

Getting the Most Out of Your Peer Group

**Bank Executive & Board Compensation Conference
Chicago – November 4, 2014**

Greg Swanson
Vice President
Pearl Meyer & Partners, LLC
greg.swanson@pearlmeyer.com

Pam Taylor
SVP, Human Resources Director
HomeStreet Bank
pam.taylor@homestreet.com

Overview

- Peer Groups are regularly established for the purpose of evaluating competitive pay for Bank executives – and potentially, much more
- This session provides tangible examples of how your Bank can maximize the potential uses of available Peer Group information
- The following uses of Peer Group information will be discussed:
 - The Basics
 - » Peer Group development
 - » Evaluating relative pay levels, target pay mix, and financial performance
 - Evaluating relative pay-performance alignment
 - Short-term incentive (STI) design practices
 - » Payout opportunities, payout curve / leverage
 - » Performance metrics & goal calibration
 - Long-term incentive (LTI) design practices
 - » Prevalence, mix, vest, performance conditions
 - » Overhang & grant rates
 - Retirement plan prevalence & design
 - Overall compensation program leverage

■ The Basics: Peer Group Development

Broad universe of public banks/thrifts

Size filters

- Assets
- Revenue
- Market capitalization

Geographic filters

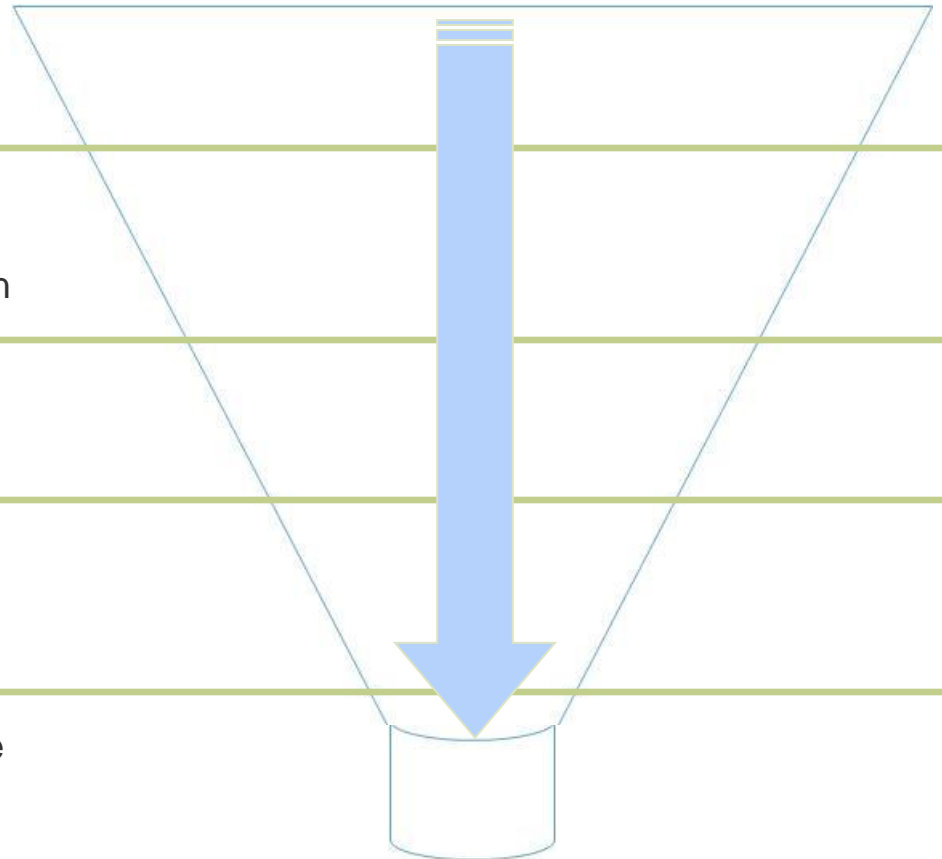
- Region
- Urban/rural

Business model filters

- Loan mix
- Revenue streams
- Growth profile

Other refining filters

- Ownership structure
- Financial health
- Etc.

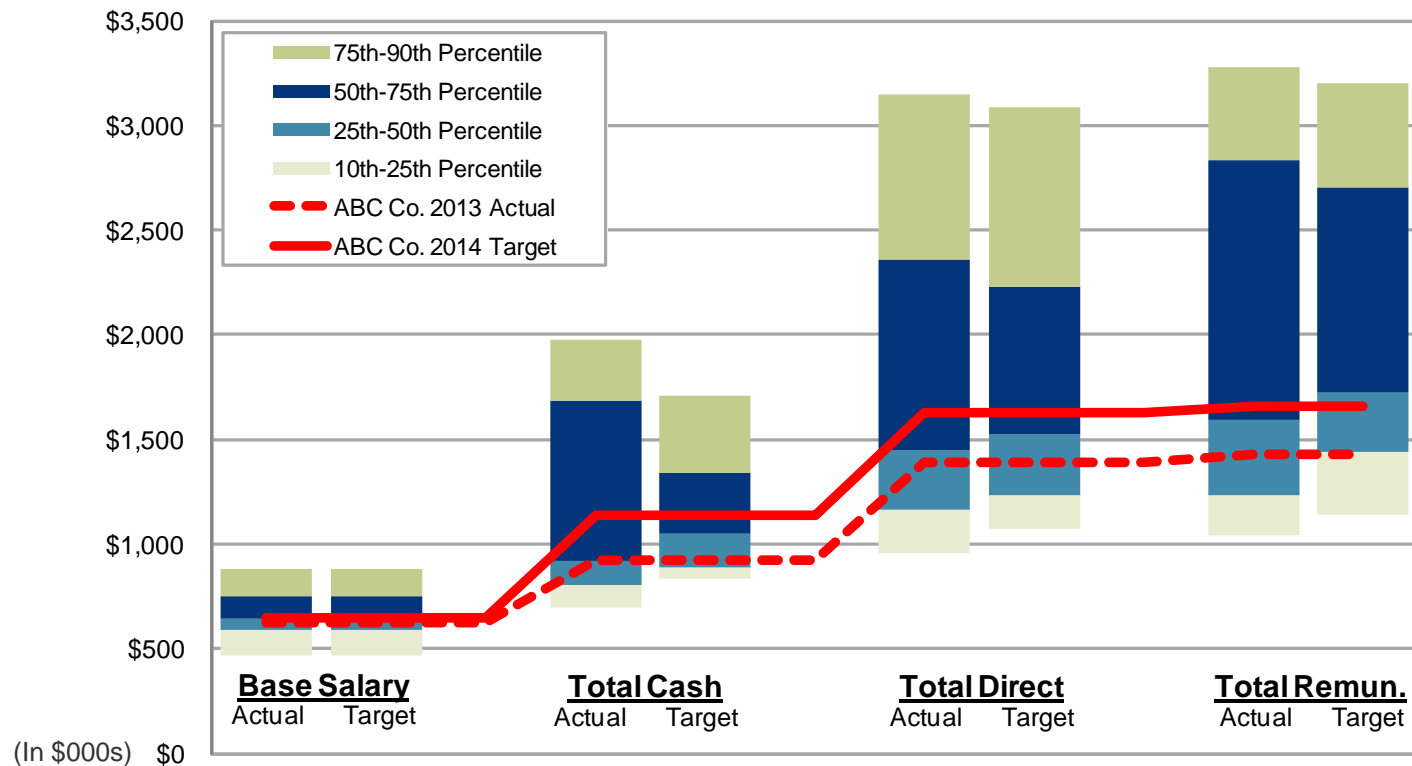


Resulting Peer Group

~ 15–20 Comparators

The Basics: Evaluating Relative Pay Levels

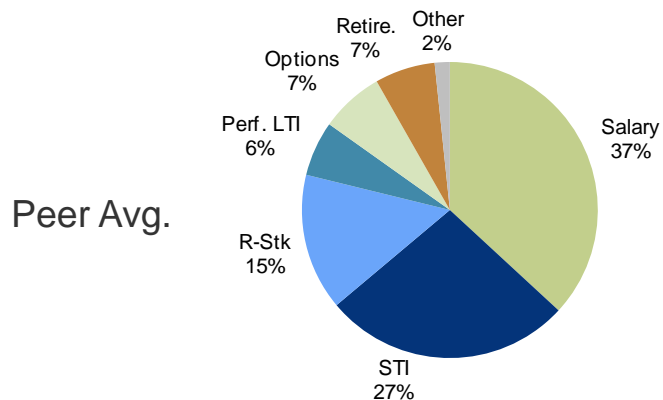
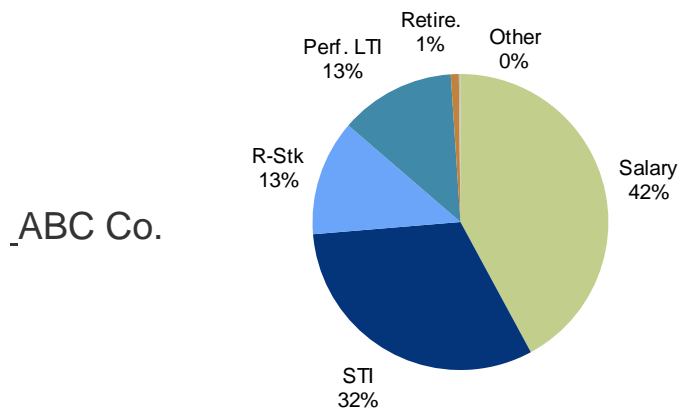
- How competitive are we?
 - » A competitive pay analysis can be conducted for the top executives individually by position and/or pay rank, as well as in aggregate (i.e. “leadership team” perspective)
 - » Proxy disclosures, along with other SEC filings, generally provide enough information to thoroughly evaluate all components of pay for a holistic competitive assessment



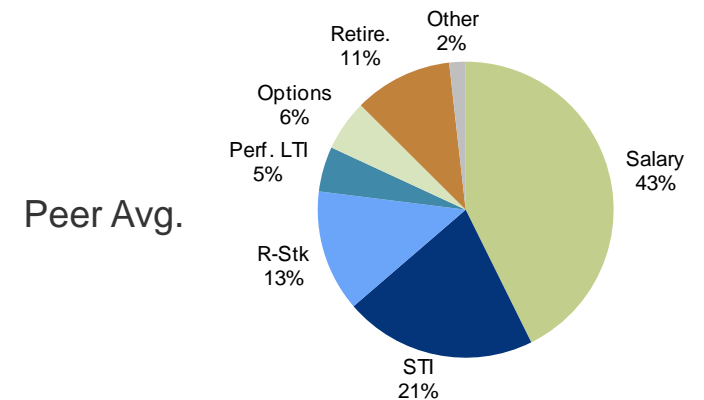
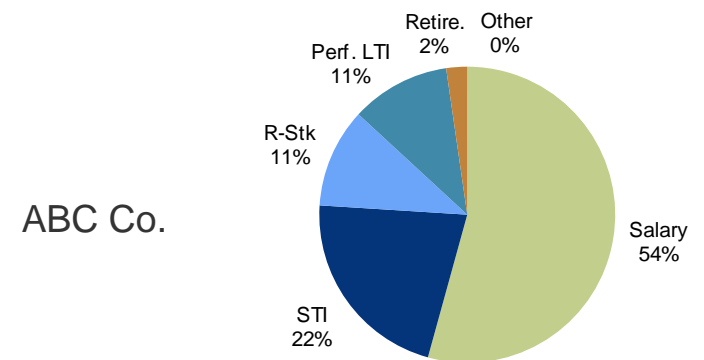
The Basics: Evaluating Target Pay Mix

- How does our target pay structure compare to our peers?
 - » Annual vs long-term; fixed vs variable; cash vs equity; etc.

CEO

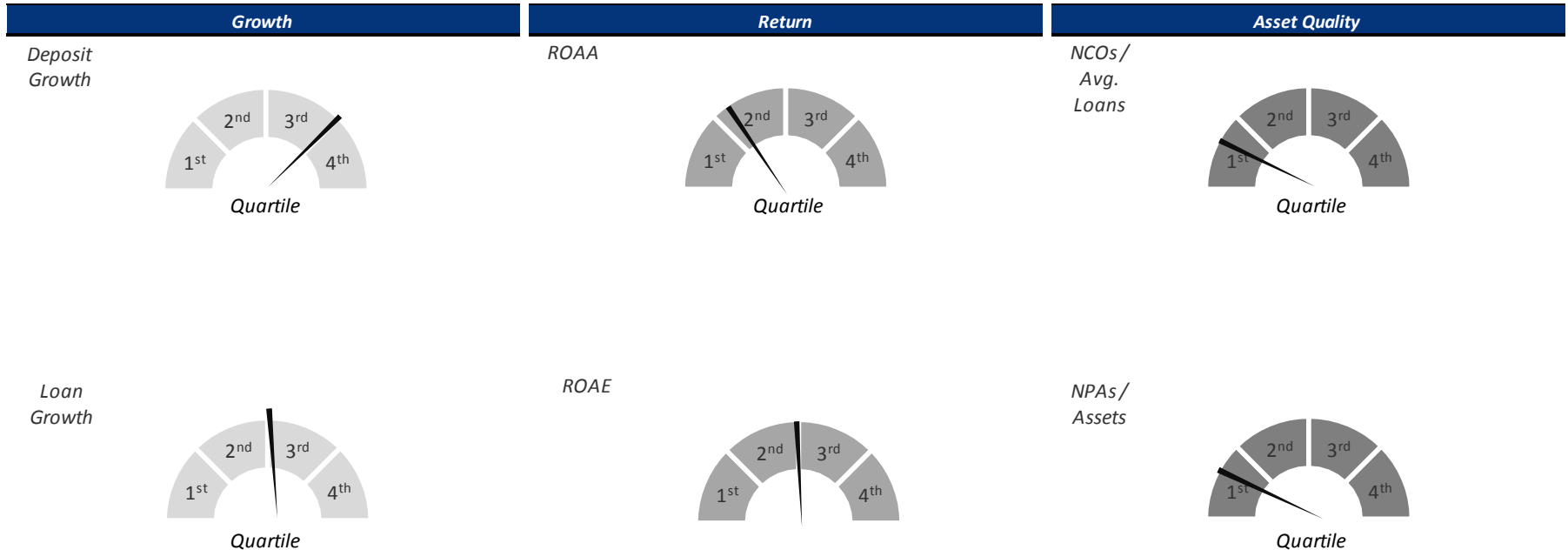


Other Named Executive Officers



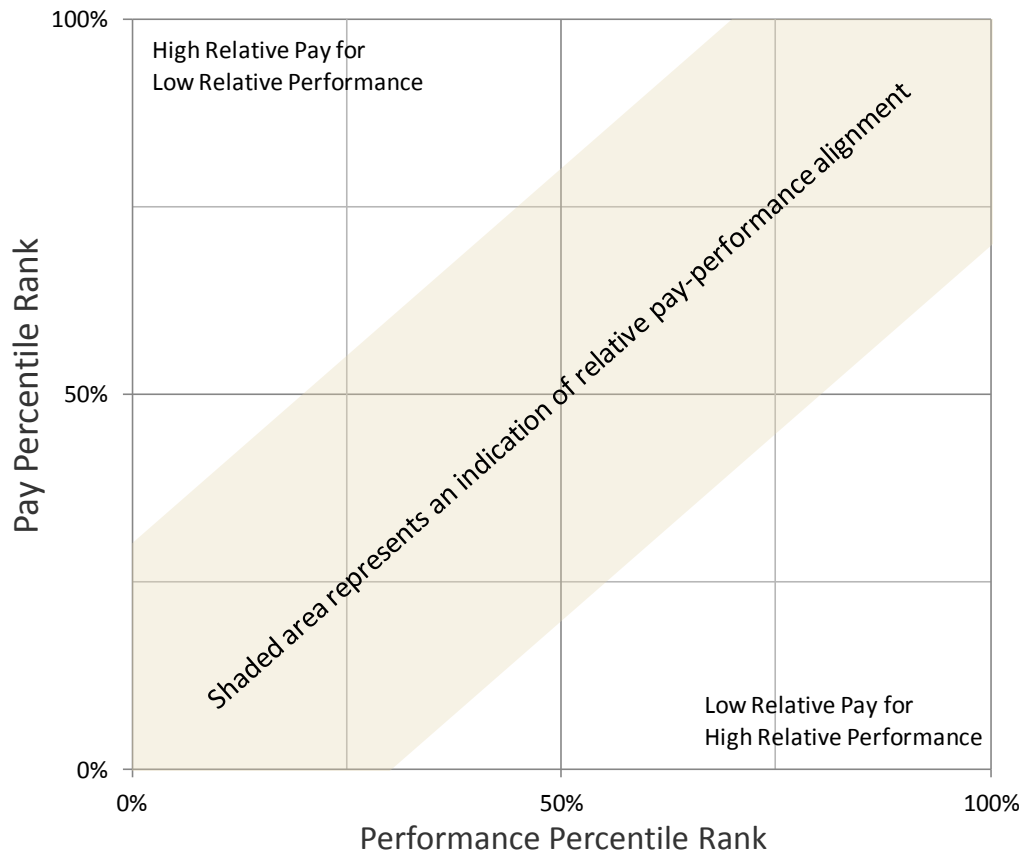
The Basics: Evaluating Relative Financial Performance

- How does our financial performance compare to our peers?
 - » Select measures of most importance to the Bank's short- and long-term strategic objectives (e.g. growth, earnings, returns, asset quality, etc.)
 - » Measure relative performance over time period(s) of the greatest interest to the Bank (e.g. most recent fiscal year, most recent 3-years, etc.)



Evaluating Relative Pay-Performance Alignment

- Quantification of relative pay-performance alignment requires:
 - » Identification of relevant comparator companies (e.g. custom Peer Group or broader index)
 - » Definitions of “Pay” and “Performance”
 - » Establishment of time period(s) over which relative comparisons are evaluated



Percentile rankings for the subject company and each peer company are plotted on a chart similar to the one on the left to reveal the strength of the subject company’s relative pay-performance alignment

STI Design: Making Use of Peer STI Disclosures

- Bank proxy disclosures have improved materially over the last several years, making valuable compensation design information publicly available
 - » The following are sample STI design excerpts from a bank proxy disclosure

“The table below summarizes the 2013 performance measures and goals approved by the Compensation Committee for the named executive officers, as well as the actual 2013 performance results.”

Goal	Weight	Threshold (25% Payout)	Target (100% Payout)	Stretch (130% Payout – CEO; 150% Payout – Other NEOs)	Actual
Return on Assets	35%	0.85%	0.95%	1.04%	0.95%
Efficiency Ratio	15%	63.17%	60.70%	58.39%	62.55%
Non-Performing Assets Ratio	20%	0.93%	0.77%	0.69%	0.86%
Commercial and Industrial (C&I) and Consumer Loan Growth	15%	7.87%	9.26%	9.72%	9.26%
Demand Deposit Account Growth	15%	7.64%	8.99%	9.44%	2.55%

“The following table sets forth the award opportunity levels for each named executive officer of [XYZ Co.] for 2013. Actual awards can range from 0% to the percentage amounts set forth in the “Stretch” column of the table, depending on corporate performance relative to the STIP performance goals:”

Position	Threshold	Target	Stretch
CEO	25% of base salary	100% of base salary	130% of base salary
Other Named Executive Officers	15% of base salary	60% of base salary	90% of base salary

- The following pages illustrate ways in which this type of Peer disclosure can be used to inform decisions related to STI design at your bank

STI Design: Payout Opportunities

- Gathering STI targets and payout ranges for Peer Banks can provide important context for evaluating the competitiveness of your Bank's STI program, as well as determining the appropriate amount of short-term leverage
- This information may be summarized as follows:

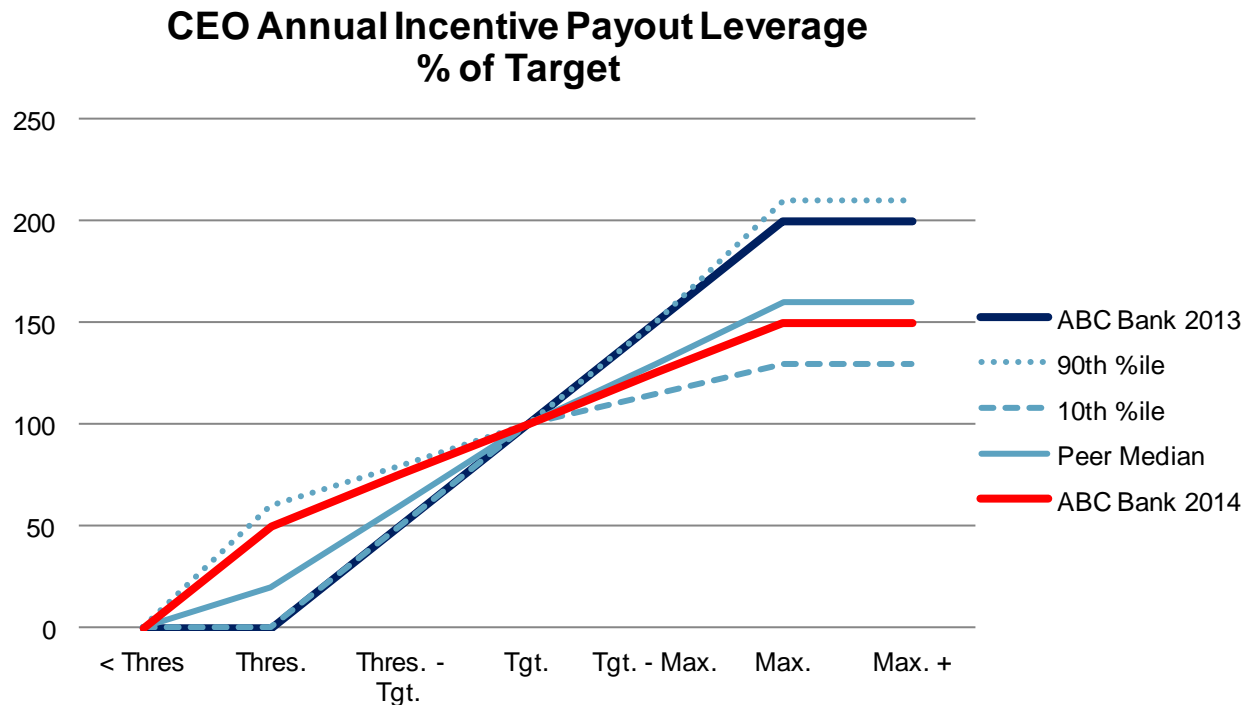
Company	CEO			Other NEOs		
	STI Target % of Base	Payout Range Thres. Max.		STI Target % of Base	Payout Range Thres. Max.	
Peer 1	60%	50%	200%	30-40%	50%	200%
Peer 2	100%	0%	200%	50-75%	0%	200%
Peer 3	70%	50%	200%	40-45%	50%	200%
Peer 4	50%	0%	150%	17-38%	0%	150%
Peer 5	75%	50%	150%	40-45%	50%	150%

Etc.

Note: The peer structures should only provide context – not drive design. Incentive design should first and foremost support the Bank's unique business and leadership strategies, even if that means going outside prevalent practices.

STI Design: Payout Curve (STI Leverage)

- Graphing peer STI payout curves is a visual way to provide context for evaluating the relative amount of leverage in the Bank's STI program
- In the example below, ABC Bank chose to make adjustments to its STI arrangement that reduce the amount of leverage (conscious decision to lower the risk profile of the plan)



STI Design: Perf. Measure Prevalence & Weights

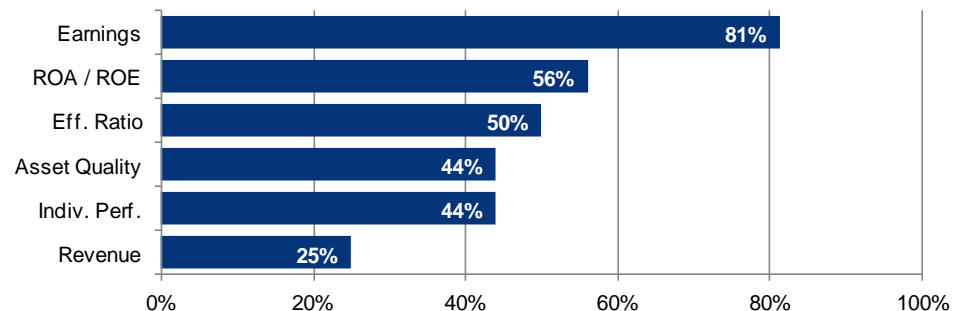
- Carefully defining and measuring performance goals within incentive arrangements is important (and challenging) work for Compensation Committees and senior management
- For those Peer Banks that disclose formal STI programs in their proxies, helpful information can be gleaned regarding their metrics and, often, the weight assigned to each metric
 - » Depending on the thoroughness of their Compensation Discussion & Analysis (CD&A), peers may also provide the rationale behind their metric selection
- Below is an example of how this information might be summarized:

Company	Balance Sheet		Operating Revenue	Earnings		Return		Efficiency Ratio	Asset Quality	Individual Bus. Perf.
	Loan Growth	Deposit Growth		Net Income	EPS	ROA	ROE			
Peer 1			20%	70%				10%		
Peer 2	X	X			X		X	X	X	
Peer 3			20%	25%			25%		10%	20%
Peer 4					30%	20%			20%	30%
Peer 5				70%				15%	15%	

etc.

The specific measures and respective weightings will be unique to each Peer's STI strategy; however, with 15-20 Peer data points, certain trends may surface that can be helpful to your bank's STI deliberations

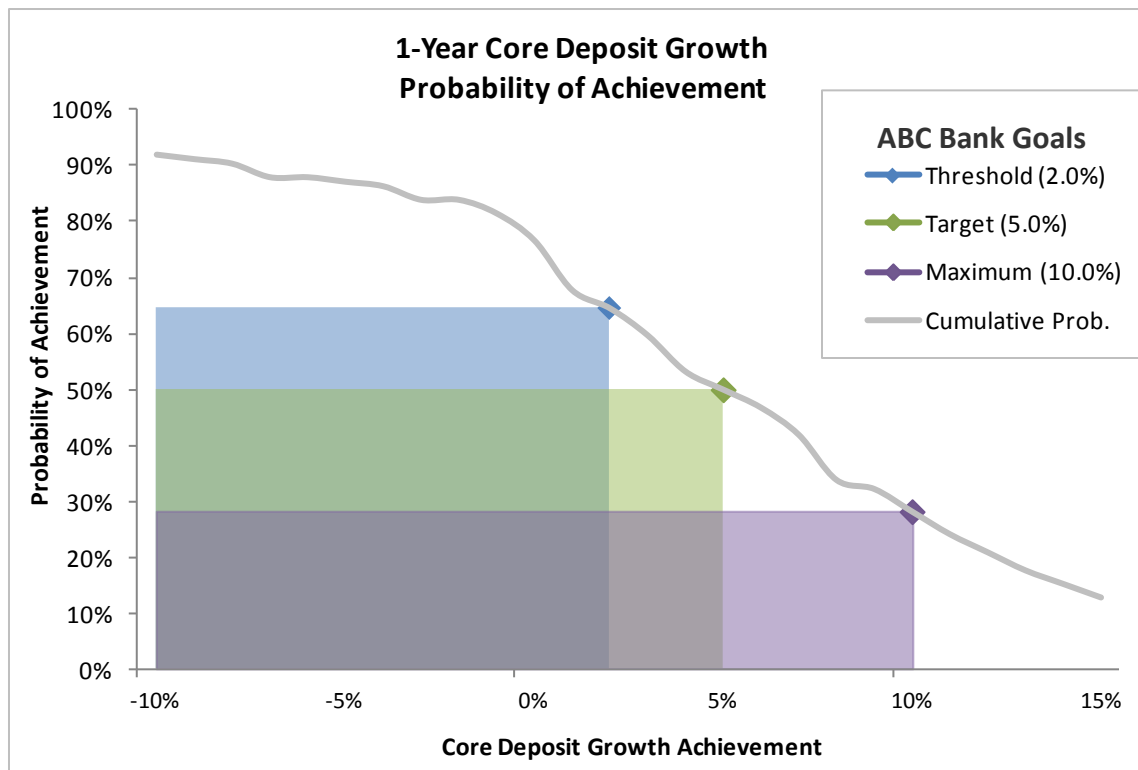
Peer Group STI Performance Measure Prevalence



STI Design: Performance Goal Calibration

- Historical Peer Bank data can be helpful in evaluating the rigor represented by a given performance goal
- The graph below depicts the peer group probability of achieving ABC Bank's 2014 core deposit threshold, target and maximum goals based on performance over the last ten fiscal years
- As a general rule of thumb, the probability of achieving the threshold, target and maximum goals should be 70 - 80%, 50 - 60%, and 10 - 20%, respectively

Example Goal – Core Deposit Growth



How to Read the Graph

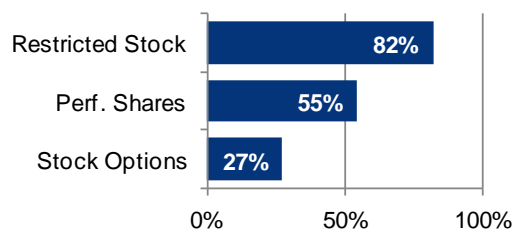
- Peer companies achieved 2% annual core deposit growth 65% of the time
- Peer companies achieved 5% annual core deposit growth 50% of the time
- Peer companies achieved 10% annual core deposit growth 28% of the time

The historical peer group data implies that ABC's 2014 core deposit growth goals are within a reasonable range based on the estimated probabilities (level of difficulty) for each goal

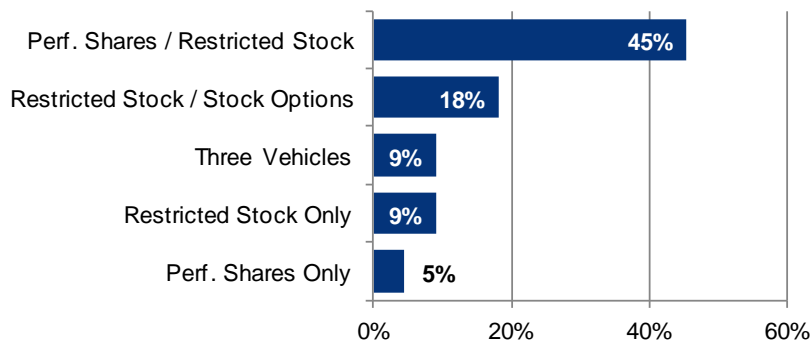
LTI Design: Prevalence, Mix, Vesting, Perf. Conditions

- A wealth of information can be gathered from Peer LTI disclosures regarding their approaches to driving retention and long-term performance; if mined, the data can provide important trends and bring fresh ideas to the LTI design process
- Peer LTI information might be summarized as follows:

Peer LTI Vehicle Prevalence



Peer LTI Award Combinations



Company	Stock Option			Restricted Stock			Performance Contingent Awards						
	Granted	Vesting		Granted	Vesting		Granted	Years	Basis	Payout	Max	Award	
		Years	Type		Years	Type						Measures	
Peer 1				X	3	Cliff	X	4	Share	Share	175%	Relative EPS Growth (75%) and Dividend Payout Ratio (25%)	
Peer 2	X	5	Step	X	5	Step							
Peer 3				X	5	Cliff	X	2	Share	Share	200%	EPS and Average Deposits	
Peer 4													
Peer 5				X	3	Cliff	X	3	Share	Share	200%	Relative TSR (50%) and ROATE (50%)	
Peer 6	X	4	Step	X	4	Step							
Peer 7				X	3	Step	X	3	Share	Share	150%	CEO: Relative TSR (75%) and EPS (25%) Other NEOs: Relative TSR (67%) and EPS (33%)	
Peer 8				X	4	Step							
Peer 9				X	3	Step	X	1	Cash	RS	150%	ROTE (25%); NPA (25%); # Accounts (25%) and Efficiency Ratio (25%)	

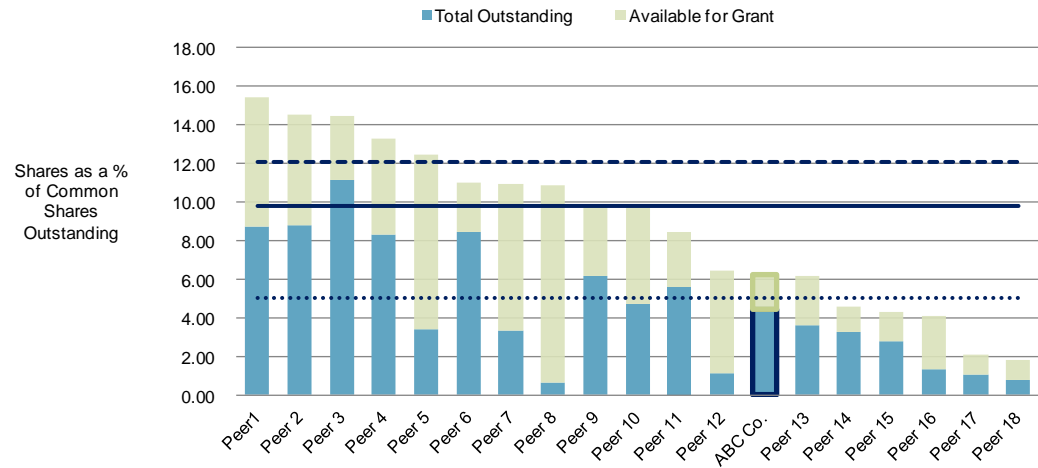
etc.

LTI Design: Overhang and Grant Rate

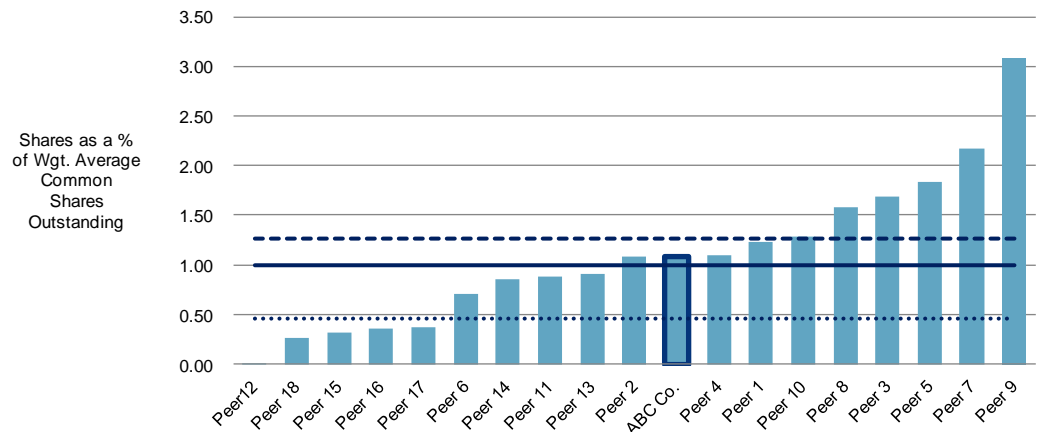
Evaluating Peer Group overhang and grant rate data can be particularly helpful for the following purposes:

- » Exploring the potential impact of changes to the Bank's LTI strategy
- » Explaining the Bank's equity compensation strategy to shareholders
- » Preparing to seek shareholder approval of a new or amended equity incentive plan
- » Understanding institutional investor expectations / tolerance in this area
- » Periodically reviewing the Board's governance of shares entrusted under the approved equity plan

Total Overhang (Outstanding + Available for Grant)



Three-year Average Grant Rate



Retirement Programs: Prevalence & Design

- Depending on the Peer Group, retirement arrangements may play a meaningful role in their total compensation packages
 - » Gaining a solid understanding of peer retirement plan practices, and, more importantly, the compensation value delivered through these plans, can be critical to understanding the Bank's true competitive positioning from a holistic perspective
 - » Prevalence and design data for Peers might be summarized as follows:

Company	Defined Benefit						Defined Contribution			
	Qualified Pension	Fixed / Formulaic	Nonqualified Pension		Formula Basis	Duration	401(k)/ Savings	ESOP	Supp'l	Profit Sharing
			Amount (\$000s)							
			CEO	Other NEOs						
Peer 1							X	X		X
Peer 2	X	Formulaic	0.65% x YOS	0.65% x YOS	Avg. Comp	Life	X	X	X	
Peer 3		Formulaic		3%-4% x YOS	Avg. Comp	Life	X			
Peer 4	Frozen	Formulaic	1.52% x YOS		Avg. Comp	Life	X			
Peer 5		Fixed	\$295	\$140 - \$155		15 Years	X			
Peer 6	Frozen						X		X	X
Peer 7	Cash Balance						X		X	
Etc.										

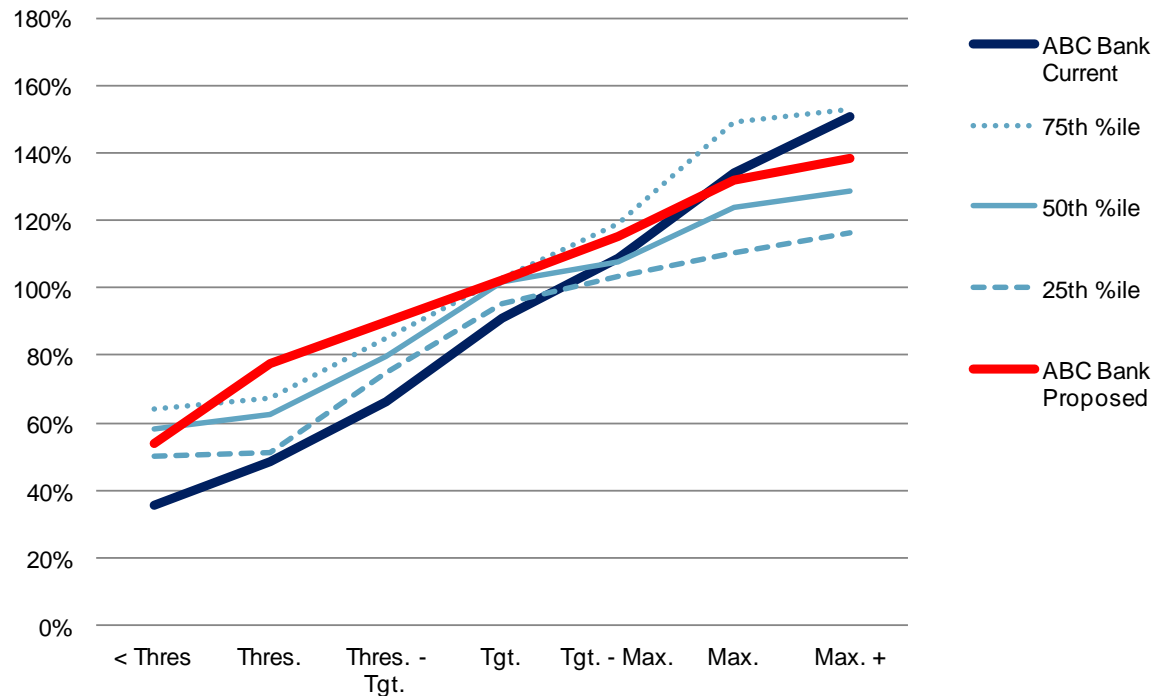
■ Total Compensation Program Leverage

- A prospective pay leverage analysis can demonstrate the positioning of the Bank's compensation program leverage, relative to Peer Banks
- Payout opportunities are evaluated for each peer compensation structure across a spectrum of performance scenarios, incorporating changes in stock price and payout assumptions for performance-based plans (e.g., STI, cash LTIP, PSUs)

In the example to the right, ABC Bank's current structure is more leveraged than the vast majority of peers, and the Compensation Committee of ABC desires to decrease the amount of leverage in the program (i.e. flatten the overall risk-reward profile)

- » Adjustments to short- and long-term incentive structures result in a total compensation structure that better aligns with the Committee's pay leverage objectives

CEO Compensation Program Leverage
Total Direct Compensation as % of Target



■ Wrap-up and Q&A

