January 2018

# Looking Back at Compensation for Regional and Community Banks in 2017

*As we kick off another year, it is important to reflect upon the evolving environment of the banking industry. From the continuing shift towards technology and the specific roles that have arisen as a result, to increased regulatory and shareholder pressures, and the emergence of tech startups, there are many variables to consider. Here's what regional and community banks need to know to prepare for regulatory updates and the future of executive, director, and staff compensation.*

## Examining Executive Compensation

Executive compensation can be easily broken down into four core elements: salary, annual incentives, long-term incentives, and total compensation. Base salary and annual incentives result in total cash compensation. Total cash compensation plus long-term incentives result in total direct compensation. Lastly, total direct compensation along with all other compensation, such as nonqualified benefits, and perquisites, equate to total compensation. Results from our 2017 Regional and Community Bank Compensation Survey indicate strong market performance and stability, in addition to increased M&A activity.

When examining compensation from a pure asset-based perspective, the median typically changes with a similar movement in the asset size of the bank. For balanced findings, we looked at a group of organizations with the same CEO year over year. At median, salary increases were from 2 – 5% for all asset classes, with varying increases in total cash, direct, and total compensation. Median cash incentives were also higher in 2016 compared to 2015, while total long-term incentives showed slower year over year growth than cash, but still increased nonetheless. Firms with decreases in CEO compensation tend to largely reflect changes in the composition of asset classes due to M&A activity.

The majority of public bank acquisitions between 2016 and 2017 were institutions with less than $1 billion, followed by banks with $1 – 3 billion in assets. 41% of the acquirers were firms ranging from $1 to $7.5 billion in assets. 3% of the acquirers were firms with $7.5 to $15 billion in assets; this level of activity is expected given the impact of the Durbin Amendment and firms moving to and materially above the $10 billion threshold. Industry consolidation has impacted the development of custom peer groups considerably. Therefore, it is critical to review your peer group composition, balancing size, geography, business model, and performance on an annual basis versus every other year, since more frequent changes may be necessary. Interestingly, the largest banks ($50 billion in assets and above) are currently not as involved in M&A activity, as many are waiting to see the changes to the SIFI designation before making any moves. Other factors affecting executive pay include proxy trends, Say-on-Pay implications, and the resulting shift towards an equity performance vesting structure, as well as geographic wage differentials for CEOs and other key executives.

## Increases in Director Compensation and Retainer Only Structures

During the economy's recovery years, director pay lagged the recovery first experienced by executive compensation. However, there were significant increases in director pay in 2016 for banks between $1 – 50 billion in assets. Annual increases in compensation between 2 - 3% typically indicate positive movement. According to our research, the latest surges were near or above 5%, which is the highest increase we've seen compared to recent years. It is important to note that this is the second year of similar increases in director compensation.

Committee fees are another hot topic in director pay. Overall, firms are generally split evenly between those that pay fees to members of all committees and those that differentiate fees paid to members by committee type. In the latter scenario, members of the Audit committee are often paid at the highest rate. Of the banks that pay the same fees to all committee members, about half pay certain committee chairs differentiated fees. Firms that differentiate committee fees typically pay the highest fees to members of the audit committee. This is particularly true for the largest banks.

You may be wondering—should banks use a traditional *per meeting* structure or move to a *retainer only* structure for board members? While there are pros and cons to both methods, movement towards a retainer only structure is gaining momentum for banks of all sizes, particularly for those with assets greater than $7.5 billion. This structure is easier to manage, requires less administration, and takes the emphasis off the overall concern of if your firm is paying at or above the median. We see a similar trend in payment for committee service in the form of retainers as well.

## Pay Differentials, Corporate Titles, and Increases in Staff Compensation

Our 2017 survey results revealed various considerations concerning competitive staff compensation: After lending and top management, development and support functions had the largest increases in direct compensation over 2016 levels; annual incentives (cash-based) continue to be more prevalent across organizations than long-term incentives, especially at lower level positions; and bonus payouts for branch employees have been significantly lower year-over-year relative to target than for most other positions.

Here are a few additional key findings:

**Geographic pay differentials:** Salaries vary with geography at all levels. Variability is lower for executives and senior level positions, as these roles are often recruited on a regional or national basis. Low market locations (non-metro areas) are the exception, since salaries at all position levels for these regions are below the national median.

**Corporate title uses:** Titles can establish credibility with the outside world. Consider title assignments—do you have criteria for assigning titles? Do your titles follow the role or the incumbent? The use of titles should be linked to specific responsibilities and reporting relationships. A firm-wide title structure or strategy for certain business lines and people in client-facing roles is essential.

**Salary increases:** 2018 salary merit increases are planned at 3% across the banking industry regardless of employee classification. This is a continuation of recent year activity and reflects the need for management of fixed compensation expenses. Salary and grade range increases are planned at 2% across most organizations.

# Your Regulatory Checklist

While there is still no immediate activity anticipated regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act, it is critical for your firm to continue monitoring its proposed rules. The CEO pay ratio disclosure is one relevant new update that *has* been finalized, and will be required in the 2018 proxy statement for most public banks. To prepare for this change, financial services firms should establish a process to educate stakeholders and identify the median employee. Your CEO pay ratio *will* be scrutinized. Don't assume your calculation will be quick and easy. Use resources to navigate the rules effectively and manage the process cleanly. Compensation committees should review a draft of your firm's CEO pay ratio as soon as possible to ensure your methodology is well tested and ready for implementation in your 2018 proxy statement. All banks subject to this requirement should explore the benefits of implementing an internal communication strategy.

Is your firm prepared for current and future regulations? Below is a regulatory checklist to see where you stand.

**Do we have a robust incentive risk review process?**

- ✓ Does your compensation committee conduct an incentive plan review annually?
- ✓ Does your compensation committee annually review and validate an internal control process for bank incentive plans and all other applicable agreements and benefit programs?
- ✓ How is your internal control structure defined, what is its charter, and who are its members?

**Are we ready for CEO pay ratio disclosure?**

- ✓ Have we shown a pro forma estimate to our compensation committee?
- ✓ Do we understand our process for determining the median employee?
- ✓ Are we prepared to finalize these calculations following the 2017 year-end?

**How are we staying up-to-date with ongoing regulatory activity?**

- ✓ Have we monitored or been audited on our retail sales practices?
- ✓ Do we know if we have a Say-on-Pay issue for the 2018 proxy season?

The future of regulation remains uncertain. Addressing these items will help ensure that your firm is up-to-date and prepared for whatever guidelines lie ahead.

For more information on compensation trends in regional and community banking for 2018, please contact our team.

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