

# NYBA

## Trends and Best Practices for Compensation and Incentive Programs *2011 Pearl Meyer & Partners' Banking Compensation Survey Findings*

**October 20, 2011**

## ■ What We'll Be Covering Today

- Highlights from Pearl Meyer & Partners' 2011 Banking Compensation Survey (New York and Northeast)
- Summary of current incentive regulations
- General trends and best practices related to compensation administration and incentive plan design

# The Current Economic Environment

Are things looking up?...



Jobs plan may create 1 million jobs – economists 9/9/11



U.S. Stocks Rally Amid Optimism About Global Economic Recovery 8/29/11

THE WALL STREET JOURNAL.

Bernanke-Fed to Help Restore Strong Growth, Mum on Measures 9/9/11

The New York Times

Or more challenging times ahead?



US stock losses hit 3% on eurozone worries 9/9/11



BofA discussing about 40,000 job cuts: report 9/9/11



Economic data suggest a stall 6/10/11

The Boston Globe

## ■ Impact on Employment and Pay

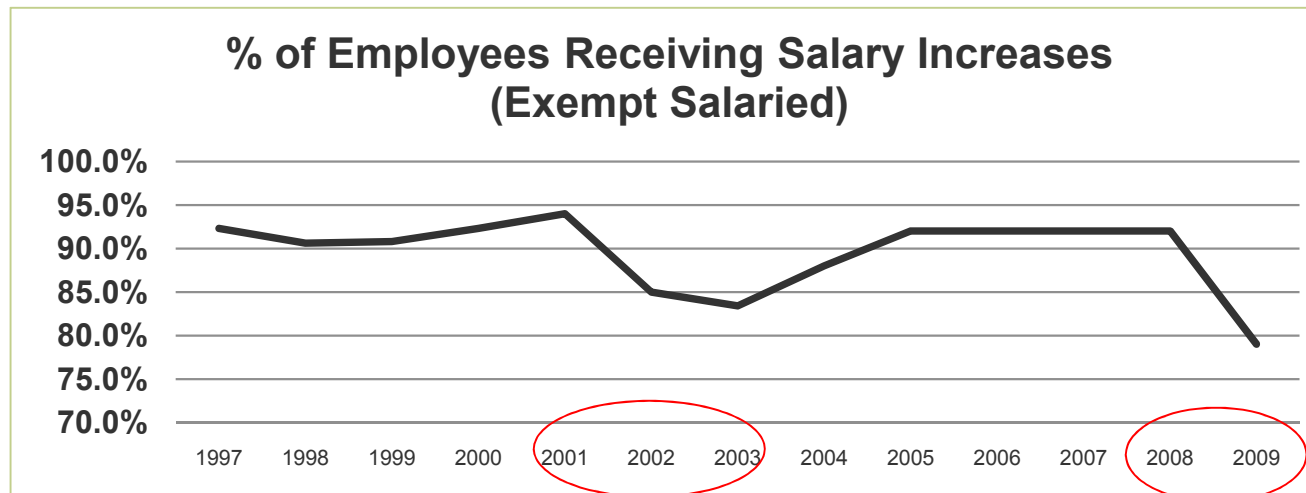
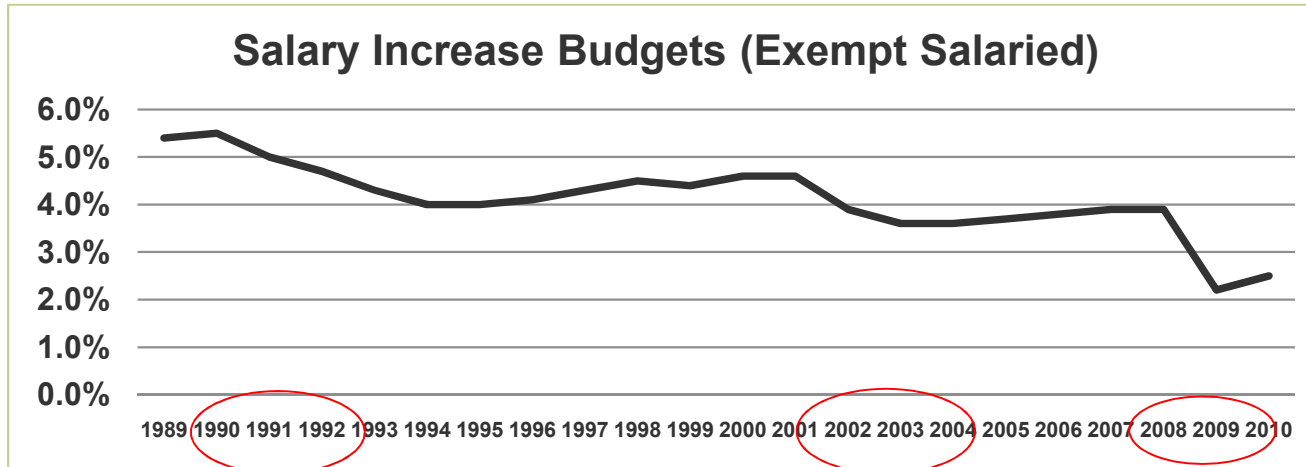
### ■ Employment Outlook

- Unemployment rate at 9.1% in September 2011, as compared to 10.1% in September 2010

### ■ Salary Increase Budgets

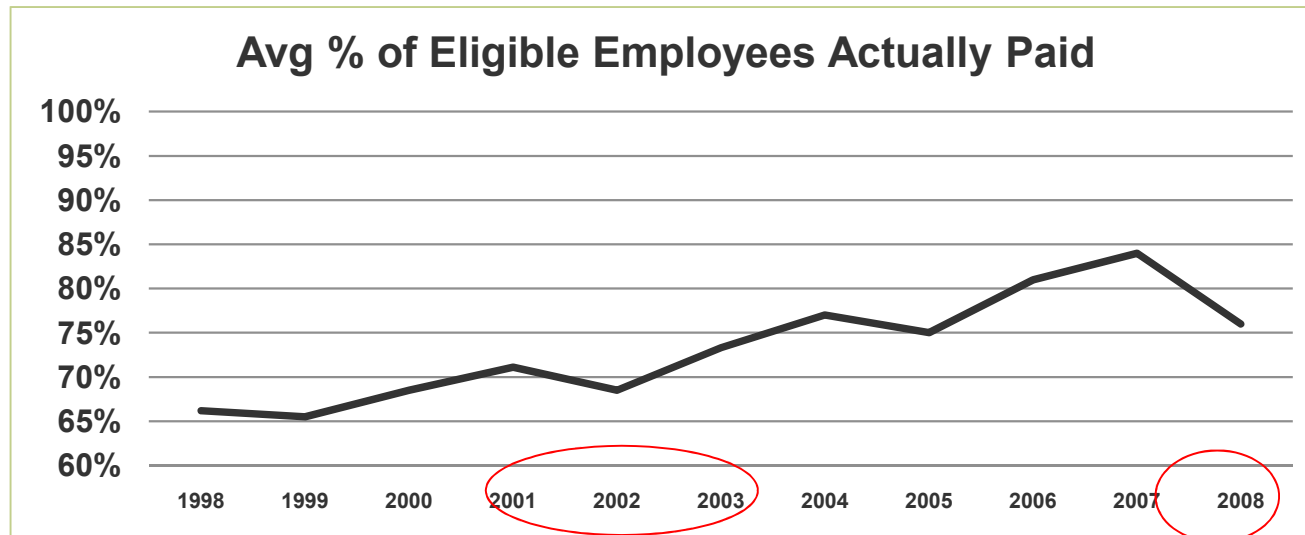
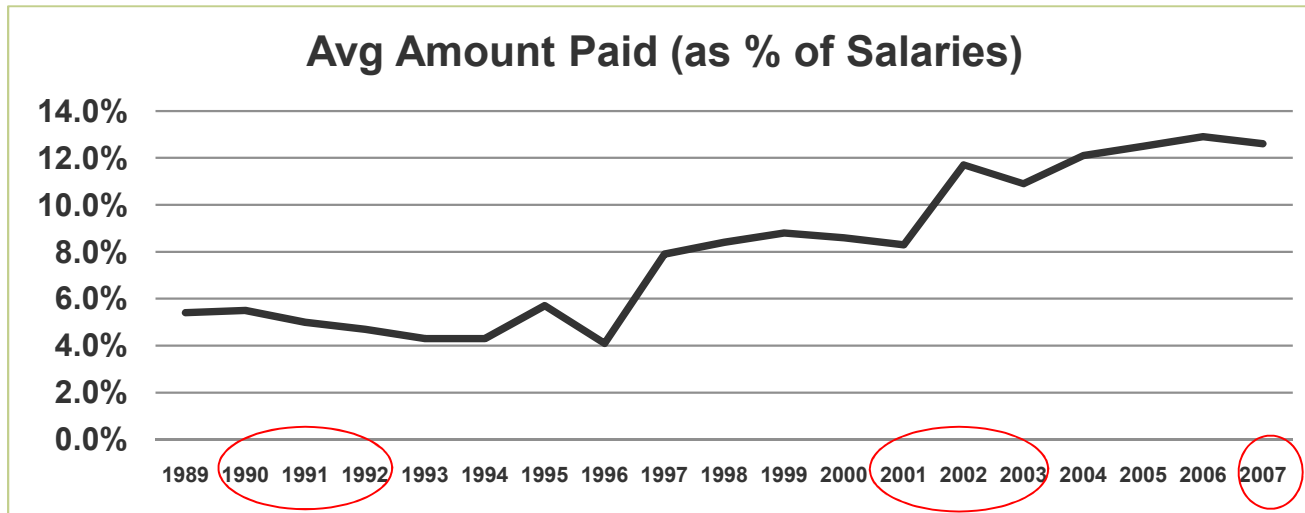
- In 2010, actual budgets ended up between 2.7% - 2.8%
- In last year's survey, 2011 projected budgets were 2.7% - 3.0%
- However, actual 2011 budgets fell in 2.8% - 2.9% range
- Similar results seen across all organizations, employee categories, regions and industries in the US according to World@Work

# The Continued Pressure on Salaries



\* Source: World@Work (ACA) Salary Budget Surveys

# The Increasing Role of Variable Pay



\* Source: World@Work (ACA) Salary Budget Surveys

## ■ What The Future Holds

- **“Managed” growth in salary levels**
- **More refined competitive pay strategies for certain positions**
- **Increased eligibility and emphasis on variable pay but more scrutiny from a risk perspective by regulators**
- **Incorporating long-term perspective within compensation program**



# **“Managed Growth in Salary Levels”**

## 2012 Projected Average Salary Increase Budgets – PM&P Banking Compensation Survey

- **2012 budgets projected between 2.8% - 2.9% across Northeast, slightly lower for New York**
  - Merit generally around 2.5%
  - Additional 0.5% -1% for promotion and/or market adjustments
  
- Need to ensure that dollars are being used wisely to ensure that high performers are recognized – performance differentiation will be critical to ensure retention and motivation

	2012 Projected (including zeros)				2012 Projected (excluding zeros)			
	Execs	Officer	Exempt	NE	Execs	Officer	Exempt	NE
New York	2.4%	2.5%	2.6%	2.6%	2.8%	3.0%	3.0%	3.1%
Northeast	2.9%	2.9%	2.8%	2.8%	3.0%	3.0%	2.9%	2.9%
	<b>2.4% – 2.6% New York</b> <b>2.8% - 2.9% Northeast</b>				<b>2.8% - 3.1% New York</b> <b>2.9% - 3.0% Northeast</b>			

## Salary Structure Adjustments

### What happened in 2011?

- We were expecting 1.9% and ended up at 1.8% (2.8% when excluding zeros)
- Frozen salary structures continue to exist

### Salary structure adjustments for 2012 approximately 1.8%

- 2.5% when excluding 0% budgets

	2012 Planned (including zeros)				2012 Planned (excluding zeros)			
	Execs	Officer	Exempt	NE	Execs	Officer	Exempt	NE
New York	1.2%	1.2%	1.1%	1.3%	2.3%	2.1%	2.1%	2.3%
Northeast	1.8%	1.8%	1.8%	1.8%	2.5%	2.5%	2.5%	2.5%
	1.1% - 1.3% New York 1.8% Northeast				2.1% - 2.3% New York 2.5% Northeast			

## ■ Merit Review Process

- Focal point review more popular over anniversary date
- Majority increase salaries effective in January (April is 2<sup>nd</sup> most popular)
- Most banks do not have an automated performance management system
- A combination of goals and competencies is the most prevalent approach for performance management

The key to a successful performance management program is to ensure it creates a link between the strategic objectives of the Bank and the day to day activities of the employees.



# “Competitive Pay Strategies”

# Refining Competitive Strategies for “Hot Jobs”

## Alignment with Competitive Advantage

<b>Competitive Advantage Groups</b>		<b>“Regular Groups”</b>		
<b>Commercial Lenders</b>	<b>Sales</b>	<b>HR</b>	<b>Finance</b>	<b>IT</b>
<b>Target Pay at 65<sup>th</sup> Percentile</b>		<b>Pay at 50<sup>th</sup> Percentile</b>		

- Ensure business alignment
- Evaluate pay mix
- Assess incentive plans
  - Target Opportunities
  - Team / Individual performance
  - Higher upside opportunities

## Commercial Lenders

- Highly competitive labor market for many banks/regions
- Incentives are critical component of total cash for these positions

Role	Role	New York			Northeast		
		Base Salary	Incentive Target	Actual Total Cash	Base Salary	Incentive Target	Actual Total Cash
Role	Jr. Commercial LO	\$62	13%	\$69	\$70	12%	\$76
	Commercial LO	\$89	12%	\$97	\$106	14%	\$113
	Sr. Commercial LO	\$123	15%	\$130	\$125	15%	\$135
	Top Comm'l Lending Executive	\$161	18%	\$185	\$150	17%	\$170

## Other 'Hot Jobs'

		New York			Northeast		
		Base Salary	Incentive Target	Actual Total Cash	Base Salary	Incentive Target	Actual Total Cash
Role	Top Audit Officer	\$103	13%	\$105	\$103	13%	\$113
	Risk Manager	\$146	17%	\$156	\$122	17%	\$141
	Credit Officer / Manager	\$83	11%	\$87	\$92	11%	\$96
	Compliance Officer	\$70	10%	\$74	\$85	12%	\$91



## More Emphasis on Variable Pay

## ■ Short Term Incentives Trends

### ■ 80% of banks across the Northeast have a short-term incentive plan

- Prevalence increases as size of bank increases
- 68% of banks with assets < \$250M versus 94% of banks with assets > \$1.5B
- In 2006 survey, 77% of participants reporting having a short-term incentive plan

### ■ Who is eligible to participate?

- 95% of banks allow officers and above to participate
- 75% of banks allow non-officers to enter the plan

### ■ Payouts

- Overall, payouts continue to fall below target but are improving over previous years
- For 2010 performance, 2011 payouts averaged 65% of target opportunities across all employee groups (Northeast results)

# Overview of Bank Regulator Incentive Guidance

- New proposed regulations expand on the Agency guidance to implement and enforce Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
- The intent is to control risk related to the use of incentive compensation arrangements (ICAs) for employees at covered financial institutions

## Agency Guidance – June (FRB, FDIC, OTS, OCC)

- Effective June 25, 2010
- Impacts all financial institutions
- Principles-based guidance
- Three principles:
  - Design features should mitigate risk taking
  - Effective controls
  - Strong corporate governance
- Size and complexity of institution and ICAs considered
- Covered individuals:
  - Senior executive officers
  - Individual employees whose activities may expose the institution to material risk
  - Groups of employees who in the aggregate may expose the institution to risk

## FDIC Proposal – February (FRB, FDIC, OTS, OCC, NCUA)

- Final rules expected by June 2012
- Impacts institutions > \$1b
- Prohibition of ICAs to Covered Persons that encourage inappropriate risk by:
  - Providing excessive compensation; or
  - Creating a potential for material financial loss
- Requires annual reports to appropriate regulator (s) of the structure of ICAs
- Requires policies and procedures for ICAs that are commensurate with the size and complexity of the institution
- Special rules for institutions with assets greater than \$50 billion
  - Mandatory deferral of a substantial portion of ICAs to executive officers
  - Enhanced internal review and approval of ICAs for other individuals who have the ability to expose the institution to significant loss

# Assessing Your Short-Term Incentive Plans for Risk

- Regulators reviewing more rigorously
  - Observation: degree of intensity varies by regulator and bank's performance
- All banks required to assess incentive compensation risk
  - Degree of analysis and reporting varies by size and complexity of programs (e.g. \$1b/\$50b thresholds for Dodd Frank)
- Includes assessment of “excessive compensation”
  - Includes executives, employees, directors or principal shareholders (10% owners)
- Requires implementation of more formal controls, processes and governance protocols to ensure compliance
  - E.g. risk adjustments, goal setting, payout approvals, board oversight
- Driving incentive plan design changes – even for smaller and mutual banks

**Tip: test programs against perception of risk; evaluate your programs through a new set of lenses; what is worse case scenario?**

## Commercial Lending Incentive Trends

- Majority of incentive plans make annual payouts
  - 81% in Northeast
  - 77% in New York
  
- Performance Measures
  - Loan Volume
  - Loan Profitability
  - Credit / loan quality (i.e. net charge offs, non-performing loans)
  - Portfolio yield
  - Referral/cross sells
  - Fee income
  
- Consider incorporating corporate performance component (i.e. net income) into framework – “we’re all in this together”
  
- Cap on earnings considered best practice however upside is higher than typical incentive plan (i.e. 200% - 300% of target opportunity)

# Commercial Lending Incentive Trends

## Qualifiers

- Design feature that allows bank to reduce a lender’s incentive based upon one or more ‘quality’ measures (i.e. loan, credit, portfolio management)
- Example: Three qualifiers that lender must meet in order to receive full incentive.

Criteria	Description	Standard
Net Charge-Offs	Net Charge Offs to Total Loan Outstanding	Less than 0.20%
Delinquencies	Delinquencies to Total Loans Outstanding	Less than 0.90%
90 Day Exceptions	90-Day Exceptions to Total Exceptions	Less than 35%

Failure to achieve 3 of the above qualifiers will result in no incentive compensation to be earned or paid. Failure to achieve 1 of the above qualifiers will result in a 20% reduction of the calculated incentive compensation to be earned and paid. Failure to achieve 2 of the above qualifiers will result in a 30% reduction of the calculated incentive compensation to be earned and paid.

## Holdbacks / deferrals

- Risk management feature that enables bank to defer portion (15% - 20%) of lender’s incentive over a certain time period (6 months – 12 months).

## ■ Retail Incentive Trends

- Objectives of most retail incentive programs
  - New customer acquisition
  - Cross-selling of new accounts to existing customers
  - Retention of existing accounts
  
- Majority of survey participants offer sales/referral incentives to their retail staff (Tellers, CSRs, ABMs, BMs, back office)
  - 66% New York survey
  - 63% Northeast survey
  
- Most banks pay retail incentives on a quarterly basis
  
- Types of plans
  - **“Unit-Based” or “Widget”**: rewarding branch personnel on individual products sales and referrals
  
  - **Balanced Scorecard**: focuses on sales and customer focus

## ■ Retail Incentive Trends

- “Unit-Based” or “Widget” plans reward for...

Product / Service	Prevalence (Northeast Survey)
New deposit accounts	84%
Customers add features to new accounts	73%
Referrals to other divisions	61%
Debit cards	55%
Retail Loan Sales - # of loans	50%
Retail Loan Sales – dollar value	32%

- Plan participants receive incentive award for each product added / sold and incentive payouts typically vary by product
  - Strategic focus / market plan, rather than profit margin, typically drives the payout amount for each product

# Retail Incentive Trends

## Average annual award prevalence for Tellers

Award Value	Asset Size				
	< \$250m	\$250m - \$500m	\$500m - \$750m	\$750m - \$1.5b	> \$1.5b
< \$100	<b>50%</b>	<b>39%</b>	<b>38%</b>	20%	<b>39%</b>
\$100 - \$249	25%	29%	25%	<b>33%</b>	22%
\$250 - \$499	17%	11%	13%	13%	22%
\$500 - \$999		14%	6%	20%	6%
\$1,000 - \$2,999		7%	6%	13%	11%
> \$3000			6%		
Non-Cash	8%				

## Average annual award prevalence for Branch Managers

Award Value	Asset Size				
	< \$250m	\$250m - \$500m	\$500m - \$750m	\$750m - \$1.5b	> \$1.5b
< \$100	25%	<b>21%</b>	6%	17%	6%
\$100 - \$249		8%	12%	8%	
\$250 - \$499	<b>33%</b>	<b>21%</b>	24%	8%	19%
\$500 - \$999	17%	13%	6%	17%	19%
\$1,000 - \$2,999	17%	<b>21%</b>	18%	<b>33%</b>	25%
> \$3000	8%	17%	<b>29%</b>	17%	<b>31%</b>
Non-Cash					

# Retail Incentive Trends

## Balanced Scorecard

- Focuses on sales and customer services
- Allows for different types of goals (bank, team, individual) and weightings
- Assign target incentive opportunity (as percent of base salary) and range (threshold to maximum)
- Can focus on monthly, quarterly or annual goals
- Example: Assumes CSR with \$36,000 base salary and 7.5% incentive target

Performance Measure	Weighting	Incentive Payout Opportunity		
		Threshold (50% of target)	Target	Stretch (150% of target)
Deposits	50%	\$675	\$1,350	\$2,025
• Individual DDA deposit \$\$ production	30%	\$405	\$810	\$1,215
• Individual time deposit, savings and MMA \$\$ production	20%	\$270	\$540	\$810
Loans	30%	\$405	\$810	\$1,215
• Consumer loans (originate) & mortgages (refer)	20%	\$270	\$540	\$810
• Business loans – enterprise (originate) & commercial (refer)	10%	\$135	\$270	\$405
Service Quality	20%	\$270	\$540	\$810
<b>TOTAL</b>		<b>\$1,350</b>	<b>\$2,700</b>	<b>\$4,050</b>

# ■ Mortgage Originator Incentive Trends

## ■ Incentive Framework

- Base + Commission (60%)
  - Base salaries typically range between \$25,000 - \$35,000
- Commission Only (46%)

## ■ Reward for production / volume

- Purchase Money Mortgages: 40 bps – 60 bps
- Internal refinances: 25 bps – 40 bps
- External refinances: 40 bps – 60 bps

## ■ Commission rates (basis points) vary based upon...

- Loan size
- Type of loan
- Achievement of production loans

## ■ Only 33% of survey participants with mortgage originators have a draw on earnings

- More prevalent with new hires for certain period of time (i.e. first 6 months of employment)



# Incorporating Long Term Performance into Compensation Programs

# Incorporating Long Term Perspective in Your Compensation Program

- 27% of participants have a formal LTI plan (50% in NY survey)
  - 15% of mutual banks in Northeast
    - 56% have phantom/synthetic plan while 39% have cash plan
  - 51% of stock banks in Northeast
- Rationale behind focusing on long-term performance:
  - Mitigates risk taking by aligning payouts more closely with time horizon of risk
  - Aligns with regulators' interests for holdback/deferral of compensation (i.e. payments made in future)
  - Rewards long-term value and soundness of institution
  - Provides means for implementing claw back (if necessary)
- Potential techniques
  - Ensure meaningful portion of compensation rewards multi-year performance
  - Holdbacks/deferrals where short term incentive is heavily weighted
  - Payment in stock – pay part (or above target) in stock
  - Shift overall pay mix toward long-term
  - Stock ownership/retention policies
  - Claw back policies

## Hoping for Better Times Ahead



## ■ About PM&P

Kristine Oliver is a Vice President in the banking industry practice at Pearl Meyer & Partners which has a significant focus on the Northeast/Mid-Atlantic community banking industry. For more information about regarding banking compensation consulting services, please visit [www.pearlmeyer.com/banking](http://www.pearlmeyer.com/banking).

Kristine Oliver  
Vice President  
508-630-1550

[Kristine.oliver@pearlmeyer.com](mailto:Kristine.oliver@pearlmeyer.com)

For twenty years Pearl Meyer & Partners ([www.pearlmeyer.com](http://www.pearlmeyer.com)) has served as a trusted independent advisor to Boards and their senior management in the areas of compensation strategy and program design, compliance and reporting, and committee structure, policies and procedures. The firm provides comprehensive solutions to complex compensation challenges for companies across all industries ranging from the Fortune 500 to smaller private companies and not-for-profits, as well as emerging high-growth companies. These organizations rely on Pearl Meyer & Partners to develop programs that align rewards with long-term business goals to create value for all stakeholders: shareholders, executives, and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, San Francisco, San Jose and Los Angeles.