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COMPENSATION

Choosing the Right Compensation Plan

Once a bank manages to find an ambitious, smart employee with leadership potential, how should they go about keeping them?

Banks have often used nonqualified deferred compensation plans such as supplemental executive retirement plans (SERPs) and deferred compensation plans (DCPs) to attract, reward and retain high-performing employees. Both plans are unsecured promises by the bank to pay benefits at a future date as documented in a legal agreement between the bank and the participant. SERPs are defined benefit plans, similar to pensions. DCPs are defined contribution plans, similar to 401(k) plans.

While they may seem similar, SERPs better serve established employees, while DCPs offer much greater flexibility. Boards and management teams should closely consider the way these plans approach employee benefits and retention, and how employees respond. Banks may find that retirement-centered SERPs are not a good fit for younger employees, who are less focused on that stage of their lives. If the employee is recruited away, the lost benefit could also be easy to replace in a negotiation.

In contrast, properly designed DCPs are customizable, cost efficient and incentivize high performance. Banks can vary the contributions based on the performance of the institution and the individual, and contributions can be a percentage of salary, a fixed dollar amount, or a combination. They can also be tailored to meet specific criteria, much like a bonus plan. The credited interest rate on the contributions is typically based on the bank's return on equity or another agreed-upon indexed rate. After separation, the rate is usually a defined fixed rate.

Banks can design DCPs to reward employees with shorter-term financial goals by providing a benefit that is payable in the near future. A financial institution could establish a program so its top loan officers receive a contribution of 5% to 15% of salary annually for five years. The deferred compensation earns interest, and the balance pays out over two years at the end of the fifth year. The bank could restart the plan and have another payout in five more years, or could use a rolling vesting schedule. While the contributions and interest credited to the account are additional expenses to the bank, the costs are made up through retention and higher performance from the officers.

Banks with young leaders already in top management positions can reward them both now and in the future by establishing a DCP with in-service payments and retirement benefits. If the contributions are based on a percentage of salary, they will naturally increase as the participant is promoted and receives raises. The deferral account continues to increase until retirement age, when the balance begins paying out over a period of 10 to 15 years.

DCPs may also allow for voluntary deferrals of compensation, which can benefit employees whose deferrals are limited in the 401(k) plan. DCPs may have a built-in death benefit or can be paired with a supplemental life insurance plan — a feature that employees with younger families may value. Institutions can use bank-owned life insurance to help with the cost-effectiveness of these plans, recover some or all of the expenses and provide the additional death benefit.

Deferred compensation plans offer flexible design options, control over annual expenses, and lucrative and meaningful incentives that encourage employees to remain loyal. They can help banks of all sizes attract, retain and reward their rising leaders, high-producing lenders and top executives.

As seen in the 1st Quarter 2020 issue of *Bank Director*