Compensation
Advisory Partners

Industry Report // 2018-2019

Regional Banking

Compensation Advisory Partners (CAP) examined 2018 executive pay levels and pay practices among 43 companies in the regional bank industry. The companies were stratified into three groups based on asset size: $1B - $5B in assets (“small banks”; n=14), $5B - $10B in assets (“medium banks”; n=15) and $10B - $20B in assets (“large banks”; n=14). This report discusses both the similarities and differences in compensation levels and practices between the three groups.

NEW YORK
1133 Avenue of the Americas
New York, NY 10036
Phone: (212) 921-9350 | Fax: (212) 921-9227
www.capartners.com

HOUSTON
One Riverway
Suite 1771
Houston, TX 77056
Phone: (713) 559-2710

CHICAGO
200 S Wacker Drive
Suite 3100
Chicago, IL 60606
Phone: (312) 462-4500

LOS ANGELES
400 Continental Blvd
6th Floor
El Segundo, CA 90245
Phone: (310) 426-2340

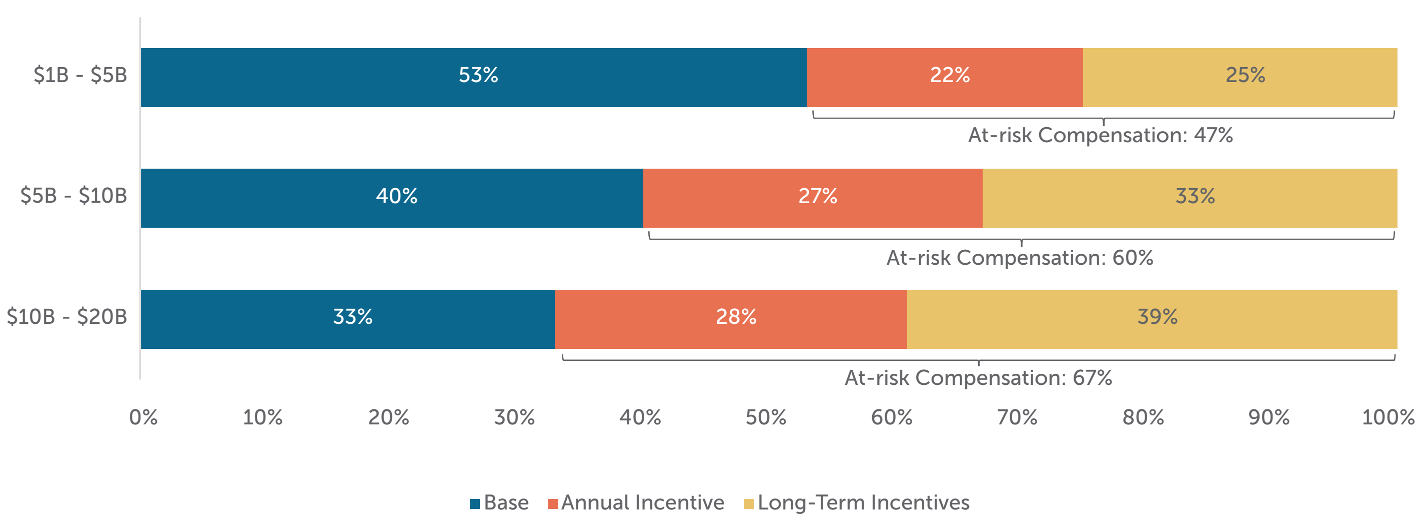
Highlights

- As banks increase in size, a higher percentage of total pay shifts from fixed compensation to at-risk or variable compensation
- 2018 was a strong financial performance year with annual incentive payouts to Chief Executive Officers (CEOs) above target for all groups reviewed
- The ratio of CEO pay relative to other Named Executive Officers (NEOs) increases as banks increase in asset size
- For all banks, the most prevalent metrics generally include Asset Quality, Efficiency Ratio, Return on Assets (ROA), Return on Equity (ROE), Earnings Per Share (EPS), and Net Income in their annual incentive plans with smaller banks also factoring in Loan and Deposit levels more frequently
- For long-term performance plans, relative Total Shareholder Return (TSR), ROA, ROE and EPS are frequently used together. Larger banks also incorporate other metrics more often on both a relative and absolute basis
- A well-designed compensation program that is aligned to the bank's business strategy is necessary to garner shareholder support and to attract and retain talent

CEO Target Pay Levels and Mix

Unsurprisingly, CEO total target compensation is correlated with bank size. This is seen across industries, as larger organizations are generally more complex and, therefore, leading these companies usually comes with greater management challenges and risks. For banks, larger asset sizes generally mean the institution has more customers and branches, and/or the bank offers more products and services. Higher pay levels also correlate with a larger portion of pay that is at-risk or variable, and comes with a higher level of scrutiny from investors and regulators. Executives are often paid more fixed compensation, on average, at smaller banking institutions and more variable compensation at larger banks.

CEO Target Pay Mix by Asset Size



This is evident when looking at the percentage of target compensation that CEOs received during the last fiscal year, where 53 percent of compensation was fixed at the small banks compared to 40 percent at the medium banks and only one-third at the large banks. Larger banks also grant more compensation in the form of equity, which is tied to either multi-year vesting and/or performance criteria. These equity grants make up approximately one-third of medium bank target pay for CEOs and roughly 40 percent at the large banks in the sample. By comparison, smaller banks only grant 25 percent of their compensation, on average, in these long-term equity vehicles. Additionally, we found that not all small banks grant equity on an annual basis.

2018 Performance and Pay Outcomes

Performance Results

Financial performance appeared strong in 2018 when compared with 2017, which can be attributed, in part, to the reduction in the corporate tax rate under the Tax Cuts and Jobs Act in 2017. This reduced tax rate magnified year-over-year changes in after-tax metrics such as EPS and Net Income, with banks of all sizes performing very well. Pre-tax Operating Income and ROE results were also strong for all groups. TSR, on a one-year basis, was generally down for the year ending December 31, 2018; however, this was consistent with the downward trend seen in the overall market and super regional and Wall Street banks at the end of 2018.

	Median Percent Change Year Ended December 31, 2018		
	Asset Size		
Metric	**$1B - $5B**	**$5B - $10B**	**$10B - $20B**
EPS	+37.4%	+29.5%	+58.7%
Net Income	+52.0%	+43.1%	+71.3%
Pre-tax Operating Income	+14.2%	+10.3%	+14.1%
Return on Equity	+171 bps	+134 bps	+251 bps
1-Year TSR	-10.1%	-18.8%	-16.4%

Bps – Basis points

Source: S&P Capital IQ Financial Database

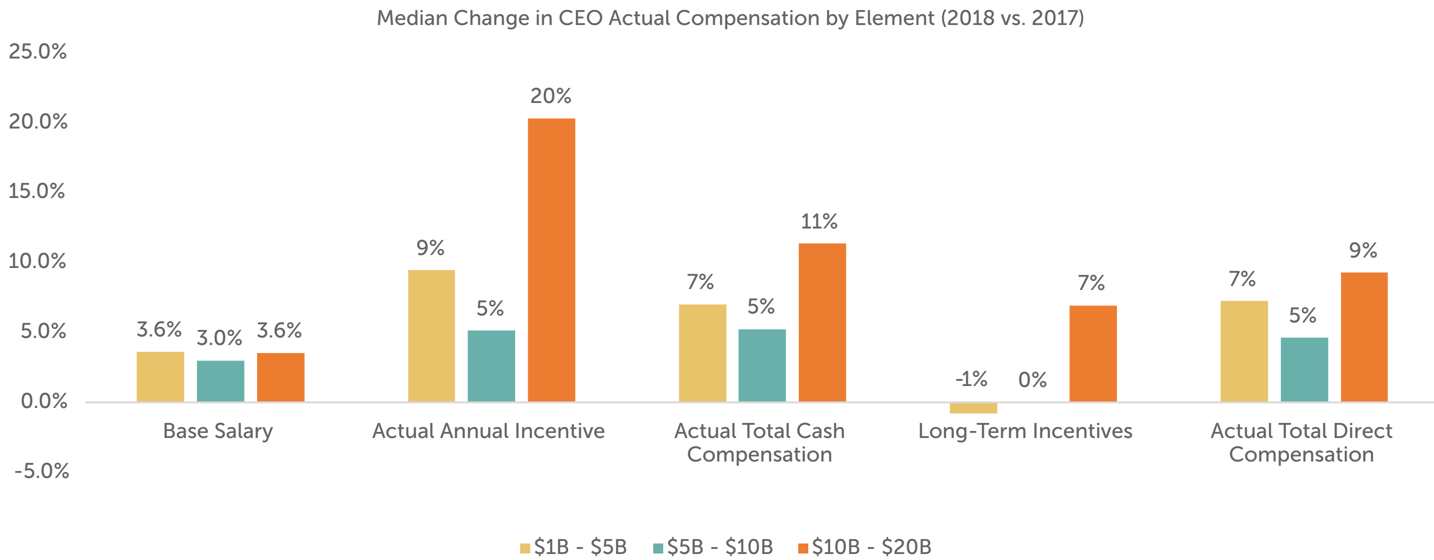
CEO Annual Incentive Payouts

Overall, the large banks had the best performance of the three groups in 2018 based on the financials reviewed, followed by the small banks. This performance was ultimately rewarded by annual incentive plans, as seen in CEO annual incentive payouts. Large banks had the highest annual incentive payouts as a percentage of target, 127 percent, at median, and only one bank in the large bank group paid an annual incentive below target.

	CEO Payout as Percent of Target		
	Asset Size		
Summary Statistics	**$1B - $5B**	**$5B - $10B**	**$10B - $20B**
75th percentile	142%	124%	147%
Median	117%	100%	127%
25th percentile	94%	76%	114%

Total Pay Changes

CEO actual total compensation (base salary, actual annual incentive and long-term incentives) also increased in 2018. The largest increase was at the large banks (9%) which was driven by a combination of higher annual incentive payouts and larger long-term equity grants. Long-term incentive (LTI) levels were flat year-over-year, at median, at both the small and medium sized banks. The actual total direct compensation increases seen at these groups (7% and 5%, respectively) were driven primarily by higher annual incentive payouts in 2018 compared to 2017. Base salaries increased modestly (3% to 3.5%), at median, for each group.



Other Executive Pay / Roles

In addition to CEO pay, companies are required to disclose compensation for the Chief Financial Officer (CFO) and the next three highest paid other executives or NEOs in their Summary Compensation Tables (at smaller companies, sometimes only one other executive besides CEO and CFO is disclosed). The positions and roles that these other NEOs have vary somewhat based on the size of the bank. NEO positions that are commonly seen across these three groups include President, Chief Operating Officer, Chief Credit Officer, Chief Lending Officer, various Bank Leaders, and Chief Risk Officer. The small and medium sized banks more frequently have Chief Credit Officers and Chief Lending Officers in their NEO group whereas the larger banks in our sample more frequently have General Counsels, Chief Administrative and Chief Information Officer positions. Differences in NEO composition among our three sample groups may be indicative of each bank's stage in their evolution and each bank's critical areas of oversight.

The CFOs at the small and medium banks were paid approximately half of what the companies' CEOs took home, at median, compared to 40 percent at median for the large banks. When looking at the median for average other NEO compensation, smaller bank NEOs are compensated the highest as a percent of CEO pay at 50 percent. This median compensation figure for other NEOs trends downward for medium banks (44%) and large banks (36%).

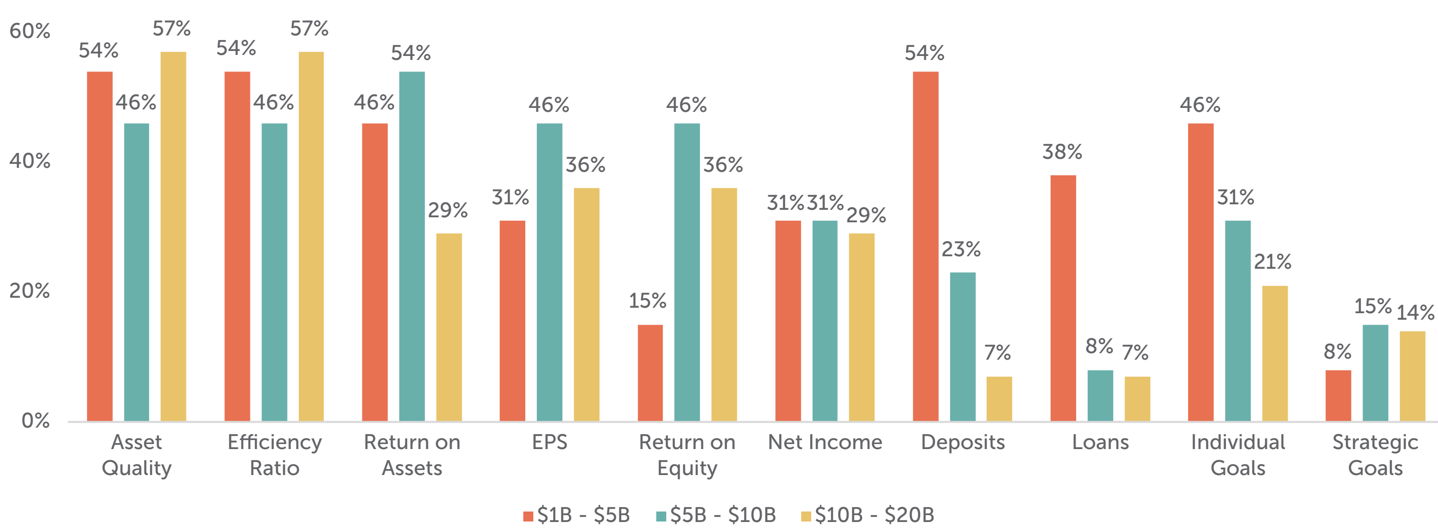
Asset Size	Percent of CEO Total Direct Compensation			
	CFO		All Other NEOs	
	Median	Range	Median	Range
$1B - $5B	51%	31% - 66%	49%	30% - 60%
$5B - $10B	49%	38% - 71%	44%	31% - 67%
$10B - $20B	40%	23% - 61%	36%	22% - 61%

Pay Practices

Annual Incentive Plans

The most common annual incentive plan approach is a "goal attainment" plan where actual financial achievement is compared to pre-established goals made at the beginning of the fiscal year. The banks in our sample typically utilize several corporate metrics when determining their annual incentive payout. Approximately 80 percent of the medium and large banks use three or more weighted financial metrics compared to 85 percent of the small banks. Return measures (ROE, ROA, etc.), Efficiency Ratio, Asset Quality, EPS, and Net Income are the most prevalent metrics used at these banks; however, Returns, EPS and Net Income were typically weighted more than Efficiency Ratio and Asset Quality metrics. The small banks differ from the medium and large banks in that they more frequently use Loan or Deposit measures in their plans, with these metrics usually accounting for no more than 20 percent of the total plan.

Annual Incentive Metric Prevalence by Asset Size

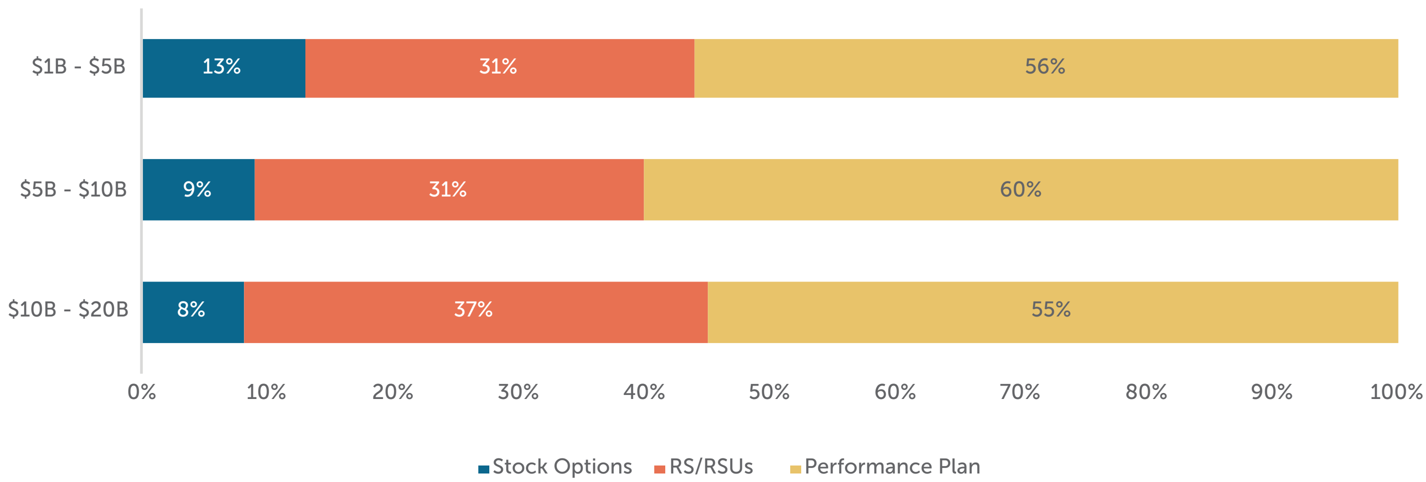


Smaller banks also tend to use and assign higher weightings to individual and strategic measures. These individual and strategic measures are prevalent at 54 percent of the small banks studied compared to 46 percent and 35 percent at the medium and large banks, respectively. These individual and strategic measures can often vary year to year due to shifting priorities of different initiatives at the bank. Diversity and inclusion measures are making headlines (i.e., Citigroup included in its scorecard for senior executives), though it is still a minority practice to formally include these types of metrics in incentive plans. These priorities are likely being discussed at all banks, and it will be interesting to see if and how these measures are incorporated in the future when determining compensation.

Long-term Incentive Plans

The most typical long-term incentives used across industries, including the banking industry, include stock options, time-vested stock (restricted stock (RS) or restricted stock units (RSUs)) and performance-vested stock. Most medium and large banks use a portfolio approach in their long-term incentive plan, with approximately three-fourths of these banks granting two or three LTI vehicles. Small banks more frequently either use a single LTI vehicle (43%) or have no long-term incentive plan (14%). The LTI mix seen between the three groups is fairly consistent, with stock options continuing to be the least utilized LTI vehicle, on average about 10 percent of the overall LTI mix. Time-vested restricted stock typically makes up about 30 percent to 40 percent of the LTI mix among these banks, with performance plans making up the bulk (55% to 60%) of LTIs in the total sample.

CEO LTI Mix by Asset Size

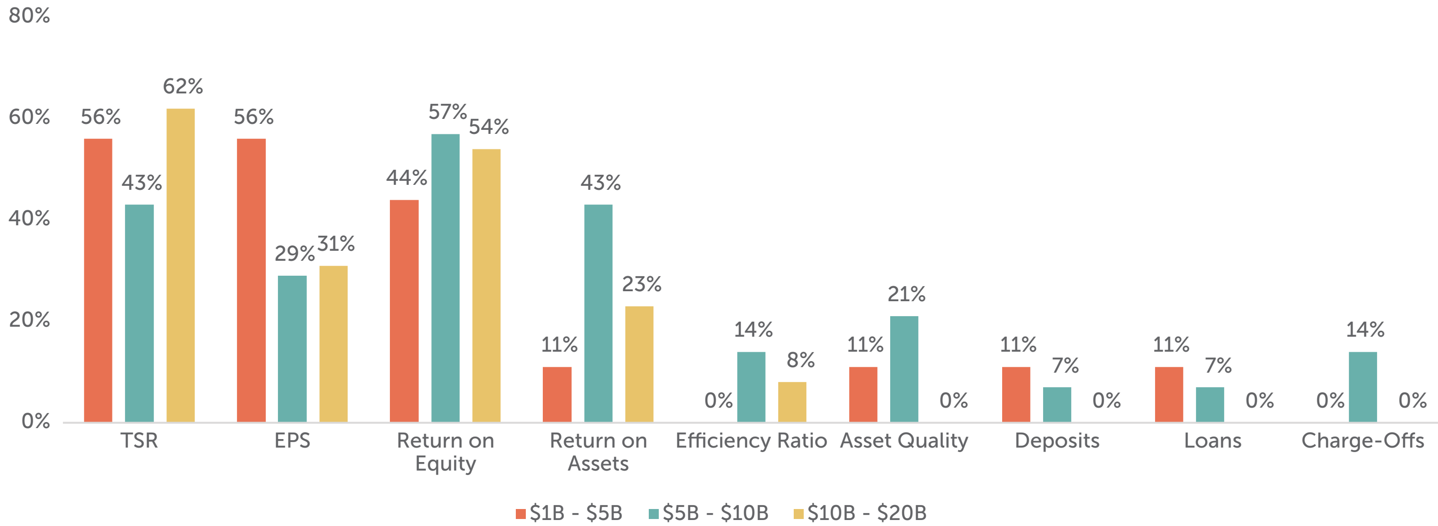


Performance plans are typically granted annually and have overlapping 3-year performance periods. Payouts can fluctuate based on achievement of performance measures, and the upside is normally limited to 150 percent to 200 percent of the target level. Over three-quarters of companies in each asset group measure performance for their performance plan against two or more metrics. The most prevalent metrics used are relative TSR, Returns and EPS for all three groups, and it is common that two of these measures are paired together to determine all or the majority of the payout. As banks increase in size, it becomes more likely that both absolute and relative comparisons are made when determining payouts; 54 percent of the large banks look at performance on both an absolute and relative basis compared with 36 percent of medium sized banks and 12 percent of small banks.

	Performance Plan Measures		
	Measurement Type(s)		
Asset Size	Absolute Only	Relative Only	Both
$1B - $5B	44%	44%	12%
$5B - $10B	43%	21%	36%
$10B - $20B	23%	23%	54%

TSR is almost exclusively measured on a relative basis, often measured against either the company-defined peer group or an industry index. Relative TSR is more commonly installed as a weighted metric and can also be used as a final modifier of the calculated payout, typically by 20 percent to 25 percent. For banks with a performance plan, relative TSR is more commonly used at the larger banks (62%) than at the small banks (56%) and medium sized banks (43%).

Performance Plan Metric Prevalence by Asset Size



Incentive Plan Metric Best Practices

It is important for banks to select performance metrics and set targets in their annual and long-term incentive plans that support each organization's business strategy and priorities for the performance period being assessed.

There is generally a negative perception when a company uses the same measure in both its short- and long-term incentive programs. Despite the different time horizons for measurement, the concern stems from the possibility of excessive risk taking to influence one particular outcome. Looking at only banks with both annual and long-term incentive plans, it is more common for the small and medium sized banks to have the same metric in both their short- and long-term incentive plans. Two-thirds of both the small and medium banks have overlapping metrics compared to less than half (46%) of banks in the largest group. This difference may be driven by the increased external scrutiny on companies as they grow in size.

Incentive plan goal setting and adjustments are also an area of focus from both proxy advisory firms and investors. When targets are set lower than the prior year target and actual results, and adjustments are made to GAAP metrics, the concern is that goals are not challenging, or adjustments are made to overly insulate management from external factors that may have impacted results.

When selecting incentive plan performance measures, alignment with what the bank is trying to achieve is important, and if the decision is made to use the same metrics across incentive plans, it is important to discuss the supporting rationale in the company's disclosures. Further, banks should disclose the process for determining specific goals and the incentive range, explain if performance goals are lower than the previous year, and describe and provide rationale for adjustments to GAAP measures.

Conclusion

While size may be an indicator of compensation levels and fixed versus variable pay, it is important for banks of all asset levels to continue to tie pay outcomes to performance. As banks review their incentive plan design, they should consider how industry related drivers, such as interest rate movements, deposit betas, ratio of fee to non-fee income, and credit cycles, should be incorporated in performance metric selection. In today's competitive environment, a well-designed compensation program that is aligned to the bank's business strategy is necessary to garner shareholder support and to attract and retain talent.

For questions or more information, please contact:

Kelly Malafis
Partner
kelly.malafis@capartners.com
212-921-9357

Shaun Bisman
Principal
shaun.bisman@capartners.com
212-921-9365

Ryan Colucci
Senior Associate
ryan.colucci@capartners.com
646-486-9745

Whitney Cook
Senior Analyst
whitney.cook@capartners.com
646-486-9748

Regional Banks in CAP's Study (n=43)

Small Banks *(n=14)*
($1B - $5B in assets)

- Bridge Bancorp, Inc.
- Capital City Bank Group, Inc.
- Central Valley Community Bancorp
- CNB Financial Corporation
- Evans Bancorp, Inc.
- Farmers National Banc Corp.
- First Business Financial Services, Inc.
- First Financial Northwest, Inc.
- German American Bancorp, Inc.
- Heritage Commerce Corp
- Independent Bank Corporation
- National Bankshares, Inc.
- Old Line Bancshares, Inc.
- Sierra Bancorp

Medium Banks *(n=15)*
($5B - $10B in assets)

- 1st Source Corporation
- Amerant Bancorp Inc.
- Banc of California, Inc.
- Boston Private Financial Holdings, Inc.
- Brookline Bancorp, Inc.
- First Busey Corporation
- First Commonwealth Financial Corporation
- First Foundation Inc.
- Lakeland Bancorp, Inc.
- LegacyTexas Financial Group, Inc.
- Opus Bank
- Park National Corporation
- Seacoast Banking Corporation of Florida
- Univest Financial Corporation
- Westamerica Bancorporation

Large Banks *(n=14)*
($10B - $20B in assets)

- Ameris Bancorp
- Atlantic Union Bankshares Corporation
- BancorpSouth Bank
- Bank of Hawaii Corporation
- Berkshire Hills Bancorp, Inc.
- Cadence Bancorporation
- Community Bank System, Inc.
- First Merchants Corporation
- First Midwest Bancorp, Inc.
- Glacier Bancorp, Inc.
- Great Western Bancorp, Inc.
- Old National Bancorp
- Trustmark Corporation
- United Bankshares, Inc.