. Life expectancy at birth for males was 74.5 years in 2020, representing a decline of 1.8 years from 76.3 years in 2019. For females, life expectancy declined to 80.2 years, decreasing 1.2 years from 81.4 years in 2019.
- The Social Security website ([ssa.gov/OACT/population/longevity.html](https://ssa.gov/OACT/population/longevity.html)) is updated on a regular basis to reflect current life expectancy data among American adults.



## Benefits Prefunding Strategies

Benefits prefunding allows credit unions to direct a portion of their excess liquidity into investments to cover certain benefit expenses. Benefits prefunding is most commonly utilized for:

- Excise tax expenses;
- Key person life insurance;
- 401(k) match contributions;
- Group life and health insurance expenses;
- Long-term and short-term disability expenses;
- Defined benefit (pension) plan contributions;
- Post retiree health benefit plan funding;
- 457(f) SERP benefit expenses.

With a formal benefits prefunding strategy, credit unions can direct funds into investments (mutual funds, annuities, equities, bonds) which have historically provided a return on investment that is more likely to match increases in employee benefit expenses. **The NCUA permits benefits prefunding strategies under NCUA regulation 701.19(c)** that specifies:

“A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations...and may purchase an investment that would otherwise be impermissible, if the investment is directly related to the federal credit union’s obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long as it has an actual or potential obligation under the employee benefit plan.”

When asked to clarify whether prefunding employee benefits is allowed, the NCUA affirmed that federal credit unions could participate in such prefunding for specified future employee benefits obligations. Federal examiners review prefunding programs annually and, as a result, have reaffirmed prefunding compliance with NCUA regulations.



## How to Protect Your Most Valuable Assets

### ONGOING EDUCATION

Ongoing education on the subject of executive compensation and benefits trends.

### SUCCESSION

Honest conversations regarding Succession for the CEO and other Senior Executives.

### ONBOARDING

Onboarding for new Board members on the plan history, objectives and the Board's intentions.



### FREQUENT PLAN REVIEWS

Frequent reviews of the plan against peer benchmarks.

### THIRD PARTY VALIDATION

Third party validation that the plan design remains competitive.

### EXECUTIVE REVIEWS

Annual reviews with individual executives to review design and reinforce the value the plan provides.



## **Contact Information**

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