Breakout 2:
Incentive Design in Uncertain Economic Times

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#BBTF24

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Incentive Design in Uncertain Economic Times: *Designing for Resiliency*

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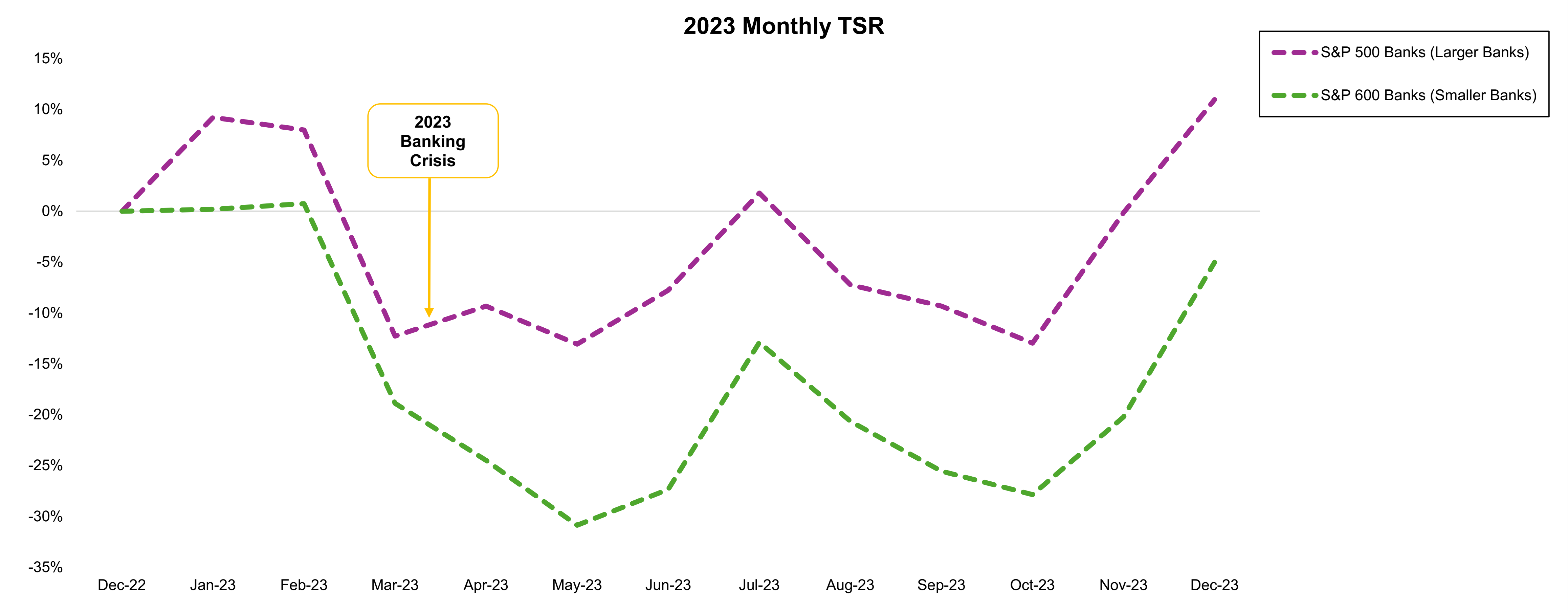
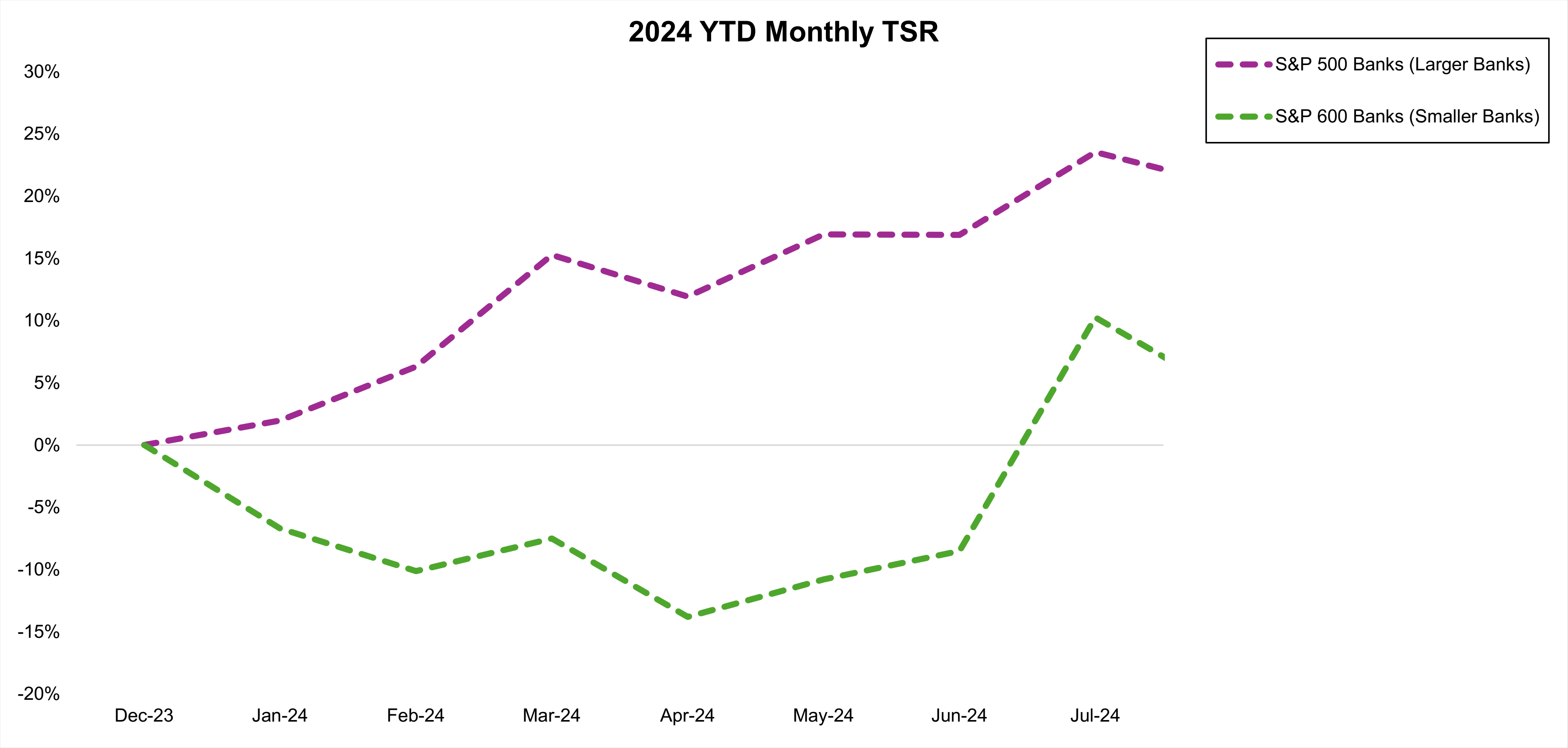
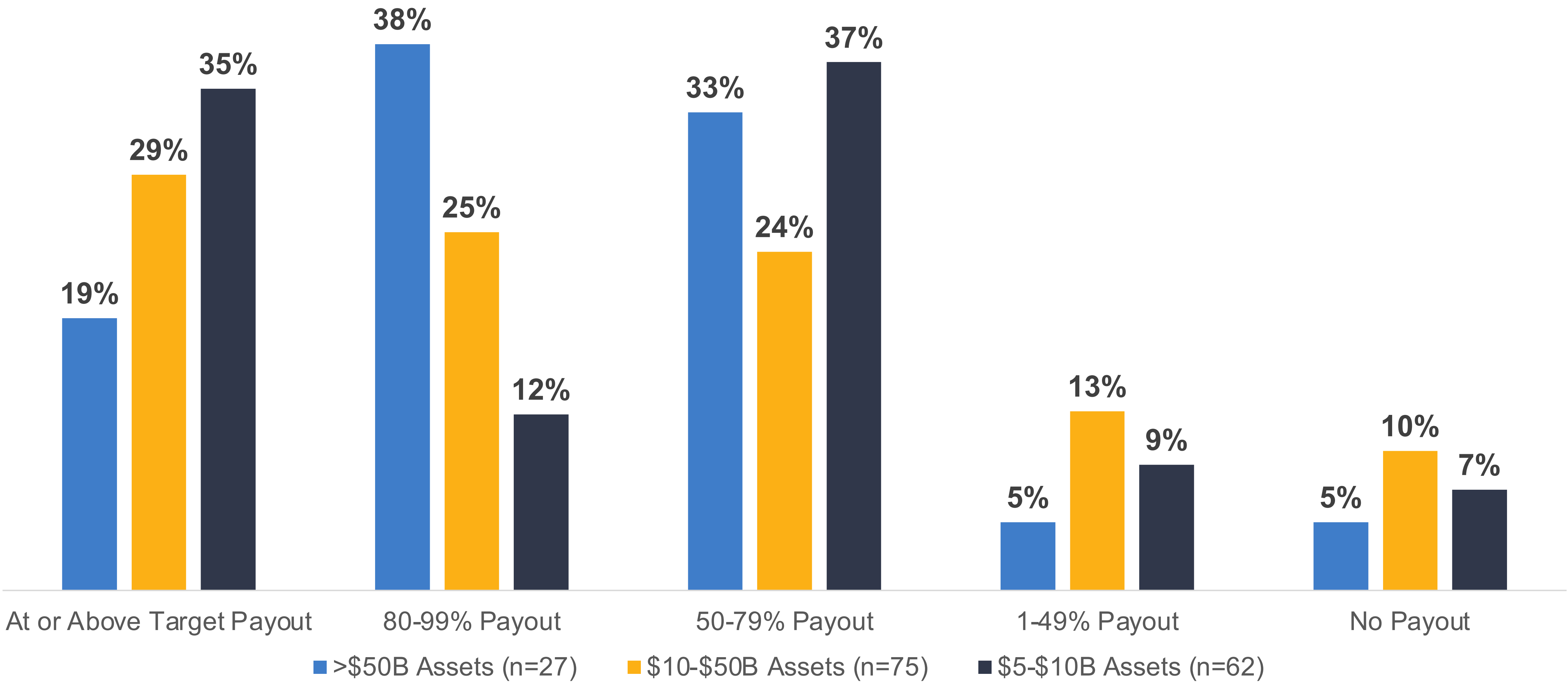
2023 was a challenging year for the banking industry, especially smaller banks



While 2024 has been an improvement, smaller banks continue to fall behind



2023 annual incentives were generally paid below target for banks of all sizes



How can you modify annual incentive design to acknowledge and adjust for continuing uncertainty?

Less scrutiny

- Change metrics going forward
- Modify performance curves
- Increase weight of strategic/individual component going forward
- Pay discretionary bonuses
- Set goals lower than prior year actuals
- Change in-flight plan goals/metrics

More scrutiny

Changing metrics is common, and typically does not attract substantial scrutiny

- Banks may change metrics to **address a shift in strategy**; for example, following the 2023 bank failures, many banks reprioritized deposits and introduced related metric(s) to their incentive plans

- To address **challenges with goal setting**, banks may measure performance on a relative basis rather than absolute

- Banks may rebalance the weighting of financial vs. non-financial performance by **increasing the weighting of strategic or individual goals**; a heavier weight on non-financial goals can provide an opportunity for management to earn a payout for achieving goals that may not flow through to financials in the short-term

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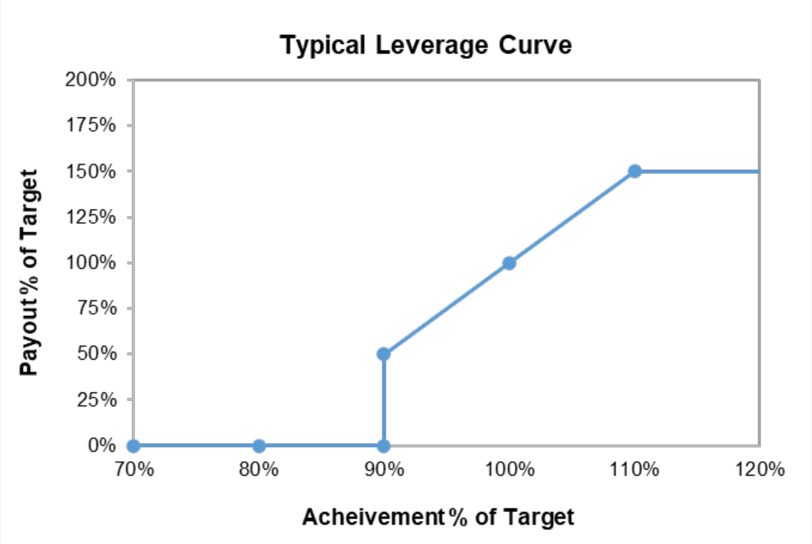
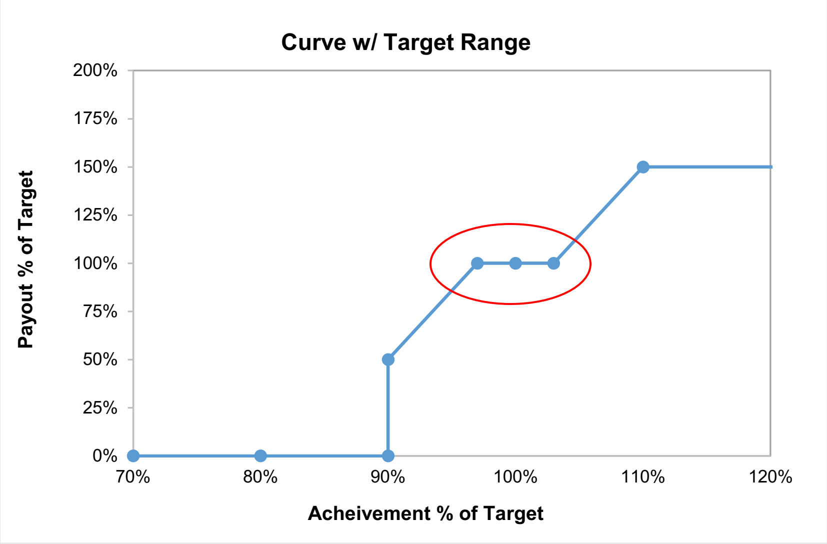
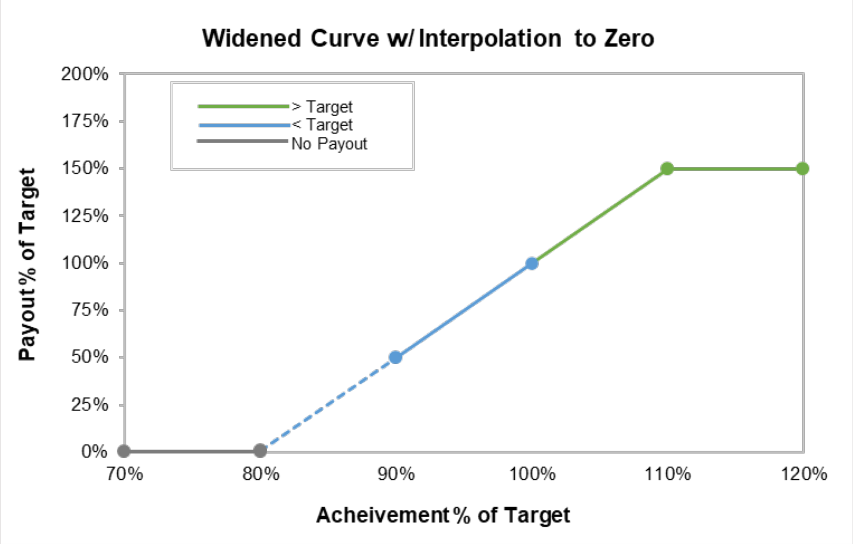
Modifying leverage curves for absolute metrics can help protect incentive programs in uncertain environments



- Standard curve with equal upside and downside
- Performance interpolated on the curve



- A kink in the curve at target provides for some flexibility in goal setting (typically due to macroeconomic factors such as uncertain inflationary/rate environment, etc.)
- Acknowledges challenge of setting a specific goal



- A widened performance curve allows for executives to get "in the money" for lower levels of performance
- The outperformance required for maximum payout should also be increased
- Curve does not need to be symmetrical around target

The following alternatives are likely to attract more scrutiny, but may be warranted in limited circumstances

Pay discretionary bonuses

- Increase calculated payout
- Will warrant supplemental robust disclosure
- Should include consideration of relative performance or other performance achievement

Set goals lower than prior year actual

- Normal practice to set goals based on expected budget
- May be viewed unfavorably by proxy advisors
- Consider potential payouts compared to prior year performance
- May require enhanced disclosure

Change in-flight plans

- A rare practice outside of unusual circumstances
- Can be highly criticized without appropriate rationale
- Often payouts capped at target or below prior maximum

Considerations for equity grants

Banks may also consider one-time program changes to retain key talent in challenging performance year(s), though should expect to face more external scrutiny for these alternatives

- **Granting enhanced equity values** may be appropriate when stock price decline leads to significant paper loss in value of outstanding equity, and a company is facing retention concerns across the executive leadership team

- **One-time special awards** can be used to address retention concerns in a turnaround, and may be targeted or spread across the executive leadership team

- **Modifying outstanding awards** is unfavorable to external stakeholders and creates accounting issues, but may be appropriate in limited circumstances to address extreme retention concerns when outstanding equity is significantly out of the money

Questions?