

ON POINT

TIMELY, ACCURATE, INSIGHTFUL

PM&P On Point: 2011 Executive Pay-for-Performance Survey

Banking Edition

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Introduction

More than ever, there is pressure on Compensation Committees and senior management to ensure that “pay-for-performance” is more than just boilerplate disclosure in the Compensation Discussion and Analysis. An uncertain economy, expanded proxy reporting requirements, and Say on Pay have all heightened the need for programs that pay executives appropriately, for demonstrated results, based on performance measures that drive meaningful organizational goals.

The *PM&P On Point: 2011 Executive Pay-for-Performance Survey Banking Edition* provides a unique look at the views held by board members and management of banking institutions regarding the multiple aspects of pay-for-performance programs, as well as the analyses and processes required to address the challenges outlined above.

Among the topics covered:

- What specific performance is relevant in the pay-for-performance equation?
- Which types of measures are important in annual vs. long-term incentive plans?
- How much discretionary adjustment of incentives is appropriate and under what circumstances?
- Who is involved in performance measure selection and goal-setting?
- What kind of data and analysis is being used to determine performance measures and goals?

The survey included 241 participants across numerous industries, 39 participants or 16% were from banking institutions. Respondents included company managers as well as members of the board of directors. Approximately 61% of participants represent publicly traded companies.

The report provides a detailed look at the survey results across a variety of demographics, including employee vs. outside Directors, form of ownership, industry, and company size.

We hope you find this information useful. If you would like to discuss any aspect of the survey findings, please contact:

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Key Highlights

PM&P's second annual pay-for-performance survey provides some interesting insights and a few surprises. The following summarizes key highlights from our Banking Edition Survey, including commentary explaining the variance in banking industry responses relative to overall survey results.

Aspects of performance that should be reflected in a “pay-for-performance” philosophy:

- Perhaps due to the uncertainties of global market influences on the stock market, banking institutions' current viewpoints placed more emphasis on *relative financial and/or stock price performance* and the inclusion of *strategic and non-financial performance*
 - Banking institutions generally *agreed* or *strongly agreed* that pay-for-performance philosophies should include *absolute* (62%) or *relative* (77%) *stock price performance*
 - All (100%) of bank industry respondents *agreed* or *strongly agreed* that *strategic and other non-financial performance* should be reflected in the pay-for-performance philosophy
- Relative to other industries, banking institutions (61%) were more likely to *agree* or *strongly agree* that pay-for-performance philosophies should include individual performance.
- Regardless of industry the vast majority of respondents agreed there were *absolute limits to reasonable compensation even with exceptional performance*.

Incentive plan focus:

- Banking institutions were generally more likely to view the majority of performance measures either somewhat important or critical in incentive plans relative to other industries.
- In general, annual plans should focus on achievement of *absolute (versus relative) financial performance* and *strategic goals*.
 - Most banks (74%) considered it critical to include absolute measures in their annual plans, although half (51%) also felt *relative financial performance* was of critical importance. This compared to 31% of other industry respondents.
 - *Working capital management* and *top line volume growth* were also considered important.
- Long-term plans should focus on *company-wide strategic goals*, as well as *absolute* and *relative financial performance*.
 - 68% of banking industry and other industry respondents believed *absolute financial performance* measurement is critical.
 - 68% of banking industry respondents indicated *relative financial performance* measurement was critical, compared to 46% of other industry respondents.
 - Across industry groups, the use of *company-wide strategic goals* was considered critically important.

Use of Discretion:

- Banking institutions generally allowed for the use of positive or negative discretion with annual incentive payouts (97%) and long-term incentive payouts (95%).
 - Other industries were more likely to disallow positive discretion for annual incentive plans (19%) and long-term incentive plans (38%).
- Banking institutions tended to support a *wider range of* discretion compared to other industries.
 - 62% of banking institutions allowed for annual/long-term incentive payouts to be modified by at least +/-15%.
 - 49% and 35% of other industry respondents indicated support for at least $\pm 15\%$ discretion under annual and long-term incentive plans, respectively.
- Banking institutions generally identified *economy/industry-wide downturns, restructuring charges, and unanticipated exchange rate* movements as factors which should influence discretionary adjustments.
- *Lawsuit settlements or unusual events with foreign operations* were considered the least acceptable circumstances for discretion.

Key inputs in the review and selection of performance measures include:

- As highlighted above, banking institutions were more likely to include relative performance measures in incentive plans. Therefore, it is understandable that when setting performance measures banking institutions were also more likely to always review *Industry Practices* and/or *Performance Against Peers*.
- When selecting performance measures, banking institutions were extremely active in reviewing the program mechanics relative to stock price, economic environment or the bank's strategic plan. Banking institutions:
 - Sometimes reviewed the *statistical link between performance measure and stock price performance*.
 - Sometimes considered *adjusting GAAP measures based on economic circumstances, and*
 - Always reviewed the bank's *strategic plan*.

Role of the Board:

- In recent years, the majority of banking institutions have increased the involvement of the Board of Directors in the performance measure selection or goal-setting processes.
- Other industries have also experienced greater Board involvement in performance measure selection and goal setting, but at a slower pace relative to banking institutions. This is likely a result of increased regulation requiring board governance and oversight of incentive arrangements in banking institutions.

Key inputs in setting performance goals include:

- Generally, banking institutions considered the *annual budget* (84%), *long-range strategic plan* (95%), and *peer performance* (51%) in setting performance goals.
- The majority of banking institutions rarely considered *analyst expectations* (58%) while 59% of other industry companies sometimes or always considered analyst expectations.

**Demographics - Firm
Characteristics
Table 1**

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Organizational Size			
Under \$100 million	19.9%		23.8%
\$100 million to less than \$300 million	8.3%	5.1%	8.9%
\$300 million to less than \$1 billion	18.3%	17.9%	18.3%
\$1 billion to less than \$3 billion	23.2%	46.2%	18.8%
\$3 billion to less than \$10 billion	17.4%	20.5%	16.8%
\$10 billion to less than \$20 billion	7.1%	5.1%	7.4%
\$20 billion to less than \$30 billion	2.1%		2.5%
\$30 billion or greater	3.7%	5.1%	3.5%
Industry Sector			
Indust / Matl	18.3%		21.8%
Consumer Discr / Staples	13.7%		16.3%
Financials / Insurance / Health	33.2%	100.0%	20.3%
Info Tech / Tele Svcs	18.7%		22.3%
Energy / Utilities	5.8%		6.9%
NFP / Tax Exempt / Govt Chartered	10.4%		12.4%
Form of Ownership			
Parent/Stand Alone	88.8%	92.3%	88.1%
Subsidiary	9.5%	7.7%	9.9%
Division	1.7%		2.0%

Executive Pay-for-Performance
Should Reflect . . .

Table 2

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Absolute financial and/or stock price performance			
Strongly Disagree	2.5%	10.3%	1.0%
Disagree	11.6%	10.3%	11.9%
Neutral	15.8%	17.9%	15.3%
Agree	41.9%	41.0%	42.1%
Strongly Agree	28.2%	20.5%	29.7%
Relative financial and/or stock price performance (e.g., peers, industry)			
Strongly Disagree	2.1%		2.5%
Disagree	5.4%	5.1%	5.5%
Neutral	14.2%	17.9%	13.5%
Agree	51.0%	53.8%	50.5%
Strongly Agree	27.2%	23.1%	28.0%
Strategic and other non-financial performance achievement			
Strongly Disagree	0.0%		
Disagree	0.4%		0.5%
Neutral	6.8%		8.0%
Agree	66.2%	57.9%	67.8%
Strongly Agree	26.6%	42.1%	23.6%
Individual effort, regardless of organizational results			
Strongly Disagree	8.4%	2.6%	9.5%
Disagree	23.9%	18.4%	25.0%
Neutral	19.3%	18.4%	19.5%
Agree	39.9%	55.3%	37.0%
Strongly Agree	8.4%	5.3%	9.0%
There are absolute limits to reasonable compensation, even with exceptional performance			
Strongly Disagree	2.1%		2.5%
Disagree	6.8%	10.5%	6.0%
Neutral	10.5%	5.3%	11.6%
Agree	50.2%	44.7%	51.3%
Strongly Agree	30.4%	39.5%	28.6%

Current Views versus Past Views

Table 3

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Absolute financial and/or stock price performance			
Less emphasis	11.8%	12.8%	11.6%
About the same	69.2%	69.2%	69.2%
More emphasis	19.0%	17.9%	19.2%
Relative financial and/or stock price performance (e.g., peers, industry)			
Less emphasis	4.6%	5.1%	4.5%
About the same	58.4%	64.1%	57.3%
More emphasis	37.0%	30.8%	38.2%
Strategic and other non-financial performance achievement			
Less emphasis	3.4%		4.0%
About the same	63.4%	50.0%	66.0%
More emphasis	33.2%	50.0%	30.0%
Individual effort, regardless of organizational results			
Less emphasis	20.3%	8.3%	22.5%
About the same	69.5%	77.8%	68.0%
More emphasis	10.2%	13.9%	9.5%
There are absolute limits to reasonable compensation, even with exceptional performance			
Less emphasis	3.4%	5.3%	3.0%
About the same	76.7%	68.4%	78.3%
More emphasis	19.9%	26.3%	18.7%

**Performance Measures Important
in Annual Incentive Plan**

Table 4

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Absolute financial performance (e.g., earnings, margins, returns, etc.)			
Less important	5.0%	5.1%	5.0%
Somewhat important	19.7%	20.5%	19.6%
Critical	75.2%	74.4%	75.4%
Relative financial performance (e.g., against a peer group)			
Less important	19.8%	2.6%	23.2%
Somewhat important	46.0%	46.2%	46.0%
Critical	34.2%	51.3%	30.8%
Top line or volume growth			
Less important	8.1%	7.9%	8.1%
Somewhat important	48.1%	55.3%	46.7%
Critical	43.8%	36.8%	45.2%
Working capital, or other balance sheet, management			
Less important	11.9%	10.8%	12.1%
Somewhat important	55.3%	45.9%	57.1%
Critical	32.8%	43.2%	30.8%
Company-wide strategic goals			
Less important	3.0%		3.5%
Somewhat important	32.6%	29.7%	33.2%
Critical	64.4%	70.3%	63.3%
Business unit or functional goals			
Less important	17.4%	10.5%	18.7%
Somewhat important	41.9%	44.7%	41.4%
Critical	40.7%	44.7%	39.9%

**Performance Measures Important
in Long-Term Plan**

Table 5

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Absolute financial performance (e.g., earnings, margins, returns, etc.)			
Less important	6.8%	5.3%	7.1%
Somewhat important	25.1%	26.3%	24.9%
Critical	68.1%	68.4%	68.0%
Relative financial performance (e.g., against a peer group)			
Less important	9.1%		10.8%
Somewhat important	41.4%	32.4%	43.1%
Critical	49.6%	67.6%	46.2%
Absolute stock performance (e.g., target price or CAGR)			
Less important	21.2%	16.2%	22.2%
Somewhat important	46.5%	54.1%	45.0%
Critical	32.3%	29.7%	32.8%
Relative stock performance (e.g., total shareholder return versus a peer group or index)			
Less important	16.0%	11.1%	16.9%
Somewhat important	42.2%	36.1%	43.4%
Critical	41.8%	52.8%	39.7%
Top line or volume growth			
Less important	9.1%	8.1%	9.2%
Somewhat important	50.0%	45.9%	50.8%
Critical	40.9%	45.9%	40.0%

**Performance Measures Important
in Long-Term Plan**

Table 5

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Working capital, or other balance sheet, management			
Less important	15.1%	8.1%	16.4%
Somewhat important	48.7%	48.6%	48.7%
Critical	36.2%	43.2%	34.9%
Company-wide strategic goals			
Less important	7.8%		9.2%
Somewhat important	26.3%	19.4%	27.6%
Critical	65.9%	80.6%	63.3%
Business unit or functional goals			
Less important	27.5%	16.2%	29.6%
Somewhat important	50.2%	54.1%	49.5%
Critical	22.3%	29.7%	20.9%

Degree of Discretion

Table 6

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
In an ANNUAL incentive plan for senior executives, final awards should allow for how much discretionary adjustment?			
+/- 25% or more	22.2%	20.5%	22.5%
+/- 15% to 20%	28.5%	41.0%	26.0%
+/- 5% to 10%	33.5%	35.9%	33.0%
None or only negative discretion	15.9%	2.6%	18.5%
In a LONG-TERM incentive plan for senior executives, final awards should allow for how much discretionary adjustment?			
+/- 25% or more	17.7%	25.6%	16.2%
+/- 15% to 20%	21.5%	35.9%	18.7%
+/- 5% to 10%	28.3%	33.3%	27.3%
None or only negative discretion	32.5%	5.1%	37.9%

**Factors That Should Influence
Discretionary Adjustment**

Table 7

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Significant economy-wide or industry-wide downturn or accelerated recovery			
Less Appropriate	14.0%	2.6%	16.2%
Appropriate	52.8%	52.6%	52.8%
Very Appropriate	33.2%	44.7%	31.0%
Unanticipated movements in exchange rates, interest rates, key raw materials prices			
Less Appropriate	39.2%	26.3%	41.8%
Appropriate	47.8%	60.5%	45.4%
Very Appropriate	12.9%	13.2%	12.9%
Unanticipated gain or loss of a key customer or account			
Less Appropriate	62.8%	54.1%	64.5%
Appropriate	26.5%	40.5%	23.9%
Very Appropriate	10.7%	5.4%	11.7%
Restructuring and/or discontinued operations			
Less Appropriate	24.0%	17.9%	25.3%
Appropriate	56.2%	66.7%	54.1%
Very Appropriate	19.7%	15.4%	20.6%
Lawsuit settlement			
Less Appropriate	61.9%	63.2%	61.7%
Appropriate	31.2%	31.6%	31.1%
Very Appropriate	6.9%	5.3%	7.3%

**Factors That Should Influence
Discretionary Adjustment**

Table 7

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Facilities accident			
Less Appropriate	63.5%	56.4%	64.9%
Appropriate	28.8%	38.5%	26.8%
Very Appropriate	7.7%	5.1%	8.2%
Unusual events associated with risky foreign operating environments			
Less Appropriate	54.8%	63.2%	53.2%
Appropriate	40.4%	28.9%	42.6%
Very Appropriate	4.8%	7.9%	4.2%
Other			
Less Appropriate	66.4%	88.2%	63.0%
Appropriate	25.6%	5.9%	28.7%
Very Appropriate	8.0%	5.9%	8.3%

Who Should Review Performance Measures

Table 8

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
CEO			
Never or Rarely	0.4%		0.5%
Sometimes	10.9%	7.7%	11.5%
Always	88.7%	92.3%	88.0%
CFO			
Never or Rarely	5.9%	5.3%	6.0%
Sometimes	25.7%	26.3%	25.6%
Always	68.4%	68.4%	68.3%
HR			
Never or Rarely	7.7%	13.2%	6.7%
Sometimes	23.6%	18.4%	24.6%
Always	68.7%	68.4%	68.7%
Other senior executives			
Never or Rarely	22.4%	25.7%	21.8%
Sometimes	62.3%	57.1%	63.3%
Always	15.2%	17.1%	14.9%
The Compensation Committee			
Never or Rarely	0.0%		
Sometimes	8.9%		10.7%
Always	91.1%	100.0%	89.3%
The Board of Directors			
Never or Rarely	3.9%	5.3%	3.6%
Sometimes	47.0%	39.5%	48.5%
Always	49.1%	55.3%	47.9%
Outside advisors			
Never or Rarely	14.2%	5.6%	15.8%
Sometimes	51.3%	63.9%	48.9%
Always	34.5%	30.6%	35.3%

Role of the Board

Table 9

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
How, if at all, has Board involvement in the performance measure selection process changed in recent years?			
Increased	56.4%	77.8%	52.5%
Decreased	1.3%	5.6%	0.5%
About the same	42.3%	16.7%	47.0%
How, if at all, has Board involvement in the goal-setting process changed in recent years?			
Increased	52.1%	64.1%	49.7%
Decreased	1.3%		1.5%
About the same	46.6%	35.9%	48.7%
Level of support from management			
Need less from them	1.3%		1.5%
About right	86.0%	84.6%	86.2%
Need more from them	12.8%	15.4%	12.2%
Level of support from outside advisor			
Need less from them	6.1%	5.3%	6.3%
About right	78.9%	73.7%	80.0%
Need more from them	14.9%	21.1%	13.7%
How does your company periodically assess "pay-for-performance"?			
Review of multi-year actual compensation versus multi-year performance (total shareholder return or financial) relative to a peer group	47.3%	51.3%	46.5%
Review of annual compensation and incentive plan performance results relative to peers	63.9%	69.2%	62.9%
No formal review of pay-for-performance	24.1%	15.4%	25.7%

**Inputs Considered in Selecting
Performance Measures**

Table 10

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Review of peer and industry practices			
Never or Rarely	2.1%		2.5%
Sometimes	38.1%	31.6%	39.4%
Always	59.7%	68.4%	58.1%
Review of company performance against peers for various measures			
Never or Rarely	3.8%		4.6%
Sometimes	40.0%	23.7%	43.1%
Always	56.2%	76.3%	52.3%
Statistical analysis of the link between various performance measures and stock price performance			
Never or Rarely	15.2%	8.1%	16.5%
Sometimes	48.9%	56.8%	47.4%
Always	35.9%	35.1%	36.1%
Consideration of adjustments to GAAP or standard measures based on company-specific economic circumstances			
Never or Rarely	16.2%	13.2%	16.8%
Sometimes	64.5%	63.2%	64.8%
Always	19.2%	23.7%	18.4%
Company strategic plan			
Never or Rarely	0.0%		
Sometimes	11.0%	7.9%	11.6%
Always	89.0%	92.1%	88.4%

**Inputs Considered in Setting
Performance Goals**

Table 11

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Annual budget			
Never or Rarely	2.1%	2.6%	2.0%
Sometimes	17.3%	13.2%	18.1%
Always	80.6%	84.2%	79.9%
Long-range or strategic plan			
Never or Rarely	0.0%		
Sometimes	5.8%	5.1%	6.0%
Always	94.2%	94.9%	94.0%
Business unit "bottom-up" plans			
Never or Rarely	6.8%	10.5%	6.1%
Sometimes	60.9%	60.5%	60.9%
Always	32.3%	28.9%	33.0%
% value sharing (e.g., % of earnings paid out to executives)			
Never or Rarely	22.6%	18.9%	23.2%
Sometimes	42.6%	40.5%	42.9%
Always	34.9%	40.5%	33.8%
Statistical analysis of financial measure linkage to share price			
Never or Rarely	24.0%	23.7%	24.1%
Sometimes	48.5%	57.9%	46.7%
Always	27.5%	18.4%	29.2%

**Inputs Considered in Setting
Performance Goals**

Table 11

	Total	Industry Group	
	All Firms	Banking	All Other
Number of Firms	241	39	202
Peer performance			
Never or Rarely	10.9%	2.6%	12.5%
Sometimes	51.0%	46.2%	52.0%
Always	38.1%	51.3%	35.5%
Variance analysis (e.g., in determining breadth of performance ranges)			
Never or Rarely	10.2%	5.1%	11.2%
Sometimes	58.9%	74.4%	55.8%
Always	30.9%	20.5%	33.0%
Implications of specific levels of performance on stock price			
Never or Rarely	23.6%	16.2%	25.0%
Sometimes	48.5%	56.8%	46.9%
Always	27.9%	27.0%	28.1%
Analyst expectations (e.g., First Call consensus estimates)			
Never or Rarely	44.2%	57.9%	41.5%
Sometimes	47.6%	42.1%	48.7%
Always	8.2%		9.7%

About Pearl Meyer & Partners

For more than 20 years, PM&P has served as a trusted independent advisor to Boards and their senior management in the areas of compensation governance, strategy and program design. The firm provides comprehensive solutions to complex compensation challenges through the development of programs that align rewards with business goals to create long-term value for all stakeholders: shareholders, executives and employees. The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, San Francisco and San Jose.

About our Community Banking Expertise

Our banking practice is headed in our Boston office where we provide consulting services and administer compensation surveys for bank executives, employees and board of directors. We have a team of consultants exclusively dedicated to serving the banking industry. For information on PM&P banking surveys or consulting services, please contact your local office.

Contact Us

For other information and guidance on compensation issues, or to learn more about Pearl Meyer & Partners' services, please feel free to contact any of our offices listed on the next page.

Please note: This survey and its contents are confidential and proprietary and should not be provided to other parties outside the firm for which the data was reported (non-participating firms) without the express written consent of Pearl Meyer & Partners.



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