

ON POINT

TIMELY, ACCURATE, INSIGHTFUL

PM&P On Point: Annual Incentive Plans for Top Corporate Officers

Banking Edition

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Introduction

The banking industry is in recovery mode and outlooks are stabilizing, with regulators and shareholders continuing to turn their attention to executive compensation. In this environment, annual incentive plans remain a highly valuable and scrutinized component of compensation. Banks are now focused on decreasing margins and increasing capital requirements and balancing with safety and soundness. The calibration of annual performance, as well as program payouts, must now meet new regulations and strategies addressing the new “normal.” Banks can build valuable perspectives from market practices in incentive plan design by determining if prevalent practices are the best approach to meeting their own strategies and priorities, or if they would be better served by developing alternative approaches.

We’re pleased to share the *PM&P On Point Survey: Annual Incentive Plans for Top Corporate Officers Banking Edition*, conducted between May 23 and June 19, 2013, which provides useful insight to multiple aspects of annual incentive plan use.

This report reflects a subset of responses from 31 participants (22%) who represent banking institutions from the total survey group of 140. The majority of bank respondents are company managers from publicly-traded companies.

Topics covered include:

- How financial goals in annual incentive plans are established, including target, threshold and maximum (stretch) levels;
- Overall, philosophy of payout levels and the likelihood of payouts;
- General, program design features (funding, performance measures, maximum opportunities, and threshold requirements).

The survey findings are reported in aggregate, as well as by institution size (total assets). Collective results for all industries are also provided for reference.

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

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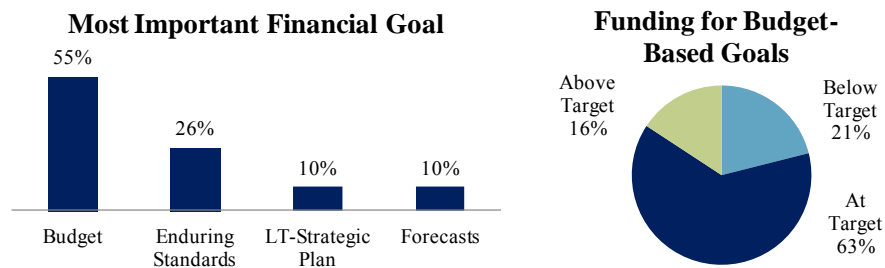
Key Highlights

Overall

Survey results from both general industry companies and banking institutions confirm the conventional wisdom regarding the most common practices in key design areas, although variations from the norm are reasonably prevalent. Conventional practices include:

- Targeting financial goals equal to the internal budget
- Achieving budget means bonus funds at target
- Setting threshold and stretch financial goals as a consistent percentage of the target goals year-over-year
- Having a high probability that target financial goals will be achieved

How Financial Goals Are Set

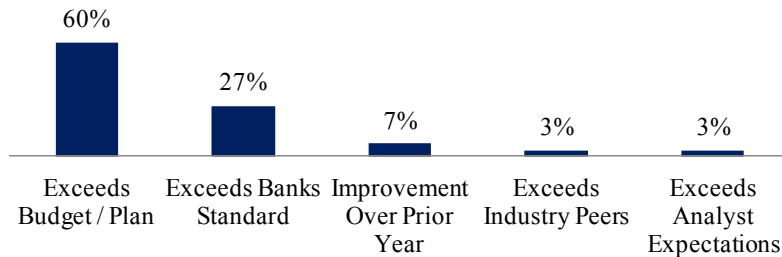


The majority of Banking respondents establish financial goals based on internal budgets (55%) and report that achieving the budget results in the bonus being funded at target (63% among those basing goals on a budget). Slightly less common is the use of enduring standard goals, such as 10% growth (26%).

- Fully 71% of respondents establish threshold and maximum goals relative to target goals and 7% of respondents review goals relative to their peers or the broader industry. Fewer respondents base threshold to maximum performance on a performance level considered appropriate.
- Longer-term focused financial forecasts or strategic plans were less likely to be considered in setting financial goals in annual incentive plans.

Threshold and maximum performance goals are most commonly established as a consistent percentage of the target goal year-to-year – e.g. 80% or 120% of target performance.

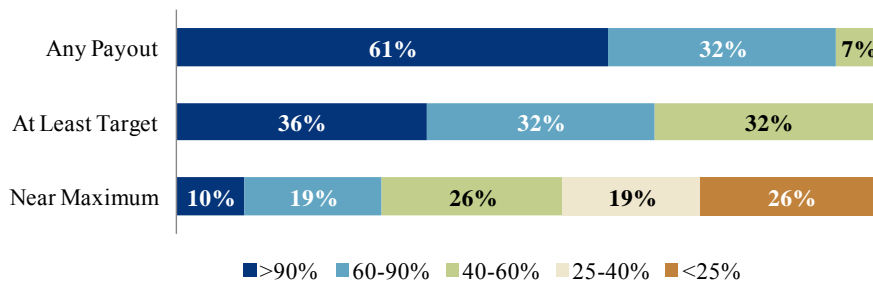
Definition of a "Good Year"



When asked to select the most important factor in defining “a good year,” the majority of bank respondents selected Exceeding the Budget/Plan, with Exceeding the Bank’s Standard the next most prevalent factor.

Probability of Bonus Payouts

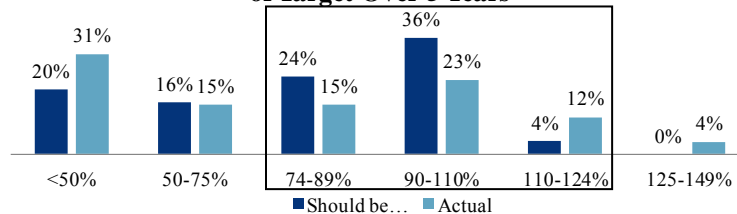
Likelihood of Bonus Payout



The majority of respondents reported a greater than 90% probability of a bonus payout, and 68% reported an above-average (over 60%) probability of at least a target payout.

- As would be expected, the greatest variation in probability is the likelihood of bonus payout at maximum

Average Payouts as a Percentage of Target Over 5 Years



To determine how programs are working relative to their desired designs, respondents were asked where bonus payouts “should be” and the actual bonus paid relative to target. Within each of the two buckets, there is some variation.

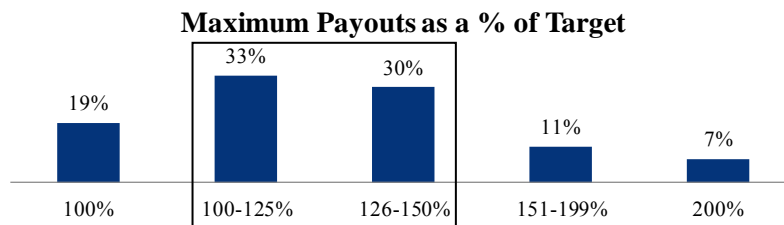
- 64% of respondent stated payouts “should be” between 74% and 124% of target, which compares to 50% of respondents who are actually paying bonuses within that range.

Program Design

A majority of respondents (74%) review individual performance when determining annual incentive payouts. Individual performance typically triggers a payout modifier to increase or decrease to the earned incentive amount, as opposed to the individual bonus being determined independently.

Bonus opportunities for top officers are most commonly established using a target-based approach (47%) versus a formula-based pool (30%). Among respondents, 23% maintain discretionary plans.

Programs typically include a performance threshold or performance level which, if not achieved, would result in no bonus payout. Among respondents, 69% maintain plans that include either a performance threshold or performance gate.



Incentive programs generally provide for bonus payouts that exceed the target. Among banking respondents, maximum incentives typically range between 100% and 150% of target.

Demographics

Table 1

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Form of Ownership				
Publicly Held – For Profit	58.6%	61.3%	62.5%	60.0%
Closely Held/Family Held – For Profit	5.0%			
Privately Held – For Profit	22.1%	16.1%	18.8%	13.3%
Mutual, Cooperative, or membership organization	10.7%	19.4%	18.8%	20.0%
Tax-Exempt or Government Chartered, including	3.6%	3.2%		6.7%
Primary Industry				
Business Services	8.1%			
Consumer	11.1%			
Energy	5.9%			
Financial	31.9%	100.0%	100.0%	100.0%
Health Care	5.9%			
Industrial	11.1%			
Materials	5.2%			
Real Estate	3.7%			
Technology	13.3%			
Transportation	2.2%			
Other	1.5%			
Revenue Size (Firms Reporting Revenue)				
Under \$100 million	12.1%			
\$100 million to less than \$300 million	12.1%			
\$300 million to less than \$1 billion	25.3%			
\$1 billion to less than \$3 billion	21.2%			
\$3 billion to less than \$10 billion	18.2%			
\$10 billion to less than \$20 billion	3.0%			
\$20 billion to less than \$30 billion	3.0%			
\$30 billion or greater	5.1%			
Asset Size (Firms Reporting Assets)				
\$100 million to less than \$300 million	7.7%	9.7%	18.8%	
\$300 million to less than \$1 billion	33.3%	41.9%	81.2%	
\$1 billion to less than \$3 billion	30.8%	29.0%		60.0%
\$3 billion to less than \$10 billion	7.7%	6.5%		13.3%
\$10 billion to less than \$20 billion	12.8%	9.7%		20.0%
\$20 billion to less than \$30 billion	2.6%			
\$30 billion or greater	5.1%	3.2%		6.7%

Establishing Goals

Table 2

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Most Important Financial Goals				
Goals are based on the Board-approved budget	62.1%	54.8%	62.5%	46.7%
Goals are based on the company's long-term strategic plan	9.3%	9.7%	6.2%	13.3%
Goals are based on enduring standards for performance	17.1%	25.8%	18.8%	33.3%
Goals are based on the historical performance of the company and/or industry peers	0.7%			
Goals are determined using internal economic models and forecasts	6.4%	9.7%	12.5%	6.7%
Other	4.3%			
Bonus Funding for Budget-Based Goals				
Achieving budget results in bonus funding at target	62.1%	42.9%	50.0%	35.7%
Achieving budget results in bonus funding below target	6.5%	14.3%	21.4%	7.1%
Achieving budget results in bonus funding above target	8.1%	10.7%	14.3%	7.1%
Bonus plan goals are not based on the internal budget	22.6%	32.1%	14.3%	50.0%
Other	0.8%			
Definition of 'Good Year'				
Results exceeded budget or plan	72.7%	60.0%	66.7%	53.3%
Results exceeded analyst expectations	3.6%	3.3%		6.7%
Results improved as expected from the previous year	7.2%	6.7%	6.7%	6.7%
Results exceeded the company's standard for performance	13.7%	26.7%	20.0%	33.3%
Results were better than industry peers	1.4%	3.3%	6.7%	
Other	1.4%			

Establishing Threshold and Maximum Goals

Table 3

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Method for Setting Threshold Goal				
A percentage of the target goal, generally consistent from year to year	71.0%	71.0%	81.2%	60.0%
Prior year results, regardless of relationship to this year's target	3.6%			
Other performance level considered to be minimum acceptable	17.4%	16.1%	12.5%	20.0%
Comparison to historical peer/industry results	1.4%	6.5%		13.3%
Other	6.5%	6.5%	6.2%	6.7%
Method for Setting Maximum Goal				
A percentage of the target goal, generally consistent from year to year	75.4%	71.0%	81.2%	60.0%
Performance level considered to be appropriate	13.0%	16.1%	6.2%	26.7%
Comparison to historical peer/industry results	2.2%	6.5%	6.2%	6.7%
No maximum applies on funding measures	4.3%	3.2%	6.2%	
Other	5.1%	3.2%		6.7%

Payout Level Philosophy

Table 4

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Likelihood of Any Bonus Payout				
Very high (90% probability or higher)	60.7%	61.3%	56.2%	66.7%
More often than not (60% to 90% probability)	31.4%	32.3%	37.5%	26.7%
Average (40% to 60% probability)	5.7%	6.5%	6.2%	6.7%
Infrequent (25% to 40% probability)	1.4%			
Unlikely (Less than 25% probability)	0.7%			
Likelihood of At Least Target Bonus Payout				
Very high (90% probability or higher)	27.9%	35.5%	37.5%	33.3%
More often than not (60% to 90% probability)	39.3%	32.3%	31.2%	33.3%
Average (40% to 60% probability)	25.0%	32.3%	31.2%	33.3%
Infrequent (25% to 40% probability)	5.0%			
Unlikely (Less than 25% probability)	2.9%			
Likelihood of Bonus At or Near Maximum				
Very high (90% probability or higher)	7.2%	9.7%	12.5%	6.7%
More often than not (60% to 90% probability)	16.5%	19.4%	18.8%	20.0%
Average (40% to 60% probability)	18.7%	25.8%	31.2%	20.0%
Infrequent (25% to 40% probability)	22.3%	19.4%	12.5%	26.7%
Unlikely (Less than 25% probability)	35.3%	25.8%	25.0%	26.7%
Average Payout Over 5 Year Period Should Be . . .				
Less than 50 percent of target	6.5%	20.0%	28.6%	9.1%
Between 50 percent and 74 percent of target	14.5%	16.0%	14.3%	18.2%
Between 74 percent and 89 percent of target	8.9%	24.0%	7.1%	45.5%
Between 90 percent and 110 percent of target	58.1%	36.0%	42.9%	27.3%
Between 110 percent and 124 percent of target	8.9%	4.0%	7.1%	
Between 125 percent and 149 percent of target	3.2%			
Average Actual Payout Over 5 Year Period				
Less than 50 percent of target	14.4%	30.8%	50.0%	8.3%
Between 50 percent and 74 percent of target	13.6%	15.4%	7.1%	25.0%
Between 74 percent and 89 percent of target	15.2%	15.4%	21.4%	8.3%
Between 90 percent and 110 percent of target	40.0%	23.1%	14.3%	33.3%
Between 110 percent and 124 percent of target	12.0%	11.5%		25.0%
Between 125 percent and 149 percent of target	3.2%	3.8%	7.1%	
Over 150 percent of target	1.6%			

**Individual Performance and Plan Design
Table 5**

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Individual Performance Impact on Bonus Determination				
Not at all	23.9%	25.8%	25.0%	26.7%
Modifies bonus amount determined using other measures	50.0%	45.2%	43.8%	46.7%
Generates bonuses independently from other measures	21.0%	22.6%	25.0%	20.0%
Other	5.1%	6.5%	6.2%	6.7%
Type of Bonus Opportunity for Top Officers				
Target-based approach	65.0%	46.7%	46.7%	46.7%
Formula-based pool	19.0%	30.0%	26.7%	33.3%
Discretionary	13.1%	23.3%	26.7%	20.0%
Other	2.9%			
Maximum Bonus as Percent of Target				
100 percent of target (target and maximum are the same)	9.8%	18.5%	26.7%	8.3%
125 percent of target or less	16.7%	33.3%	33.3%	33.3%
126 percent to 150 percent of target	23.5%	29.6%	20.0%	41.7%
151 percent to 199 percent of target	6.1%	11.1%	13.3%	8.3%
200 percent of target	34.1%	7.4%	6.7%	8.3%
Over 200 percent of target, but with a stated maximum	5.3%			
Unlimited	4.5%			
Have Minimum Financial Performance Requirement?				
Yes, plan only has one measure that includes a threshold performance goal	31.3%	34.5%	28.6%	40.0%
Yes, and plan has other performance measures that determine actual bonus assuming minimum requirement is first satisfied	35.8%	34.5%	42.9%	26.7%
No, results in any performance measurement area can generate bonus funding	32.8%	31.0%	28.6%	33.3%

Financial Performance Goals

Table 6

	All Firms	Banking Industry	Asset Size	
	Total	Total	Under \$1B	\$1B and Above
Number of Respondents	140	31	16	15
Firms Using \$ Amount Financial Measure	114	24	13	11
Financial Measures Used For Goals Expressed as \$ Amounts				
Revenue / Sales	44.7%	30.8%	46.2%	15.4%
Operating Income	57.7%	46.2%	46.2%	46.2%
Net Income / Earnings Per Share	31.7%	57.7%	69.2%	46.2%
Economic Profit	7.3%	19.2%	23.1%	15.4%
Other	21.1%	11.5%	7.7%	15.4%
\$ Amount Goals Represent				
Not Applicable	54.8%	25.0%	15.4%	36.4%
Total for the year	79.4%	68.0%	83.3%	53.8%
Improvement/change from the previous year	7.1%	16.0%	16.7%	15.4%
Not applicable, we do not express financial goal as a \$ amount	11.1%	12.0%		23.1%
Other	2.4%	4.0%		7.7%
Firms Using % Financial Measure	47	18	11	7
Financial Measures Used for Goals Expressed as a Percent				
Growth Over Prior Year	16.3%	20.8%	30.8%	9.1%
Profit Margin	10.6%	25.0%	38.5%	9.1%
Return on Investment / Capital	19.2%	54.2%	53.8%	54.5%
Other Ratios	10.6%	4.2%	7.7%	0.0%

About Pearl Meyer & Partners

For more than 20 years, Pearl Meyer & Partners (www.pearlmeyer.com) 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 for multinational companies ranging from the Fortune 500 to not-for-profits as well as emerging high-growth companies. These organizations rely on Pearl Meyer & Partners to develop global programs that align rewards with long-term business goals to create value for all stakeholders: shareholders, executives, and employees. Pearl Meyer & Partners maintains U.S. offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, San Francisco and San Jose, as well as an office in London.

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PM&P serves hundreds of bank clients annually through a national team of consultants exclusively dedicated to serving the banking industry. These consultants work closely with a wide range of banking organizations, from de novo banks, mutuals and credit unions to super regional and international financial institutions. Our services include compensation and governance advisory services to Compensation Committees and Boards, the development of executive and employee compensation programs tailored to the business needs of each client, and the administration of compensation surveys for bank executives, employees, and Board of Directors.

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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