Six Effective Compensation Committee Practices

By Dan Wetzel

Over the years, the role and purpose of the community bank Compensation Committee hasn't changed significantly. What has changed is the visibility of its responsibilities and scrutiny of its effectiveness. We have identified six Compensation Committee practices that, when thoughtfully enacted, will help committees design and govern compensation programs that support long-term business strategies, drive shareholder value creation, retain key talent as well as meet interagency standards of safety and soundness and the expectations of shareholders and their advisors.

I. Annually Review the Committee Charter

A charter establishes the duties and responsibilities of the Compensation Committee including the purview of compensation programs and the nature of the committee's action. Publicly held banks have additional requirements that may affect the charter. Typically, the committee's purview includes:

- CEO compensation arrangements and incentive programs
- Assessment of CEO performance
- Management (Section 16 Officer) compensation arrangements
- Broad-based benefit and equity programs
- Compensation of non-employee directors
- Annual assessment of risk related to compensation
- Approving compensation disclosures in securities filings (for public banks)

The charter should be reviewed annually by the committee and its outside advisors to ensure recent legislative or regulatory requirements are addressed.

II. Align the Compensation Philosophy with Bank Strategy

A bank's compensation philosophy establishes its approach to compensation program design. Articulating this philosophy creates context for structuring executive compensation programs and compensation programs and considering future actions. Typically, the philosophy will include the desired compensation mix, targeted market pay level and the role of pay programs in driving business strategy.

III. Plan the Committee Calendar in Concert with the Charter

The calendar serves as a useful tool to facilitate committee oversight of management performance and compensation. Many committees meet quarterly, often coinciding with the quarterly full board meetings to facilitate dialogue between the two. A reliable schedule and detailed agenda can ensure priorities are appropriately addressed.

IV. Ensure Committee Chair and Member Independence

The importance of selecting who serves on the Compensation Committee is driven in part by the Dodd-Frank Wall Street Reform and Consumer Protection Act, which required the stock exchanges adopt listing standards for Compensation Committee member independence. Among other requirements, the exchanges require that independence be assessed taking into account any compensation received by a director, not tied to board or committee service (e.g., consulting fees), and other affiliations the director may have with the bank or its management. Some shareholder advisory groups have developed an even higher set of standards for director independence than what is required by the exchanges.

Of great importance is the selection and role of the committee chair, an appointment that can be time consuming and at times high profile. Key attributes in a director nominated as the committee chair include experience with executive compensation program design, strong leadership qualities and ample availability.

One thing to consider – while independence is critical, committee membership does not have to rotate constantly. There are benefits in maintaining a committee chair or members that are effective and meet expectations.

V. Devote Time to Succession Planning

At a minimum, committees should address succession planning for the CEO annually. This ought to include a review of internal and external approaches to succession and can be expanded to include succession for key executives, as well as the bank's internal training and development process.

We note that some banks elevate the issue of succession planning to the full board. Even in these situations, the Compensation Committee plays a key supporting role by reviewing the retention and motivation elements of the pay programs.

VI. Consult with Independent Advisors

Committees should actively manage advisor engagements and provide clear expectations. Effective advisors exhibit a collaborative nature, are responsive and capable of taking a stand on key issues and their performance should be regularly assessed. It's important to preserve independence and an advisor engagement should always be based on an agreement as to how that independence will be maintained.

Conclusion

We are all aware of the scrutiny banks face from employees, shareholders, media and regulators with regard to executive compensation. However, boards cannot afford to take a simple "follow the pack" mentality driven by solely regulation and prevalent practices. Compensation is one of the biggest expenses on a bank's income statement, and in today's environment of continued pressure on bank profitability it is imperative that compensation programs be designed to support the strategic business plan. The Compensation Committee's role is vital to the success of any bank and a well structured, managed and advised committee can remain focused on driving strategy, rather than being overly burdened with compliance. ●

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Example of Annual Compensation Committee Calendar

Quarter	Agenda Items
1	Performance evaluations Prior year bonus approvals
2	Promotions New year compensation program • Salary adjustments • Target bonus • Equity awards Review of compensation consultant's independence Review of the Compensation Discussion and Analysis (CD&A) and the proxy statement
3	Review annual agendas, meeting schedules and charter Committee performance evaluations Risk assessment of compensation programs
4	Competitive benchmarking, including market trends Management's recommendation regarding program revisions Rigor of bonus program Update on new regulations and legislature

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