BankDirector. Strong Board. Strong Bank.

2018 COMPENSATION SURVEY

Fueling Future Growth

WHITE PAPER

Compensation Advisors

A Member of Meyer-Chatfield Group

Over the past year and a half, there's been a lot of good news for the banking industry. New regulators have been appointed who are more industry-friendly. Congress managed to not only pass tax reform, but also long-awaited regulatory relief for the nation's banks. And the economy appears to remain on track, exceeding 4 percent gross domestic product (GDP) growth in the second quarter of 2018, according to the Bureau of Economic Analysis.

Bank Director's 2018 Compensation Survey, sponsored by Compensation Advisors, a member of Meyer-Chatfield Group, finds that the challenges faced by the nation's banks may have diminished, but they haven't disappeared, either.

Small business owners are more optimistic than they've been in a decade, according to the second quarter 2018 Wells Fargo/Gallup Small Business Index survey. This should fuel loan demand as business owners seek to invest in and grow their enterprises. In turn, this creates even more competition for commercial lenders—already a hot commodity given their unique skill set, knowledge base and connections in the community. Technological innovation means that bank staff—and boards—need new skills to face the digital era. These innovations bring risk, in the form of cybercrime, that keep bankers—and bank regulators—up at night.

For key positions in areas like commercial lending and technology, "banks have to spend more," says Flynt Gallagher, president of Compensation Advisors. "You have to pay top dollar."

But a solid economy with a low unemployment rate—dropping to 3.8 percent in May, the lowest rate the U.S. has seen in more than 18 years—means that banks are facing a more competitive environment for the talent they need to sustain future strategic growth.

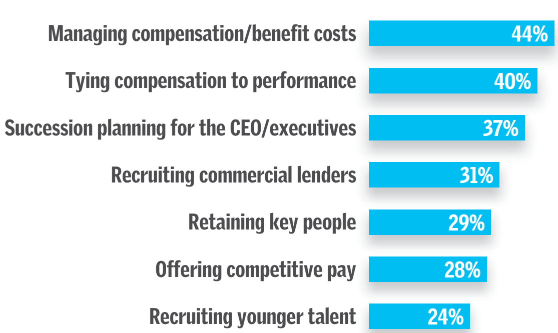
And regulatory relief doesn't mean regulatory-free: With the the legacy of the financial crisis, along with the challenges of facing economic, strategic and competitive threats, all of which are keeping boards busy, there's more resting on the collective shoulders of bank directors than ever before, and boards will need new skill sets and perspectives to shepherd their organizations forward.

Rising Compensation Costs

For several years now, the 2018 Compensation Survey has asked respondents—CEOs, human resources officers, other senior executives and board members—about the top compensation challenges facing their institutions. Until this year, bank leaders consistently pointed to tying compensation to performance as the top area of focus. Following the financial crisis, this made sense, given the regulatory expectation that bank leaders should not incent the types of undesired behaviors that lead to the approval of loans that may later default.

FIG. 1

What are your top three compensation challenges for 2018?



It should be noted that 40 percent of respondents still cite this as a top-three challenge. It's an issue we're still seeing the effects of today, most recently with Wells Fargo & Co.'s litany of scandals and fraud conducted by many of the bank's employees.

But 44 percent of survey respondents indicate increased awareness around the importance of managing compensation and benefit costs, up 13 points from last year's survey. Banks are beginning to feel pinched as the U.S. labor market grows tighter, and the U.S. economy faces a perfect storm of low unemployment and lost skills as baby boomers exit the workforce.

"It's a tight labor market, and the expense to hire and retain talent is going up," says Gallagher. "Banks have increased salaries to be competitive—the costs are more prominent, and bank boards and management teams are aware of this." Some banks are feeling the pinch even more, with 28 percent saying that offering competitive pay is a key challenge.

Both of these factors—labor costs and competitive pay—could ultimately constrain the growth banks might otherwise find in today's favorable economic environment.

To combat rising compliance costs, Gallagher recommends banks uncover what benefits, perks and cultural practices employees value. "This will minimize turnover and the significant costs related to hiring, training and onboarding, which can erode profitability, in addition to the opportunity cost associated with replacing a productive employee," he says.

Attracting and Retaining Talent

A competitive labor market is particularly challenging for the financial industry, given the need for specialized talent—further driving up compensation costs. Lending is a critical revenue stream for banks, and the majority of survey respondents, at 68 percent, indicate that commercial lending is a top skill set they'll seek this year. Further, 31 percent say that recruiting commercial lenders is one of their bank's top-three compensation challenges.

Thirty-eight percent indicate that technology is a skill their bank will actively recruit for in 2018. Given the attention paid within the industry to the importance of technological innovation—whether through digital transformation to better meet cus-

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>
> — **Flynt Gallagher, Compensation Advisors**

FIG. 2

What skills do you expect your bank to actively recruit for in 2018?

tomer needs, technology in the back office and other areas to make the bank more efficient, or rising needs for technology to better comply with regulations (also known as regtech solutions), it's perhaps no surprise that banks are seeking technology talent, and 14 percent indicate that recruiting technology talent is one of their bank's top-three compensation challenges for 2018. Nineteen percent identify cybersecurity as another key skill they're recruiting for this year. Compliance, for 21 percent, and risk, for 19 percent, are also skill sets that are in high demand.

> "Find out what they value, and where possible, customize the compensation plan for that individual."
>
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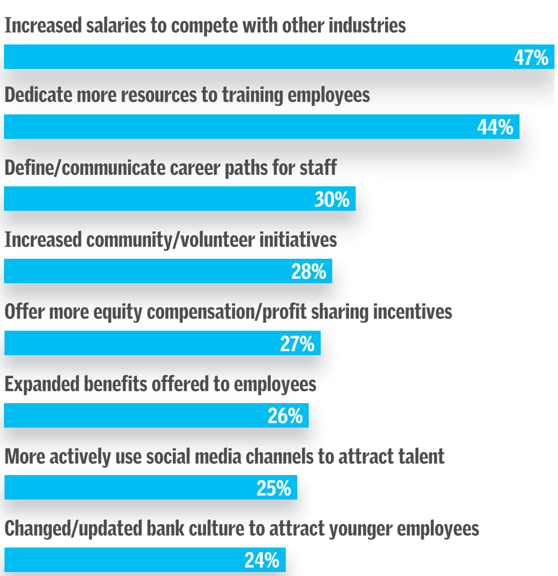
Attracting and developing the talent needed for the bank's future is another potential growth constraint impacting the industry. Overall, the survey reveals concerns about recruiting and retaining the talent a bank needs across several main areas: Twenty-nine percent express concern about retaining key people, and respondents cite worries about recruiting younger talent (24 percent) and key executives (15 percent). U.S. companies, including banks, are going to continue to have a tough time seeking the talent they need for the foreseeable future. *The Wall Street Journal* reported in early July, using U.S. Labor Department data, that 3.4 million Americans quit their jobs in April to seek a better employment opportunity, nearing a peak last seen in 2001.

In addition to seeking specific skills, many banks are seeking younger talent—skilled millennials who can grow with the organization and eventually become the leaders the bank needs. Forty-seven percent of survey participants say that over the past three years, their bank has increased salaries to be competitive with other industries—not just peer banks—in order to better attract and retain younger employees. But money isn't everything.

FIG. 3

How have your bank's compensation and hiring practices changed over the past three years to attract and retain younger talent?



A Gallup study conducted in 2016 found that for millennial employees, company culture can be just as important as pay. The 2018 Compensation Survey indicates that banks are deploying a variety of tactics—expanding benefits, shaking up corporate cultures and investing in individual employee development—to create a more attractive workplace for millennial employees.

Bank training programs fell by the wayside as financial institutions sought to recover from the financial crisis, but today's banks seem to be putting more resources into training employees. Eighty percent of respondents indicate their bank offers external training or career development for at least some employees, and 74 percent have an in-house training program.

Faced with a competitive marketplace for talent, it's become increasingly difficult to hire away experienced bankers, says Gallagher. "The choice is: Do we outspend other banks, or do we train our employees to get the talent we need."

Gallup affirms that personal development and coaching are attractive to millennial employees. Forty-four percent responding to the 2018 Compensation Survey say their bank has dedicated more resources to training over the past three years to better appeal to prospective millennial employees. But less than one-third define and communicate career paths for staff, and just 15 percent offer a mentorship program. This reflects an oversight on the part of many banks seeking to develop and retain their millennial staff.

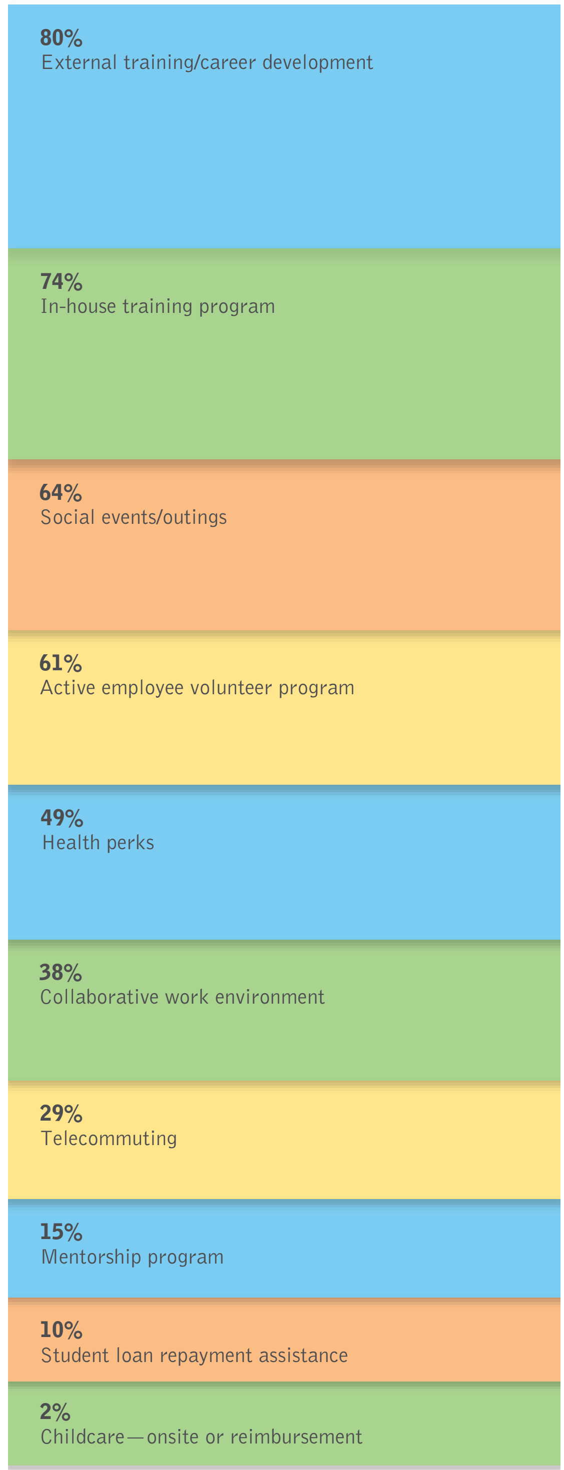
"Millennials want communication, and they want to hear from people at the top," says Jeff Fairchild, senior compensation consultant at Compensation Advisors. "Defining career paths is huge for retention."

Employee training helps a bank build the workforce it needs. But be aware that other factors—pay, benefits and perks, and corporate culture—should remain competitive as well. Otherwise, these well-trained employees could fly the coop to work for another organization.

The survey indicates areas for improvement for the industry. Just 24 percent indicate that their bank has updated its culture to attract younger

FIG. 4

Which perks does the bank offer to at least some of its employees?



employees. One-quarter say their bank more actively uses social media channels to recruit employees—an odd misalignment with the generation that invented Facebook, and something that should be relatively easy and inexpensive for bank human resources teams to execute.

Another misalignment with the digital age is the relatively low percentage of banks that allow some employees to telecommute, at just 29 percent. For trusted employees who aren't in customer-facing roles and have been on staff for a designated period of time, allowing telecommuting as an option can help banks attract talent from outside its market area, or make them more attractive for prospective employees.

And given the rising level of student debt, and the rising cost of childcare for millennials who are just now starting to raise families, it's surprising that few offer student loan repayment assistance (10 percent) or childcare benefits (2 percent).

Millennials are "saddled with a lot of debt, and student loan repayment would be something that could be used as a benefit" for these employees, says Gallagher.

The varying needs of millennials (whose ages span between 22 and 37), along with the Gen X'ers and baby boomers still employed by the bank, underscore the need for customization in employee compensation plans, according to Gallagher. "Find out what they value, and where possible, customize the compensation plan for that individual," he says.

Ensuring Future Leadership

Just 4 percent say their bank plans to actively recruit a CEO in 2018—not necessarily a surprise, given the number of banks that try to promote from within and the few that are planning for a transition in their top spot this year. However, 37 percent indicate that succession planning for the CEO or key executives is one of their bank's top challenges.

While the survey reveals that gains have been made in succession planning for the CEO—thirty-six percent say their bank has not identified a successor or potential successors for their current CEO, a significant improvement from 48 percent in the 2017 survey—not having a plan in place for the CEO, no matter that person's age, is an oversight that boards must work to correct.

"That's a recognized risk in banking," says Gallagher. Banks should have both short-term and long-term succession plans in place for the CEO and key executives. "A long-term plan focuses on replacing the executive with the best option, not necessarily the executive who has been waiting in the wings," he says.

The median age of a bank CEO is 58 years, with 57 percent between the ages of 50 and 60. One-third are older than 60, and just 10 percent are younger than 50.

Executive succession isn't the only area that boards need to address to ensure the organization has the leadership it needs. Forty-five percent of respondents say that developing a director succession plan is a top board challenge, particularly in terms of recruiting new directors with the skill sets banks need today, like technology and cybersecurity.

Forty-three percent indicate a need to conduct an effective board evaluation, a process that can help identify the skills needed on the board. While 44 percent say their board needs to recruit tech-savvy directors, other skills are needed to create a well-rounded board of directors. The survey indicates that the industry still has a lot of ground to cover in adding diverse directors to the mix: Just

FIG. 5

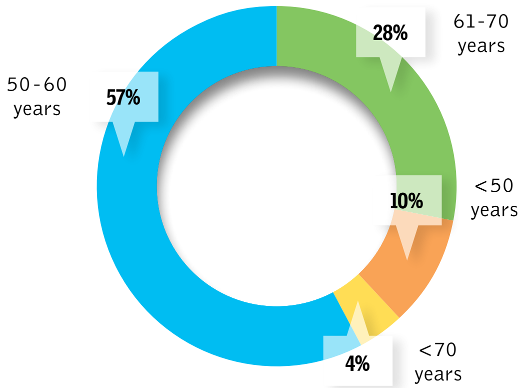
Median CEO Compensation (FY 2017):

Region	South	Northeast	Midwest	West	Total
Salary	$353,106	$425,000	$306,859	$350,000	$370,232
Cash incentive	$127,800	$179,310	$75,000	$200,000	$124,200
Equity grants (fair mkt value)	$169,219	$184,450	$105,314	$140,000	$162,784
Benefits & perks	$35,000	$64,422	$30,000	$50,000	$40,000
Total CEO compensation	$537,450	$808,935	$462,000	$660,000	$621,000

FIG. 6

What is the age of your bank's CEO?

Numbers don't add up to 100% due to rounding.



14 percent have at least three female members, 84 percent lack a director aged 40 or younger, and 77 percent don't have at least one director who is ethnically diverse.

A strong governance committee is vital in addressing these board composition challenges. Seventy-four percent of survey respondents say their board has a governance/nominating committee, but the practice skews toward larger banks above $1 billion in assets. "I would expect more bank boards to have a governance committee," says Gallagher. "We're seeing more [regulatory] attention on governance issues: how [boards] nominate directors, how they review and vet them, and how the board operates in discharging its responsibilities."

Conducting a board evaluation can guide governance committees that are seeking to rotate nonperforming directors off the board—a composition challenge cited by 31 percent of respondents—making room for new skill sets and viewpoints.

But all this is easier said than done, so it will require work and planning on the part of a dedicated board and governance committee that understands the skills and backgrounds needed by the board, as well as its culture. "Any time you introduce new people, it upsets the balance," says Gallagher. "So you have to have the experience and understanding to help fill the [skill] gaps" on the board.

About the Survey

Bank Director's 2018 Compensation Survey, sponsored by Compensation Advisors, a member of Meyer-Chatfield Group, surveyed 236 independent directors, chief executives, human resources officers and other senior executives of U.S. banks to examine the talent landscape for the banking industry, including bank boards, as well as trends in director and CEO compensation. The survey was conducted in late March and throughout April 2018. Concurrently, CEO and director compensation data for fiscal year 2017 was collected from the proxy statements of 100 publicly traded financial institutions. Fifty-four percent of the data represents publicly traded companies.

About Compensation Advisors

Compensation Advisors, a member of Meyer-Chatfield Group, has served the community banking industry providing guidance on the latest compensation and hiring developments. As benefit experts they convey insightful strategies and solutions to help retain, recruit and reward critical talent at all levels. Simply put, they find solutions others miss. Compensation Advisors works with financial institutions across the United States delivering: Executive and Director Compensation Reviews, Pay-for-Performance Incentive Plan Structures, Equity Allocation Plans, Benefit Plan Designs, Base Salary Reviews (company-wide), Risk Assessments, Regulatory Updates and Compensation Committee Governance. Visit the website at www.compensationadvisors.com.

About Bank Director

Since 1991, Bank Director has served as a leading information resource for the directors and officers of financial institutions. Through *Bank Director* magazine, its executive-level research, annual conferences and website, BankDirector.com, Bank Director reaches the leaders of the institutions that comprise America's banking industry. Bank Director is headquartered in Brentwood, Tennessee.

BOARD COMPOSITION CHALLENGES

Bank boards are seeking the right skills and perspectives to oversee the organization today.

Top Concerns Identified in the Survey

- 45% Developing a board succession plan
- 44% Recruiting tech-savvy directors
- 42% Conducting an effective board evaluation
- 35% Recruiting female directors
- 33% Recruiting younger directors

Board Stats*

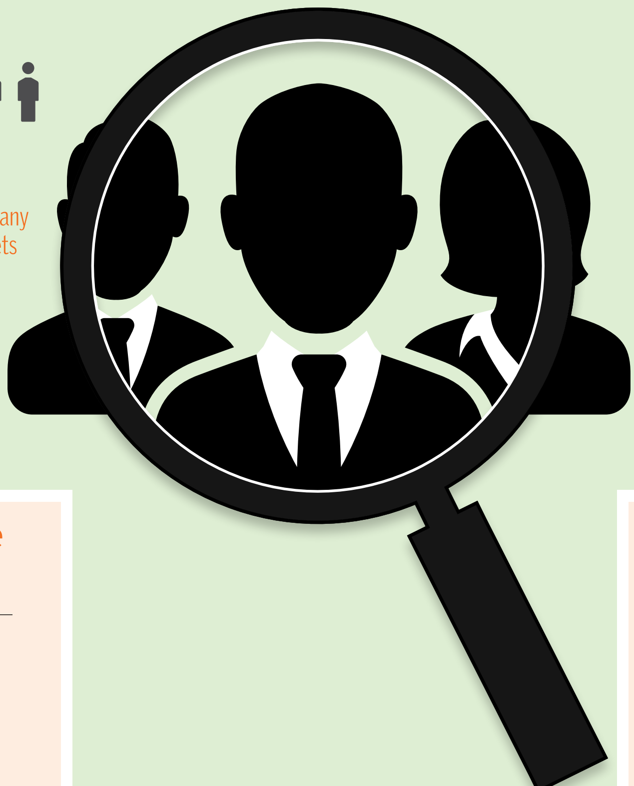
10

The typical holding company has 10 directors and meets 10 times.

20hrs

Time spent on board activities

*Median values reported.



Board Diversity Stats

77%
say their bank has at least one female director

24%
have one or more ethnically diverse directors

16%
have one or two directors aged 40 or younger

Non-Executive Chairman

$1,000
Median meeting fee

$35,000
Median annual retainer

Compensation Types

Type	%
Annual cash retainer	77%
Board meeting fee	70%
Equity compensation	46%
Deferred compensation/benefits	18%

Committee Structure

Committee	%
Audit	99%
Compensation	89%
Governance/nominating	74%
Loan	48%
Risk	43%
Technology	20%

Source: Bank Director's 2018 Compensation Survey

Outside Director

$1,000
Median meeting fee

$24,000
Median annual retainer

Compensation Types

Type	%
Annual cash retainer	71%
Board meeting fee	70%
Equity compensation	45%
Deferred compensation/benefits	16%