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EXECUTIVE COMPENSATION PLANS

Strategies for attracting and retaining top talent

By Ken Derks and Trey Deupree, NFP

In today's rapidly changing and competitive banking environment, attracting and retaining top performers is essential for the success and stability of your bank. In fact, it may be your competitive advantage.

PERFORMANCE MEASURES USED FOR ANNUAL INCENTIVE PLANS

If Institution performance or department/functional performance are considered, the following specific performance measures are used for annual incentive plans.

Return on Equity (ROE)	31%
Return on Assets (ROA)	52%
Core Earnings	46%
Operating EJiciency/EJiciency Ratio	51%
Deposit Growth	61%
Loan Growth	65%
Loan Quality	36%
Net Interest Margin	26%
Non-Interest Income	25%
Regulatory	29%
Other	19%

Source: 2023 National Banking Compensation Survey, Pearl Meyer & Partners

Based on findings from the 2023 Pearl Meyer National Banking Compensation Report, it is projected that executives and senior officers can anticipate a 4.0% increase in budgeted base salary for 2024, while other employee groups can expect a 3.5% increase. Additionally, the report indicates that 81% of banks offer a short-term incentive plan on an annual basis, with 79% extending eligibility to nonexempt employees. On average, banks allocate 13% of payroll and 12% of net income towards these short-term incentive plans.

The retention of younger talent remains a challenge, as indicated by 64.9% of respondents in the 2023 TBA Compensation and Benefits Survey Respondents indicated it was "somewhat or very challenging" to retain younger talent, up from 63.3% in 2022 and 46.5% in 2021. According to the survey, the banking industry can provide younger talent with the experiences they are seeking through automation, remote work flexibility, and a work culture that emphasizes experience and values over solely compensation. The survey also reported, "inadequate total compensation" as an area that banks will have to address as part of efforts to reduce turnover, as low pay was cited as the second most common reason employees left. "Lack of career development and advancement" was the most common reason employees sought employment elsewhere.

BENEFITS OFFERED TODAY:

		High/Moderate Impact on Plan Success
Performance-based annual incentive	64%	98%
Non-qualified deferred compensation plan	60%	83%
Supplemental executive life insurance	51%	63%
Employment/severance agreements	30%	82%
Fringe benefits	28%	73%
Stock equity	27%	88%
Supplemental executive disability coverage	26%	52%
Signing bonus	24%	87%
Supplemental executive medical insurance	9%	89%
Tax gross ups for taxable benefits	8%	38%
Loans to buy/pay stock, a home, loans, etc.	7%	57%
Guaranteed annual minimum annual incentive	7%	57%
College tuition for children	3%	100%

Banks with higher retention rates typically offer at least two to four various types of compensation plans, in addition to salary and bonus, of which several are mentioned below:

1. Employee stock ownership plans (ESOPs)
2. Equity Plans, such as stock options, restricted stock, phantom stock, and stock appreciation rights (SAR)
3. Supplemental Executive Retirement Plans (SERP)
4. Deferred Compensation Plans (DCP)
5. Long-term/mid-term cash incentive plans

The design flexibility of these plan types can provide for payments to participants either at retirement or while employed. In some cases, banks will offer a combination of both in-service and post-retirement distributions.

The ability to customize such benefit plans has emerged as an important strategic tool to incentivize strong performance while fitting the demographics and needs of key personnel, regardless of age or life stage. There is no one-size-fits-all plan. Also important is performing a review of current plans and restructuring as appropriate to align with shareholder expectations.

To help you develop a plan for recruiting and retaining your best people, we have identified and discussed three key approaches below.

INCENTIVE PROGRAMS

Sharing value with those who help create value is a common characteristic among high-performing banks. Top individual performers are looking for the right balance between guaranteed and variable compensation as well as between both short and long-term incentives. While objectives differ from bank to bank, every board should be able to identify the particular outcomes it wants to pursue and how their fulfillment will impact the financial future of the bank.

An effective incentive plan should have measurable goals and specific rewards tied to achieving those goals. They should include a blend of bank goals that the individual can help shape as well as individual goals. The key employee must be able to make a measurable difference and see how his or her actions affect the outcome.

STRATEGIC DEFERRED COMPENSATION

Used when a bank wants to create both a recruiting and retention incentive for top talent. A strategic and customizable deferred compensation plan (DCP) is fully funded by the bank, often based on performance criteria designed to support bank strategic goals. These programs are not usually “all or nothing” in nature. In other words, there is a range of contribution levels tied to achieved performance levels, including no contributions in down years. Strategic DCPs can allow for contributions and earnings to be credited to balances based on ROA, ROE, or a phantom stock price, thereby tying the long-term value of contributions to the performance of the bank.

Deferred compensation plans often include a vesting schedule for bank contributions, designed to incentivize participants to stay employed in order to fully benefit from the plan. This serves as a mechanism to align your top performers with the goals of the bank.

For younger generations, boards should consider a feature that allows for in-service distributions. “In-service” DCP payment schedules are customizable and can be made at any point, e.g., three, five or 10 years, or even to coincide with certain life events. These can include a home purchase, student loan repayments, or a child entering college.

According to the 2023 NFP Executive Compensation and Benefits Trends Study, 60% of banks had some type of nonqualified deferred compensation plan. Of those, 83% stated they cannot afford to lose top executives, and 92% felt that executive benefits have helped to retain top talent.

EQUITY PARTICIPATION

Equity plans can be an important part of an officer’s compensation package. However, while many privately owned banks are reluctant to share actual equity with their employees, some have been more open to this strategy. An alternative strategy to sharing real shares is a deferred cash bonus plan that is tied to the appreciation of the bank's value over time.

PHANTOM STOCK/STOCK APPRECIATION RIGHTS (SAR)

Phantom stock and SARs are ways to provide an equity-like benefit to employees without having them own actual stock.

These plans can be designed to pay key officers bonus compensation tied to an increase in the bank's stock or book value. In a SAR plan, the bank determines a hypothetical stock price through an internal or external valuation of the bank. Officers are awarded some number of hypothetical or "phantom" shares that include specific terms and conditions. At a pre-determined time, the officer receives a cash payment equal to the difference between the original price and the appreciated price.

For example, let's assume the officer receives 1,000 phantom shares with a beginning price of $50. At the end of three years, the bank calculates the phantom stock price to be $75, and then pays the officer any positive difference, in this example, the bank would pay the participant $25,000.

NOW IS THE TIME TO PREPARE

The current banking environment poses many challenges, with increasing competitive pressure, a continued shortage of key talent, regulatory requirements, and future economic uncertainty. Bank leadership should be proactively taking steps to attract and retain the best people. Often times, the greatest risk to an institution is doing nothing.

Compensation should be viewed as an investment in your people and franchise and not simply an expense. If your bank has not undertaken a formal review of the competitiveness of its compensation program for officers in recent years, now is the time.

Ken Derks and Trey DeuPree are consultants with NFP Executive Benefits, which both the ABA and TBA endorse for executive and board benefits consulting, administration of BOLI and nonqualified benefit plans, BOLI portfolio solutions and BOLI risk assessment. Derks and DeuPree are registered representatives with Kestra Investment Services, Member FINRA/SIPC. NFP and Kestra Investment Services are not affiliated. To learn more, contact Ken Derks at ken.derks@nfp.com or Trey DeuPree at trey.deupree@nfp.com.


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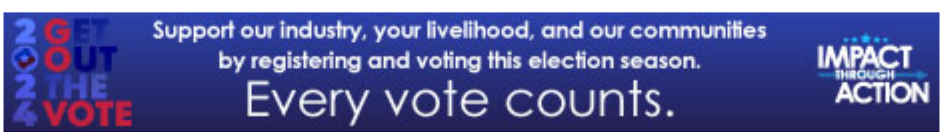
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