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2019 COMPENSATION SURVEY

Creating Space for New Views

WHITE PAPER

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Could groupthink be the greatest risk facing bank leadership teams and boards today? Merriam-Webster defines groupthink as "a pattern of thought characterized by self-deception, forced manufacture of consent, and conformity to group values and ethics." It often occurs when members of a group — say, a bank's board — don't reflect a diversity of backgrounds and perspectives. Given the homogenous nature of many corporate boards and leadership teams (including banks), it's a very real issue that threatens creative decision making and strategic planning.

Cognitive diversity, where a variety of perspectives are represented on the board, counteracts this risk. In fact, a higher level of cognitive diversity correlates to better performance, according to a study conducted by two British professors from the London Business School and Ashbridge Business School.

Bank boards today are largely comprised of male baby boomers, and bank boards and leadership teams face a generational shift as boomers increasingly exit the workforce. With this change, it's become even more important that directors focus an appropriate level of attention on executive succession planning — perhaps the board's most important responsibility.

At the same time, boards and nominating/governance committees must work to recruit new directors with new perspectives to the board. But finding qualified talent that contributes to board discussions — with the right mix of skills, diversity and, perhaps, youth — can be difficult to achieve, particularly when boards lack the tools and resolve to bid adieu to less engaged directors and attract new directors to serve on the board.

Identifying potential director candidates in the bank's community is a perpetual responsibility of the board and nominating/governance committee, says Flynt Gallagher, president at Compensation Advisors. "Boards need to know who they want to target, what skills do they need on the board that they don't have or need to replace," he says. "It's an ongoing process, just like hiring an employee or an executive, so you need a pool of those candidates, that's the tough part. So, [nominating/governance] committees have a very important place in the structure of the board of directors."

Bank Director's 2019 Compensation Survey, sponsored by Compensation Advisors, focuses on these issues.

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Board Refreshment

Bank boards are typically composed of talented business leaders plucked from the institution's markets. Historically, board service has been viewed as an honor, and it's an opportunity to gain a deeper perspective of an industry that's vital to local and national economies. Bank Director's 2017 Compensation Survey found that 62% of directors cited personal growth as the greatest reward they receive for board service, followed by respect from the community, at 13%.

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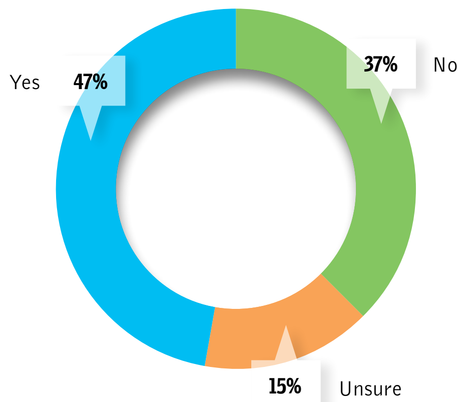
>
> — **Flynt Gallagher, Compensation Advisors**

FIG. 1

Is the board and/or nominating/governance committee working to recruit younger directors?

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



"For established community banks, those that have been around for 100 years, the board position was almost a rite of succession. Your father was on the board, you have succeeded him in his industry, you succeed him to his board seat," says Gallagher.

That picture is changing, however.

Over the past two years, the Compensation Survey has affirmed that banks remain overwhelmingly comprised of older white men. The 2019 Compensation Survey finds that the typical director responding to the survey is 64 years old, and has served on the board for a median of 13 years. (Sixty-eight percent have served on their board for at least a decade, and 27% have a tenure exceeding two decades.) Last year, just 40% told Bank Director that two or more women served on their board; just one-quarter had at least one director who was ethnically diverse.

Examining the age of the youngest director sitting on a bank board reveals a median age of 48. But that doesn't tell the full story: For 22%, the youngest director is 55 — meaning two full generations of adults (Generation X and millennials) still aren't represented on these banks' boards.

So, for most banks, getting the talent the board needs — a technology or risk expert, perhaps, or someone with more traditional expertise, like a lawyer — must also be balanced with gaining diverse backgrounds, by gender, race or ethnicity, and age.

This can be even more difficult to achieve if the board lacks policies that encourage board refreshment.

Mandatory retirement policies have been the more traditional method to remove underperforming directors from the board and make room for new viewpoints. In the survey, 41% say their board has a mandatory retirement policy in place, at a median age of 75. Interestingly,

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that's a three-year increase from the last time we examined the mandatory retirement age, in 2016. That increase can be seen as an indicator of how difficult it is to find the skills boards need, leading some to increase the retirement age to ensure they're not losing critical expertise.

And this has been a key argument against the use of mandatory retirement policies. Why lose the institutional knowledge found in a tenured director due to something as arbitrary as age?

"There's more responsibility and liability on directors than ever, so you're seeing efforts to shift pay practices to accommodate that."

— **Flynt Gallagher, Compensation Advisors**

These directors, with their inherent experience and knowledge, are difficult to replace, says Gallagher. "You look at the top reason for difficulty in bringing on a director who is younger: lack of experience, plus, they're focused on their own career. You've got somebody who is 72, typically their career is being a director," he adds. "They've got the time, and if bank still wants them, that means they're sharp enough to really contribute."

Perhaps a more equitable method would be to conduct an annual board evaluation or peer assessment, but this method is less frequently used: Less than one-third indicate they conduct a board evaluation annually, and of those who do, 59% use it as an opportunity to identify underperforming or less engaged directors.

Forty-four percent have never conducted such an assessment, and 24% conduct an evaluation irregularly.

Conducting a board evaluation requires courage and commitment on the part of the chairman or the nominating/governance committee. The results often mean someone on the board, typically the chairman, must have difficult conversations with directors who aren't pulling their weight. But when the board is fully engaged in the process, an evaluation can enhance the performance of the board.

The survey finds that boards with a nominating/governance committee exhibit a stronger approach to these governance practices.

Governance Structure

When it comes to a bank's committee structure, regulators offer a lot of flexibility, as do the New York Stock Exchange and the Nasdaq exchange. Most banks (97%, according to the survey) have an audit committee in place, which is required by the Federal Deposit Insurance Corp. Eighty-six percent have a compensation committee, which is advised by FDIC guidance, and required by Nasdaq and NYSE.

Though it is only required at banks trading on the NYSE, 64% of directors responding to the survey say their board has a nominating/governance committee.

The survey finds that the nominating/governance committee enhances a board's approach to refreshment. While less than one-third of respondents overall say their board conducts an annual evaluation, that percentage spikes to 53% if their board has a nominating/governance committee. At 46%, they're slightly more likely to have a mandatory retirement age in place, compared to 41% overall. And they're more likely

FIG. 2

Mandatory Retirement

have a mandatory retirement policy

Median mandatory retirement age

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to focus on recruiting younger talent, at 60% for banks with board-level nominating/governance committees versus 47% overall.

In short, bank boards with governance committees are more likely to walk the walk when it comes to fostering board-level diversity, not just talk the talk.

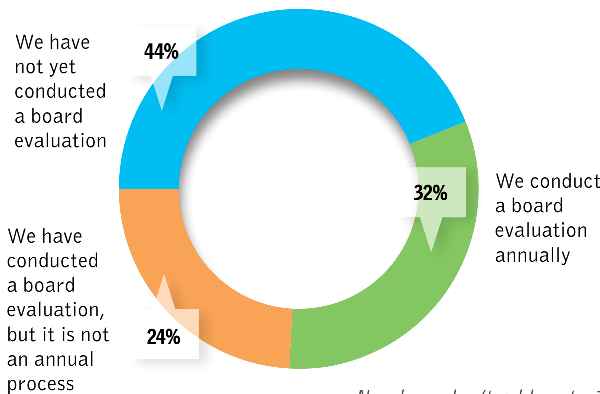
Competitive Board Pay

Boards may be more focused in recent years on recruiting diverse talent, but it can be difficult to get that talent to come on the board. There's a lot of demand coming from corporate boards of various industries, creating an increasingly competitive landscape for qualified directors.

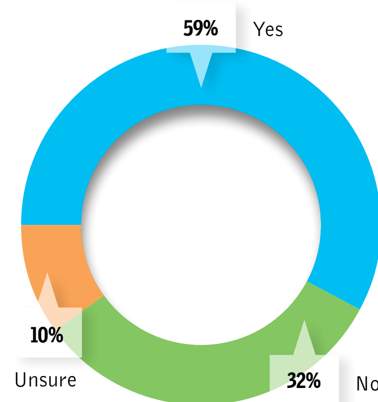
FIG. 3

Board Evaluations

Does your board conduct an annual board evaluation to identify training gaps, evaluate board processes and procedures, and/or examine the performance of individual directors?



Is the board evaluation used to identify underperforming or less engaged directors?



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

And the lack of diversity on corporate boards is getting a lot of external attention from proxy advisory firms like Institutional Shareholder Services (ISS) and Glass Lewis. In late 2018, ISS announced a new voting policy mandating that the boards of S&P 1500 and Russell 3000 firms include at least one female director. Following a one-year grace period, intended to give these companies time to recruit qualified female directors, ISS will recommend against nominating chairs where the board lacks gender diversity. That policy takes effect in February 2020.

Legislators are also scrutinizing board diversity. A law passed in California in 2018 requires public company boards with executive offices in the state to have a minimum of one woman on the board by the end of 2019, and two (at boards with five or fewer directors) or three (at boards with six or more members) by the close of 2021.

When it comes to attracting younger directors, more than half of survey respondents say potential candidates lack the necessary experience. Forty-two percent say they're too focused on building their own careers to dedicate the requisite time to serve on the board. Eighteen percent say younger directors aren't interested in serving on a bank board.

Pay Could Be an Issue

Sharon Edwards, a director at $1.8 billion asset Reliant Bancorp, based in Brentwood, Tennessee, believes the current level of director compensation typically seen in banking isn't competitive with other industries. "Bank boards typically pay a little bit less than other public company boards," she says.

This plays a role in driving the increasing popularity of paying an annual retainer to directors, as a supplement or an alternative to per-meeting fees. It also simplifies compensation in an era when directors can attend meetings remotely, and

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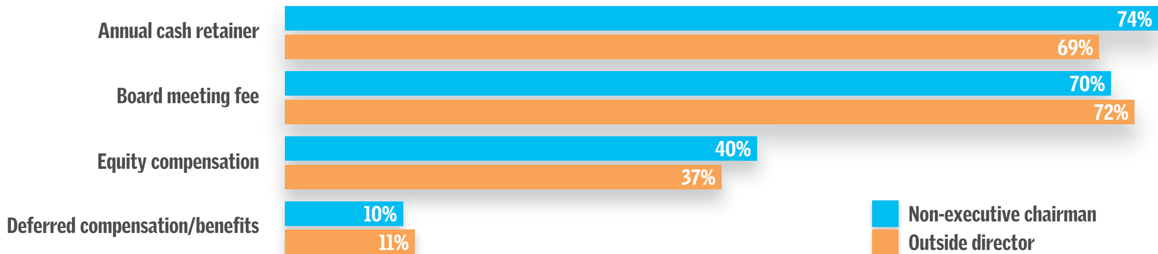
FIG. 4

Non-executive chairmen and outside directors receive the following types of compensation.



Cash Compensation Amounts, FY 2018

By title	Non-executive chairman	Outside director
Fee per board meeting	$900	$900
Annual cash retainer	$30,000	$20,000
Equity compensation	$25,000	$30,000

are spending more time between board meetings focused on banking issues.

"Meetings are lasting longer, because there's more material to cover," says Gallagher. "There's more responsibility and liability on directors than ever before, so you're seeing efforts to shift pay practices to accommodate that."

Seventy-four percent pay an annual retainer to the chairman, at a median of $30,000. Sixty-nine percent pay an annual retainer to outside directors, at a median of $20,000.

"How do you attract new directors, especially if there are limitations on how much you can pay them, because you're never going to compensate them — good directors especially — for the time they put in, and the expertise and knowledge they bring," says Gallagher. For this reason, finding truly talented directors who exhibit the intellectual curiosity required to educate themselves on the complexities of the banking industry and contribute to board discussions can be difficult to find without focusing the appropriate resources on the issue, no matter their age.

Another financial barrier to bringing on younger directors can be the investment required to serve on the board. In Bank Director's 2016 Compensation Survey, 44% of respondents reported that their board had stock ownership guidelines in place for their directors.

This year, 32% of respondents believe prospective younger directors can't afford to make a sufficient investment in the bank. It's a barrier that can be easily overcome, says Gallagher. "The bank can always award them the equity needed to meet minimum stock ownership guidelines. They can find a way to overcome that," says Gallagher.

Adding new viewpoints in the form of younger directors can add value to board discussions, but take care not to omit the perspectives of older directors who are still willing and able to serve on the board. "I've met directors who are 86, 87 who are as sharp as can be, and I've met some who are 60 who shouldn't be on the board; they don't understand what they're doing or they've lost their enthusiasm or their ability to do it," says Gallagher.

Serving on the board isn't a function of age. It's a function of providing value to strategic discussions.

Succession Planning

While baby boomers will still be serving on bank boards for some time to come, they're more quickly retiring from C-suite positions. Twenty-one percent of survey respondents believe it's time for the bank's CEO to announce his or her retirement, and almost one-quarter think their CEO could depart over the next two years due to retirement and/or health issues.

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FIG. 5

What challenges does your board face in attracting younger directors?

Nine percent believe it's likely their CEO could be poached by another bank.

However, 37% indicate their bank doesn't have a successor or potential successors for the bank's most important position. And it's the board's responsibility to oversee the performance of the CEO and ensure there will be someone to step in when that person eventually departs.

Gallagher advises banks to build flexibility into succession plans, keeping a few possible successors in mind until it's time for the incumbent CEO to lay the groundwork to leave. It's not wise to designate a successor, and then leave him or her waiting in the wings for several years.

"The longer you keep the designee in waiting, the more discontent there is and the greater risk that they're going to get tired of waiting and leave," says Gallagher.

Boards without a succession plan run the risk of being compelled to sell their bank when it's time for the CEO to leave. "The banks that are in that position, their plan is, 'we're going to ride the CEO as long as we can get him to stay, and then we're going to sell the bank,'" says Gallagher. "There isn't a strong candidate to step in."

About the Survey

Bank Director's 2019 Compensation Survey, sponsored by Compensation Advisors, surveyed 348 independent directors, chief executives, human resources officers and other senior executives of U.S. banks to examine trends in director and CEO compensation, and how banks are approaching succession planning and board refreshment. The survey was conducted in April 2019. Compensation data for directors and CEOs in fiscal year 2018 was also collected from the proxy statements of 103 publicly traded financial institutions. Thirty-one percent of the data represents a financial institution between $1 billion and $10 billion in assets, and almost one-quarter a bank between $500 million and $1 billion. Forty-nine percent represent a publicly traded institution. Sixty-four percent are located in the South or the Midwest.

About Compensation Advisors

Compensation Advisors serves the financial industry providing guidance on compensation and hiring developments. They offer LINQS+, a solution that delivers executive, director and shareholder benefits. Other deliverables include executive and director compensation reviews, pay-for-performance incentive plans, equity allocation plans, benefit plan design structures, risk assessments, regulatory updates and committee governance. 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.

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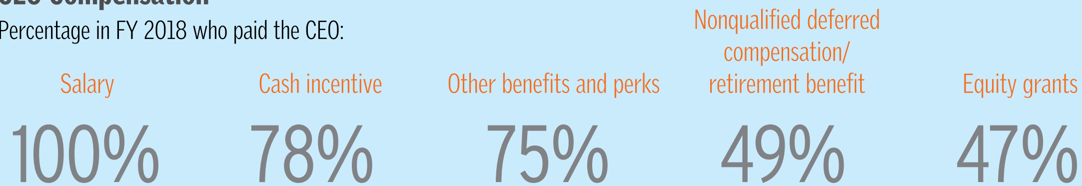
FOCUS ON THE CEO

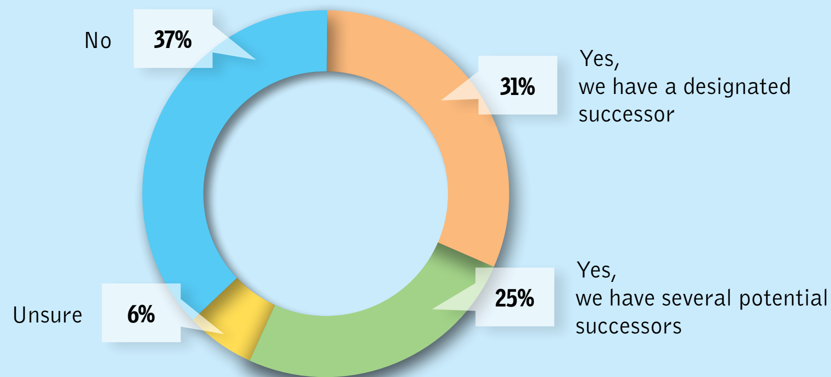
More than one-quarter of respondents believe their CEO could exit the organization in the next two years, primarily due to retirement or health — no big surprise, as 70% of bank CEOs are baby boomers. Will these banks' compensation packages be competitive enough to attract and retain the next generation of leadership?

CEO Compensation

Percentage in FY 2018 who paid the CEO:



Has your bank identified a successor or potential successors for the CEO?



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

Median CEO Compensation (FY 2018)

Ownership structure	Total	Public	Private	Mutual
Salary	$ 325,000	$ 423,000	$ 250,000	$ 350,000
Cash incentive	$ 118,446	$ 200,000	$ 71,025	$ 66,840
Equity grants (fair market value)	$ 215,268	$ 325,780	$ 55,500	—
Benefits & perks	$ 40,050	$ 50,000	$ 25,000	$ 48,000
Total compensation	$ 515,728	$ 839,389	$ 331,837	$ 506,331

Competing for CEO Talent

How could your bank's CEO compensation package be improved?

	Public	Private	Mutual
Offer non-equity, long-term incentive compensation	23%	39%	52%
Offer equity at greater levels	33%	23%	—
Pay a higher salary	19%	23%	24%
Offer equity or some form of ownership in the bank	12%	29%	10%
Offer a higher cash incentive	12%	20%	10%
Expand our health and/or wellness benefits	17%	9%	14%

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