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*Comprehensive Compensation*SM



Bank Director Assembly

The Four C's of Director and Executive Compensation: Compliance, Consistency, Clarity and Competitiveness

Laura Hanf

Vice President

laura.hanf@pearlmeyer.com

(704) 651-4885

■ Best Practices in Director and Executive Compensation Begin with the Four C's...

- **Compliance** with new and emerging regulations
- **Consistency** with business objectives and market norms
- **Clarity** of compensation philosophy
- **Competitiveness** of overall compensation package

■ Compliance: Increased Oversight of Regulators



■ 2008

- CPP/TARP

■ 2009

- Obama Administration releases Executive Compensation Principles and Proposals for U.S. Public Companies
- SEC enhances executive compensation disclosures

■ 2010

- Federal Reserve joins forces with FDIC, OCC and OTS to issue final guidance on incentive compensation oversight and risk
- Dodd-Frank Financial Services Reform Act signed into law
- Implementation of some Dodd-Frank provisions delayed until 2012 proxy season

■ 2011

- SEC finalizes Say on Pay rules
- FDIC approves rules to implement Dodd-Frank limits on incentive pay risk

Compliance: Other Major Influencers



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■ Compliance: Say on Pay

■ Say on Pay

- Mandatory vote for 2011 shareholder meetings scheduled after 1/21/11
- Non-binding advisory vote on NEO compensation as disclosed in the proxy statement
- Separate vote on the frequency of say on pay votes (every one, two or three years)
 - » Separate vote on frequency at least every 6 years thereafter
 - » Advisory firms favor annual votes

■ Say on Golden Parachutes

- Requires companies to hold a separate non-binding vote on golden parachute arrangements for named executive officers
 - » Applies only when seeking shareholder approval for a merger, consolidation, or sale of substantially all assets

■ Compliance: Say on Frequency Trends

- **Frequency** – Of the 245 companies with SOF votes (from 12/2/10 – 2/24/11):
 - 29% recommended Annual,
 - 6% recommended Biennial,
 - 60% recommended Triennial, and
 - 5% did not make a recommendation to shareholders.
- Financials are similar 29% recommended Annual; 71% recommended Triennial
- **Vote Results**
 - SOP: Out of the 93 companies that have disclosed SOP vote results, 91 have received shareholder support for executive compensation and 2 received negative votes (Jacobs Engineering and Beazer Homes).
 - SOF: Out of the 90 companies that have disclosed SOF vote results, 60% of votes were consistent with the recommendation, 31% were against the recommendation, and 9% of votes were at companies that had not made a recommendation.



■ Compliance: Dodd-Frank Limits on Incentive Pay Risk

- New regulations create a framework for implementing and enforcing 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 executives at covered financial institutions with consolidated assets of at least \$1 billion
- Among the new requirements and restrictions:
 - Prohibition of ICAs to covered individuals that are considered to encourage inappropriate risk
 - Mandatory deferral and enhanced oversight for institutions with assets greater than \$50 billion
 - Annual disclosure of the structure of ICAs
 - Policies and procedures to enforce Section 956

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Consistency: Strategic Alignment

The ultimate goal of an effective executive compensation program is to motivate performance and provide rewards commensurate with the achievement of specific business goals.

Questions to

- ✓ What is the bank's mission, values and vision?
- ✓ How will the bank differentiate/compete in today's environment?
- ✓ What are the bank's most critical business goals/objectives (short and long term)?
- ✓ How should the bank define high performance (short and long-term)? How is that similar or different than in the past?
- ✓ Overall, do the bank's compensation programs support and motivate achievement of these goals?
- ✓ Which elements should be changed to better align with our future direction?

Denovo

“Community”

“Expanding”

one size doesn't fit all

■ Consistency: Link to Business Objectives and Performance

- **Performance measures should reward the “right” things**
 - Business strategy/critical goals
 - Earnings vs. sound risk management
 - Consider multiple perspectives
 - » growth, profitability, shareholder, expense, operations
- **Ensure “Balance”**
 - Short vs. long-term performance
 - Bank/team vs. individual performance
 - Absolute vs. relative performance
 - Formulaic vs. discretionary
- **Keep it simple and focused**
 - 2-5 goals for short term incentive
 - 1-2 goals for long-term incentives.
 - Goals should serve as a “screen” for behavior/action
- **Target performance goals should raise the bar, but be realistic**
 - Minimum – lowest level of acceptable performance – guideline 80% of time
 - Target – reflects budget/expectations – guideline 60-70% of time
 - Stretch – stars are in alignment – guideline 10-15% of time

■ Consistency: Link to Business Objectives and Performance

- **If the Bank's ability to predict is limited, consider:**
 - Relative measures (best for long-term incentives)
 - Widening the range of performance between minimum and stretch while also lowering the incentive opportunity
 - Providing the Committee with some discretion but define expectations upfront
- **Payouts should vary appropriately to reflect performance.**
 - Model both upside and downside; short and long-term performance
- **Don't lose sight of good business judgment**
 - Formulas aren't perfect. Consider the "big picture"
 - Awards should focus on the Bank's highest performers
 - » In tough year(s) or when no plan payout – consider discretionary awards for high performers
 - Some discretion is okay, if appropriate and can be effectively "explained"

■ Consistency: Market Trends and Norms

■ Director Compensation

Component	Trend
Board Cash Compensation	The market has exhibited little movement from in Board retainers and meeting fees for the past several years. Anecdotally, there is mounting pressure to increase fees due to added workload and risk.
Board Equity Compensation	Greater focus on changes to the structure of equity incentives as opposed to levels <ul style="list-style-type: none"> ▪ Move to time-based full value shares ▪ Reducing vesting to immediate or 1 year vesting to align with trend to de-staggered Boards
Committee Cash Compensation	Some Boards are using retainers only rather than retainers and/or meeting fees
Chairman Pay	Wide variation in pay levels for non-executive Chairman (Pay many times depends on the institution's specific reason for the role)

■ Consistency: Market Trends and Norms

■ Executive Compensation

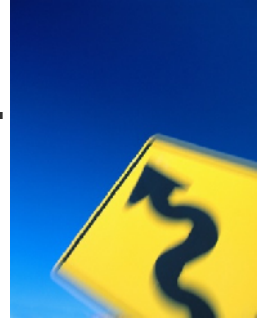
Component	Trend
Base Salary	Banks providing modest increases
Short-term Incentives	<p>Many have revamped annual plans</p> <ul style="list-style-type: none"> ▪ Change in performance measures toward asset quality rather than growth; profits still key ▪ Implementation of risk mitigators – clawbacks, deferrals ▪ Increased committee discretion to reduce or eliminate payouts
Long-term Incentives	<p>Banks granting combination awards</p> <ul style="list-style-type: none"> ▪ Performance shares gaining prevalence ▪ Stock options continue to be used but typically in combination with other awards
SERPs	<p>Committees continue to review for appropriateness and fit with business objectives</p> <ul style="list-style-type: none"> ▪ Growing use of non-qualified defined contribution plans ▪ Funding may be dependent on performance/profitability

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■ Clarity: Define Your Compensation Philosophy

- Now, more than ever, you must define your compensation philosophy and let it, not quick reactions, drive your programs.
- It's your road map. It defines:
 - The objectives and purpose of each element
 - The “mix” of total compensation
 - Your pay-for-performance approach
 - Your competitive perspective
 - How your compensation program supports your business strategy and aligns with shareholder interests
- It's your “message” to regulators, shareholders, executives and potential recruits
 - For public banks it's critical to SEC disclosure – CD&A – it's your “story”
- It should be proactive and purposeful – don't let your programs dictate your philosophy – which can easily happen!



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■ Competitiveness : Things to Consider

- **A few points about being “competitive”**
 - Market data provides one perspective – don’t be a slave to the data.
 - Ensure proper peer group
 - Understand how total compensation and performance compares to “market” or “peers”.
 - Okay to target market – but pay should vary based on actual performance and contributions.
 - 75th percentile pay should reflect superior (i.e. 75th percentile) performance
- **Test your programs**
 - How much is the total compensation package?
 - » “Median” compensation can result in a total package over or under the market depending on its components
 - What is the upside and the downside?
 - » Is the upside appropriate given profitability and shareholder return?
 - » Is the downside “fair” and balance market forces with shareholder return?

■ What to Do Now

- **Compliance** – Understand the new regulations as well as standards from influencers
- **Consistency** – Align compensation program with business objectives and market norms
- **Clarity** – Consider your compensation philosophy as a principle-based process rather than a document
- **Competitiveness** – Weigh market data with other factors