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Long-Term Incentives for Credit Unions: More than SERPs

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A stakeholder-friendly objective of successful compensation philosophy and strategy is the linkage of executive compensation to the performance of the organization beyond annual performance periods. A challenge for compensation committees at credit unions focused on this objective is finding the right balance between annual short-term cash incentives and long-term incentive (LTI) compensation. Since the credit union doesn't have equity shares (i.e., stock) to award executives like their for-profit competitors in the banking industry, this can seem like a difficult balance to strike.

Traditionally, Supplemental Executive Retirement Plans (SERPs) have been the primary form of long-term executive compensation offered at most credit unions. In Pearl Meyer's 2020 Top 200 Credit Union CEO and Senior Executive Total Compensation survey, 89% of participants reported offering a SERP to the CEO, and most respondents included additional executives beyond the CEO in the SERP benefit offered. Clearly, executive SERPs are an important tool in a credit union's compensation plan, but they lack some critical reward and retention elements usually found in correctly designed LTI plans.

In the survey, only 27% of respondents indicated they offered any executives a "traditional" long-term incentive. Of the 73% of credit unions who reported they do not offer an LTI plan, only 12% indicated an interest or were considering implementing one. It would appear that a majority of credit unions either don't see value in an LTI from a reward and retention perspective or are not sure how to construct such a plan. In our frequent discussions with credit union directors serving on compensation committees, we often hear concerns about how to balance short-term, cash-based awards with longer-term performance goals. So, SERP plans are commonly offered and incorrectly viewed as the only way to provide longer-term compensation.

For any compensation strategy to be effective, the key objectives of attracting, motivating, rewarding, and retaining executives need to be present. Without a long-term incentive element in the pay mix, there's a lack of focus on organizational performance over a period longer than just a year at a time. Concentration on just an annual plan can be seen as a weakness of the compensation strategy and a deterrent to executing on long-range strategies. A long-term incentive plan should be considered as part of an overall balanced compensation strategy and implementing one doesn't have to be complicated.

In most publicly traded companies, stock-based incentive plans are the most common form of LTI. For credit unions, even though there is no stock to be shared, we believe performance-based LTI can still be part of the pay mix and compensation strategy. We advise thinking of the LTI plan like an annual plan but with fewer and longer-range measures selected to counter-balance the short-term measures in the STI plan.

An initial step in the development of an LTI plan is identifying the measurable key performance indicators (KPIs) important to execute the strategic plan of the credit union.

Selecting the key measures and the level of performance required to earn the LTI payout requires board agreement on the value of successful achievement of the KPIs to stakeholders. The KPIs can be financial measures (e.g., growth in assets or loans, revenue, or a measure of profitability) or non-financial (e.g., member satisfaction or member growth). Frequently some mix of financial and non-financial metrics is used in the LTI plan. Unlike annual cash incentive plans, LTI plans typically have just two to three KPIs to create laser focus for executives to achieve the strategic plan. A key to a balanced compensation strategy is to properly align the measures in the STI plan with those in the LTI plan.

The next step is to determine the performance period over which the KPIs will be measured. Typically, three years is the most common measurement period for LTI plans, as it can be difficult to project performance beyond a three-year period. Further, awarding annual or bi-annual grants (or opportunities to earn awards) within the LTI program, each with their own three-year performance period, establishes a layered series of awards with overlapping performance periods providing a strong retention element to the total compensation plan.

Finally, at the completion of each LTI performance period the payout earned by executives will be determined by measuring the actual percentage achieved of the expected performance range established at the beginning of each LTI grant. The delivery of awards earned in the LTI plan will be made at the end of each performance period and payable in cash.

As credit union boards seek ways of tying compensation to performance, they continue to ask about incentive compensation tied to strategic performance. Long-term incentive plans both reward for achievement of strategically important objectives and retain high-performing executive teams. By including LTI compensation in the total remuneration, credit unions can better compete for executive talent in the highly competitive financial institution markets.

About the Author

Randy McGraw joined Pearl Meyer in August of 2019 in the acquisition of Matthews Young Management Consulting. He has almost 20 years' consulting experience, with a primary focus on the financial institution industry, and works in all areas of executive and board compensation with publicly traded clients, private clients, and credit unions. His areas of expertise include executive and board of directors pay competitiveness reviews, cash and equity incentive plan design, and supplemental retirement program design.

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