Pearl Meyer

TRENDS & ISSUES

Evaluating Bank Board of Directors' Compensation

In today's complex business environment, non-employee directors' oversight role continues to evolve and expand in new areas. Bank directors are overseeing and guiding strategies in cybersecurity, technology innovation, and leadership in the age of millennials. They are also designing complex compensation programs to support the safety and soundness of their organization. Ensuring a board has the right balance of skillsets requires a dynamic approach to evaluating as well as compensating directors.

Director Evaluations

Bank boards have well-established processes for evaluating management performance and determining succession. Board and committee performance are also regularly evaluated. In contrast, individual director evaluations are an emerging practice.

Combined with existing processes, individual director evaluations can be a very valuable tool to aid the board's evolution, ensuring that it is comprised of directors with the knowledge and skillsets required to meet the long-term strategic goals of the bank. The first step is a clear understanding of what capabilities are needed. Boards should annually identify the skills and experiences required to support not only the bank's near-term goals, but also to manage the evolving regulatory environment and the competitive market.

"On average, director compensation for 50 west coast banks increased 8-12 percent relative to 2015."

Individual director evaluations can aid in this assessment of the current board's expertise and can help determine if board membership should be rebalanced through the addition of directors or through the retirement of current members. A proactive approach to board refreshment is more effective than relying on blunt instruments such as a mandatory retirement age or term limit. Most recognize that requiring the departure of a valuable director based on such a requirement is not in the best interest of an organization, nor is waiting on set calendar dates before taking a needed action.

Consider the advantage of conducting evaluations at the beginning of the year or shortly after the review of the strategic plan. This allows sufficient timing to identify gaps, consider changes, and identify new board candidates in time for the annual shareholders' meeting.

As published in *Western Independent Bankers Directors Digest*

April 2017

West Coast Bank Director Compensation

While evaluating director and overall board performance is one aspect of supporting a dynamic board, ensuring compensation levels are sufficient to compensate directors for their time commitments and responsibilities is another.

Unlike employee and executive compensation programs, director compensation has not generally been evaluated on an annual basis. Instead, banks often review every second or third year. However, heightened scrutiny on plan design and levels of compensation for board members has resulted in many publicly-held banks evaluating their programs annually, even if no action is taken. In addition, the rapid growth of banks, often through acquisition, and the enhanced oversight responsibilities of the board have resulted in a need for more frequent assessments. The implication of this is increasing levels of board compensation.

On average, director compensation for 50 west coast banks increased 8-12 percent relative to 2015. Changes in compensation varied based on bank asset size and director compensation structure.

- West coast banks with assets over $1 billion have largely adopted best practices in director compensation. They deliver fixed annual cash retainers for board or committee service and equity awards targeted to a fixed value. This structure minimizes dramatic swings in compensation year-over-year which is often triggered by providing fees for attendance at meetings or delivering equity based on a fixed number of shares. Among these west coast banks, increases in compensation were generally delivered as additional equity or higher levels of committee compensation.

- Among west coast banks with assets less than $1 billion, total remuneration year-over-year varied considerably due to the greater prevalence of banks compensating directors for meeting attendance or delivering equity on a periodic rather than annual basis.

The table below summarizes board remuneration among 50 publicly traded west coast banks with first quarter 2016 total assets between $500 million and $20 billion.

West Coast Bank Asset Range	Total Remuneration* (Board + Committee Compensation)		
	25th	Median	75th
$500 Million - $1 Billion	$24,794	$37,281	$48,750
$1 Billion - $5 Billion	$58,345	$66,096	$74,231
$5 Billion - $20 Billion	$82,657	$120,795	$193,243

* Based on 2016 proxy filings.

In Summary

Given growth trajectories of the west coast banks, as well as the average increases in director compensation, it is evident that compensation committees are evaluating board pay on a more frequent basis and this trend is likely to continue.

2017 is poised to be a dynamic year in the banking industry; the market is anticipating a stronger economic environment, rising interest rates, and the potential loosening of regulations which have catapulted bank stock prices to higher levels. Board evaluations and director compensation work in tandem, both aiding the development of strong boards that can most effectively support a bank's long-term strategy in these complex times.

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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