

**Bank**Director.

**Breakout 1:**  
**Bank Director 101:**  
**Compensation Primer**

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#BBTF23

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**VALUE**

**RELATIONSHIP**

**EXPERTISE**

# ***Bank Director 101: Compensation Primer***

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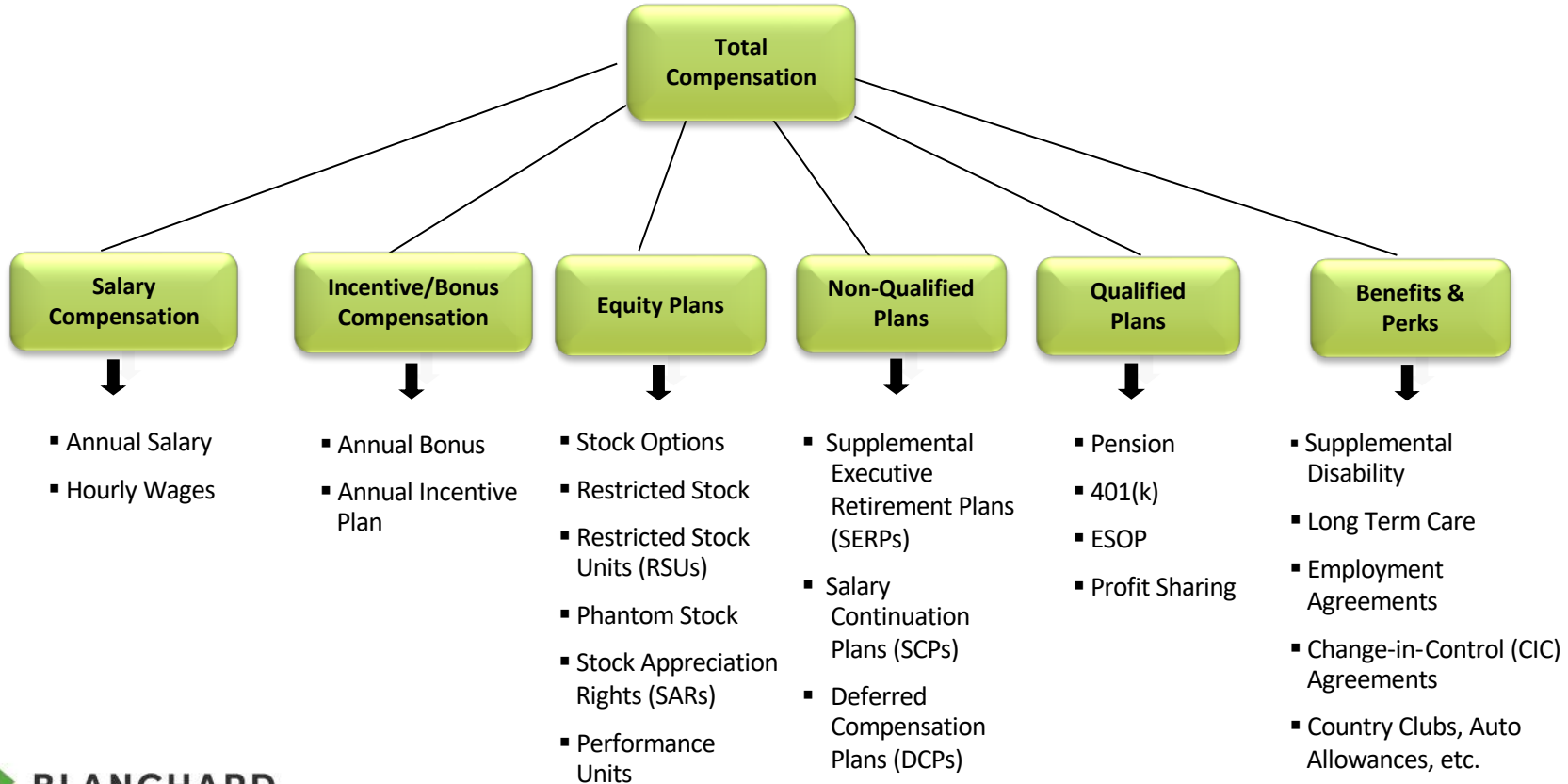
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***Bank Director Training Forum – Sep. 2023***

# Key Topics To Be Covered

- ***Total Compensation***
- ***Base Salary Strategies***
- ***Annual Cash Incentive/Bonus Plans***
- ***Equity-Based Incentives***
- ***Executive Benefits***
- ***Director Compensation***

# Elements of Total Compensation



# CEO Compensation Mix

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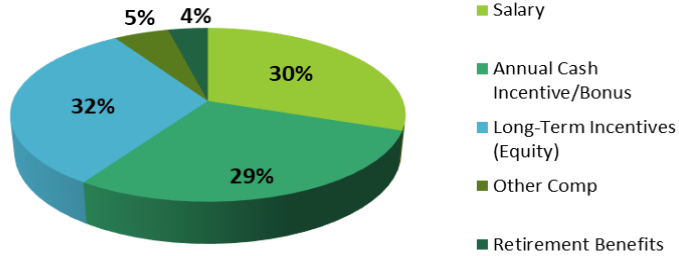
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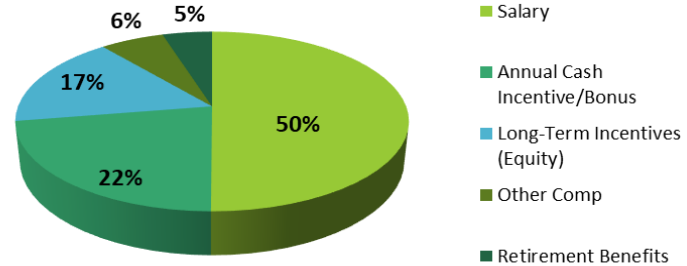
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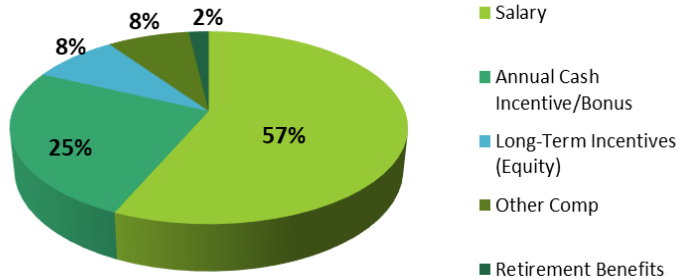
HIGHEST PAID EXECUTIVE Banks >\$3B



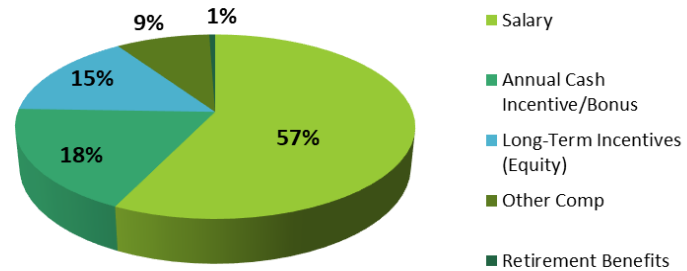
HIGHEST PAID EXECUTIVE Banks \$1B-\$3B



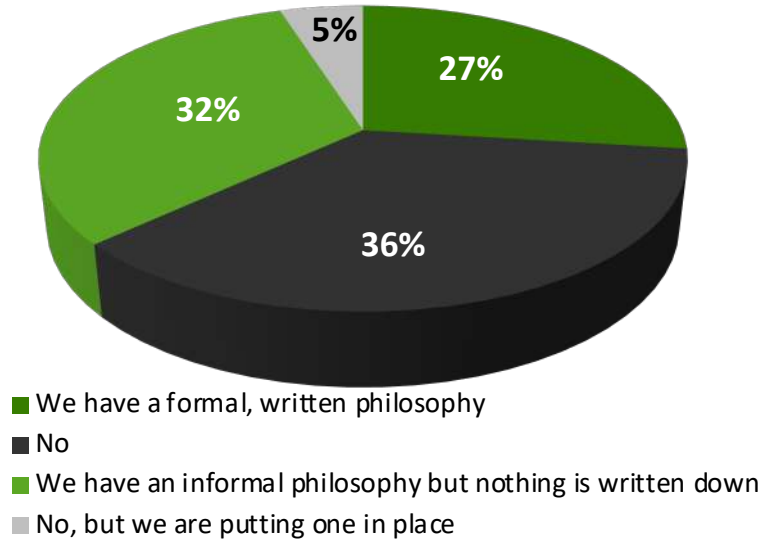
HIGHEST PAID EXECUTIVE Banks \$500M-\$1B



HIGHEST PAID EXECUTIVE Banks <\$500M



## 59% Have an Informal or Formal Compensation Philosophy



- ✓ A written compensation philosophy should align the Bank's goals/strategy with compensation, define its market, and indicate the Bank's targeted compensation levels versus market. **The strategic use of compensation starts with a well-defined compensation philosophy.**

# *Base Salary Strategies*

# Salary Budget Increases

Blanchard Consulting Group conducted a flash survey about “projected” 2023 salary budget increases in October. The results of this survey and others are shown below.

Projected Median Salary Increase Budget				
Survey Source	Number of Orgs.	Projected 2023 Salary Budgets		
		Executive	Exempt	Non-Exempt
<b>Blanchard Consulting Group – Financial Institutions</b>	<b>139</b>	<b>4.0%</b>	<b>4.0%</b>	<b>4.0%</b>
Compease	--	4.0%	4.0%	4.0%
The Conference Board	250	4.1%	4.4%	4.2%
Empsight International	169	4.0%	4.0%	4.0%
Mercer	1,200	4.2%	4.2%	4.2%
Payscale	97	3.8%	4.0%	4.0%
Salary.com	--	4.0%	4.0%	4.0%
Willis Towers Watson	1,430	4.1%	4.1%	4.1%
WorldatWork	2,445	4.0%	4.0%	4.0%
<b>Average</b>		<b>4.0%</b>	<b>4.1%</b>	<b>4.1%</b>

**3% Salary Increase Budget was the number from 2012 to 2022 (1<sup>st</sup> increase in a long time in 2023)**

- The salary structure increase amount was predicted to be around 3% for 2023.
- 62% of banks made special salary adjustments during 2022 as a result of market pressure or inflation.



## Step 1: Evaluating the Position

1. Review Job Description: duties, accountabilities, knowledge, skills, and abilities
2. Review Responsibility Level: supervision, decision making authority, impact on policy and procedures
3. Experience Level: necessary banking experience, supervisory experience, and education level

## Step 2: Review Market Compensation Data

### Example Resources:

1. Proxy data from publicly traded companies (executives)
2. Market surveys - regional, national, Blanchard Survey (all employees)
3. HR department/compensation consultant's internal database

## *Annual Cash Incentive/Bonus Plans*

# Basic Principles of Cash Incentive Plans

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## Objectives

- ✓ Motivate and reward achievement goals/metrics
- ✓ Reward for performance “within some control of the participant”
- ✓ Align employee behaviors with the Bank and shareholders
- ✓ Position total compensation at a market competitive position
- ✓ Provide “upside” and an ability to differentiate “superstars”

## Key Considerations

- ✓ Consider the “riskiness” of plan designs
- ✓ Determine the appropriate **BALANCE** between profitability, quality, and strategy
- ✓ Implement “clawback” features
- ✓ Acknowledge regulatory impacts: Sound Incentive Guidance, Dodd-Frank, Reg Z, etc.

## Important Question To Ask Yourself

*\*\* Do we have effective controls, administration, documentation, and corporate governance surrounding our incentive plans?*

# Annual Incentive Plan Payouts – 2022 BCG Trends Survey

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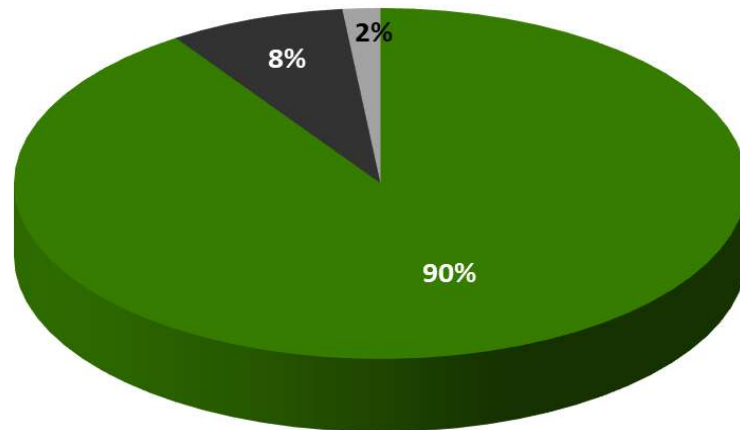
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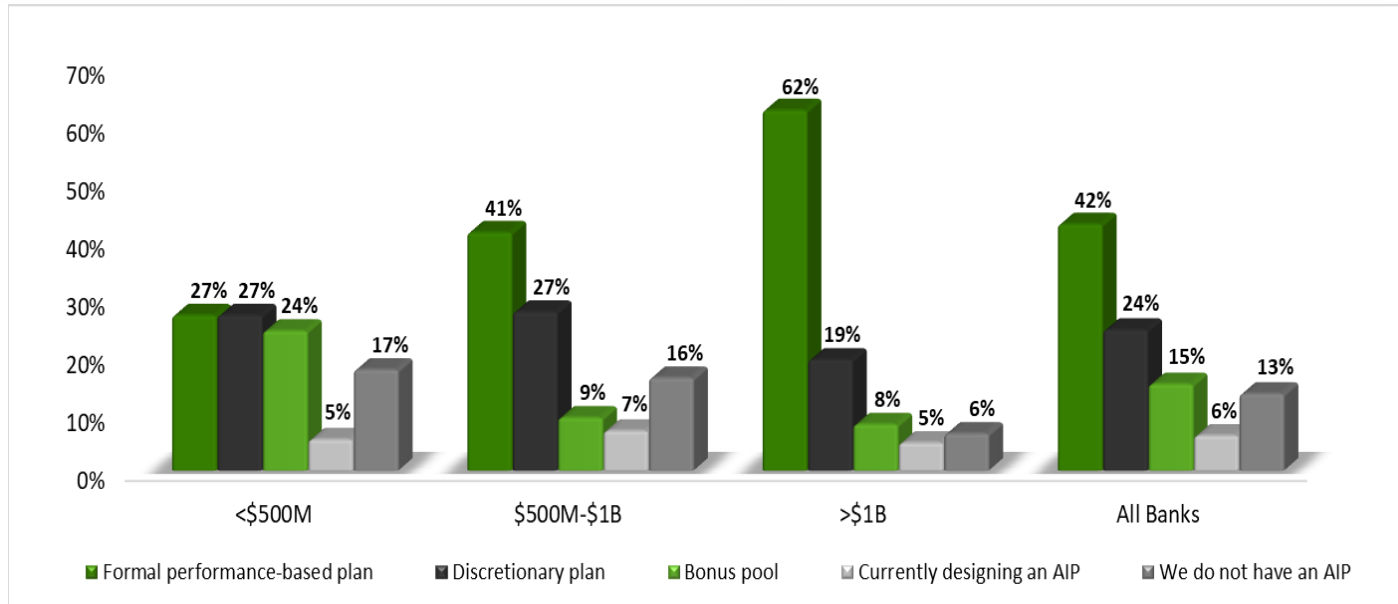
## 92% Paid Cash Incentives/Bonuses for 2021 Performance



■ Yes ■ No ■ Not for our executives, but we will pay some for our staff

- ✓ **92% of banks paid some type of incentives based on 2021 performance.**
- ✓ 68% of respondents with an incentive plan set incentive goals ***based on the bank's budget***.
- ✓ Approximately one-fourth (23%) use a combination of both the bank's budget and comparisons to a peer group (i.e. ROA must be at the 65th percentile of the peer group).

# Types of Annual Incentive Plans – 2022 BCG Trends Survey



- ✓ Highest prevalence is performance-based plans (42%).
- ✓ 60% have a document that lists out the various incentive plan(s) and describes how they work.
- ✓ 72% of banks reported their compensation committee has reviewed their incentive plans for risk.

# Annual Incentive Plans - Typical Payout Opportunities

The following table shows typical ranges for annual incentives as a percentage of salary for banks with assets between \$250M and \$10B. The data is based on market research and Blanchard Consulting Group's experience in the banking industry.

## Typical Annual Cash Incentive Payouts as a Percentage of Base Salary

### Industry Data – Assets \$250M-\$1B and \$1B-\$10B

	<u>Annual Award as a % of Salary</u>				Typical Allocation/Weighting of Goals & Objectives	
	<i>(Assets \$250M-\$1B)</i>		<i>(Assets \$1B-\$10B)</i>		Company	Dept./Individual
	Target	Maximum	Target	Maximum		
Executive						
CEO	15% - 40%	30% - 60%	30% - 60%	50% - 100%	90%	10%
EVP	12.5% - 30%	25% - 50%	20% - 40%	30% - 70%	60%-80%	40%-20%
SVP	10% - 20%	20% - 40%	15% - 30%	30% - 60%	50%-60%	50%-40%
VP/Producer	5% - 15%	10% - 25%	12.5% - 25%	20% - 50%	25%-50%	75%-50%
Staff	2.5% - 10%	5% - 20%	5% - 15%	10% - 30%	25%-75%	75%-25%

# How to Reduce Risk in Annual Incentive Plans

- 1. Avoid “excessive” incentive payout opportunity levels and/or “uncapped” plans**
  - ✓ Ensure award opportunities are reasonable and appropriate
- 2. Review performance measures**
  - ✓ Variety of internal and external performance measures
  - ✓ Ensure an appropriate number of measures (not one & not too many)
  - ✓ Do not focus solely on single short-term financial metrics (i.e. ROA and ROE)
  - ✓ Incorporate asset and credit quality metrics
  - ✓ Include some level of discretionary adjustment
  - ✓ Ensure a link to the Bank’s strategic plan and long-term goals
- 3. Ensure performance targets are not set too high or too low**
  - ✓ Use historical bank and peer group information to ensure goals are appropriate
- 4. Use annual or multi-year performance payout periods**
  - ✓ Remove quarterly payments and short turnarounds on awards
- 5. Ensure appropriate plan approval, governance, documentation, and communication**
- 6. Consider implementation of a “clawback” policy**
  - ✓ On June 9, 2023, the SEC approved its new rules regarding “Clawback” disclosure requirements with an official compliance date of December 1, 2023.
- 7. Consider deferring a portion of incentives in cash or stock**

# *Equity-Based Incentives*



# Common Types of Equity-Based Incentives

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**Real Equity** - Actual shares of stock, which create real equity holdings and shareholder dilution

- Incentive stock options (ISOs)
- Non-qualified stock options (NSOs)
- Stock appreciation rights (SARs) – stock settled
- Restricted stock
- Restricted stock units – stock settled

**“Synthetic” Equity** - Value is tied to share price, but no real stock is transferred (cash payments)

- Stock appreciation rights (SARs) – cash settled
- Phantom stock
- Performance shares
- Restricted stock units – cash settled

**Reminders:**

\*\* *Appreciation-based vehicles (example: stock options) - value is only created with appreciation*

\*\* *Full-value vehicles (example: restricted stock) - value is immediate and is always there so long as share has value*

# Equity Incentive Plans – Usage Trends

**Full-value shares are more prevalent than stock options.**

- The table below shows the prevalence of restricted stock vs. stock options in the Blanchard Consulting Group database of public banks.

Prevalence	Equity Prevalence in Public Banks		
	Restricted Stock	Stock Options	Blend <sup>1</sup>
All Banks (n=430)	75%	18%	15%
Banks that Granted Equity (n=338)	95%	23%	19%

<sup>1</sup>Blend indicates that the bank granted both restricted stock and stock options in 2021 (not necessarily to the same executive).

# Equity-Based Plans - Typical Payout Opportunities

The following table shows typical ranges for long-term incentives as a percentage of salary for banks with assets between \$250M and \$10B. The data is based on market research and Blanchard Consulting Group's experience in the banking industry.

## Typical Long-Term Cash Incentive Payouts as a Percentage of Base Salary

### Industry Data – Assets \$250M-\$1B and \$1B-\$10B

	<u>Annual Award as a % of Salary</u>			
	<b>(Assets \$250M-\$1B)</b>		<b>(Assets \$1B-\$10B)</b>	
	<b>Target</b>	<b>Maximum</b>	<b>Target</b>	<b>Maximum</b>
<b>Executive</b>				
CEO	10% - 30%	20% - 50%	25% - 60%	50% - 100%
EVP	7.5% - 20%	15% - 40%	20% - 40%	40% - 80%
SVP	5% - 10%	10% - 20%	15% - 30%	30% - 60%
VP/Producer	0% - 7.5%	0% - 15%	0% - 15%	0% - 30%

**Executives & Officers:** *Most vesting provisions in banks are 3-5 years.*

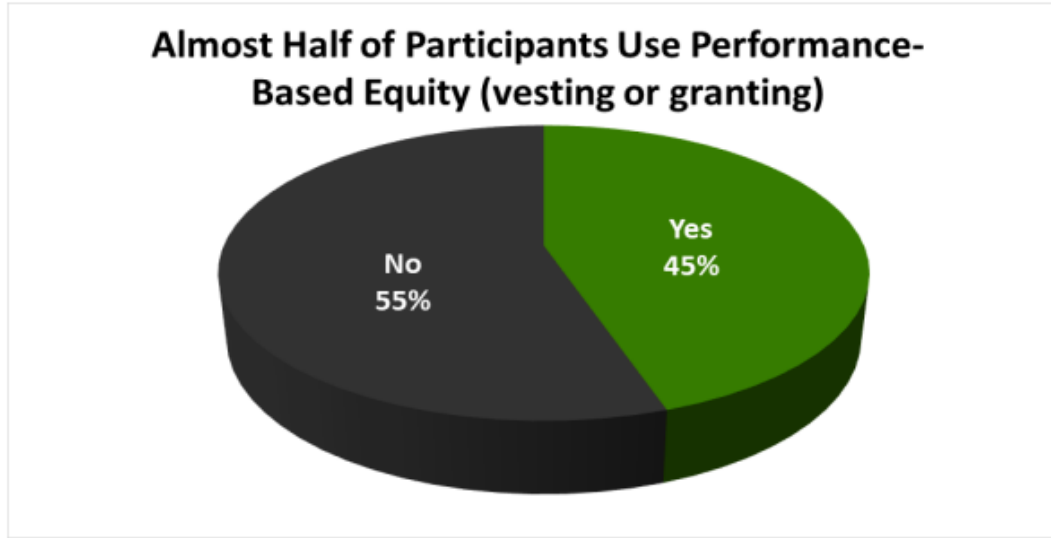
***Stock Options:***

- Ratable Vesting: Awards vest in tranches over the vesting period (i.e.,  $\frac{1}{4}$  per year in each of 4 years)

***Restricted Stock:***

- Cliff Vesting: Awards vest entirely at the end of the vesting period (which is typically a time period or after meeting performance criteria)

# Performance-Based Equity – Blanchard Survey



- ✓ The most prevalent performance metrics utilized in determining the granting or vesting of equity awards are:
  - Net income (54%) / Loan Growth (46%) / ROE (40%) / ROA (37%) / Asset Growth (37%)
- ✓ 83% of participants with an equity plan have a minimum of a 1-year vesting period.
- ✓ 59% of banks that maintain an equity plan allow for accelerated vesting of outstanding equity grants in the event of a change-in-control (without a termination event – “single trigger acceleration”).

# *Executive Benefits*

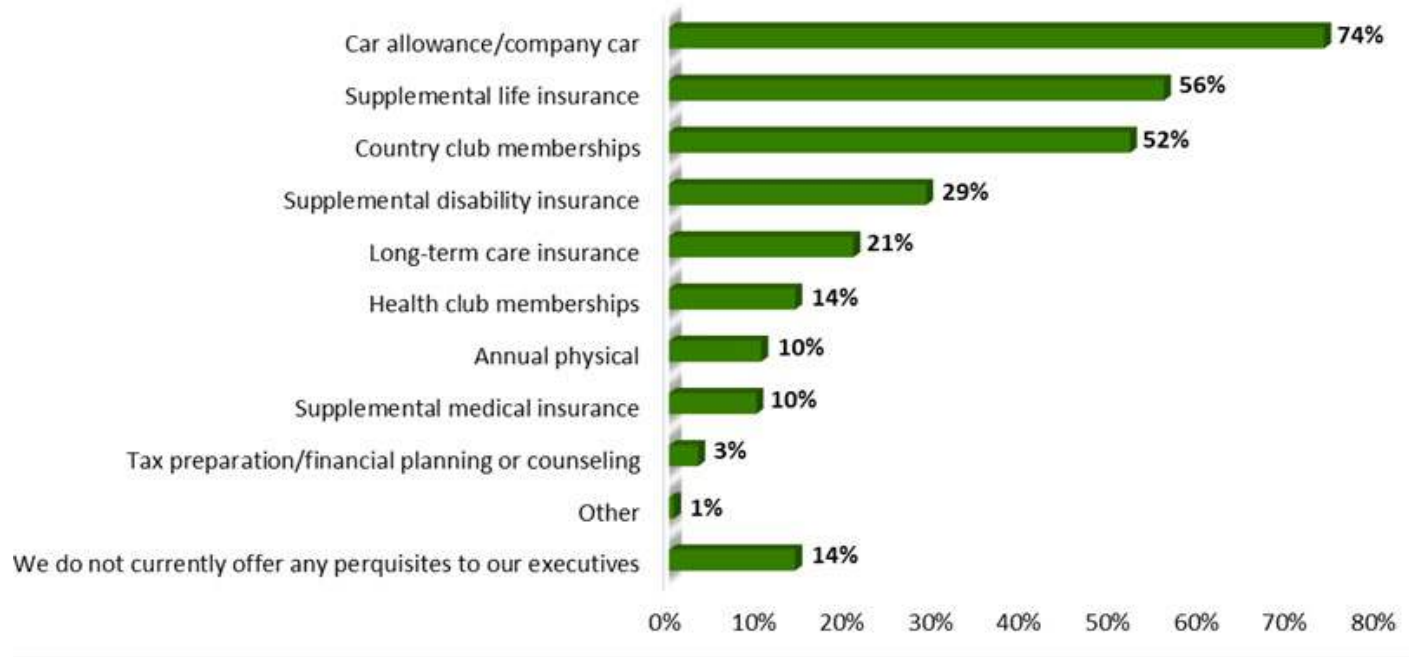
# Executive Benefits

This table provides industry prevalence information on various compensation and benefit plans at community banks at various asset sizes. ***This information is from Blanchard Consulting Group's internal database of publicly-traded banks.***

			Agreements		Retirement					
			Employment	Change-in-Control	401(k) Plan	Qualified Profit Sharing	Qualified Pension Plan	Deferred Comp. Plan	SERP	Deferred Comp or SERP
Assets	N	Median Assets (\$000)								
All Orgs	204	1,878,784	73%	85%	99%	56%	8%	34%	42%	64%
<\$500M	21	351,878	76%	76%	100%	62%	5%	10%	38%	48%
\$500M-\$1B	20	820,611	65%	80%	95%	45%	5%	20%	50%	60%
\$1B-\$3B	95	1,664,323	72%	85%	100%	58%	11%	28%	45%	62%
>\$3B	68	5,614,998	76%	88%	99%	56%	7%	53%	37%	72%

# Executive Perquisites – BCG Survey

The table below shows the prevalence of perquisites offered to executives at each of the participating banks.\*



\* Respondents were allowed to choose more than one option; therefore, the percentages will not sum to 100%.



# Executive Deferred Compensation Prevalence – BCG Survey

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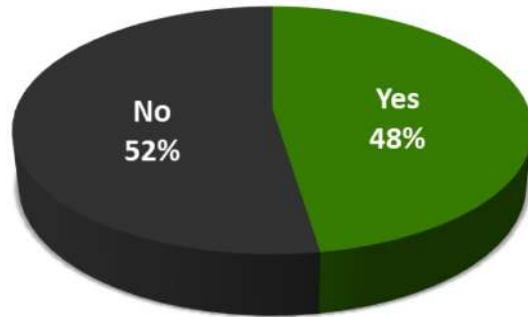
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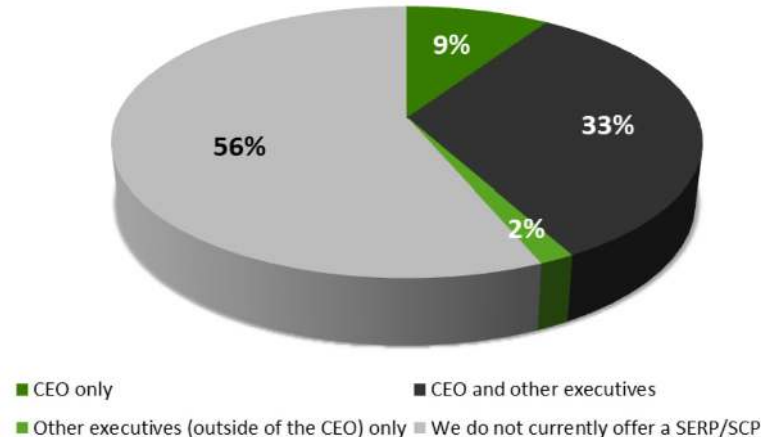
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Does your bank offer a DCP for your executives?

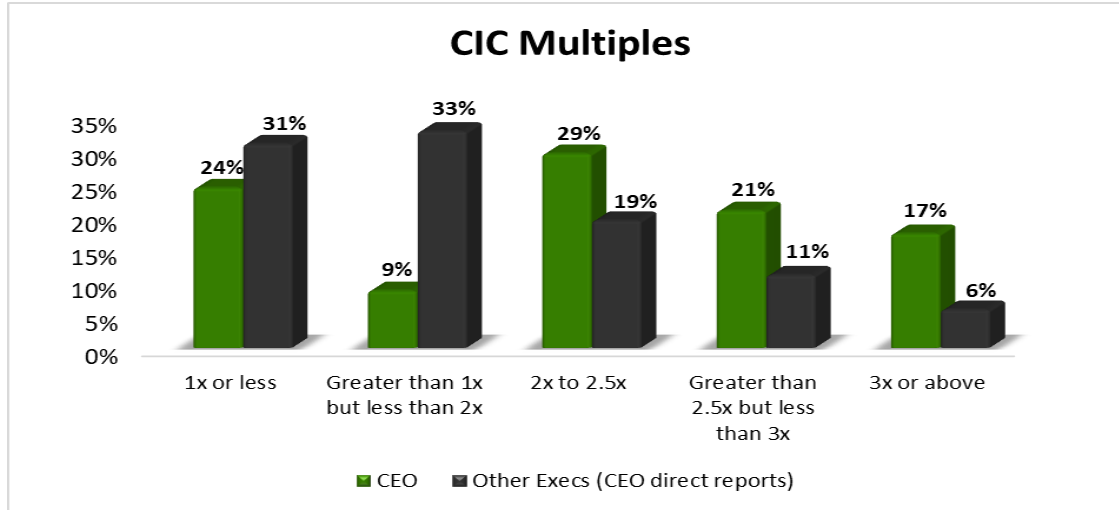


Which executive(s) have a SERP or SCP?



- Almost half of the responding banks offer a deferred compensation plan to executives.
- Approximately 44% of the responding banks offer a SERP/SCP to at least one executive.

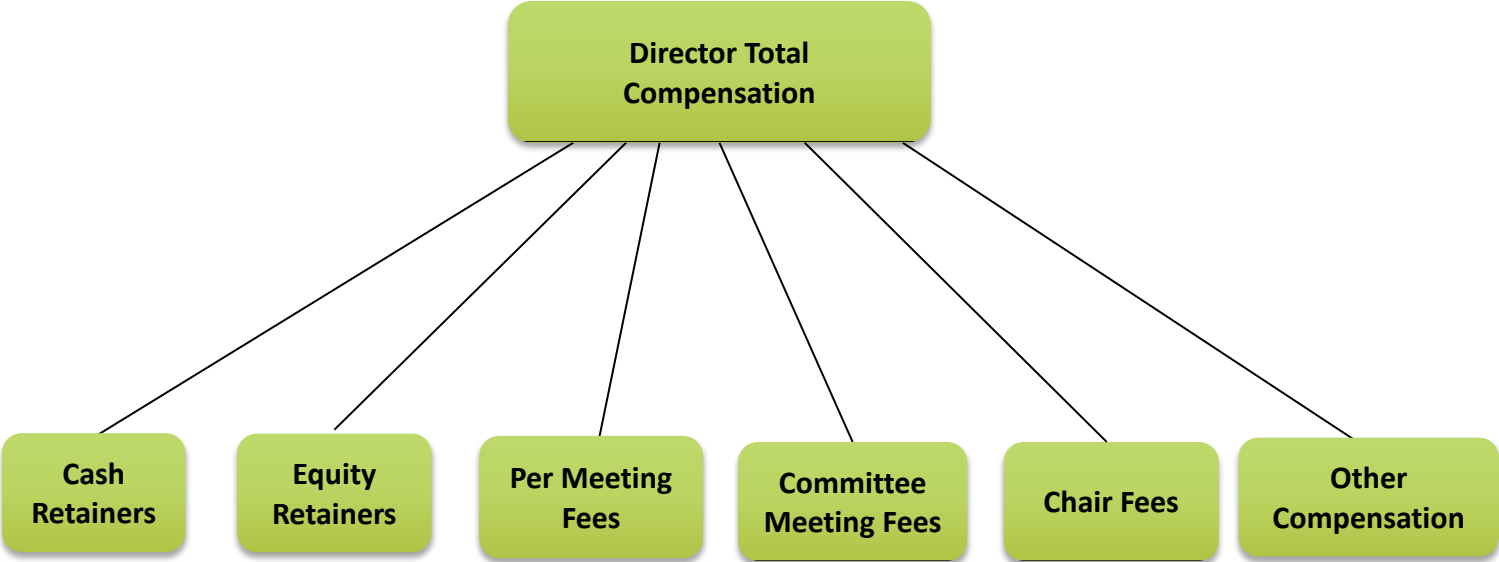
# Change-in-Control (CIC) Severance Multiples



- The amount of the CIC severance benefit will vary upon several factors, including the officer's title, the size and location of the bank, the tenure and equity holdings of the officer, and the performance of the Bank.
- The severance benefit payout is typically a multiple of salary, cash compensation (salary + annual cash incentive/bonus), W2 average compensation, etc. at the time of termination.
- 55% of respondents who pay CIC severance benefits to the CEO base the benefit on the CEO's salary and 34% base the benefit on cash compensation.
- **Gross Ups for 280(G)** are no longer prevalent as 79% of participating banks DO NOT provide a gross-up.

# *Director Compensation*

# Director Compensation



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# Director Compensation Trends

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## Basic Director Compensation Trends

- ✓ Gradual increases in Director compensation over the last 10 years.
  - Typically, director compensation adjustments occur every 2 or 3 years (not annually)
  - 32% increased in 2022 / Increase percent was 10% and average hours spent 8 hours/month.
- ✓ Director compensation should have a different philosophy from executive compensation.
  - **Pay for time and expertise**
- ✓ Director **annual incentives** based on bank results are **frowned upon by regulators**.
  - Focus should be on long-term results and sustainability
- ✓ **Use of equity as a component of director compensation is considered a best practice.**
  - Typically, an equity retainer and restricted stock (vs. stock options)
  - Shorter vesting for director equity grants
- ✓ **Increased focus on retainers** and a decreased focus on per meeting fees
- ✓ Director compensation **differentiation for chairs versus non-chairs**

## 2022 Director Compensation (Avg. Director)\*

Total compensation consists of fees earned or paid in cash, stock awards, option awards, non-equity incentive plan compensation, change in pension and non-qualified deferred compensation earnings, and all other compensation.

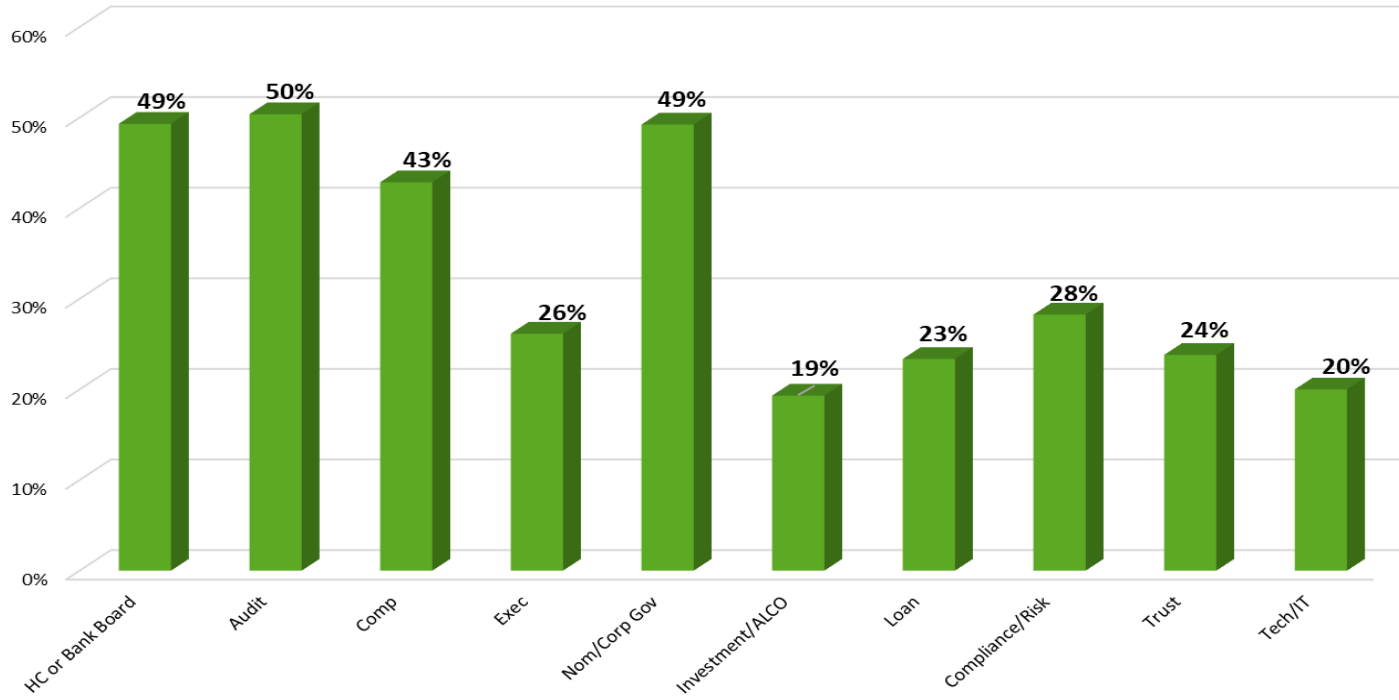
The table below shows the total compensation paid to an **average director**. An average director excludes the board chair, employee directors, and any directors with extraordinary events in 2022 (i.e. retirement or partial year board service).

Data Cut	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Total Granted Equity (\$)	Non-Equity Incentive Plan Comp (\$)	Change in Retirement Benefits (\$)	All Other Comp (\$)	Total Comp Per Average Director (\$)
<b>All Banks, Med=\$780M (n=146)</b>								
Average	27,027	19,815	31,346	21,866	14,084	14,055	8,044	33,393
25th Percentile	15,000	9,712	16,819	8,730	8,194	10,848	698	17,333
50th Percentile	24,000	16,900	26,203	18,500	11,919	12,262	3,680	26,875
75th Percentile	35,603	25,575	46,313	29,137	17,809	15,469	10,651	45,000

\* Each column represents the summary statistics for the banks that have this form of compensation (0's are excluded); therefore, total compensation per average director is not a sum of the previous columns.

# Board and Committee Chair Compensation – Additional

Prevalence of Banks that Pay Additional Fees to the Board Chair/Lead Director and Committee Chairs



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# Speaker Biography

## Mr. Matt Brei – President

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Matt Brei is the President of Blanchard Consulting Group. He has been a compensation consultant since 2000 and has been exclusively focused on the banking industry since 2002. Prior to founding Blanchard Consulting Group, he worked at Amalfi Consulting, Clark Consulting, and Arthur Andersen. He serves in a lead role with his client engagements and focuses on identifying the unique compensation needs and concerns of each individual client. Matt's areas of expertise encompass multiple disciplines within executive, director, and staff compensation. Matt frequently speaks at banking conferences on various compensation related topics and has written a number of published articles within banking specific publications. Matt received a Bachelor of Arts degree with a double major in Accounting and Business Management from Luther College in Decorah, IA.

# Speaker Biography

## Mr. Michael Blanchard – CEO

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Mr. Michael Blanchard is the CEO of Blanchard Consulting Group. He has extensive experience in the human resources field and has conducted or supported over 500 compensation planning, market research, and organizational development projects over the past seventeen years, with over thirteen years specific to the banking industry. Mike has presented to various national and state banking associations including the American Bankers Association, the Southeastern Bank Management and Director Conference, and the Western Independent Bankers association on a variety of compensation and board governance topics. With a master's degree in advanced industrial and organizational psychology, Mr. Blanchard's experience includes advising clients on assessing total compensation, incentive planning, and performance appraisals.



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