Thinking Outside the Box on Deferred Compensation

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Mark Santero: Good afternoon, everybody. This is Mark Santero with Homestead Advisers, Homestead Funds, and welcome to our Investment Insights and Business Strategies webinar. We're going to get started. Appreciate everybody jumping on this afternoon, or this morning, wherever your location puts you. Today, our webinar is on Thinking Outside the Box on Deferred Compensation, part of our Investment Insights and Business Strategies webinar series.

Our meeting format has not changed. I will give a brief capital markets review and then we'll spend about 25, 30 minutes on deferred compensation ideas with two of our guest speakers from our Deferred Compensation Consulting Team and a guest speaker from our electric cooperative membership. All attendees are on mute. So if you could submit any questions you may have through the Q and A feature in the WebEx format, and as always, this meeting is being recorded. You'll get the recording via email next week. So all of you or any of you that look for CEU credits, proof of attendance will be provided in the post-event email. All right. So let's get started.

I'm going to give a brief market review and outlook. We did a deferred compensation meeting earlier in the year. And the overwhelming feedback was less of Santero talking and more of our deferred compensation consultants talking. And plus the market hasn't been that great to talk about. So I'm going to try to get through this as quick as possible.

So, no surprise to anyone, this year has been both a bear market for both stocks and bonds, where both asset classes were down at midyear. Here we are, almost at the end of the third quarter, and stocks are in bear market territory. Inflation continues at a higher-than-expected pace. We just, uh, have The Federal Reserve has hiked rates four times already through July. They are in meetings as we speak, and we all expect a rate hike tomorrow [9/21/22] afternoon. And the market is already priced in 75 basis points; some are saying 100. I don't think that that will be the case, but we'll know tomorrow. But from what we've seen so far, 75 basis points, which would put us at — right now, we're at 2.25% to 2.50% on fed funds — so that would put us at 3% to 3.25% on fed funds.

When we look at inflation and supply-side pressures, from COVID lockdowns in China, the Russia-Ukraine war, and, you know, we've got a perfect storm across the board for such a dismal market for both stocks and bonds. The hard landing is going to be something that we think is going to happen. And that's because the Fed missed it on the way in. They continue to do quantitative easing by buying Treasuries and government securities. Through March of this year, they were slow to raise rates, first rate hike being 25 basis points.

So, one good news is that company earnings remain sturdy to date. And with P/E [price-to-earnings] valuations down substantially, we'll see what happens as we go quarter to quarter from here on out.

So what have been the drivers of the volatile markets? Inflation — again, that comes the first thing out of everybody's lips — continued uncertainty about the Fed tightening. I think now that we're going to be in the 3% to 3.25% fed funds rate, how high do we go? You know, whether it's 3.5% to 4%, 4% to 4.25%, I think a lot of that is going to be determined in the months to come when we see how inflation reacts to the higher cost of capital.

The Russia-Ukraine war — when will it end? Again, every day something new is going on, but for all that we hear it's going to be protracted. Lockdowns in China — what's next? That has effects on the supply chain. And what's the bottom of lofty equity valuations levels? We continue to talk with the companies that we invest in here at Homestead Advisers, and where the bottom is...um, not yet determined.

Recessionary fears have been flashing now for several months. We've got an inverted yield curve, meaning that the two-year yield is higher than the 10-year yield. Typically when that happens: a recession. Every recession has been preceded by an inverted yield curve; however, not every inverted yield curve leads to a recession. But what we've heard from Chairman Powell at the Federal Reserve, they're not as concerned about a recession as they are with controlling inflation. So the risk of recession seems to climb every month, and we'll have to see how it goes. But a bad labor market has yet to appear. Matter of fact, it's been quite a robust labor market.

So as I mentioned, the risk of recession grew in the second quarter. It has not abated in the third quarter. The latest numbers that have come out have actually spurred more inflationary pressures. And we don't see that stopping anytime soon until these rate hikes take effect on the consumer.

So consumer sentiment has plummeted in the second quarter. I'm going to touch base on that in a second, because it's interesting what's happening with our consumer. As we know the American consumer drives two-thirds of all economic activity. If we can go to the next slide, please [SLIDE 8].

So we're at record low in consumer sentiment. We go back to July of 2008, through 2009, where we haven't seen such low levels. We look at where we were as of July of 2022. Having said this, the consumers, the American consumers, which are the most driven spenders on the planet, are still spending at a pretty high clip here.

So although sentiment is down, their spending habits have not changed. Now, their spending habits have changed the type of spending they're doing. When we came out of the pandemic — when you look at July 20 through 21, that uptick in consumer sentiment — a lot of discretionary spending was taking place: furniture, automobiles, appliances. Now with spending still continuing, it's more on consumer goods, so food and consumer staples. So although spending hasn't abated, it has shifted from discretionary to more consumer cyclicals.

So it's been a bumpy ride for stocks. This isn't a chart that we like to feel great about, but it's been a volatile market. The S&P has fallen 17.5% year to date as of 8/31.

So although stocks may be down and even bond prices are down, but bond yields are up, those with long-term investment time horizons — you know, these are the times when we look and see buying opportunities.

Again, we are long-term investors here at Homestead Advisers. Economic cycles from the ‘50s all the way through ’22 — there have been 11 recessions, and each one has been followed by a recovery. Every recession can be deep or can be narrow, or shallow. We don't know if we have a recession whether it's going to be a deep one or it's going to be a shallow one or the duration of it. Every recession is based upon different factors. The mini recession that we had coming out of the 2020 pandemic was deep, but it was very short in duration. And we rebounded rather well after that one.

But we do have a perfect storm that's been in the markets now for quite some time, and that is — as I pointed out — high inflation, supply chain issues, the war in Ukraine, lockdowns in China. Every one of those events could’ve triggered volatile markets. But again, economic downturns may present buying opportunities in the future. This slide demonstrates that statement. If we look back from the ‘50s to ’22, every downturn, if you look at ‘54, you look at ‘58, let's look at ‘74 when we were really in dire straits, ’84, ‘90, the dot-com bubble, 2008 — a pretty significant recession — look at 2020. What has preceded that has been quite powerful. So, what do we see for the remainder of ’22? Volatility. We believe volatility will continue to be elevated. We've had this since ‘21. And again, that's because of all the uncertainty that's gone on in the markets that I pointed out. The Federal Reserve doesn't have an idea when it's going to stop, but it is going to be aggressive in its task to bring down inflation.

We do expect inflation will peak and slowly normalize over the long term. We think that the yield curve will remain flat to inverted, the two versus the 10. And we have seen some supply chain issues kind of dissipate over time. They are going to remain there in a challenged event — challenged given the lockdowns in China as well as the Ukraine and Russian war; however, supply chain issues just don't fix themselves overnight. These are part of long-term economic trends that hopefully, over time, the U.S. adjusts and we start to see some changes in how we operate. But again, opportunities to add positions at attractive values exist in the market today.

So one of the things that when we look at the causes for inflation — and all of our clients and the electric cooperative membership are experiencing — tight labor markets. Even though we may be in a recession, we still, as a country, continue to see labor issues. If we can go to the next slide [SLIDE 13].

And when we talk about tight labor markets and what we can do to help cooperatives with their hiring and retention challenges that they’ve faced, we thought, again, this is the second time this year that we brought Tamika Bishop and Cindy Irving, two of our senior consultants in the Deferred Compensation Benefit Program that we offer, to talk about what we can do to help your cooperative.

And, I've said this throughout this year, and I'm going to ask this question, and Tamika and Cindy are going to expand upon it, but when was the last time your co-op reviewed your deferred

compensation plan? When's the last time you dusted it off and looked at its relevancy? Do you, in fact, even have one? Because deferred compensation plans need to be a living, breathing benefit, especially in these labor markets where you've got recruiting challenges, retention challenges, and rewarding challenges of key employees. In a tight labor market, deferred compensation could be that benefit that helps you retain, attract or reward those key employees.

So, I'm going to ask you, when was the last time you dusted it off? When was the last time you looked at your employees and the salary components that they're at, and do they qualify now for your deferred compensation plan? What other benefits in your plan should you be looking at? So I'm going to pause and I'm going to turn this over to Tamika and Cindy to talk about the ways Homestead Advisers and our deferred compensation offerings could help your co-op attract, retain and reward your key employees. So take it away, Tamika and Cindy.

Cindy Irving: Thanks, Mark. I'm Cindy. Tamika will be joining us in a few minutes talking about another topic. But thanks to everybody for joining us. As Mark said, it's our second webinar this year covering non-qualified deferred compensation programs. Last time we met in January, we talked about two plans that are available to tax-exempt co-ops: the executive compensation 457(b) plan — *b* as in boy — and the EBR or executive benefit restoration plan. Just as a quick refresher on those two plans, the 457(b) plan allows executives to defer additional income, current income, on top of the amount that they defer into the 401(k). So it's a pretty powerful way to transfer or shift their tax liability from now into the future, after separation or retirement.

And again, this is a contributory situation that allows them or the co-op, in fact, to save over and above on a tax-deferred basis — over and above the 401(k) amounts that either the participant or the co-op is putting into the 401(k).

And then the EBR, you may remember, is a very specific plan that is designed for the co-op to replace any planned benefits that may be limited due to IRS imposed limitations on the retirement security plan. So that's a pretty specific plan.

So those are the two plans we talked about in January, but today we're going to talk about a third plan, the 457(f) — as in Frank — performance incentive plan, or as I like to think about it, *f* as in flexible, because it provides a board and the executives an ability to tailor a plan to the top executives or to key employees to encourage someone, as Mark said, to stay around, to not take another job offer, and a way to reward them if they meet a particular performance goal. So we'll talk about that for a few minutes, and then you're going to hear from somebody who's actually used this plan and put together one with his board. And I think you'll find it very interesting.

Just a reminder that this is a plan that's available to tax-exempt co-ops only — the one we're talking about today, the (f) plan; however, there are similar plans available for taxable entities. So please reach out to me or Tamika if you're interested in learning more about these taxable plans for taxable co-ops.

So let's quickly go over some key features of the 457(f) plan. First of all, this is exclusively an employer-funded plan. Only the co-op puts money into it, and as such the potential funding of the benefits is not capped on an annual or on an overall basis. So it's essentially unlimited; the benefit can be unlimited, unlike the 457(b) plan that has annual contribution limits.

Like the EBR plan, the 457(f) plans require a vesting date that is at least 24 months in the future. And once the vesting date is reached, the benefit must be paid and it must be taxed to the participant at that point in time. It's not deferred taxation after the vesting date. Like all non-qualified plans, the assets set aside for these plans are owned by the co-op until they're actually paid out to the participant. And if the participant does not reach their vesting date, no partial payment is made. It's either all or nothing, except of course, in the event of death or disability. And like all non-qualified deferred compensation plans, Homestead Funds, Homestead Advisers, serves as the consultant on these plans, and the co-op is therefore the key plan sponsor and administrator. So those are just some few key points to know about 457(f) plans.

So some co-ops use these 457(f) plans on a stand-alone basis to provide that lump sum carrot for a key employee to stay around and/or to reward for a superior performance in general or as it relates to a specific goal. Perhaps your co-op is thinking about launching a new product like broadband, or is in the middle of doing that, and the person who's doing it is very important — it's very important that he or she stay around and finish the job — or to meet a maybe a specific, very specific business-oriented goal: building a facility or meeting some sort of target on time and on budget.

So the plans can be used on a stand-alone basis to reward for a specific task or activity; they can also be used in tandem with a more common 457(b) plan that I mentioned earlier. And Tamika's going to talk a little bit more about 457(b) plans after me. So in using it in tandem, such a program might work something like, say, your co-op board wants to set aside some amount annually over five, 10, 15 years in order to retain or reward the CEO or another C-suite individual. And they want to do more than what might be allowed by the 457(b) plan. But using it in tandem, the co-op would deposit the maximum first to the 457(b) on the participant's behalf, and the reason that is important is because the 457(b) is immediately vested. There's no vesting date in the future they have to reach. So the participant, when they leave, if it's before or after the vesting date for the remainder of the plan, they can take it with them.

The downside of the (b) plan is that you can only do a certain amount each year; this year it's $20,500. But then the co-op might take the remainder of whatever planned incentive that they wanted to create for the participant and deposit that into a 457(f) plan.

Typically we're talking about much larger amounts than the $20,500. And it can be the same amount annually, or it can be a variable amount each year. The funds go into an account designated for the 457(f) plan. The investments can be directed by the participant, or they can be directed by the board; that's up to the board to decide. And then whatever amount is in that account at the vesting date — that five, 10, 15 years, whatever the board decides — the amount is then paid out to the participant, typically like a performance bonus. So it's a win-win because the participant knows that they're at least always going to get what's in the 457(b) plan that the co-op has set aside because that's

immediately vested. And then they have the additional carrot, and the board retains control of any funds that are set aside in the 457(f) plan, up until the vesting date and the payout.

We're seeing this more often with younger CEOs and senior staff who really are looking for an intermediate way to be rewarded. The board's looking to reward them, hopefully to keep them around as far in the future as possible, but sometimes in this very fluid labor market, you have a 40-, 45-year-old CEO or senior person and that they're looking at a retirement date, say, of 62 or 65. If a carrot is created out there that far in the future, or it's related somehow to the RS plan benefit, they may just not be incented enough to stay around. So this is sort of an intermediate way to create an incentive for someone to stay and for obviously someone to do an excellent job.

And just leaving aside, just as a stand-alone plan for a minute, sometimes boards when they find that their CEOs or other senior executives are limited as we mentioned earlier, as I mentioned earlier, related to the RS plan benefit by IRS restrictions, they may look into an executive benefit restoration plan, the EBR. And one of the functions of the EBR — one of the features, I should say, of the EBR — is that the actual restriction is not known until the retirement date — the normal retirement date or normal retirement age — is reached. The unknown is the high-five salary and the particular interest rates at that time. And so some boards are getting more and more reluctant to commit to it, an unknown number, in the future. So instead of committing to that unknown amount, the CEO and the board may agree on a specific amount after working with us to get a realistic range of possible restriction amounts.

So for example, I've worked with a number of co-ops where we can run numbers that say, using high/low interest rates and high/low potential high-five salaries, what is the range? So if there's a range of, oh, I don't know, $400,000 to $800,000, the co-op board may say, $800,000 — we just don't think we could ever fund that or feel comfortable doing that. But maybe we all agree the number is $500,000. So they set aside the money in a 457(f) plan in some way — either upfront, over time, etc. — with a particular vesting date that's geared towards the RS plan. And the beauty of that is both the co-op and the individual know what the benefit is going to be. The co-op knows what their liability is going to be, and the individual knows what their particular benefit is going to be. It may not be their exact restriction — it could be more, it could be less — but at least there's a certainty involved. So that's how 457(f) plans are used in a slightly different way.

Enough of all this theoretical talk. What I'd like to do now is welcome our guest speaker, Bobby Ferris, to describe why and how he and his board decided to implement a pretty unique tandem plan, as I was mentioning earlier. Just to give you a little background on Bobby, you see his smiling face there [SLIDE 17] and on the screen as well.

Bobby's a native of Georgia. He has 26 years of experience at four different co-ops. He's currently serving as the executive vice president and general manager of Lee County Electric Cooperative, which is located in Lovington, New Mexico, where he manages about 73 employees and his co-op serves about 16,000 members within New Mexico and Texas. I guess they're right there at the border. One of these days I'm going to go out and visit. New Mexico is one of my last three states that I have to get to, so I have to make it out there sometime. In his spare time, in which I'm not sure he has a

whole lot based on when I talk to him. He always seems to be working and planning to work, but he enjoys hunting and fishing and spending time with his wife of 24 years, Amberly.

So I'd like to introduce everyone to Bobby. And Bobby, if you could, could you please give the audience an overview of the plan that you and your board set up and what your rationale was when you did that?

Bobby Ferris: So first I just want to thank you for the opportunity to join Homestead, to share a little bit about my experience, working with you and developing a customized plan. And I think it's something people will be interested in hearing.

You know, when I visited with my board when I came here, they didn't understand about the IRS limitations on what you have available to employees that are highly compensated through the RS plan. And that's no fault to the co-op; so high-income earning or managers or other individuals at the co-op that are limited by IRS rules — that's not the co-op's business. So trying to figure out a way to make those employees whole was the approach that I took when visiting with the board: Look, this is what the IRS says — the limits are that can go in the in the RS plan. These is the limits on what an employee can contribute to the 401(k) plan.

So between those two, people that are highly compensated or in your management position, sometimes are just missing out on those other benefits. And that's tied to total compensation — it's not just pay, we're talking about total compensation. So we had to go back and look at a way to do a win-win solution.

And I love where Miss Cindy said, we're talking about the 457(f) and she used the word flexible in there. And that's exactly what you're looking for because a board, a lot of time, is not wanting to tie itself down long term in a very rigid environment, because you don't know what the future holds for the co-op. So having that flexible in there meant a lot.

So what we did is we looked at ways to combine the 457(b) plan, maxing that out to the IRS limits, combining it with a 457(f) plan that has a performance and incentive and retention bonus included in it. And all of that is contractually done between myself and the board and tied to a period of time with a vesting date that is beyond the minimum two-year time limit, and then make sure that I am performing well for the co-op. And that I'm achieving the goals that the board has set and that at the end of the day, it's a win-win. I'm being compensated for the job that I'm doing and being made whole for what the IRS is limiting for my retirement plan. And at the same time, it becomes an attraction and or retention tool for my other managers, because sometimes you get into discriminatory testing based on your 401(k) plans and other things, and others that are wanting to set aside more money for the retirement program. And for just a small nominal fee for Homestead to administer the funds, you can open this up to your highly compensated management-type positions at the co-op, and it creates a great retention and attraction tool. And then it's a good compensation tool for myself. So I think the plan that we created is very unique but very rewarding. And it's good for the co-op and it's good for the employee.

Cindy Irving: Thanks so much for that overview. Bobby, can you just tell us what the pros and cons — when you were going through and thinking about this, setting up this tandem plan, what were the pros for doing it and what are some of the downsides that you might see.

Bobby Ferris: Absolutely, Cindy. So when you look at the traditional EBR-type plans, you got a vesting date of, say, if your co-op has a normal retirement date of 65. When I came here, I was 44 years old, so that's a 21-year commitment, and that dollar figure was a very large dollar figure for what would be the difference between today's retirement number and what it's going to be — what you have to project is going to be there in 65 and what that gap is that the co-op would have to fund.

And to me, that's just a huge hurdle, both for the employee to commit for 21 years to something and then for the board to have to fund it at that level from day one; those to me are just deal stoppers. I think the EBR works very well for somebody that's late in their career, with maybe less than 10 years left and a lot more known and measurables in there. When you're younger and you come into these positions and you've got 20, 25 years left to work, having the flexibility to tie it to your performance over a shorter window of time and not having the large financial commitment for the board and creating that flexibility — it gives both of you surety that you're going to be doing your job and that you're achieving these milestones along the way and the comfort level between the two — between the board and the employees. So to me, that's where that win-win comes in. You set the goals, you meet the goals and objectives, and then you can also reevaluate the plan going forward. So you do the first contract at two years with X dollars going into it, and you meet those goals and you renegotiate the next contract, say, maybe for three or five years, and you can ask for a little bit more to go in there based on your historical performance and the goals that the board sets going forward.

So you just get the flexibility that you don't get with the old-type plans.

Cindy Irving: So you negotiated your plan — or you and your board together negotiated your plan — in context or in tandem, I should say, with your work contract, with your employment contract, is that correct?

Bobby Ferris: That is correct. These plans have to have a contract tied to them for the vesting date. So in that, it's really easy to structure a contract with key metrics involved in it. Because I've always been a firm believer that what gets measured gets done. So you put goals in there, whether it's for outage interruption, whether it's for safety, other financial metrics — you put all those things together and it's easy to measure a person's performance at that point. And then it gives board surety that you're getting the job done, and then you get rewarded at the end of the day for doing that job.

Cindy Irving: Yeah, that makes a lot of sense. So were you contributing to the 457(b) plan when you set this up? Can you remind me?

Bobby Ferris: No, I was not. So this was the beginning of the 457(b) and (f) plan for me.

Cindy Irving: Okay, so if somebody's already contributing to the 457(b) plan, one thing I was just going to point out is that if the co-op now took over the full amount, that would foreclose somebody from doing it on their own. So that's a little bit of a — I don't want to say a drawback — but it's just something, if you're considering a plan like this, you might want to consider. In Bobby's case, he was not contributing yet. And so the co-op used that as a way of taking up the full amount, because they contribute the maximum each year, correct? To your (b) plan?

Bobby Ferris: That is correct. You know, and that's the full advantage with having the two plans working in tandem is you take the tax hit on the (b) plan automatically; as soon as the money goes in, you pay the taxes on it and you're completely vested. In the (f), you don't pay the taxes until the vesting date of the contract. So it kind of breaks up the tax burden on top of your salary as well.

Cindy Irving: What do you mean? Just to make sure I'm clear on that, you mean like the employment taxes? You're not going to pay income taxes. Nobody pays income taxes on that until you actually take the (b) funds out, correct?

Bobby Ferris: That's correct. That's correct.

Cindy Irving: Yeah. So, how long did it take, and do you have any advice for any of our participants who might be interested in establishing a similar structure?

Bobby Ferris: Oh, absolutely. So the first idea was to have the conversation with you. Depending on the workload at Homestead, you have to get an actuarial run to kind of know what that gap is on funding. So sometimes that's two weeks, three weeks, could be four weeks, but you want to get that number — and be comfortable with that number — because you need to run scenarios and you have to estimate what you think your raises might be in the future, what interest rates might do in the future. And Homestead is great to help somebody come up with what those numbers might be.

So you take that basis, and then from that you have to have a sit-down, one of those heart-to-heart conversations where you say, this is the gap. You're trying to get to being made whole, but you understand that that's a leap, and you may not be able to get all of that at one time.

So you look for those opportunities — you know, those win-win opportunities — where you go in and say, dangle a carrot for me and set some goals and let me meet those goals and then reward me with that carrot. So then you start taking bites out of that big number, because that number, the younger you are, that number's large, or can be really large; if you add 3% or 4% raises just for the next 20 years for an employee, and you're already at that IRS limit, that number gets pretty large, pretty quick.

And that's really hard, I think, for a board to fathom what that number is, that gap number. So doing it in smaller bites and looking at it more frequently — every two, three, five years — I think that gives you a better opportunity to renegotiate your position each time and to show your value again, each time, and make sure that you are also staying on track, on task. And that you're earning, that this is a bonus — that it's a retention deal and that you're earning your keep every day. So I think that gives some board some surety in that, too, because the money is vested in the board and the co-op until you meet those goals, that the co-op is made whole; there's very little risk to the co-op in this. And that's one good way to say it.

But I would say two to three months would be a good fast-track timeline to make this happen. You know, introducing the concept to the board, entering into some resolutions to begin setting up the plan with Homestead, taking care of the paperwork, working through a contract with the board and getting all of that taken care of. I'd say two to three months would be kind of a fast track.

Cindy Irving: Yeah, I think that makes a lot of sense. And so essentially you're saying that you started with the fact that you knew you were going to be limited. If you stayed to age 62 or 65 — I can't remember what your normal retirement date or age is — but you started with that and we ran some numbers for you, and we did some ranges: You know, at this salary increase and at this set of interest rates, this is sort of the range. And so that was your starting point, correct?

Bobby Ferris: That's correct. So, yes, knowing that I had a full retirement age at 65.

And starting at this capacity and being at the IRS limit pretty much when I started as far as what could go into the RS plan, I knew that that gap was going to be large and get larger as time went on.

Cindy Irving: And so you, essentially, you sort met in the middle with your board and you didn't expect them to fully replace that high-end number. But you felt like you wanted to be restored at least somewhat. And it also gave you the flexibility since you didn't have a vesting date so far out in the future to feel like you were getting some of that restoration earlier rather than later, as long as you met your goals.

Bobby Ferris: That's exactly right, Miss Cindy. It's just really hard to know what's going to happen in the next 20 years. We're seeing a lot of drastic changes. And to say anybody's going to work anywhere for 20 years — we'd like to think that happens, but you know, there's just so many things that happen nowadays that's out of your control; you'd rather take it in small approaches. But yeah, not making that board commit to that really large number up front.

Maybe if you've been at the co-op your whole life and they're comfortable with that, and you're never going anywhere, maybe that's a different conversation. But I was new here. They didn't know me. They hired me on faith, and the contract protected them, protected me, but at the same time, it set empirical goals for me to meet, and then at the end of it, you get rewarded. So it makes sure that you're staying on task and that you're doing what you're hired to do, and that you're performing at a high level.

And when you do that, you get rewarded, just like you would get rewarded at another company. And that's the whole deal when you say this, when you're trying to sell this to the board is, we're not unique. There were, I think you said when I started this, other co-ops had some sort of executive benefit restoration plan. So if you're one of the people that those companies would be looking to hire eventually, that's one of the carrots that they're going to dangle; it's not just the salary but the overall compensation package. And so this co-op not having that plan in place — that was a limiting factor for them.

So they understood that, and they knew that they were going to have to be competitive in the marketplace today, going back to some of Mark's comments. This is attracting, retaining good employees.

Cindy Irving: And I appreciate your comment about if somebody is five, 10 years from retirement, the EBR can make total sense, and I'm not at all — I don't think you and I, either of us are saying that the EBR isn't a plan that works. It's just that sometimes it works better for other folks than others, and for co-ops, some co-ops rather than others. This is just sort of another way to think about rewarding and retaining. And, in fact, in your case, even replacing some of your restriction.

Bobby Ferris: Exactly.

Cindy Irving: Okay. Well, thank you so much. Is there anything else, any other words of wisdom you want to leave us with? And I think we might have time for one question after that?

Bobby Ferris: You know, Cindy, I think the biggest thing is just earning the trust with your board and showing the numbers, being transparent and looking for that win-win situation in the end. And also making sure that you use it as a tool for other employees that are in your high-income, in that qualifying group, making sure that you're not just looking out for yourself, that you look out for your other employees too.

Cindy Irving: Yeah, very good point. We have a number of co-ops that use certainly the 457(b) and the 457(f) for that select group of managers, as we call them. So it's not just for the CEO. Some co-ops there may be only the resources for the CEO, and maybe that's the only person that they have the challenge retaining. But in other co-ops, that could be two, three, four people depending on the size.

Bobby Ferris: Yes, ma'am.

Cindy Irving: Well, thank you. Laura? Do we have any questions right now for Bobby? Because we'll have time at the end as well, but I wanted to see if we had any questions that have come in, in between time.

Laura Tillman: We do. I'll start with this one and then come back to me if we have more time and we'll pick up the others. For the 457(f) plan, is there a minimum base salary requirement to be

considered as a participant? I ask because we're having a lot of local competition on specialized electrical.

Cindy Irving: No, the answer is no. And the 457(f) plan is a little different than some of the other executive compensation plans in that it can be for not just your C-suite level, but it can be for a key employee, too, as well. So if you've got somebody like your IT person who's maybe building out a particular project, that 457(f) plan is something you can offer them as well. And there's no salary max or min for the (f) plan. For the 457(b) plan, you do have to be in that smaller select group. But the (f) plan is a little more, as I was saying, *f* as in flexible than some of the other ones. That's a good question. Thank you for whoever asked that.

Laura Tillman: Here's another one. When does a 457(f) contribution show up on a 990?

Cindy Irving: Hmm, that's a good question. I'm not sure that the contributions ever show up. I'm going to have to probably get back to whoever answered that question after I check with some folks on our tax side and our accounting side that know more about this. But since it's at risk, you have to meet a vesting date. I don't think that has to be reported until later, but I'm going to have to get back to you on that one. Bobby, do you happen to know of how you're treating it on your 990?

Bobby Ferris: Yes. It doesn't show up until the vesting date on that. The 457(b) money shows up immediately, but on the 990, the (f) will not show up until the end of the contract term when it's vested.

Cindy Irving: Okay. Thanks. That's good information.

Mark Santero: Bobby, I can't thank you enough. You were great and I really appreciate your support of the Homestead Funds and team. So back to Tamika and Cindy.

Cindy Irving: Thanks, Mark. Yes, now I'm going to turn it over to Tamika. Tamika is going to talk about how to expand participation in your 457(b) plans.

Tamika Bishop: Thank you, Cindy and Bobby, for sharing with everybody the value that having a 457(b) plan brings to the cooperative, especially when you're looking to recruit, retain and reward your key employees.

So as we pivot a bit, we can talk about expanding your 457(b) plan. And as Cindy reminded us of the webinar that we did back in January of this year, it was called Competition for Top Talent Heats Up — very good topic. And we got a lot of attendees for that. So we know that these are very popular conversations that are being had. We covered the full details and examples of the most commonly used plan, and that's the 457(b), which Cindy just recently referred to. And so today I'm not going to talk too much about it; I just want to highlight and focus on how co-ops can expand that plan in conjunction with any other plans that they may have. So if you missed that presentation and are

interested in getting that video, feel free to look up the video on the Homestead Funds website. And again, that's Competition for Top Talent Heats Up.

As you can see this plan, the 457(b) plan, it's very attractive because it is an additional savings to those eligible participants or eligible employees [SLIDE 19]. And so just a quick overview of the features: It does allow both the employer and the employee to make contributions and deferrals, respectively. And so anytime there's any discretionary contributions that want to be made on behalf of the employer, it can be done, not to exceed the annual maximum of $20,500. That's in this year, 2022; it could go up next year. It goes up every couple of years, sort of aligning with the 401(k) annual contribution limit for participants. So as long as you don't go over that, you're fine.

There's also a special catch-up option that's available. Very different from the catch-up in a 401(k), but it's something that we will help you to manage, if you have a participant that is interested in a special contribution.

We also know that these contributions are immediately vested. That's why participants really enjoy that, because it's not based on how long they are going to be remaining at the co-op, but it's upon separation of service. That's when a distribution can be made. But we want to always remember that these assets are always owned by the cooperative until a distribution takes place. That’s important to note, because it can be up for general creditors, if in the event there are any sort of liquidity issues or bankruptcies.

Also these plans are sponsored by the co-op; they're sponsored and administered by the co-op. So you want to make sure that you utilize us in the event you have — and when I say “you,” I'm referring to the BAs [benefits advisors] or HR teams — you refer to us as consultants — when you have any questions coming from your participants.

From a distribution standpoint, the distributions can be elected by participants at the time they are enrolled in the plan and they can choose when and how they want their distributions for a later time. Also note that there are no rollovers in that plan.

So those are the features of the plan. But we also want to remind you who can participate in that. So, if you take a look at this chart here [SLIDE 20], there's a word that we commonly use and it's called “select group of management,” and that simply refers to key employees. So always keep that in mind. This particular chart helps you to determine who qualifies for any non-qualified plan. So it's sort of a way to, if you're ever questioning a position or whether someone is eligible, then you can go to your org chart and take a look at where they fall ,and remembering that the key here or key word is “key employee.” So I think that kind of makes it easy. If you know they're a key employee, then they are very likely eligible to contribute and plan. But if you have any questions about it, always feel free to reach out to Cindy or myself for assistance.

Now because we're doing all that we can to make sure that the awareness of these plans are available, there are multiple reasons that these plans are becoming even more popular [SLIDE 21]. I know that with qualified plans, there's far less attention that's given to these particular plans, but

they really are to attract your senior employees — keep them there and to make sure that you are rewarding them as they need to be rewarded.

You also know if you are at a cooperative or have been at a cooperative where they have not passed non-discrimination testing, then that will limit those key employees as to how much they can contribute to the 401(k) plan. That can be a real problem for someone who definitely wants the ability to defer additional income.

And so here's the plan that they can do that in. It also provides the flexibility, as I spoke of before, the flexibility of those employer discretionary contributions. So again, as long as the employee and the employer contributions don't go over the annual compensation limit, then the rewards can be done in this plan.

And the fact that it's minimal costs for most of those who have these plans, they realize that the annual cost is very low relative to maybe some of the other plans that you have. So all good reasons for making sure that you are offering this plan to your key executives.

Now, increasing your participation — another big topic [SLIDE 21]. Cindy and I talk to many participants over the day-to-day of the week. And so one of the things that we see is, again, because it's less popular or doesn't get as much attention as the qualified plans, it's easily forgotten when it comes to hiring new executives.

So we encourage our benefit administrators, HR teams, to make sure that they include the paperwork enrollment forms, brochures, whatever you need, in the new hire paperwork that you might provide to an executive. Also we encourage that you include it in your co-op's annual enrollment process. We know that things get real tight around that time, but if you set it up so that you can always remember to promote the plan to those eligible participants, then it won't be left forgotten. And also we want to make sure that we know that it's not just for CEOs. I know for earlier on I started noticing that the plans that we have were CEO-only plans. And so this plan wasn't being offered to other key employees at the cooperative. And so we're trying to change that. We're reaching out to our BAs, especially as they reach out to us, and we're letting them know that this plan can be re-adopted so that it can benefit not just the CEO but the VPs and anyone else considered as a key employee.

So those are things that we want to capitalize on as well as making sure that our BAs are continuously being educated, right? We have developed a Homestead Funds Deferred Compensation Program website, and we are excited about it. And we want to make sure that you're utilizing those resources. We have not only the website, but we've done some tutorials that will be very helpful in going through and understanding from beginning to the administrative functions of the plan that you can take advantage of. And they're short videos that you can look at, and the way that we've segregated them is so that they cover a topic. So each one of them, you don't have to sit and wait through the whole video. I think the longest video is about 15 minutes or so. So the videos range from anywhere from six to seven to 15 minutes long each. And so it's a great resource for you to go out there and understand the administrative functions that lie within this 457(b) plan.

And we don't want to forget about increasing participation in the very way of making sure that we're offering this plan to our directors [SLIDE 23]. Yes, I said it: The 457(b) plan is not only for employees, but there is a director plan as well. And so your directors would be very appreciative, I'm sure, in many cases of being able to contribute to a 457(b) plan. It would be administered very similarly to the employee plan. But they are two separate plans, and it's very appealing because if you have an active director, then they can defer their per diem or whatever their compensation is up to a hundred percent as long as it's within that $20,500 contribution limit. And so they get to defer that now until some future date. If you have retired directors, they will also like to participate in deferring having to take a distribution at the later of age 70 and a half, or age 72, depending on the co-op's plan document and the year obviously that the participant was born, or separation of service. So depending on the order in which those things happen, they can delay their required minimum distributions for that time, that future time frame.

And certainly we don't want to forget that we are here — the Homestead Funds advisors deferred compensation team — we're here to provide director education. So we can schedule a time and set up a date to meet with you and your board to discuss this plan for employees or for directors or both at any time that you're available.

And lastly, we just want to take a moment to show you exactly how excited we are about this new website [SLIDE 24]. If you haven't heard, hear me now. We are thrilled that we have a new website for you all to utilize and go to, and we invite you all who are in attendance to take advantage of it.

Tons of information here. Anything that you don't know, it's probably on the website. Of course, we're here too. We're not going to let the website replace us, but it's definitely a lot of information that you can get quickly. So if you're waiting for us to get back to you in an email or you leave a voice message for us, you could probably find the answer to the website here.

And what you're looking at right now is a visual of the website and what you'll see after clicking on the Deferred Compensation Programs link. And so if you go into the link from left to right, you can see the different defined benefit plans, options, depending upon whether your filing status is a tax-exempt or a taxable co-op. So just utilize the relevant buttons that relate to your co-op.

And then finally, if you want to learn more about establishing the deferred compensation plans, or as I mentioned earlier, processing transactions with Homestead Funds, you can choose the last button there on the right. So it's all here. It's all available. Again, we're excited about the launch that has taken place with Homestead Funds and all that's coming with it. So be sure and take a look so that we can make sure that you're fully aware of the great benefit of deferred compensation that you're entitled to.

And with that, I'll wrap that up and turn it back over to you, Mark.

Mark Santero: Great. Thank you, Tamika. Thank you, Cindy. And special thanks to Bobby Ferris for providing those insightful thoughts on what's going on at his co-op at Lee County Electric and how they're using deferred compensation.

Laura, any questions that we have before we close?

Laura Tillman: Yes. We did get a few questions in on the 457(b) plan. If employers are contributing to this 457(b), what percentages are you seeing? I have the plan, but my employer does not contribute.

Mark Santero: Tamika or Cindy? You know, that's part of education too. We're here to help and educate individuals if your co-op is great to offer a 457(b) plan and people are reluctant to sign up for it, part is financial literacy and importance of saving, we can help with that, those conversations. I encourage the HR and BAs to give us a call to help with the enrollment and the participation process. But any idea on percentages, Tamika or Cindy?

Tamika Bishop: At the moment, I don't have the percentages. Cindy may, because she does a lot more fact finding.

Cindy Irving: Yeah, I would say it's not real common for co-ops to contribute to 457(b) plans, but it does happen and it is available and it's rarely on a percentage basis. It's more because they're trying to tailor something and it's more an amount certain than a percentage, I would say. I don't know of a single co-op that uses their 457(b) like in a sort of matching way, if that's the percentage question that the person was asking about.

Mark Santero: If we haven't answered your question, we can go to the next page [SLIDE 26]. In closing, we're here to help your co-op with any investment programs that you may need in managing your co-op's savings, investments, whether it's storm reserve, deferred compensation, a medical retiree savings plan. And also these deferred compensation plans and tailoring a program to meet your specific co-ops needs. So we have both my email, any investment-related questions, but also our deferred comp mailbox at homesteadfunds.com. And that's my phone number. So please, if we haven't answered your question, we'll get back to you. Appreciate you asking, but you can also email me or email the deferred comp team and we'll get right back to you.

So thank you. And we really appreciate your support of Homestead Advisers and the Homestead Funds. Have a wonderful afternoon.

Fed funds rate is the target interest rate set by the Federal Reserve at which commercial banks borrow and lend their excess reserves to each other overnight.

Standard & Poor's 500 (S&P 500) Stock Index is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks.

A **recession** is a deep and prolonged decline in economic activity, technically defined as two or more consecutive quarters of falling GDP.

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