

Breakout II: Beyond Cash Compensation

#BDComp22

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Beyond Cash Compensation



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Bank Director Compensation and Talent Conference – November 2022

Key Topics To Be Covered

- *Total Compensation*
- *Equity-Based Incentives*
- *Executive Benefits & Perquisites*
- *Employee Benefits*

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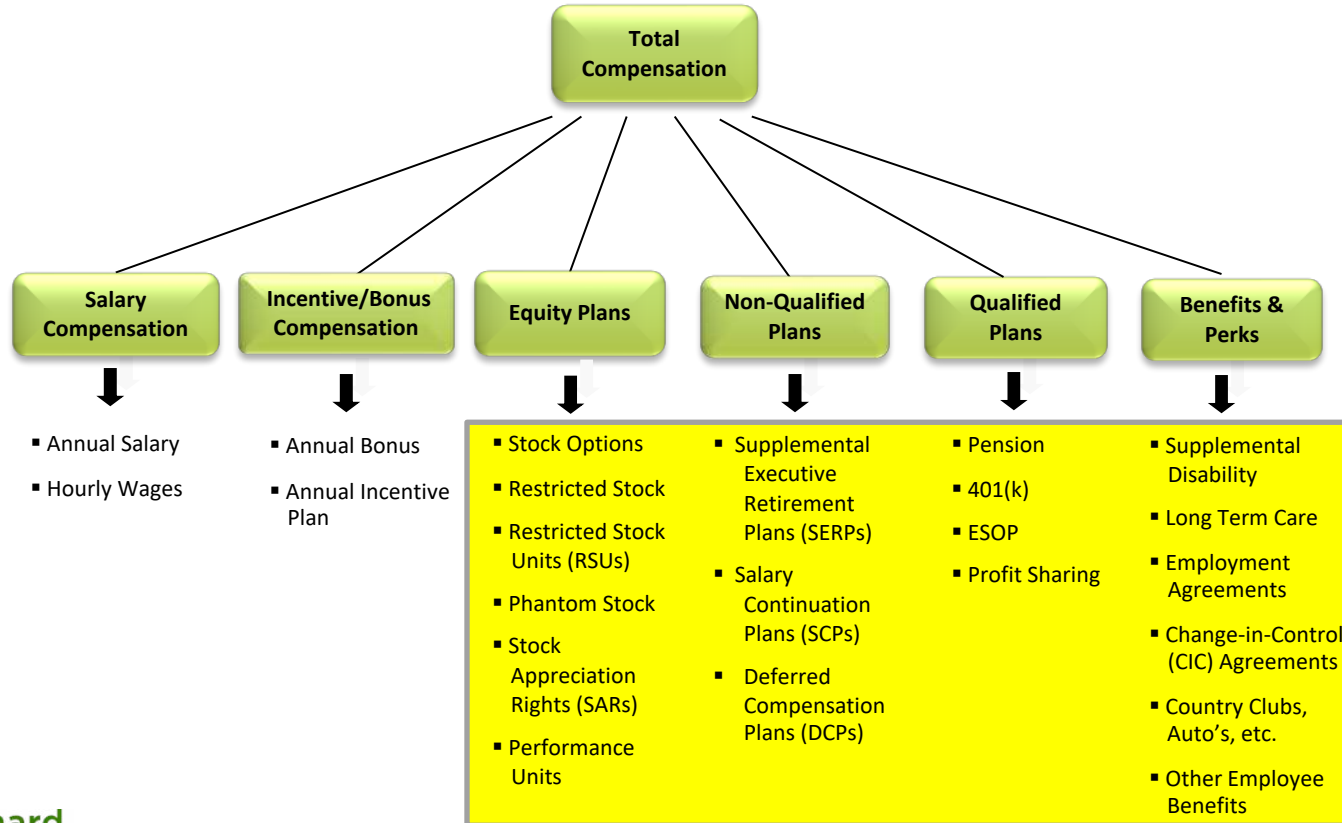
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Elements of Total Compensation



Compensation Mix

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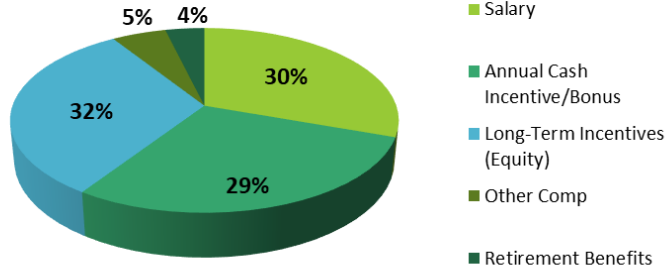
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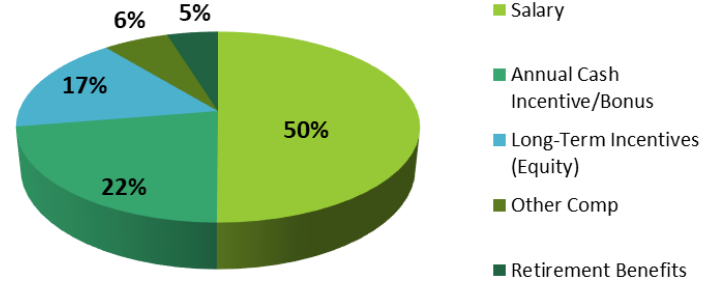
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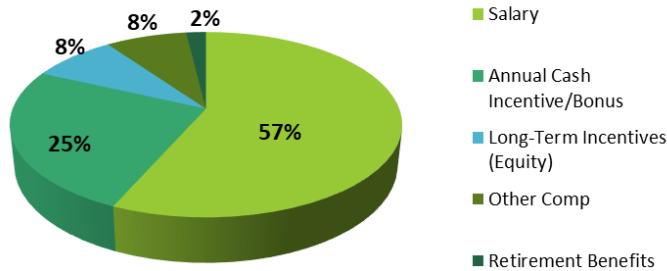
HIGHEST PAID EXECUTIVE Banks >\$3B



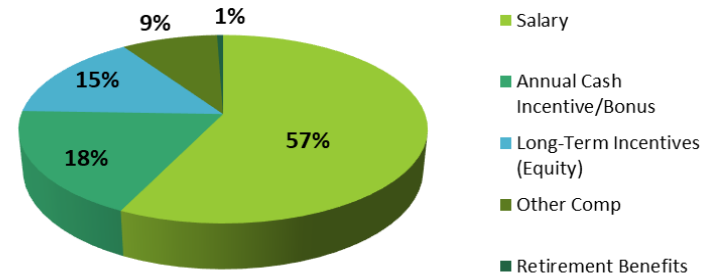
HIGHEST PAID EXECUTIVE Banks \$1B-\$3B



HIGHEST PAID EXECUTIVE Banks \$500M-\$1B



HIGHEST PAID EXECUTIVE Banks <\$500M



Total Compensation

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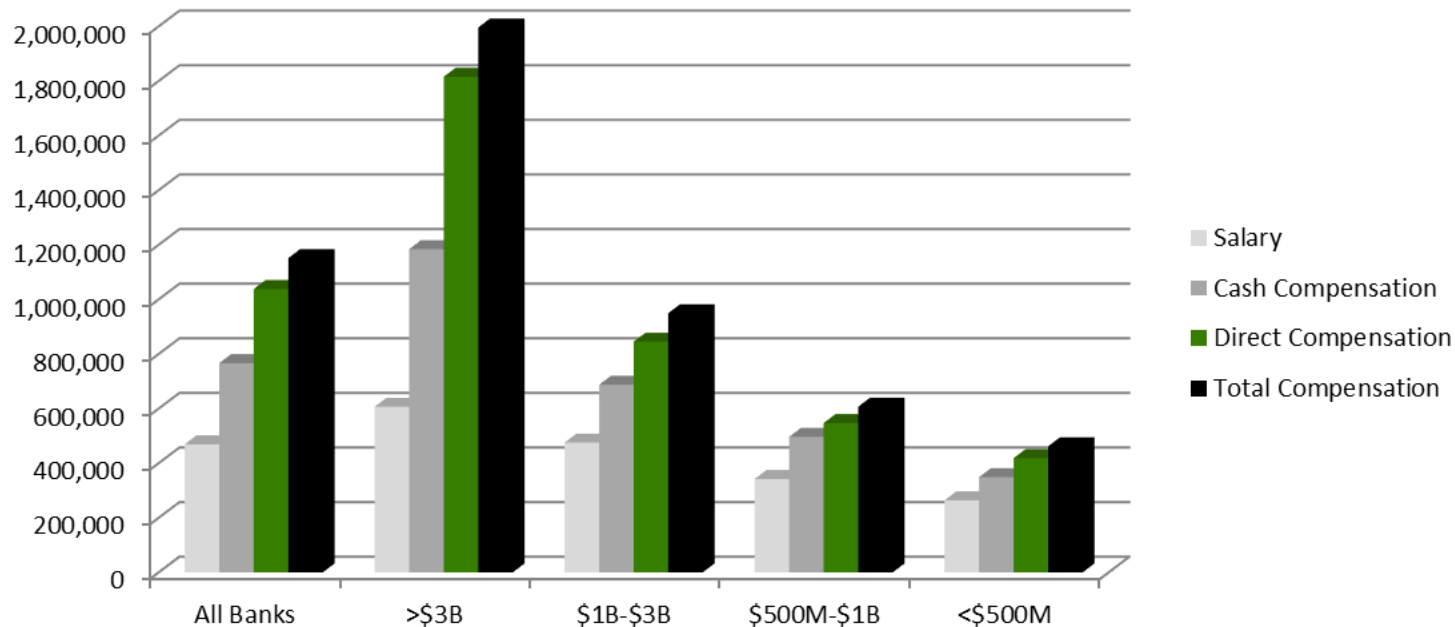
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Highest Paid Compensation (Median)



Survey Findings Included Throughout

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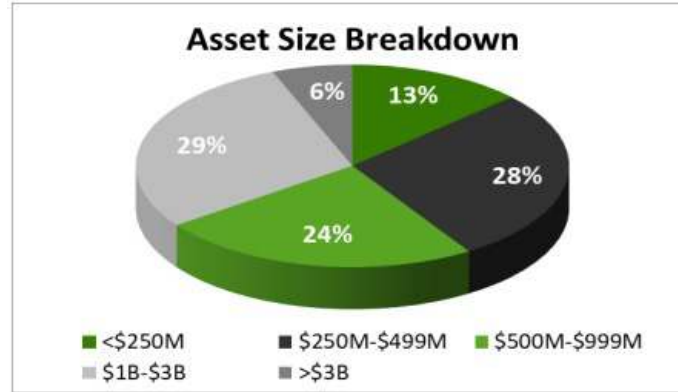
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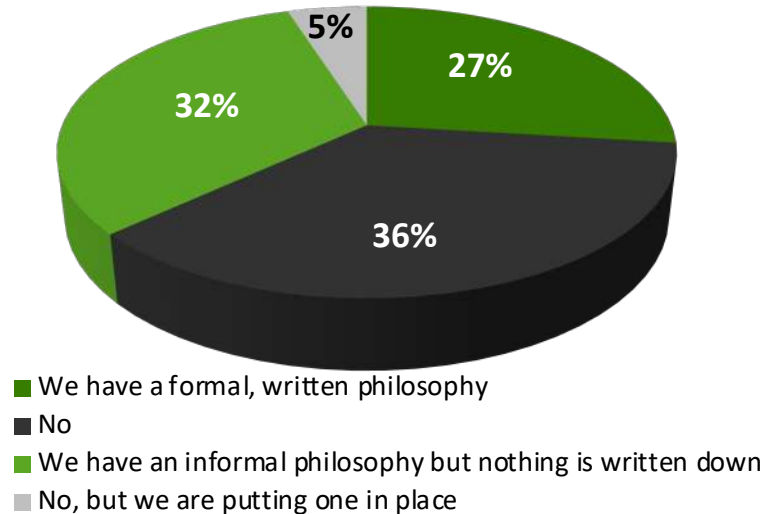
BCG 2022 Compensation Trends & Employee Benefits Survey *Included 183 banks (137 private & 46 public)*



BCG 2021 Salary & Cash Compensation Survey *Included 207 banks ** (2022 Version has 214 banks)*

Asset Cut	N
All Orgs	207
<\$250M	32
\$250M-\$500M	58
\$500M-\$1B	50
\$1B-\$3B	51
>\$3B	16

59% Have an Informal or Formal Compensation Philosophy



- ✓ A written compensation philosophy should align the Bank's goals/strategy with compensation, define its market, and indicate the Bank's targeted compensation levels compared to market. **The strategic use of compensation starts with a well-defined compensation philosophy.**

Equity-Based Incentives

Common Types of Equity-Based Incentives

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Real Equity - Actual shares of stock, which create real equity holdings and shareholder dilution

- Incentive stock options (ISOs)
- Non-qualified stock options (NSOs)
- Stock appreciation rights (SARs) – stock settled
- Restricted stock awards
- Restricted stock units (RSUs) – stock settled

“Synthetic” Equity - Value is tied to share price, but no real stock is transferred (cash payments)

- Stock appreciation rights (SARs) – cash settled
- Phantom stock
- Performance shares
- Restricted stock units – cash settled

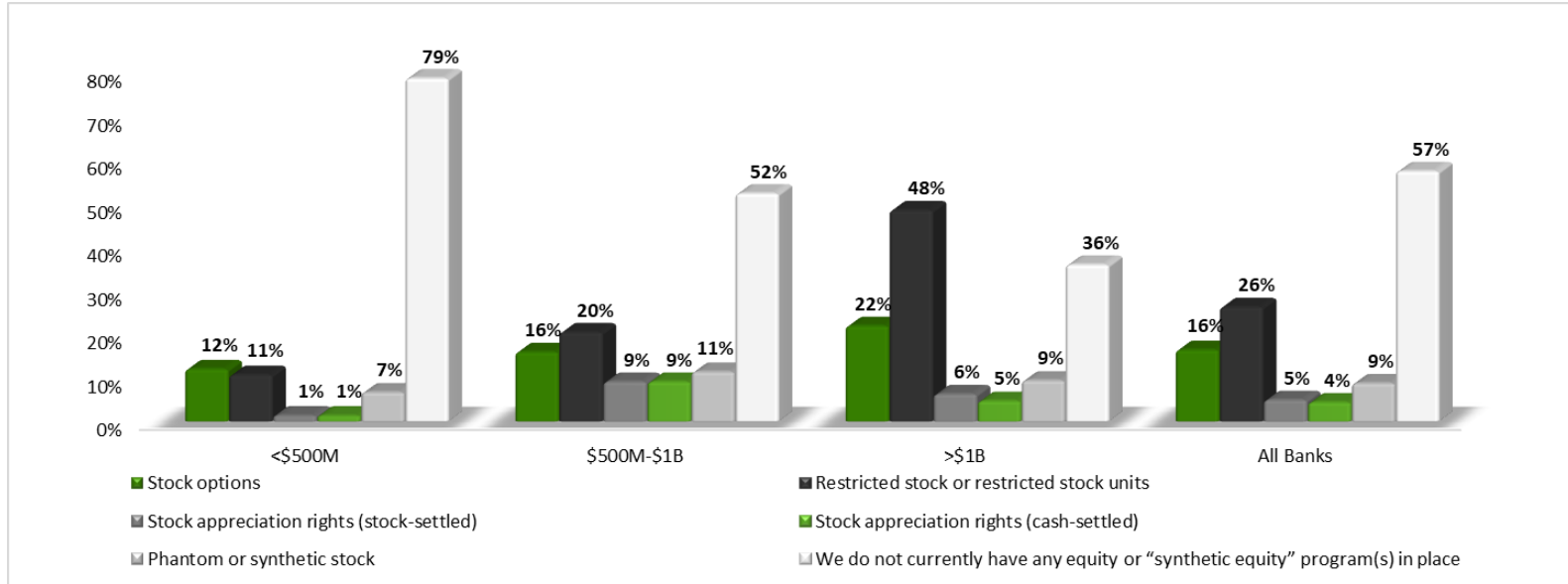
Reminders:

** *Appreciation-based vehicles (example: stock options) - value is only created with appreciation*

** *Full-value vehicles (example: restricted stock) - value is immediate and is always there so long as share has value*

Equity-Based Incentives - Prevalence

The table below from the Blanchard Consulting Group 2022 Compensation Trends and Employee Benefits Survey shows the prevalence of equity-based compensation programs/plans.*



- (43%) of the participating banks offer some form of equity/long-term incentive program. As shown in the chart above, the prevalence of banks utilizing equity/long-term incentives increase with asset size.
- Banks over \$1 billion in assets are more likely to use restricted stock or restricted stock units.

Accounting Impact of Equity Vehicles

Description	Form of Equity	Accounting Impact (Bank)	Tax Impact (Executive)	Add'l Factors
Most Common Appreciation-Based Equity Vehicles				
Incentive Stock Option (ISO)	Settled in stock at exercise where value is based on increased stock price from grant date to settlement date.	Fixed at grant date accounting based upon grant date fair value and expensed over vesting period.	<ul style="list-style-type: none"> - Taxed on appreciation - Capital gains eligible - Taxed at sale 	<ul style="list-style-type: none"> - Impacts fully diluted EPS; not eligible for additional NQ deferral
Nonqualified Stock Option (NSO)	Settled in stock at exercise where value is based on increased stock price from grant date to settlement date.	Fixed at grant date accounting based upon grant date fair value and expensed over vesting period.	<ul style="list-style-type: none"> - Taxed on appreciation - Ordinary income - Taxed at exercise 	<ul style="list-style-type: none"> - Impacts fully diluted EPS calculation - Non 409A treatment¹
Cash SAR	Paid in cash based on increased value in stock price from grant date to settlement date.	SAR measured at fair value on grant date; SARs expensed over vesting period and re-measured each reporting period at fair value until settled.	<ul style="list-style-type: none"> - Taxed on appreciation - Ordinary income - Taxed at settlement 	<ul style="list-style-type: none"> - Earnings dilution - Non 409A treatment¹
Stock SAR	Settled in stock where value is based upon increase in stock price from the date of grant to the settlement date less the stock basis and taxes due.	Fixed at grant date accounting based upon grant date fair value and expensed over vesting period.	<ul style="list-style-type: none"> - Taxed on appreciation - Ordinary income - Taxed at settlement 	<ul style="list-style-type: none"> - Impacts fully diluted EPS calculation - Non 409A treatment¹
Most Common Full-Value Equity Vehicles				
Restricted Stock	Settled in stock when vesting conditions are met; value based upon stock price at vesting date.	Fixed at grant date accounting based upon grant date fair value and expensed over vesting period.	<ul style="list-style-type: none"> - Taxed on full value - Ordinary income (or 83(b)) - Taxed at vesting (or grant) 	<ul style="list-style-type: none"> - Earnings dilution - Non 409A treatment¹
Restricted Stock Units	Settled in stock after vesting schedule is met; value based on stock price at date of vesting.	Fixed at grant date accounting based upon grant date fair value and expensed over vesting period.	<ul style="list-style-type: none"> - Taxed on full value - Ordinary income - Taxed at vesting 	<ul style="list-style-type: none"> - Earnings dilution - No voting or dividends - Non 409A treatment¹
Phantom Stock	Paid in cash that increases in value based upon the full value of the stock plus any appreciation from the date of grant to the settlement date.	Phantom Stock is measured at fair value on grant date; Phantom Stock is re-measured each reporting period at fair value until award is settled.	<ul style="list-style-type: none"> - Taxed on full value - Ordinary income - Taxed at settlement 	<ul style="list-style-type: none"> - Earnings dilution - Non 409A treatment¹

Equity Incentive Plans – Usage Trends

Full-value shares are more prevalent than stock options.

- The table below shows the prevalence of restricted stock vs. stock options in the Blanchard Consulting Group database of public banks.

Prevalence ¹	Equity Prevalence in Public Banks		
	Restricted Stock	Stock Options	Blend ²
All Banks (n=430)	75%	18%	15%
Banks that Granted Equity (n=338)	95%	23%	19%

Executives & Officers: *Most vesting provisions in banks are 3-5 years.*

Stock Options:

- Ratable Vesting: Awards vest in tranches over the vesting period (i.e., $\frac{1}{4}$ per year in each of the 4 years)

Restricted Stock:

- Cliff Vesting: Awards vest entirely at the end of the vesting period (which is typically a time period or meeting performance criteria)

Performance-Based Grants vs. Performance-Based Vesting

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General Industry: Frequently uses performance-based vesting with LTI plans.

- ✓ **Performance-Vesting Methodology:** Grants are made at the beginning of a performance period and vesting only occurs when pre-defined performance metrics are met.

Banking Industry: Tends to use retention focused grants (discretionary with time vesting) or performance-based grants with additional time vesting for LTI plans.

- ✓ **Performance-Granting Methodology:** Grants are made at the end of a performance period (typically one year) with an additional 3-5 year service/time vesting after the grant.

Performance-Based Equity – Blanchard Survey

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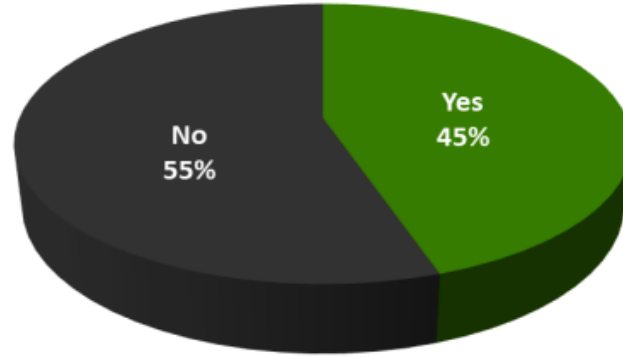
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Almost Half of Participants Use Performance-Based Equity (vesting or granting)



- ✓ The most prevalent performance metrics utilized in determining the granting or vesting of equity awards are:
 - Net income (54%) / Loan Growth (46%) / ROE (40%) / ROA (37%) / Asset Growth (37%)
- ✓ 83% of participants with an equity plan have a minimum of a 1-year vesting period.
- ✓ 59% of banks that maintain an equity plan allow for accelerated vesting of outstanding equity grants in the event of a change-in-control (without a termination event – “single trigger acceleration”).

Equity Incentive Plan Goals – General Industry

General Industry: Total Shareholder Return (TSR) is the most common “Relative” measure used in LTI plans, while Earnings is the most common “Absolute” measure used in LTI plans.

<u>Performance Measure Categories</u>		
Category	Performance Measure	Percent of Companies with Performance-Based Equity
Total Shareholder Return	<i>Stock Price Appreciation + Dividends</i>	67%
Profit	<i>EPS, Net Income, EBITDA Operating, etc.</i>	55%
Capital Efficiency	<i>ROE, ROA, Return on Capital</i>	38%
Revenue	<i>Revenue, Organic Revenue</i>	23%
Cash Flow	<i>Cash Flow, Operating Cash Flow, etc.</i>	15%
Other	<i>Safety, Quality, New Business, Individual Performance</i>	14%

***Data is Based on the FW Cook Top 250 Report*

Equity Incentive Plan Design

Sample Performance-Based Equity Incentive Plan Design

Tier	Title	Equity Award (% of Salary)		Equity Allocation	Total Over 10 Yr Period	
		Target	Max	Restricted	Target	Max
I	President/CEO	10%	20%	100%	3,300	6,598
II	Chief Credit Officer	5%	10%	100%	1,173	2,343
II	Senior Lender	5%	10%	100%	1,081	2,164
II	Commercial Lending & Private Banking	5%	10%	100%	879	1,760
II	Chief Financial Officer	5%	10%	100%	854	1,707
II	Loan Admin & Deposit Operations	5%	10%	100%	807	1,617
II	Retail Banking & Chief Compliance Officer	5%	10%	100%	772	1,543
III	SVP/Commercial Lending	2.5%	5%	100%	533	1,071
III	SVP/Mortgage Lending	2.5%	5%	100%	309	615
	Discretionary Tier	1,500 shares/yr.		100%	15,000	
Total # of Shares					24,708	34,418
Total Estimated Expense					\$2,636,024	\$3,614,514

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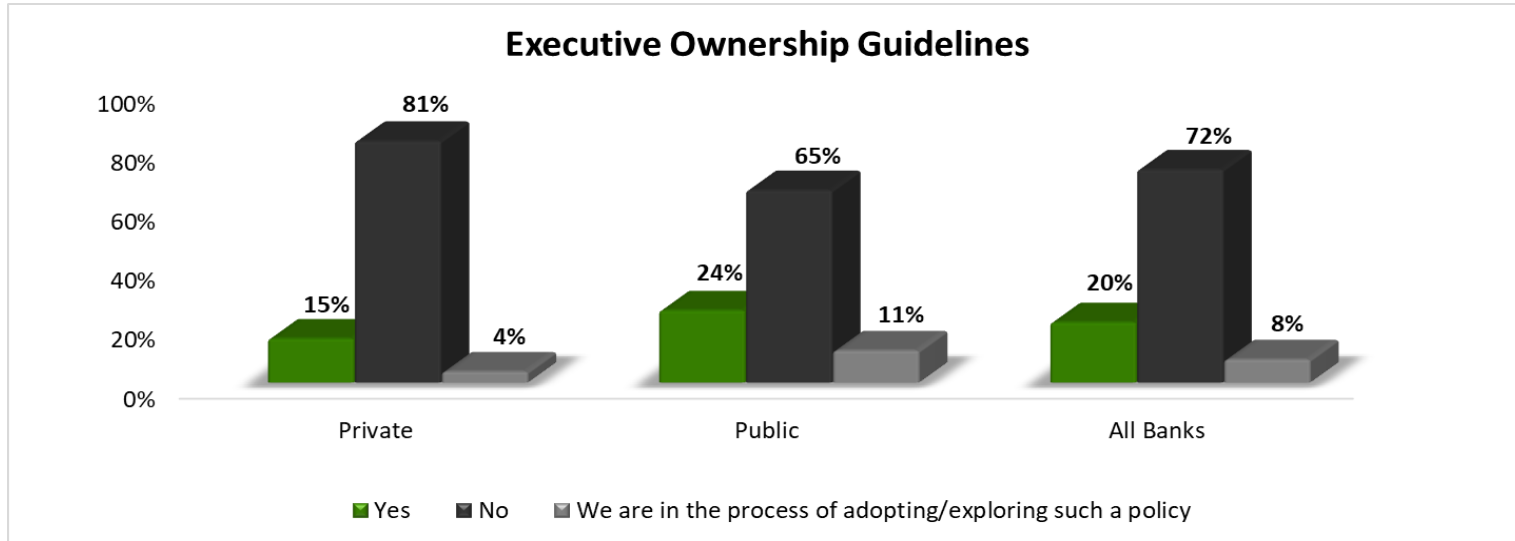
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Equity Incentive Plans – Ownership Guidelines

Equity Ownership Guidelines

- Prevalence of ownership or holding requirements is expected to continue to increase as this is considered a best practice by industry experts and shareholder advisory groups.
- Chart below shows how they are starting to be adopted in the banking industry.¹



¹ Executive Ownership Guidelines are from the Blanchard Consulting Group 2022 Compensation Trends and Employee Benefits Survey.

Institutional Shareholder Guidelines for Equity Plans

For publicly-traded banks registered with the SEC, institutional shareholder groups such as ISS and Glass Lewis will evaluate any new equity plan. Plan provisions that these groups evaluate include the following:

Shareholder Value Transfer (amount of wealth flowing from shareholders to employees/directors).

Plan Features

- Minimum vesting requirements (at least one year)
- Change-in-Control vesting (single or double trigger)
- Share recycling
- Re-loading of shares that are forfeited or not earned
- Performance-based grants or vesting
- Board Discretion on accelerating vesting
- Dividends on unvested awards

Grant Practices

- Burn Rate (how much equity is granted over a 3-year period)
- Overhang (potential dilution (shares available to grant + unvested/unexercised shares to total common shares))
- Plan Duration (estimated time that the share reserve will last)

Executive Benefits & Perquisites

Executive Benefits

This table provides industry prevalence information on various compensation and benefit plans at community banks at various asset sizes. ***This information is from Blanchard Consulting Group's internal database of publicly-traded banks.***

Assets	N	Median Assets (\$000)	Agreements		Retirement					
			Employment	Change-in-Control	401(k) Plan	Qualified Profit Sharing	Qualified Pension Plan	Deferred Comp. Plan	SERP	Deferred Comp or SERP
All Orgs	247	1,607,330	74%	87%	100%	56%	7%	34%	44%	63%
<\$500M	21	300,532	81%	86%	100%	67%	10%	14%	29%	38%
\$500M-\$1B	50	778,448	56%	84%	100%	50%	8%	22%	48%	64%
\$1B-\$3B	110	1,646,727	79%	87%	100%	58%	7%	34%	49%	63%
>\$3B	66	5,293,943	77%	89%	100%	55%	5%	52%	36%	71%

Executive Deferred Compensation Prevalence – BCG Survey

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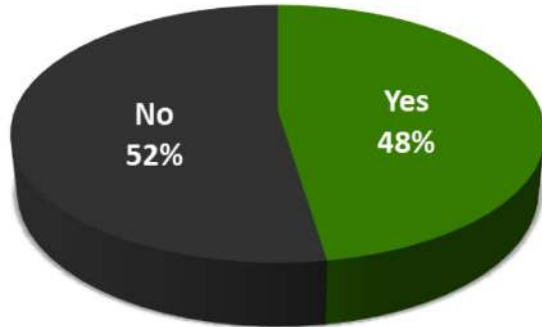
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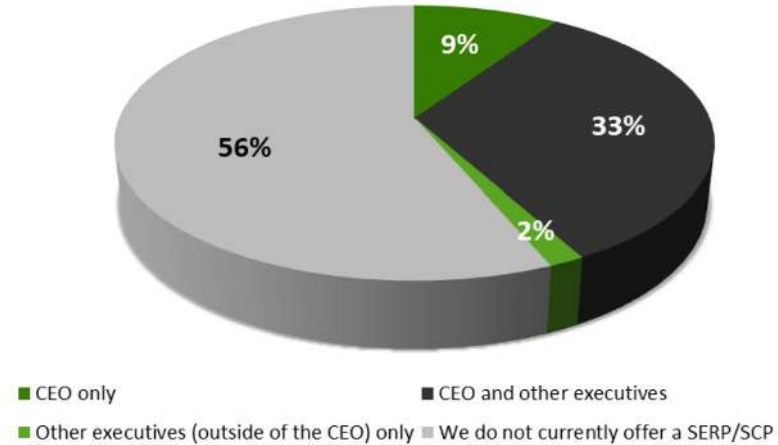
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Does your bank offer a DCP for your executives?



Which executive(s) have a SERP or SCP?



- Almost half of the responding banks offer a deferred compensation plan to executives.
- Approximately 44% of the responding banks offer a SERP/SCP to at least one executive.

Supplemental Executive Retirement Plans (SERPs) – BCG Survey

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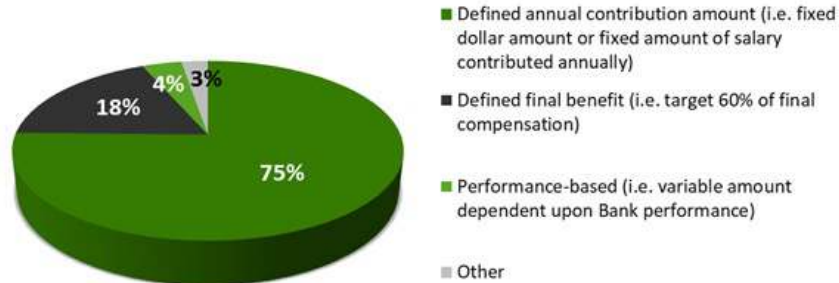
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Benefit amount calculations for the CEO's SERP/SCP



Annual Contribution (fixed dollar amount):

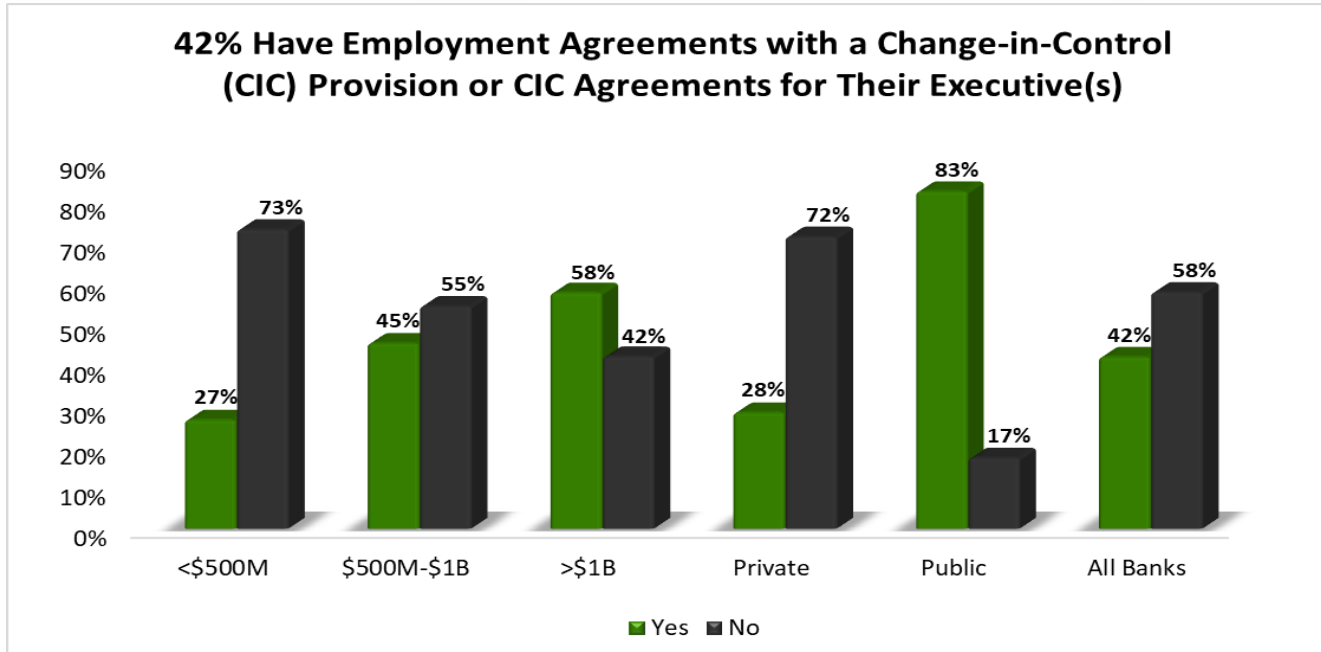
- Greater than \$300,000 (7%)
- \$200,001-\$300,000 (7%)
- \$150,001-\$200,000 (22%)
- \$100,001-\$150,000 (19%)
- \$50,001-\$100,000 (26%)
- Less than \$50,000 (19%)

Defined Final Benefit (target percent of final comp):

- 50% or more of final compensation (79%)
- 40%-49% of final compensation (14%)
- 30%-39% of final compensation (0%)
- 20%-29% of final compensation (7%)
- 10%-19% of final compensation (0%)
- Less than 10% of final compensation (0%)

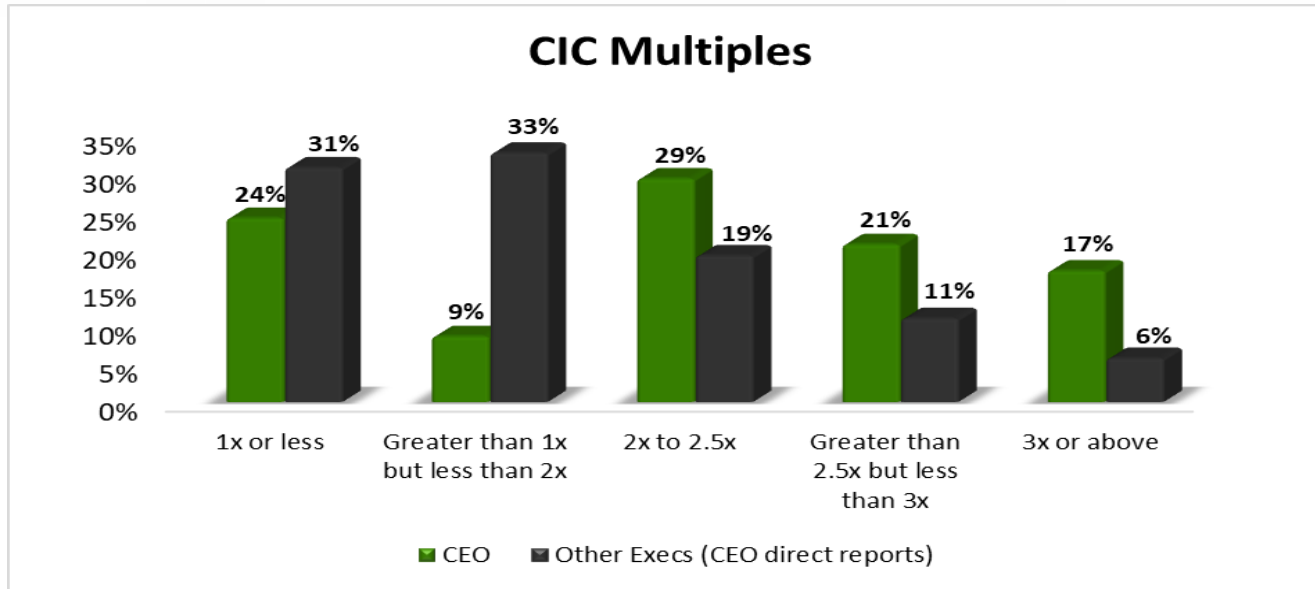
- The majority of participants define "final compensation" as projected salary (57%) or cash compensation (salary + bonus) (36%).

Employment/Change-in-Control (CIC) Agreements – BCG Survey



- ✓ Only 42% of the responding banks report having some form of change-in-control provision in place for executives. However, as shown in the chart above, **public banks show a higher prevalence (58%)** of having employment/change-in-control agreements.
- ✓ Of the responding banks that have an employment agreement for their CEO, 41% have a term of three years. In addition, seventy-five percent (75%) of banks with an employment agreement for their CEO have automatic renewals.

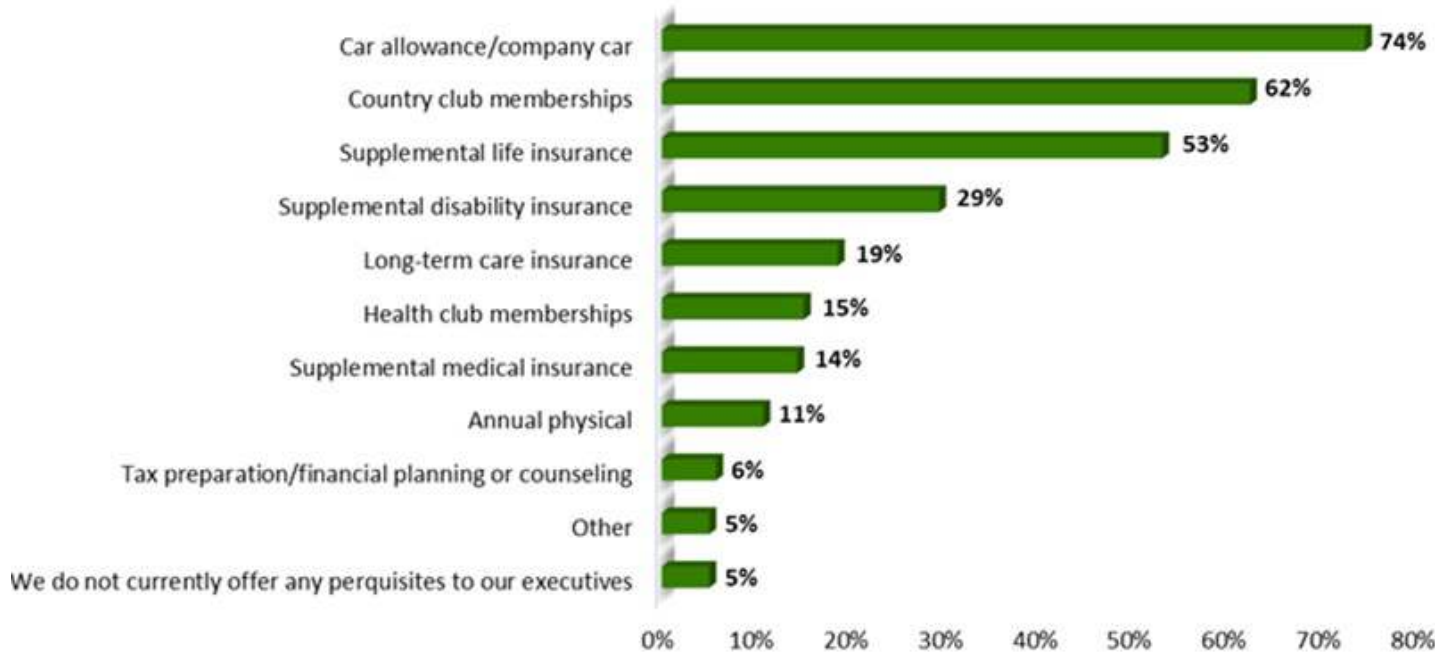
Change-in-Control (CIC) Severance Multiples – BCG Survey



- The severance benefit payout is typically a multiple of salary, cash compensation (salary + annual cash incentive/bonus), W2 average compensation, etc. at the time of termination.
- 55% of respondents who pay CIC severance benefits to the CEO base the benefit on the CEO's salary and 34% base the benefit on cash compensation.
- **Gross Ups for 280(G)** are no longer prevalent as 79% of participating banks DO NOT provide a gross-up.

Executive Perquisites – BCG Survey

The table below shows the prevalence of perquisites offered to executives at each of the participating banks.*



* Respondents were allowed to choose more than one option; therefore, the percentages will not sum to 100%.

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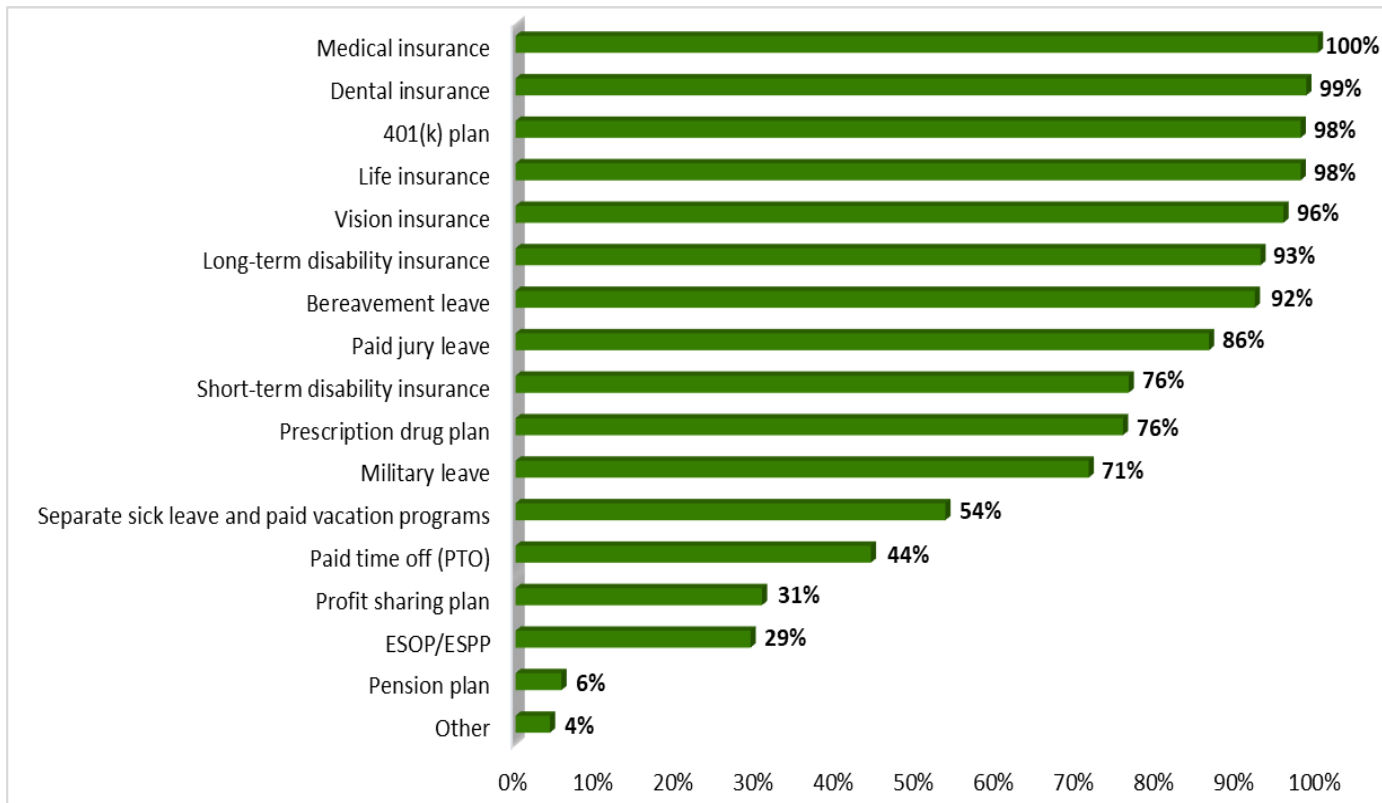
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Employee Benefits

Employee Benefits – BCG Survey

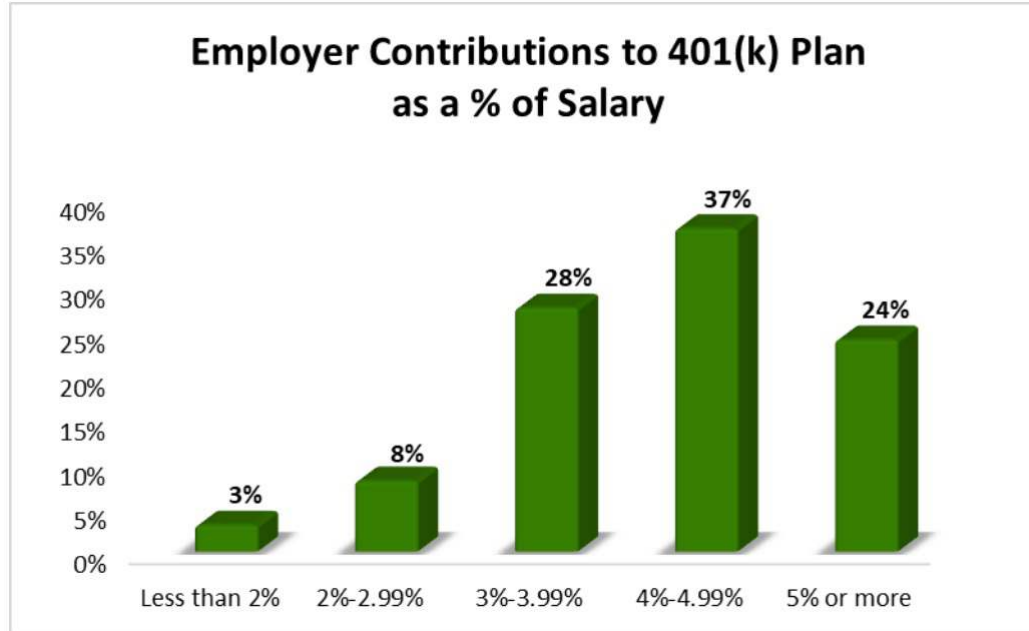
The table below shows the prevalence of benefits offered to employees at each of the participating banks.*



* Respondents could choose more than one option; therefore, the percentages will not sum to 100%.

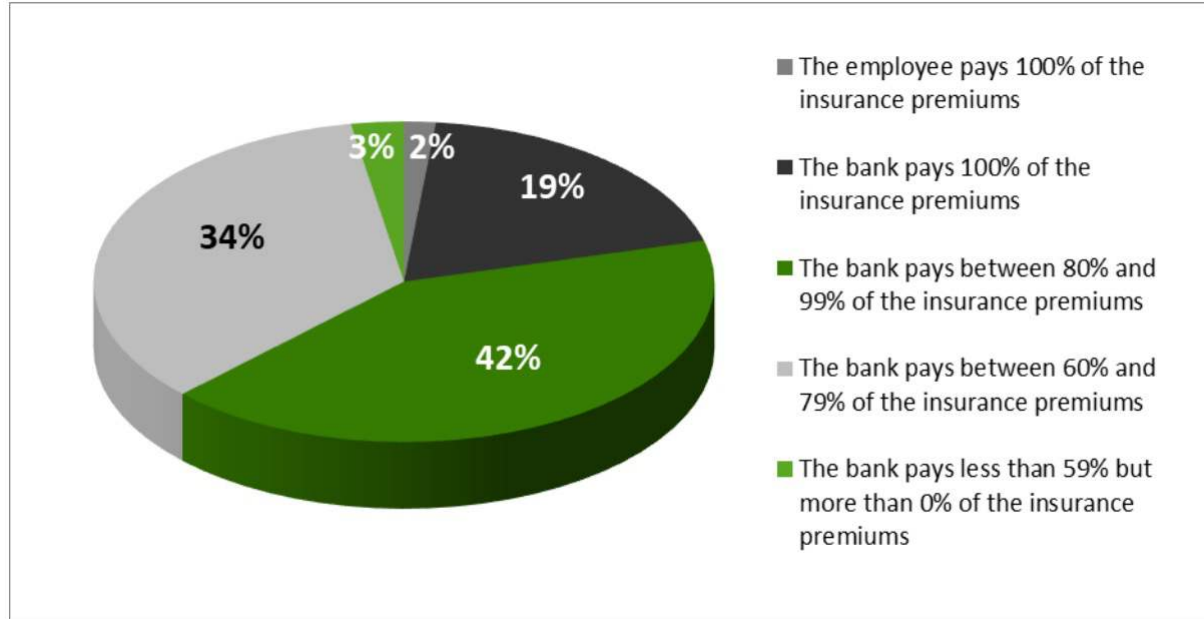
401(k) Matches – BCG Survey

Ninety-seven percent (97%) of the participating banks offer a 401(k) plan to their employees. Of those, 94% make an employer matching contribution. We summarize these contribution levels below.



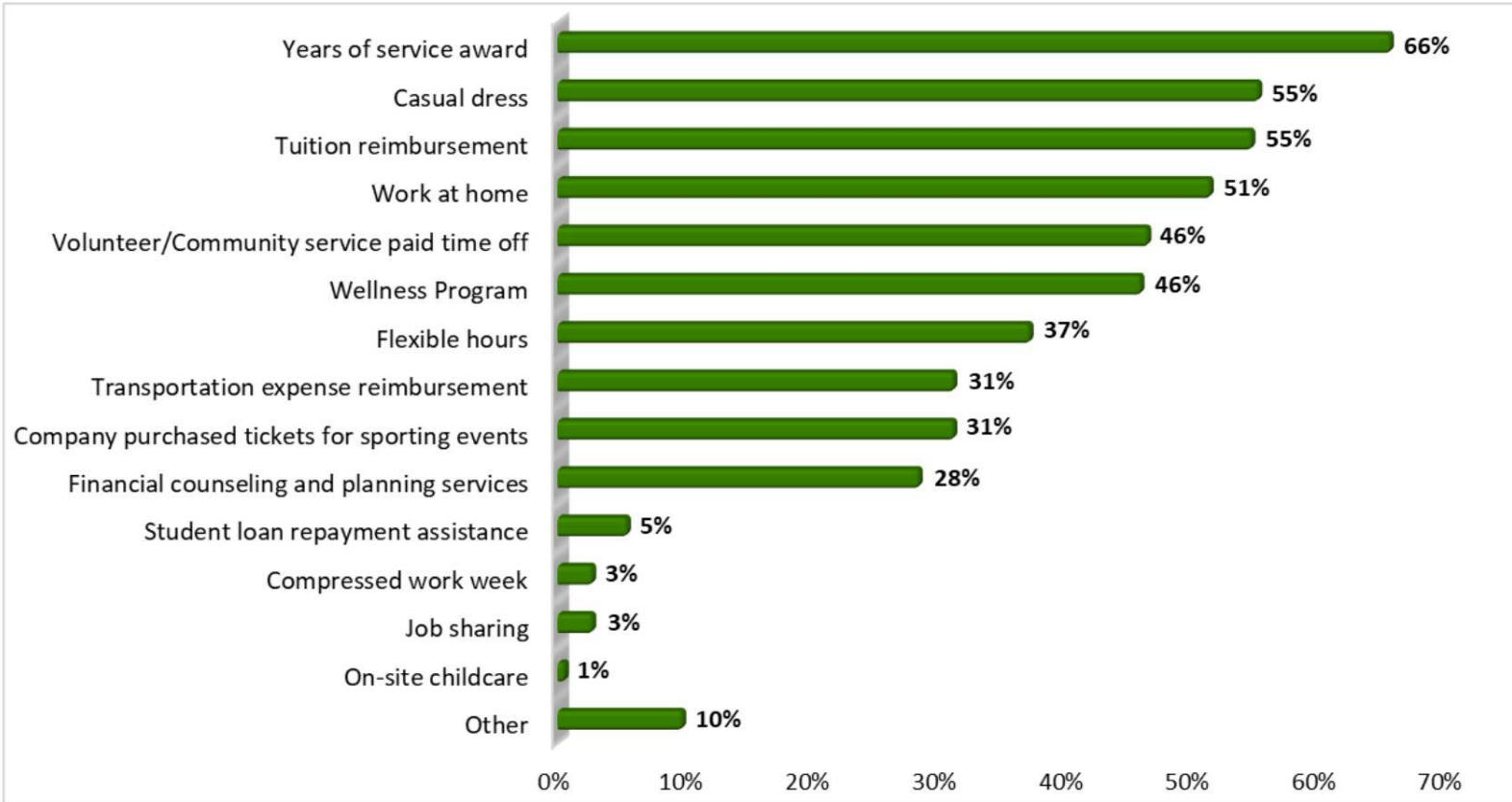
Medical Benefits

All of the participants offer medical insurance to their employees. The table below summarizes the portion of the medical benefit paid for by employers



✓ 73% had a cost increase, 18% stated no change in costs, and 9% said they had a cost decrease.

Non-Traditional Benefits



Other Trendy Benefits

A few other benefits making “noise” in the marketplace include:

- **Pet Insurance**
- **Student Loan Repayment**
- **Unlimited PTO**
- **Identity Theft Insurance**
- **Fertility Benefits**
- **Financial Planning Assistance**
- **Mental Health Assistance**

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Questions?

