Collateral Assignment Split Dollar:
A Dynamic Benefit Planning Tool

The Collateral Assignment Split Dollar Supplemental Executive Retirement Plan is growing in popularity among credit unions. Here's why.

Today, an increasing number of credit unions are incorporating supplemental executive retirement programs (SERPs) into their executive compensation structure. In fact, the use of SERPs has jumped significantly over the last decade. It's estimated that in larger credit unions, some 65% have a SERP in place for their CEO, and many of these credit unions also have programs in place for some of their senior executives.

There are a number of practical reasons for this growth. One of the biggest drivers is the need to fill the retirement gap created by 401(k) plans that typically replace less than 25% of an executive's final pay. Another motivation is the desire to implement a secure succession plan. A SERP can help ensure that a particular executive remains with a credit union to help create a smooth transition when he or she retires.

Insuring Success

While SERPs continue to grow in popularity, their structure has changed rather significantly over the years. Today, SERPs are more often than not funded with some type of life insurance policy. There are a number of reasons for this:

- Life insurance policies often provide attractive guarantees,
- They generally are not subject to negative trends in the markets,
- Their interest or dividends are attractive in today's low interest rate market, and
- Most important, the returns from these insurance policies are predictable.

Certainly, this approach is different than what was used in the late nineties and well into the last decade when equity-based funding programs were more the norm.

The Benefits Are Clear

Many life insurance-based SERPs implemented today are set up using a "split dollar" arrangement in which the death benefit is split between two parties, thus the split dollar moniker. In the case of credit union SERPs, the credit union's investment to pay for the life insurance policy is protected by the death benefit, while the executive's beneficiary is assured of receiving a distribution in the event of an untimely death of the executive.

One of the most popular split dollar arrangements is the collateral assignment split dollar (CASD). This dynamic benefit planning tool incorporates many key features that have proved very popular to credit unions. Included among them is a life insurance policy that is often paid for over a 10-year period, thus eliminating the lump sum funding challenges of other SERP arrangements. In addition, the CASD's death benefit ensures the program is self-completing. As discussed above, in the event of the untimely death of the executive, the life policy pays back the credit union and provides a life insurance distribution to the executive's beneficiary that approximates the value of the SERP retirement benefit. This feature provides real security for the executive's family.

The CASD also has some very favorable tax treatment built into it. The executive takes his or her supplemental retirement distribution in the form of loans against the cash value of the policy, and these loans are tax free. In addition, the CASD does not require a lump sum distribution, so the executive is not subject to a large tax impact on the lump sum amount.

Meanwhile, the accounting for the CASD is very favorable to the credit union. There are no direct expenses that have to be charged to the credit union's books when using a CASD. Each time the credit union makes a premium payment on the life insurance policy, the executive signs a loan note for the amount of the premium payment. These loan notes are booked just as any other loan. If the SERP contains a cost of funds recovery feature, then the credit union can annually book this amount as interest earned. So instead of having to book a large expense amount to fund a SERP, the credit union can book ten loans and annually record interest from these loans, which enhances its bottom line.

Finally, distribution flexibility for the executive makes the CASD even more attractive. Instead of taking a lump sum distribution, the executive takes the distribution over a number of years as loans against the cash value (tax free). During this time, the executive has the flexibility to increase or decrease the distribution amount and skip years in the distribution, all without any tax ramifications. This flexibility makes tax management and estate planning much easier for the executive after retirement.

A Trusted Option

The supplemental executive retirement program has become an extremely important compensation tool used to attract and retain key executive staff. While there are numerous ways to construct a SERP, most credit unions choose the CASD as the mechanism to fund their program. The CASD's guarantees, tax advantages, accounting and flexibility make it the approach of choice for credit unions interested in offering the most cost-effective, secure and competitive program.

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