



Effects of the 2023 Banking Crisis on Compensation Committee Oversight

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2023 Banking Crisis

Largest Bank Failures in U.S. History

Washington Mutual	\$307B	September 2008
First Republic Bank	\$212B	May 2023
Silicon Valley Bank	\$209B	March 2023
Signature Bank	\$110B	March 2023
IndyMac Bank	\$31B	July 2008

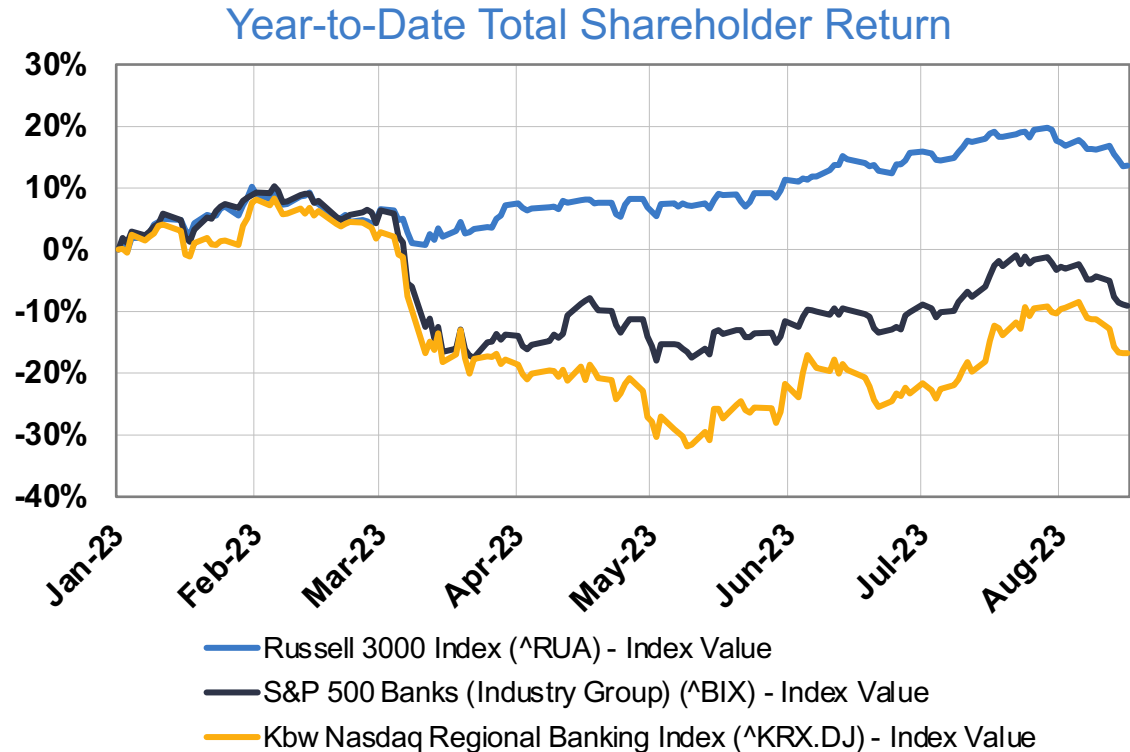
Causes:

- Rapid increase in interest rates
- Shrinking net interest margin
- Asset-liability mismatch
- Concentrated customer base
- Uninsured deposits
- Social media

The Federal Reserve's report on SVB and FDIC's report on SBNY each found lapses in regulatory oversight but also revealed repeated inaction by both management teams to address identified issues and risks

The Aftermath for Regional and Community Banks

- Loss of deposits to large institutions
- Increased cost of deposits
- Decreasing net interest margins
- Tightening of credit standards
- Focus on liquidity
- Increased regulatory scrutiny



Source: S&P Capital IQ

Identified Concerns with Incentive Compensation

Federal Reserve Report on SVB Failure

4 Pages on Incentive Compensation

- Noted concerns raised in 2022 exam:
 - Minimal linkage to risk management and control factors
 - Insufficient documentation of performance evaluations
 - Too much weight placed on “fear of attrition” (or retention risk)
- Concluded compensation practices did not adequately reflect:
 - Longer-term performance
 - Nonfinancial risks
 - Unaddressed audit or supervisory issues
 - Input from internal control functions

“SVB’s senior management responded to the incentives approved by the board of directors; they were not compensated to manage the bank’s risk, and they did not do so effectively.”

Existing Guidance

2010 Guidance on Sound Incentive Compensation Practices

*To be consistent with safety
and soundness, incentive
compensation arrangements
should comply with these
principles*

1

Balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk

2

Be compatible with **effective controls and risk management**

3

Be **supported by strong corporate governance**, including active and effective oversight by the organization's board of directors

What May Be Next

RECOUP Act

- “Recovering Executive Compensation Obtained from Unaccountable Practices”
- Passed Senate Banking Committee
- Recoupment of incentive compensation plus money received from stock sales during the 24 months before a bank’s failure
- Require banks to adopt standards promoting safety, soundness and responsible bank management

Human Capital Scrutiny

- Increasing regulatory focus on human capital topics
- Expanding Board and Compensation Committee expectations for oversight
- Topics include culture, workforce planning, management of talent acquisition and retention risks, and succession planning
- Increased SEC disclosure requirements also appears likely

Dodd-Frank 956

- Requires regulatory rulemaking on banking incentive compensation
- Rules proposed in 2011 and 2016
- Congressional push on regulators to finalize
- On SEC regulatory agenda for spring 2024
- Potential for significant impact on industry practices (incentive metrics, deferrals, caps on payout leverage, clawbacks, recordkeeping)

Incentive Compensation Challenges

- What to do with 2023 incentive plans?
 - Goals set before significant challenges emerged in external environment
 - Many tracking well below target
 - In-flight adjustments challenging
- Outstanding equity awards have declined in value
- Negative shareholder returns set poor context for special actions

Actions for Compensation Committee Members

Compensation Considerations

<input checked="" type="checkbox"/>	Establish principles for evaluating adjustments to 2023 incentive plans
<input checked="" type="checkbox"/>	<p>Ensure appropriate consideration of risk before finalizing payouts</p> <ul style="list-style-type: none">• Establish process for obtaining input from Risk• Maintain structure allowing for risk/compliance related reductions• Document key inputs into payout decisions• Validate retention risk through analysis, not solely opinion• Emphasize accountability
<input checked="" type="checkbox"/>	<p>Evaluate incentive plan design for 2024</p> <ul style="list-style-type: none">• Assess effectiveness of metrics and goals through different economic environments• Consider relative metrics in long-term plans• Consider if changes are needed to ensure strong controls and risk mitigation

Actions for Compensation Committee Members

Human Capital Considerations

<input checked="" type="checkbox"/>	Ensure the Board is providing oversight of human capital <ul style="list-style-type: none">• Potential expansion of Compensation Committee charter
<input checked="" type="checkbox"/>	Evaluate sufficiency of current staffing as well as talent pipeline and succession planning for control functions
<input checked="" type="checkbox"/>	Discuss human capital risks (e.g., turnover, staffing, culture)
<input checked="" type="checkbox"/>	Focus DEI initiatives on expanding the talent pool (e.g., recruiting, retention, promotion)
<input checked="" type="checkbox"/>	Maintain appropriate documentation of human capital policies, procedures and outcomes