Pearl Meyer & Partners
Comprehensive Compensation®

# Bank Director Workshop

# Attracting, Retaining and Rewarding Executives in Today's Environment

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NACD
NATIONAL ASSOCIATION OF CORPORATE DIRECTORS
Florida Chapter


**Susan O'Donnell**
**Pearl Meyer & Partners**
**Managing Director**


AABD
American Association of Bank Directors

# The Challenges

- **Economic and Business Turmoil**
  - Margin and earnings pressures
  - Credit risk
  - Housing slump
  - Recession
  - Plunging stock prices
  - Surviving vs. high performing (where to set the bar?)

- **Scrutiny and Pressures on Executive Compensation**
  - Increased investor interest and "say on pay"
  - Congress – SOX – and now executive consultant objectivity
  - IRS – regulations (162m, 409A) and audits
  - New SEC disclosure rules
  - Media scrutiny
  - Banking regulators

- **Top Talent Wanted**
  - Increased number of retirements
  - Competition for top talent, particularly highly sought positions
  - Competitive compensation packages
  - Generational preferences (e.g. retirement focus vs. incentive focus)

# THE NEED:

# Effective and Responsible Executive Compensation Practices In Today's Environment

# The Foundation – Good Governance

## The Compensation Committee should:

- Be independent, knowledgeable, objective and willing to ask the difficult questions.
- Clarify and review their charter, roles and responsibilities annually.
- Have direct access to independent counsel of attorney and compensation consultant (i.e. hire/fire authority).
- Clearly define the roles of management, the compensation consultant and other advisors. Approve any work consultant performs directly for management.
- Create an annual schedule and set meeting agendas.
- Meet in executive session (preferably at each meeting).
- Maintain open communication with the Board (updates of Committee meetings).
- Oversee CEO performance and compensation (and other executives).
- Conduct annual assessments of executive compensation (tally sheets, competitive position, pay-performance relationship).
- Conduct annual self assessment of Committee performance.
- Use the CD&A to tell their "story".
- Be able to stand up to any investor/regulator questions or scrutiny on executive compensation.

## The Compensation Consultant should:

- Report Directly to the Compensation Committee
- Be an objective advisor who is willing to raise issues.
- Not be a data slave.
- Understand your industry, business and performance drivers.
- Educate and guide the Committee on best practices in compensation and governance.
- Note: Goal is not to divide management and the Committee, but to foster an environment of proper information sharing and involvement..

## Management should:

- Provide input, perspectives, data, information to the Board, Committee and advisors.
- Maintain open and positive relationship with Committee and Board.
- Be part of the process, but not drive the process (i.e. consultant engagement, pay decisions, committee agenda is Committee responsibility).
- Not be present for discussions on their own compensation.

# Define Your Compensation Philosophy

- **It's your road map.  It defines:**
  - The objectives and purpose of each element
  - The "mix" of total compensation
  - Your pay-for-performance approach
  - Your competitive perspective
  - How your compensation program supports your business strategy and aligns with shareholder interests
- **It's your "message" to regulators, shareholders, executives and potential recruits**
  - It's critical to SEC disclosure – CD&A – it's your "story"
- **It should be proactive and purposeful – don't let your programs dictate your philosophy**

**A few points about being "competitive"**

- Market provides one perspective – its' not the only goal.
- Ensure proper peer group – public companies must disclose this list
- Understand how total compensation and performance compares to "market" or "peers".
- Okay to target market – but pay should vary based on actual performance and contributions.
- 75th percentile pay should reflect superior (i.e. 75th percentile) performance

# Ensure Pay For Performance

- **Inherent challenge – It's not as simple as it looks**
  - Different cycles/time periods
  - Different perspectives (i.e. investors, median, management)
  - Economic and industry influences beyond executive control (positive and negative)
- **Selection of performance measures a challenge**
  - Should align with business strategy and reward achievement of specific goals
  - Focus on key metrics
  - Short term goals typically reflect core business plan
  - Long-term goals typically reflect stock/profit/capital growth over time
- **Balance is key**
  - Short vs. long-term performance
  - Bank/team vs. individual performance
  - Absolute vs. relative performance (relative better for long-term)
  - Formulaic vs. discretionary
  - It's the sum of the parts
- **Don't lose sight of good business judgment**
  - Formulas aren't perfect. Consider the "big picture" (i.e. windfalls or downfalls).
  - Look at multi-year impact of decisions (e.g. tally sheets)
  - Recognize factors outside management control, but don't ignore. Executives share in the same risk/reward as investors.
  - Review performance and pay relationships and be prepared to explain.

It's called variable pay and "pay at risk" for a reason. High performing companies show the greatest variability and leverage in their pay programs. More risk – more reward! But not necessarily every year.

# Take a "Total" View

- **The "Right" Mix**
  - Different components focus on different needs
    - Fixed vs. variable
    - Annual vs. long-term
    - Reward vs. benefit
  - Take a multi-year perspective – mix can vary
  - Total perspective
    - Take holistic view
    - What is overall "message" of the rewards program
  - Compensation delivered vs. compensation earned
    - Understand the difference
    - Both are visible to investors
    - Focus tends to be on what's earned under certain circumstance (e.g. termination, retirement, change in control)
- **Tally and Scenario Analysis – The "Holy Cow" Calculation**
  - How does total compensation vary under different scenarios
    - Performance
    - Termination
  - Review severance and change in control benefits in light of desired philosophy and objectives.
  - How leveraged is the total compensation program? What is at risk? What is guaranteed?
- **Ownership Perspective**
  - How much ownership do executives have? Are they expected to have? Is ownership level considered in compensation decisions?

# Checks and Balances of Executive Compensation

| Business Alignment | Compensation Philosophy | Competitive Perspective |
| --- | --- | --- |
| **Does your compensation program support the Bank's business strategy?** | **Do you have a formal compensation philosophy?** | **Is your total compensation appropriately aligned with market?** |

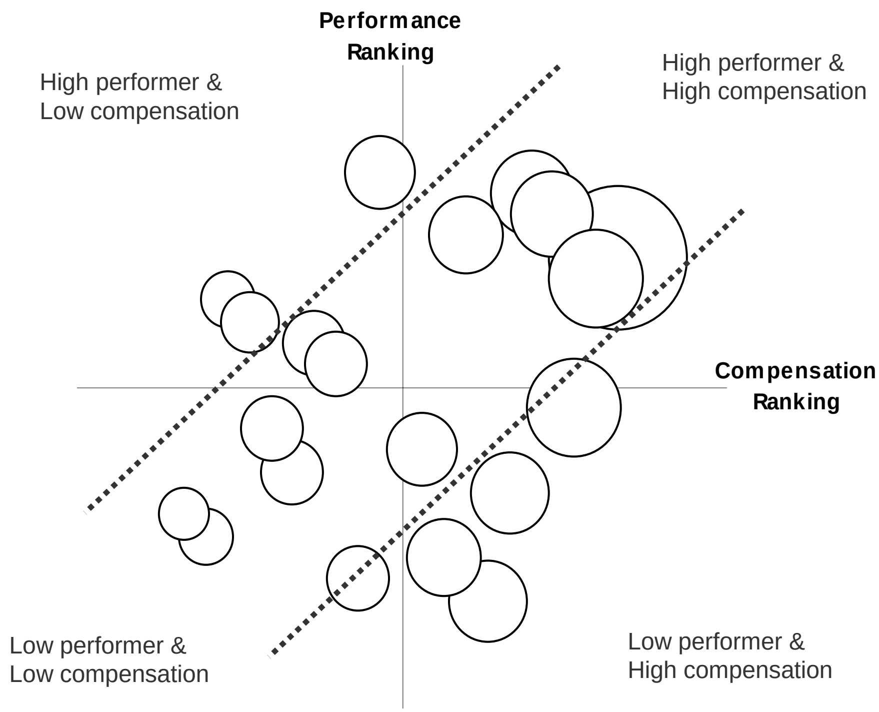
| Performance Measures | Performance Alignment | Balance |
| --- | --- | --- |
| **Do incentive plans reward the "right" performance measures? Over the "right" timeframes?** | **What proportion of total compensation is performance based? Do you test the pay-performance relationship?** | **Is the total compensation program appropriately balanced?** |

| Holistic/Total View | High Performers | Good Governance |
| --- | --- | --- |
| **Do your programs & decisions consider the aggregate value (under different scenarios)?** | **Is your Bank attracting and retaining the top talent?** | **Is your Committee appropriately informed and accountable for its decisions?** |

# Testing Alignment – Where is Your Bank?

## CEO compensation relative to 3-Year TSR

### An Illustration of banks between $1b - $15b Assets



# THANK YOU

**Susan O'Donnell**
**Managing Director**
**Pearl Meyer & Partners**
**susan.odonnell@pearlmeyer.com**
**(508) 630-1493**