

Bank Director Workshop

Attracting, Retaining and Rewarding Executives in Today's Environment

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■ The Challenges

- **Economic and Business Turmoil**
 - Margin and earnings pressures
 - Credit risk
 - Housing slump
 - Recession
 - Plunging stock prices
 - Surviving vs. high performing (where to set the bar?)

- **Scrutiny and Pressures on Executive Compensation**
 - Increased investor interest and “say on pay”
 - Congress – SOX – and now executive consultant objectivity
 - IRS – regulations (162m, 409A) and audits
 - New SEC disclosure rules
 - Media scrutiny
 - Banking regulators

- **Top Talent Wanted**
 - Increased number of retirements
 - Competition for top talent, particularly highly sought positions
 - Competitive compensation packages
 - Generational preferences (e.g. retirement focus vs. incentive focus)



THE NEED:

Effective and Responsible Executive Compensation Practices In Today's Environment

■ The Foundation – Good Governance

The Compensation Committee should:

- Be independent, knowledgeable, objective and willing to ask the difficult questions.
- Clarify and review their charter, roles and responsibilities annually.
- Have direct access to independent counsel of attorney and compensation consultant (i.e. hire/fire authority).
- Clearly define the roles of management, the compensation consultant and other advisors. Approve any work consultant performs directly for management.
- Create an annual schedule and set meeting agendas.
- Meet in executive session (preferably at each meeting).
- Maintain open communication with the Board (updates of Committee meetings).
- Oversee CEO performance and compensation (and other executives).
- Conduct annual assessments of executive compensation (tally sheets, competitive position, pay-performance relationship).
- Conduct annual self assessment of Committee performance.
- Use the CD&A to tell their “story”.
- Be able to stand up to any investor/regulator questions or scrutiny on executive compensation.

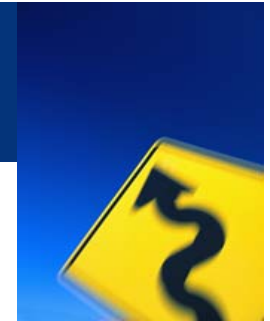
The Compensation Consultant should:

- Report Directly to the Compensation Committee
- Be an objective advisor who is willing to raise issues.
- Not be a data slave.
- Understand your industry, business and performance drivers.
- Educate and guide the Committee on best practices in compensation and governance.
- Note: Goal is not to divide management and the Committee, but to foster an environment of proper information sharing and involvement..

Management should:

- Provide input, perspectives, data, information to the Board, Committee and advisors.
- Maintain open and positive relationship with Committee and Board.
- Be part of the process, but not drive the process (i.e. consultant engagement, pay decisions, committee agenda is Committee responsibility).
- Not be present for discussions on their own compensation.

▪ Define Your Compensation Philosophy



- **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**
 - 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**

A few points about being “competitive”

- Market provides one perspective – its' not the only goal.
- Ensure proper peer group – public companies must disclose this list
- 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

■ Ensure Pay For Performance

- **Inherent challenge – It’s not as simple as it looks**
 - Different cycles/time periods
 - Different perspectives (i.e. investors, median, management)
 - Economic and industry influences beyond executive control (positive and negative)
- **Selection of performance measures a challenge**
 - Should align with business strategy and reward achievement of specific goals
 - Focus on key metrics
 - Short term goals typically reflect core business plan
 - Long-term goals typically reflect stock/profit/capital growth over time
- **Balance is key**
 - Short vs. long-term performance
 - Bank/team vs. individual performance
 - Absolute vs. relative performance (relative better for long-term)
 - Formulaic vs. discretionary
 - It’s the sum of the parts
- **Don’t lose sight of good business judgment**
 - Formulas aren’t perfect. Consider the “big picture” (i.e. windfalls or downfalls).
 - Look at multi-year impact of decisions (e.g. tally sheets)
 - Recognize factors outside management control, but don’t ignore. Executives share in the same risk/reward as investors.
 - Review performance and pay relationships and be prepared to explain.

It’s called variable pay and “pay at risk” for a reason. High performing companies show the greatest variability and leverage in their pay programs. More risk – more reward! But not necessarily every year.

Take a “Total” View

- **The “Right” Mix**
 - Different components focus on different needs
 - » Fixed vs. variable
 - » Annual vs. long-term
 - » Reward vs. benefit
 - Take a multi-year perspective – mix can vary
 - Total perspective
 - » Take holistic view
 - » What is overall “message” of the rewards program
 - Compensation delivered vs. compensation earned
 - » Understand the difference
 - » Both are visible to investors
 - » Focus tends to be on what’s earned under certain circumstance (e.g. termination, retirement, change in control)
- **Tally and Scenario Analysis – The “Holy Cow” Calculation**
 - How does total compensation vary under different scenarios
 - » Performance
 - » Termination
 - Review severance and change in control benefits in light of desired philosophy and objectives.
 - How leveraged is the total compensation program? What is at risk? What is guaranteed?
- **Ownership Perspective**
 - How much ownership do executives have? Are they expected to have? Is ownership level considered in compensation decisions?

Checks and Balances of Executive Compensation

Business Alignment

Does your compensation program support the Bank's business strategy?

Compensation Philosophy

Do you have a formal compensation philosophy?

Competitive Perspective

Is your total compensation appropriately aligned with market?

Performance Measures

Do incentive plans reward the "right" performance measures? Over the "right" timeframes?

Performance Alignment

What proportion of total compensation is performance based? Do you test the pay-performance relationship?

Balance

Is the total compensation program appropriately balanced?

Holistic/Total View

Do your programs & decisions consider the aggregate value (under different scenarios)?

High Performers

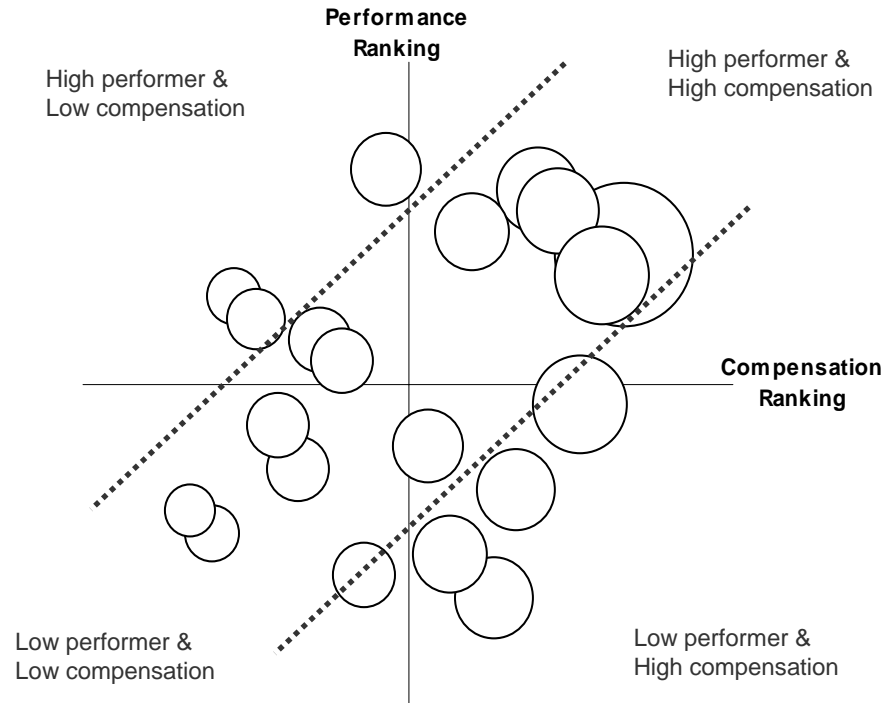
Is your Bank attracting and retaining the top talent?

Good Governance

Is your Committee appropriately informed and accountable for its decisions?

■ Testing Alignment – Where is Your Bank?

CEO compensation relative to 3-Year TSR An Illustration of banks between \$1b - \$15b Assets





THANK YOU

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