

Pearl Meyer

On Point

TIMELY, ACCURATE, INSIGHTFUL

Looking Ahead to Executive Pay
Practices in 2016

Banking Edition



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Our survey series, ***Pearl Meyer On Point: Looking Ahead to Executive Pay Practices*** is designed to provide organizations with an annual perspective on how their peers are responding to the latest changes in the environment for decision-making around executive pay and governance. This special edition provides insight into banking industry practices.

The 67 participants in the banking industry represent organizations ranging in size from less than \$100 million in assets to over \$30 billion in assets.

- More than 50% of the banks are greater than \$1 billion in assets.
- Over 70% of the banks are publicly, closely, or privately held.

We hope you find this information useful as you make compensation-related decisions for the coming year. If you have any questions or are interested in discussing these findings, please contact:

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Projections for Executive Pay in 2016

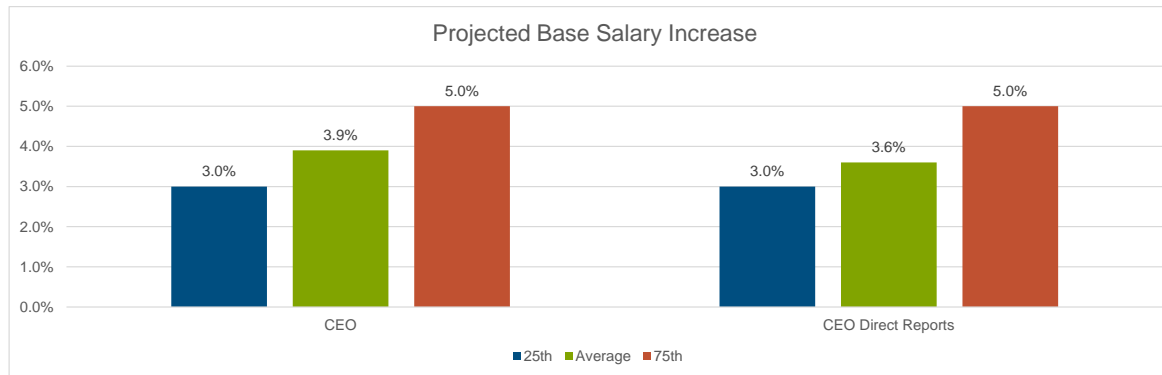
Projections for Executive Pay in 2016

- Merit increase percentages for 2016 are continuing to strengthen.
 - **Base Salary Growth**
 - Almost 90% of banking participants and 95% of direct reports are projecting a merit (excluding promotion) increase for the CEO and/or the CEO's direct reports.
 - On average of the banks providing a merit increase, projections are 3.9% and 3.6% for the CEO and the CEO's direct reports, respectively.
- The majority of firms are projecting short- and long-term awards to be about the same or somewhat higher than the prior year.
- Similar to general industry trends, almost all firms are planning to incorporate one or more modifications to their long-term incentive plan in the upcoming year. The most common planned change, by far, is changing the performance metrics used in performance-based awards, followed by changing the mix of vehicles.

Base Salary Projections

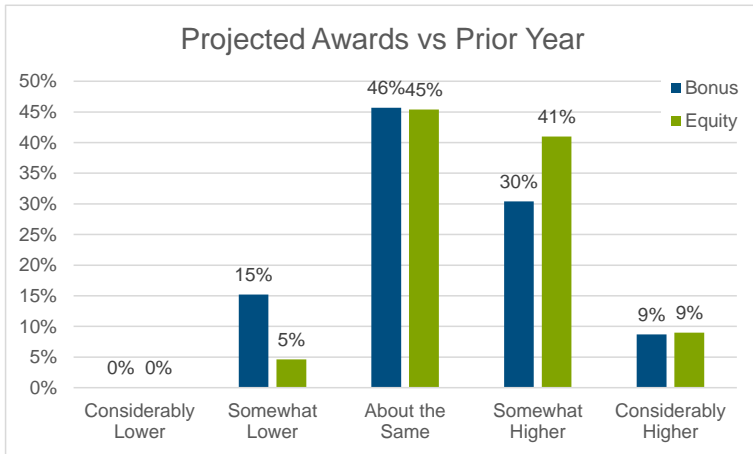


An overwhelming majority of firms are planning to provide base salary increases to their executives...

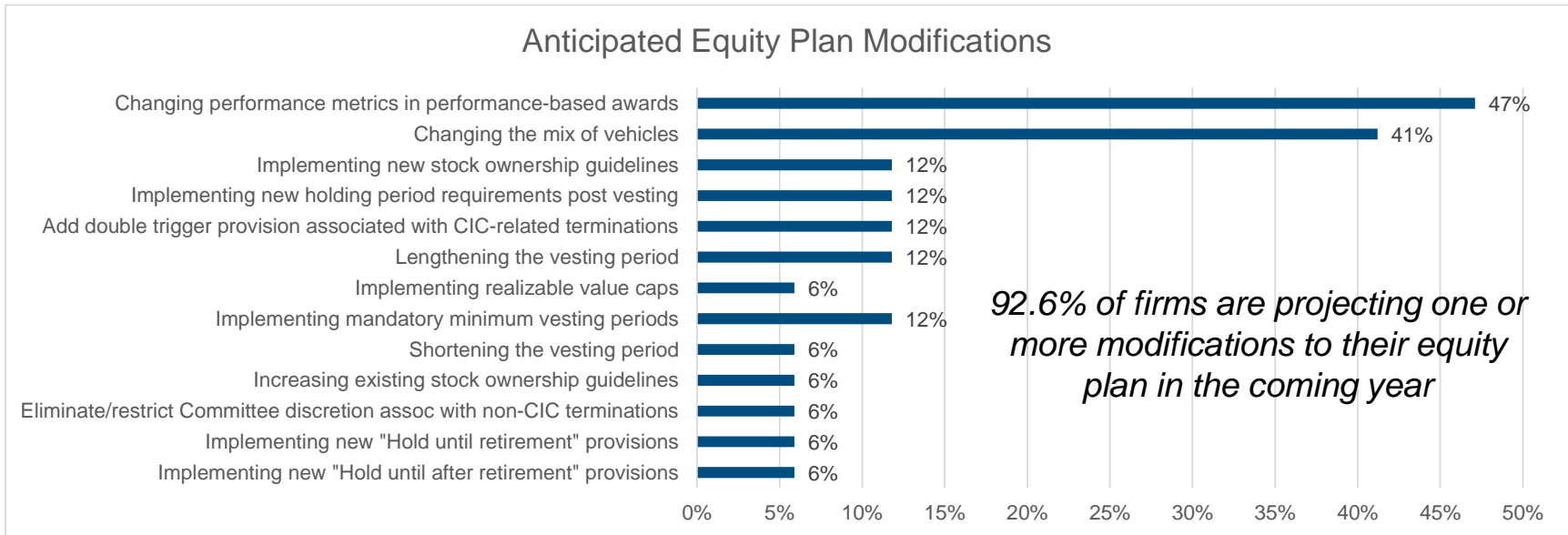


...although those increases continue to be modest

Incentive Plan Projections



Incentive awards – short-term and long-term – are expected to be generally the same to somewhat higher than the prior year



92.6% of firms are projecting one or more modifications to their equity plan in the coming year



Relative Total Shareholder Return in Equity Incentive Plans

Relative Total Shareholder Return (rTSR) in Equity Incentive Plans

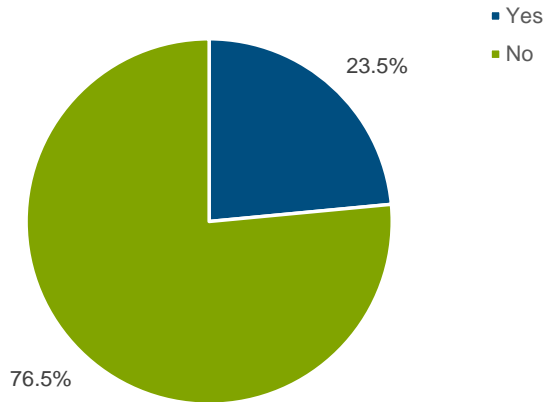
- Approximately one quarter of banks indicate that rTSR is a measure in their long-term incentive program, versus almost 50% in the broader survey. Of those using rTSR, almost 75% of banks use it along with one or more additional measures of performance, in long-term incentive plans.
 - The practice of using rTSR as the *sole* measure is less common among banks than in the broader survey (27% versus 36%).
- The popularity of rTSR has increased very recently, with approximately 80% of the surveyed banks indicating that they have used this measure for three or fewer years.
 - Among firms not currently using rTSR, most cited that the measure was not relevant (i.e., the company is not public) or the company prefers financial or other measures. Fewer than 10% of these firms indicated that they are considering adding rTSR as a measure in the future.

Relative Total Shareholder Return (rTSR) in Equity Incentive Plans (continued)

- The most common reason cited for incorporating rTSR is to align investor and management interests, followed by creating balance to existing financial metrics.
 - Outside pressures, however also clearly play a strong role.
 - Approximately 70% of respondents cite peer practices as a somewhat or very important reason for the use of rTSR, while approximately half say investor concerns play a somewhat or very important role in its use. Less than half of respondents indicated that responding to proxy advisory group concerns played a somewhat or very important role in including rTSR in the equity plan.
- Approximately half of the banks believe that the inclusion of rTSR as a long-term incentive metric plays a very important role in fostering the right executive behaviors and even more believe it reflects the overall performance of the executive team.
 - Similarly, many believe it has had some positive or significant positive impact on either firm financial performance (40%) or actual Total Shareholder Return (60%).

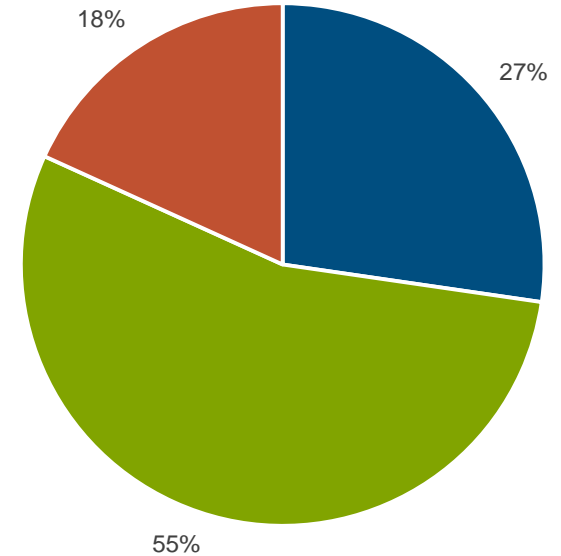
Relative Total Shareholder Return (rTSR)

Firms Including rTSR in LTI Program



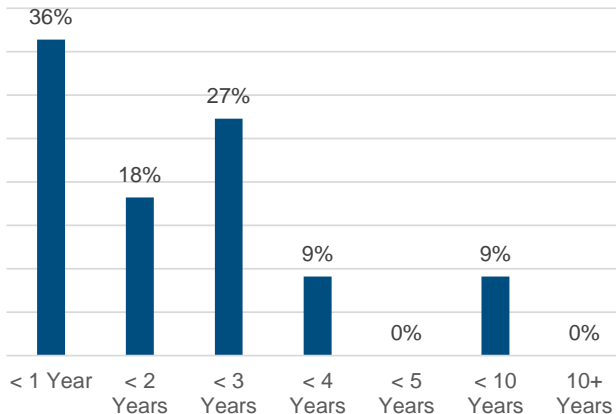
Less than 25% of banks surveyed include relative TSR as a measure in their LTI program

Number of Measures



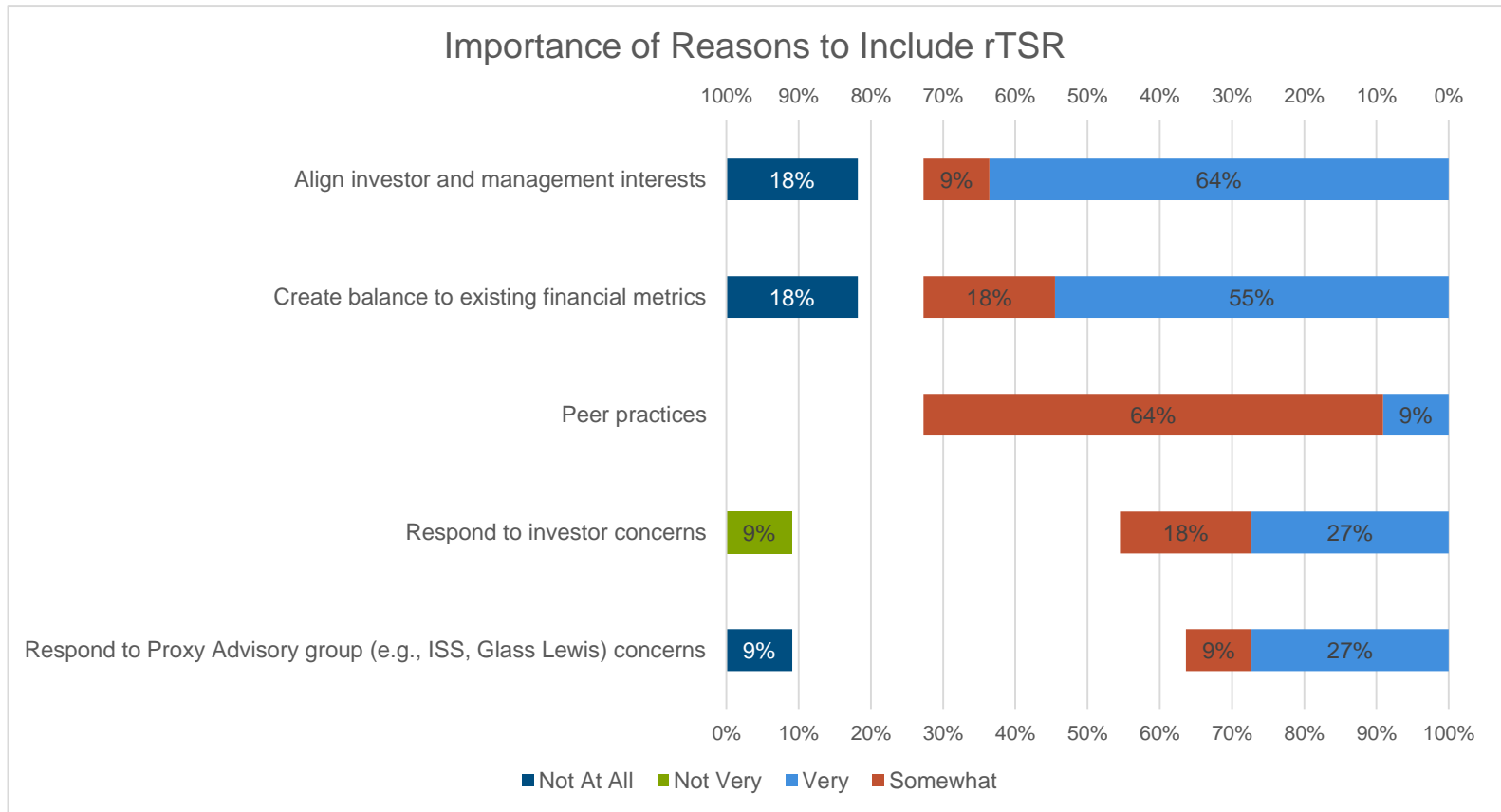
Just under 75% use rTSR as a supplement to other measures

Measure Has Been In Place For . . .

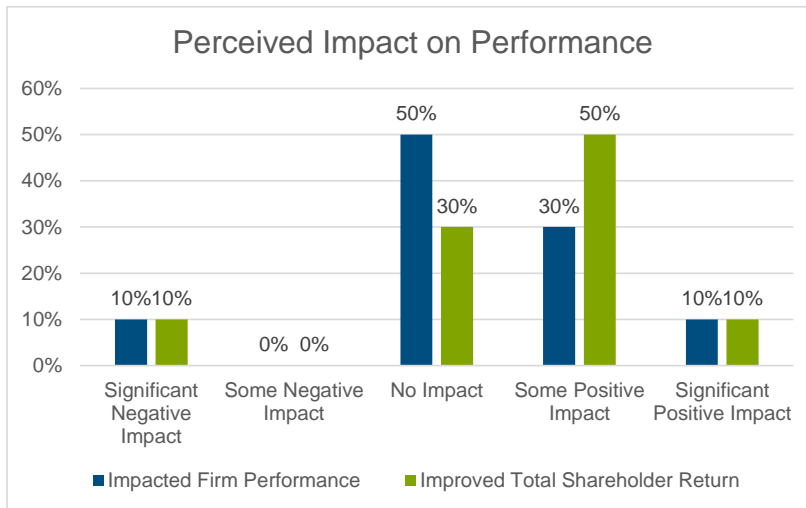


However, the use of rTSR is increasing in recent years; half of the firms have included rTSR for three or fewer years

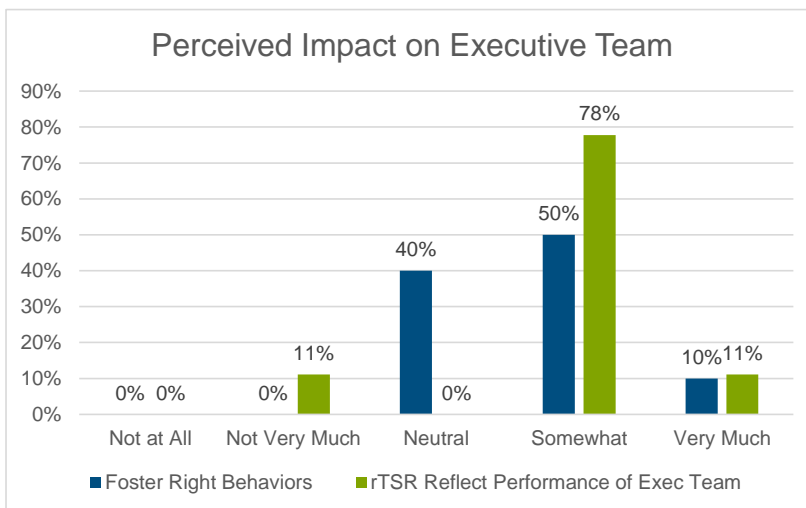
Relative TSR



Relative TSR



More than half of banks believe that the inclusion of rTSR has impacted the firm positively on performance and Total Shareholder Return



Most firms believe that the inclusion of rTSR has had little to somewhat positive impact on fostering the right executive behaviors; more than 75% of banks believe that rTSR accurately reflects the performance of the executive team

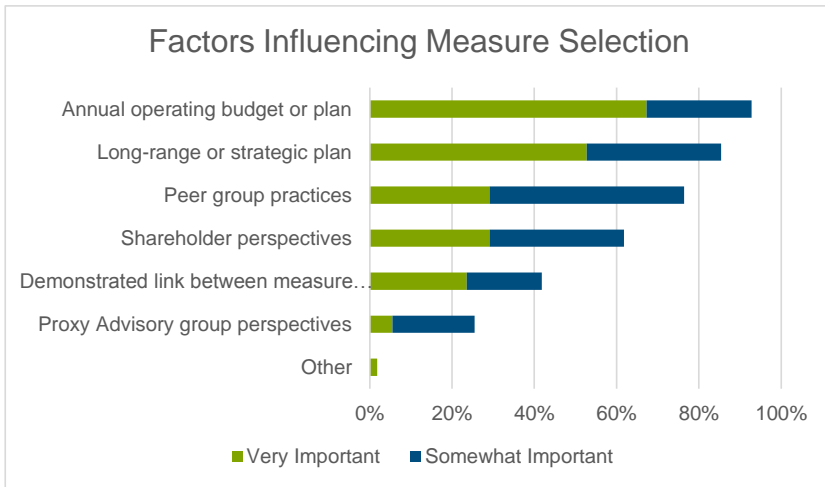


Performance Measure Selection and Setting Performance Standards

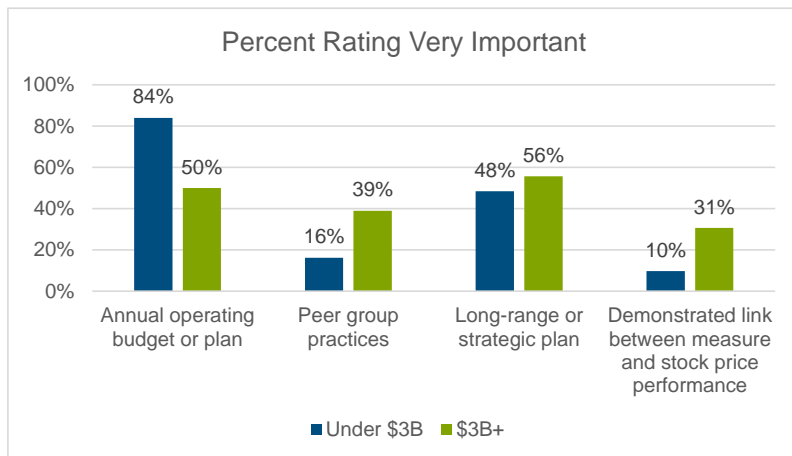
Performance Measure Selection and Setting Performance Standards

- Not surprisingly, the annual operating budget and the long-range or strategic plan are top considerations when selecting performance measures and setting annual standards or goals.
 - Peer group practices were also indicated as somewhat or very important, cited by almost 80%.
 - Interestingly, 41.7% of Boards indicated that proxy advisory group perspectives have a somewhat important impact on the selection of performance measures, while 47.3% of management indicated proxy advisory group perspectives were not at all important.
- When setting performance standards (or goals), Boards and management generally consider the same factors, although Boards give less consideration to percent value sharing (i.e., percent of earnings paid out to the management team) and historical company financial performance.
- Over half the banks surveyed indicate that the degree of Board involvement in these processes has increased over the past several years.
 - However, participants either believed the degree of involvement had increased (49.1%) or stayed about the same (49.1%). Interestingly, Outside Directors were approximately 4X more likely to indicate their involvement had increased.
 - At the same time, most organizations indicate that the level of involvement is just about right.

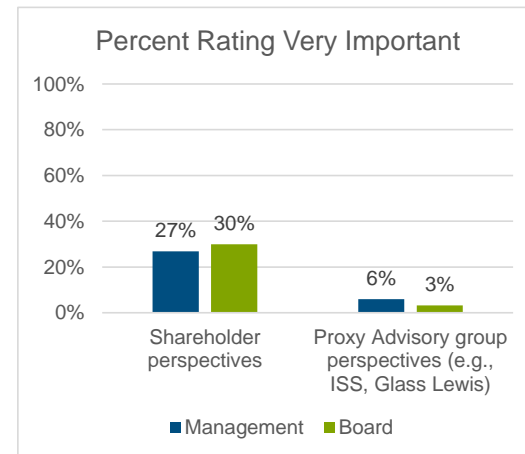
Performance Measure Selection



Annual operating budget remains most common factor influencing measurement selection



Larger, more complex organizations tend to emphasize stock price performance, while smaller banks are most concerned about annual budgets/plans



Board and management views are similar with respect to external influences on measure selection

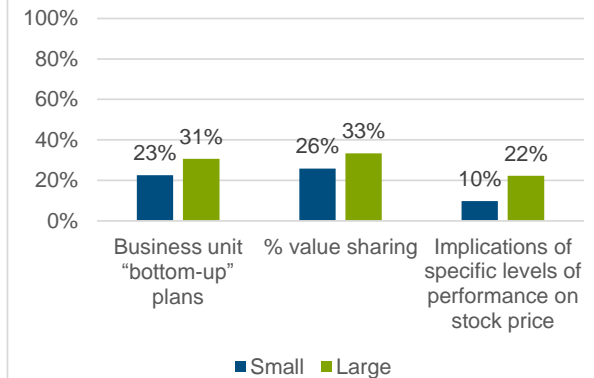
Setting Performance Standards or Goals

Factors Influencing Goal Setting



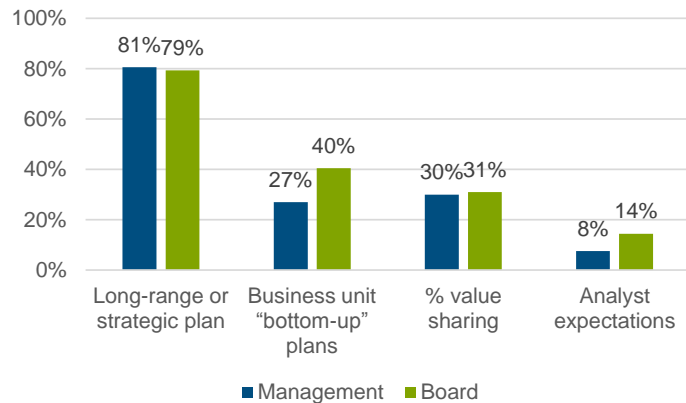
Many factors are concurrently considered, however the degree to which they are "always" considered varies (except for long-range or strategic plan and/or annual budget)

Percent Rating Very Important



Boards and management value most items similarly; The area with the largest gap is the degree to which business unit "bottom-up" plans should influence setting performance standards

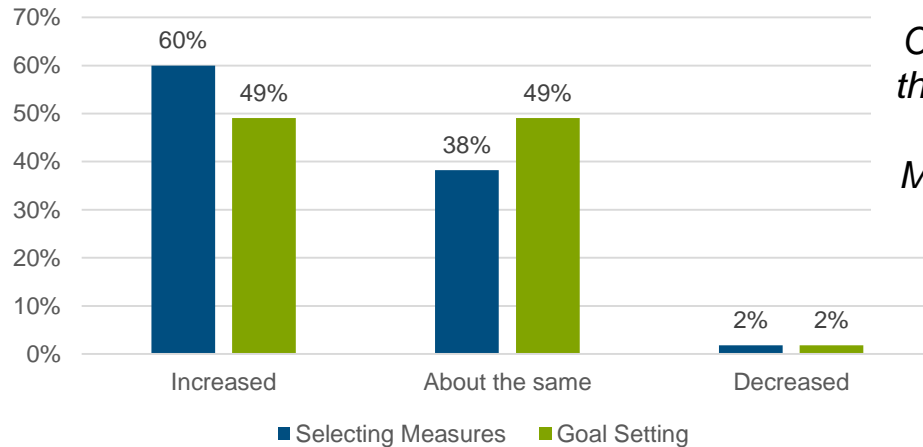
Percent Rating Very Important



Bank size can influence which factors are emphasized

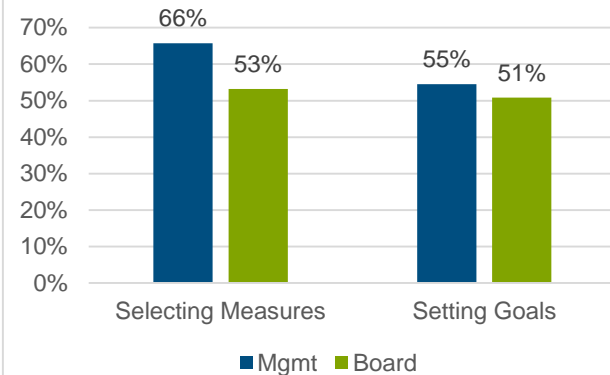
Board Involvement in Measure Selection and Goal Setting

Level of Board Involvement Has...



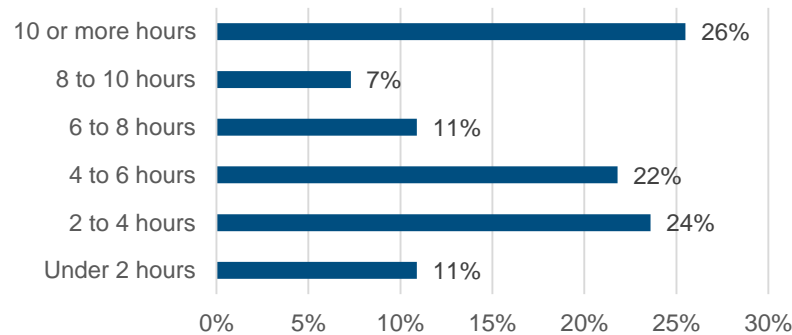
Over recent years, in many banks the level of Board involvement has increased; More increase is seen in selecting measures than in goal setting

Percent Saying Involvement Increased



The majority of Board members feel their involvement has increased

Annual Board Time Investment





Peer Group Selection

Peer Group Selection

- Among organizations that employ both a benchmarking and a performance peer group, the majority (approximately 50%) use the same group of banks for both types of comparisons.
- Industry affiliation is the most important factor when selecting either a benchmarking or a performance peer group, followed by firm size.
 - Geography and business model are somewhat important factors when selecting a peer group (either performance or benchmarking).
 - Talent competitors, life cycle and inclusion in proxy advisory peer groups play a somewhat smaller role when selecting a peer group (either performance or benchmarking).



Extraordinary Events, Exclusions, and Discretion

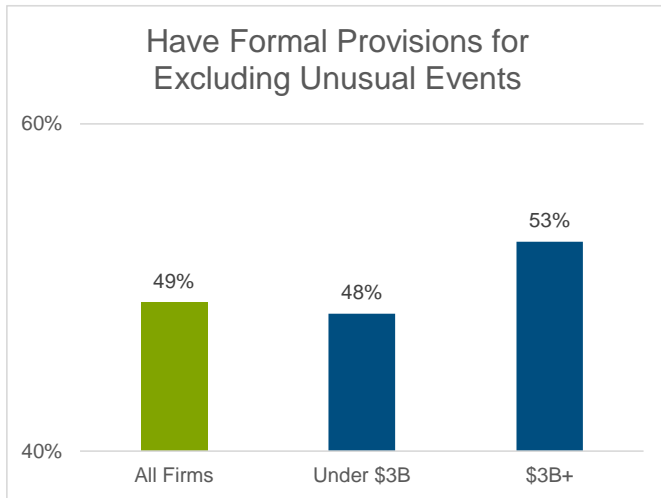
Extraordinary Events, Exclusions, and Discretion

- Approximately half of respondents indicate that their incentive plans *formally* provide provisions for dealing with extraordinary events.
 - Most organizations formally exclude or make adjustments for non-recurring items.
 - Less than 10% of banks formally address foreign exchange rates.
 - More than 75% of banks exclude foreign exchange impacts from the calculation.
- The majority of respondents believe some level of Board discretion is appropriate when determining final incentive plan awards.
 - 30.8% of management believes final awards should allow +/- 25% or more as a discretionary adjustment compared to 25.0% allowing +/- 5% to 10% and 25.0% allowing +/- 15% to 20%.
 - Board members are more likely to allow +/- 5% to 10% or +/- 25% or more. Board members are also more likely to believe there should only be negative discretion or no discretion at all.
 - Again, management is relatively evenly divided in their belief that long-term incentive plans should allow for +/- 5% to 10%; +/- 15% to 20%; or +/- 25% or more as a discretionary adjustment.
 - 41.7% of Board members believe final long-term incentive awards should allow for +/- 5% to 10% discretion.

Extraordinary Events, Exclusions, and Discretion (continued)

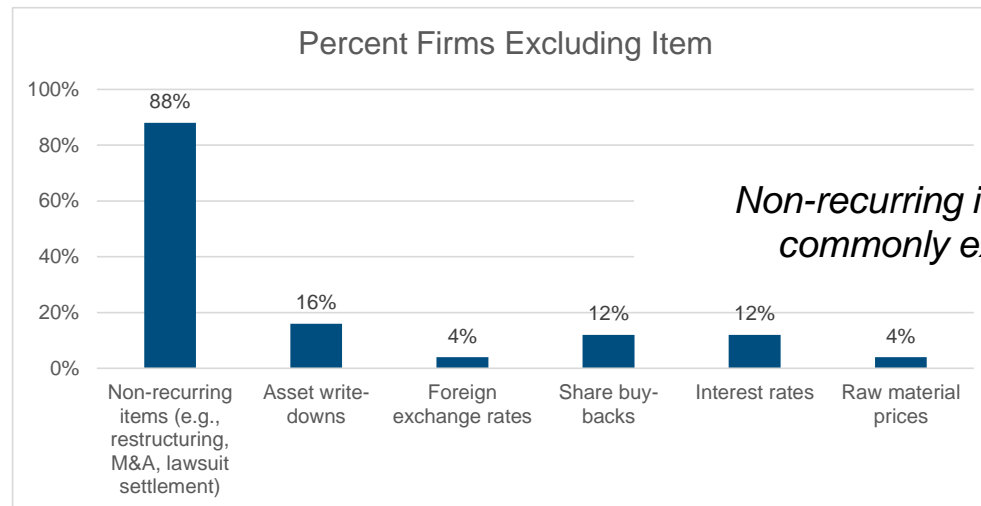
- Factors most commonly identified to be considered include significant economy-wide or industry-wide downturn and restructuring and/or discontinued operations.
- Factors most commonly identified to NOT be considered include unanticipated changes in key raw materials prices and unanticipated gain or loss of a key customer.

Exceptions and Exclusions



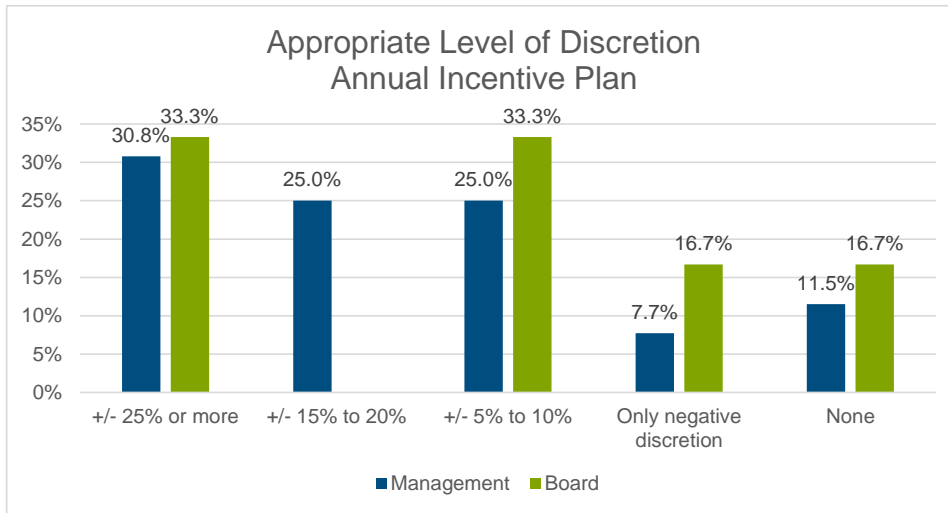
The majority of banks incorporate formal provisions in their incentive plans for excluding unusual events

Larger firms are somewhat more likely to incorporate these provisions

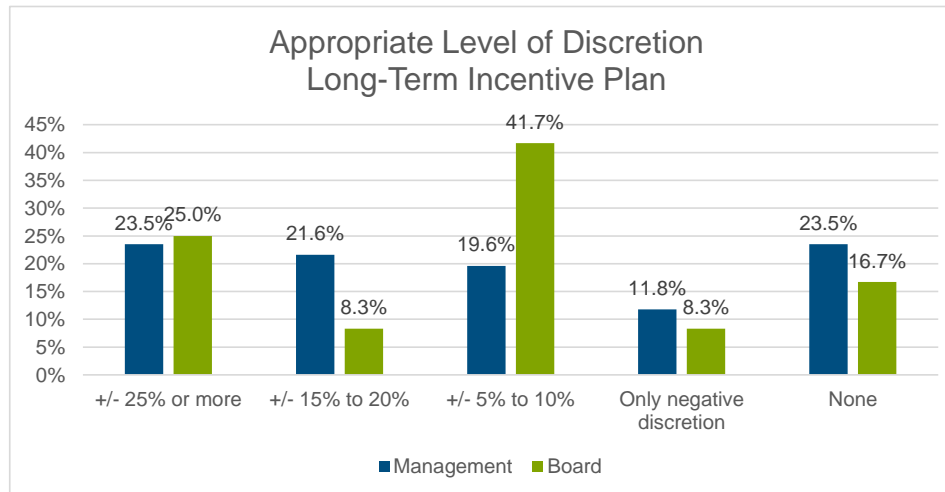


Non-recurring items most commonly excluded

Board Discretion

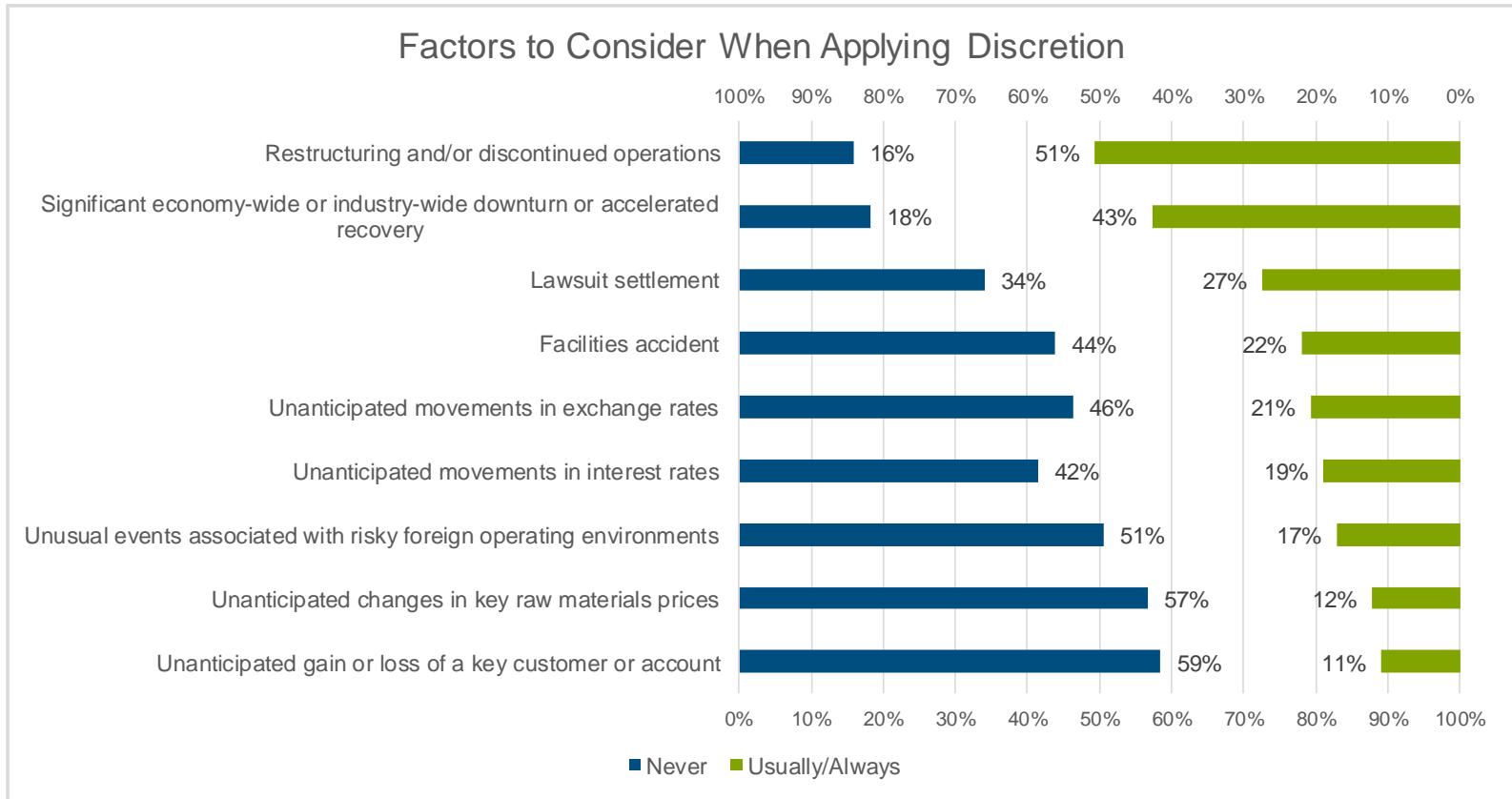


While management and Board members typically believe some level of discretion is appropriate, management believes the discretionary adjustment can vary more so than the Board



Overall, views on the appropriate level of discretion to apply in long-term incentive plans is substantially more conservative (compared to annual incentive plans)

Board Discretion



Restructuring and significant economy-wide downturns were identified as the most common factors to consider when applying discretion

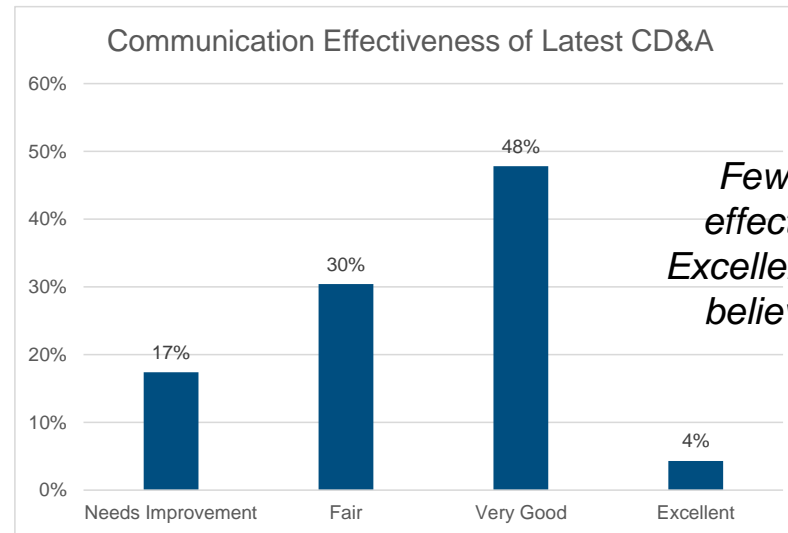


Compensation Discussion & Analysis (CD&A) and Communication Effectiveness

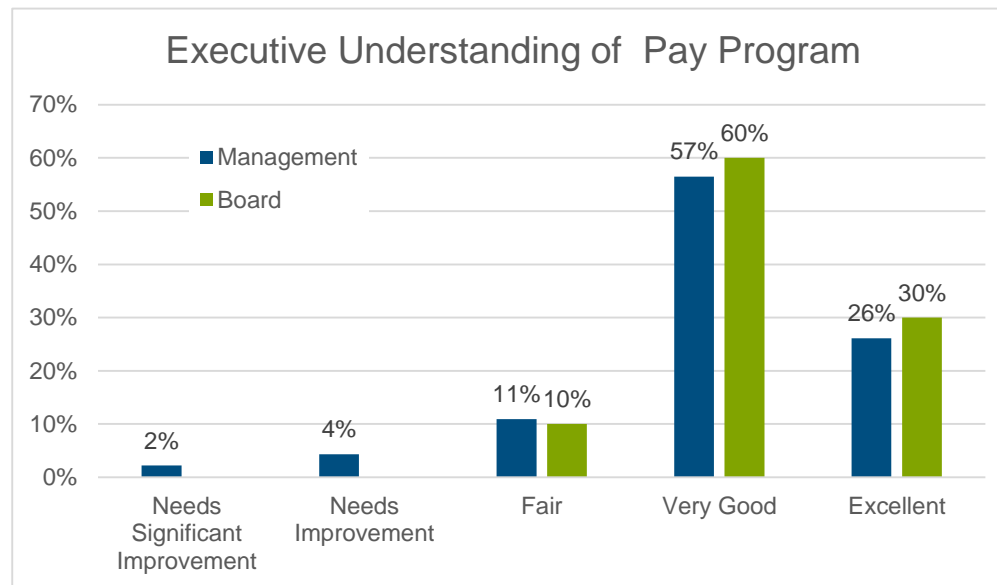
CD&A and Communication Effectiveness

- Across-the-board, organizations are making investments to improve the clarity and effectiveness of their CD&A, with all banks implementing one or more changes to their CD&A in the past year.
 - More than half are also planning to make further enhancements to tone and/or style in the upcoming year.
- The most common addition is the inclusion of an executive summary at the beginning of the CD&A followed by the addition of a proxy summary; charts and/or graphs on change in CEO pay from current to prior year; charts and/or graphs on ratio of variable vs fixed pay for the CEO and/or NEOs; and a table listing major criteria for peer group (e.g., revenue, assets, market cap).
- The 40.6% of banks rate their proxy as Very Good. However, even with all of these enhancements, only 4.0% of respondents rate their CD&A as Excellent.
- More than 80% of banks rate executive understanding of the pay program as Very Good or Excellent.

Communication Effectiveness



Few companies perceive the effectiveness of their CD&A as Excellent – although just under half believe it is at least Very Good



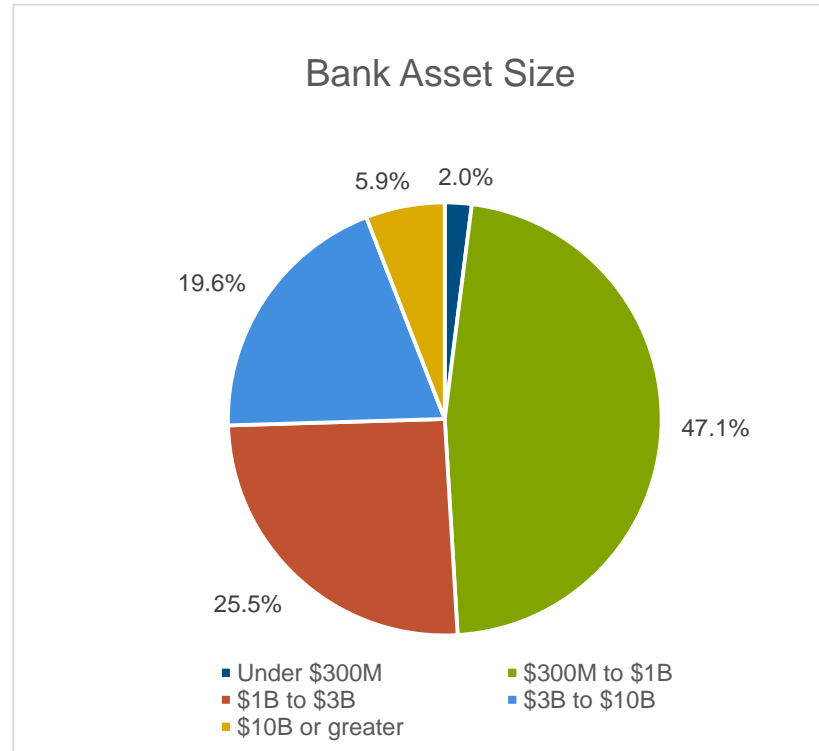
Nearly 85% of firms believe their executives have a very good to excellent understanding of their pay program

Executives themselves, however, rate their understanding lower than their Board members



About the Survey

About the Survey



A total of 67 banks participated in the survey, 45 of which were public companies. Respondents included 55 senior executives and HR professionals, along with 12 non-employee Board members. Survey was conducted online in August 2015.



About Pearl Meyer

Pearl Meyer is the leading advisor to Boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.



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