Compensation Trends & Best Practices - Today and Looking into the Future

September 26, 2017

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Agenda

- CEO Compensation Trends
- Regulatory Update
- CEO Pay Ratio Disclosure
- Post Vest Holding Periods
- Director Compensation
- Governance Update
- Looking Ahead
CEO Compensation Trends
CEO Compensation – Median Values

### $1B - $3B Median Compensation over Time

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$1B</td>
<td>338,917</td>
<td>6%</td>
<td>357,959</td>
<td>4%</td>
<td>400,237</td>
<td>4%</td>
</tr>
<tr>
<td>$1B-$3B</td>
<td>550,665</td>
<td>-3%</td>
<td>638,727</td>
<td>-8%</td>
<td>747,783</td>
<td>-8%</td>
</tr>
<tr>
<td>$3B-$7.5B</td>
<td>900,000</td>
<td>6%</td>
<td>1,235,500</td>
<td>4%</td>
<td>1,426,565</td>
<td>8%</td>
</tr>
<tr>
<td>$7.5B-$15B</td>
<td>1,266,250</td>
<td>-3%</td>
<td>2,102,996</td>
<td>1%</td>
<td>2,475,459</td>
<td>9%</td>
</tr>
<tr>
<td>$15B-$50B</td>
<td>2,081,625</td>
<td>10%</td>
<td>3,931,841</td>
<td>12%</td>
<td>4,470,164</td>
<td>13%</td>
</tr>
<tr>
<td>&gt;$50B</td>
<td>3,700,000</td>
<td>8%</td>
<td>8,573,400</td>
<td>3%</td>
<td>11,167,322</td>
<td>-4%</td>
</tr>
</tbody>
</table>

### $3B - $7.5B Median Compensation over Time

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
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<td>8,573,400</td>
<td>3%</td>
<td>11,167,322</td>
<td>-4%</td>
</tr>
</tbody>
</table>

% Change

Cash Comp

Direct Comp

Total Comp

Compensation ($)
CEO Matched Sample Analysis – Median YOY Change

Examines median year-over-year pay changes for the same incumbent each year.

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
<th>2016</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$1B</td>
<td>276,005</td>
<td>5%</td>
<td>338,917</td>
<td>7%</td>
<td>357,959</td>
<td>7%</td>
<td>400,237</td>
<td>6%</td>
</tr>
<tr>
<td>$1B-$3B</td>
<td>417,935</td>
<td>4%</td>
<td>550,665</td>
<td>5%</td>
<td>638,727</td>
<td>4%</td>
<td>747,783</td>
<td>4%</td>
</tr>
<tr>
<td>$3B-$7.5B</td>
<td>575,000</td>
<td>4%</td>
<td>900,000</td>
<td>7%</td>
<td>1,235,500</td>
<td>7%</td>
<td>1,426,565</td>
<td>9%</td>
</tr>
<tr>
<td>$7.5B-$15B</td>
<td>742,713</td>
<td>3%</td>
<td>1,266,250</td>
<td>6%</td>
<td>2,102,996</td>
<td>6%</td>
<td>2,475,459</td>
<td>9%</td>
</tr>
<tr>
<td>$15B-$50B</td>
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<td>2%</td>
<td>2,081,625</td>
<td>7%</td>
<td>3,931,841</td>
<td>3%</td>
<td>4,470,164</td>
<td>3%</td>
</tr>
<tr>
<td>&gt;$50B</td>
<td>1,061,538</td>
<td>0%</td>
<td>3,700,000</td>
<td>4%</td>
<td>8,573,400</td>
<td>12%</td>
<td>11,167,322</td>
<td>15%</td>
</tr>
</tbody>
</table>

### Cash Bonus – Median YOY Change

- Cash bonuses were meaningfully higher in 2016 compared to 2015.
- Equity awards showed lower increases.
Industry consolidation is affecting peer groups.
- More frequent changes may be needed. Example – once a year vs. every other year.
- Peer selection often becomes a series of compromises to balance size, geography, business model, performance.

Peer changes can produce volatility in the market compensation and performance data.
## Equity Vesting Structure

<table>
<thead>
<tr>
<th>Year</th>
<th>Performance</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>18%</td>
<td>$1B-$3B</td>
</tr>
<tr>
<td>2015</td>
<td>30%</td>
<td>$3B-$7.5B</td>
</tr>
<tr>
<td>2016</td>
<td>26%</td>
<td>&lt;$1B</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Performance</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>43%</td>
<td>$1B-$3B</td>
</tr>
<tr>
<td>2015</td>
<td>46%</td>
<td>$3B-$7.5B</td>
</tr>
<tr>
<td>2016</td>
<td>60%</td>
<td>&lt;$1B</td>
</tr>
</tbody>
</table>

- Trend towards performance-based equity continues.
- Pace of new adoption has slowed for mid-sized banks.
## Cash Incentive Plans – Upside Leverage

<table>
<thead>
<tr>
<th>Max as % of Target</th>
<th>% of Banks Above 150%</th>
<th>% of Banks Below 150%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>25th</td>
<td>50th</td>
</tr>
<tr>
<td><strong>Assets Below $10B</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>144%</td>
<td>150%</td>
</tr>
<tr>
<td>2011</td>
<td>145%</td>
<td>150%</td>
</tr>
<tr>
<td>2016</td>
<td>150%</td>
<td>150%</td>
</tr>
<tr>
<td><strong>Assets Above $10B</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>150%</td>
<td>200%</td>
</tr>
<tr>
<td>2011</td>
<td>150%</td>
<td>181%</td>
</tr>
<tr>
<td>2016</td>
<td>150%</td>
<td>150%</td>
</tr>
</tbody>
</table>

Upside leverage = Max payout / Target payout

- Cash incentive plan leverage decreased in the years following the financial crisis.
- Incentive plan upside is more normalized today across asset sizes compared to prior years.
- As plans become more balanced relative to risk, will 150% remain the new norm? We are starting to see some banks move back to 200%.
Regulatory Update
Dodd-Frank Status

- Full implementation of Dodd-Frank remains a work in progress

<table>
<thead>
<tr>
<th>Dodd-Frank Rule</th>
<th>Status With SEC</th>
<th>Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Say-on-Pay</td>
<td>Final and Active</td>
<td>In effect since 2011</td>
</tr>
<tr>
<td>Say-on-Golden parachutes</td>
<td>Final and Active</td>
<td></td>
</tr>
<tr>
<td>Pay Ratio Disclosure</td>
<td>Final and Active in 2018 Proxy Season¹ (currently under review by SEC Staff)</td>
<td>Begin preliminary modeling during 2017 to understand desired methodology and any areas of potential exposure</td>
</tr>
<tr>
<td>Pay vs. Performance Disclosure</td>
<td>Initial Rules have been Proposed (status uncertain; no longer on regulatory agendas)</td>
<td>Continue to monitor final regulations; possibly begin to understand desired methodology and any areas of potential exposure</td>
</tr>
<tr>
<td>Incentive Compensation</td>
<td>Initial Rules have been Proposed (status uncertain; no longer on regulatory agendas; earliest implementation 2020)</td>
<td>Continue to monitor final regulations</td>
</tr>
<tr>
<td>Clawbacks</td>
<td>Initial Rules have been Proposed (status uncertain; no longer on regulatory agendas)</td>
<td></td>
</tr>
</tbody>
</table>

¹ Does not apply to smaller reporting companies, emerging growth companies, or foreign private issuers.
Banks reverting to Sound Incentive Compensation Policies ("SICP")

The Guidance (finalized June, 2010) requires incentive compensation plan arrangements to balance risk and financial results in a manner that does not encourage employees to expose their organization to imprudent risk. The Guidance applies to individuals or groups of employees that have the ability to expose an organization to material amounts of risk.

- The Guidance is principles based and require that incentives:
  - Balance risk and reward
  - Be compatible with Controls and Risk Management
  - Have strong Corporate Governance

- The Guidance sets forth four, non exclusive, methods for balancing incentive compensation and risk:
  - Risk adjusting awards
  - Deferring payment
  - Using longer performance periods
  - Reducing the sensitivity of awards to measures of short-term performance

Current focus area for most banks below the $50b “Large Bank” threshold
Emerging Focal Points – Sales Practices

- Ongoing Fed/OCC reviews in this area
  - Level 1 Reviews: Focused on retail business practices
  - Level 2 Reviews: Focused on compensation practices and process for retail
  - Any firm with any complaints registered is a target for an OCC two phase audit

- Are ICPs driving the right outcomes / have appropriate controls?
  - Move to centralized governance / controls. Work on connecting the dots
  - Move away from product sales; focus on customer experience
  - Increased call monitoring / audits; better controls to identify performance anomalies
  - Enhanced customer complaint / whistleblower protocols
  - Addition of a sales practices officer or oversight committee?
On February 6th, the SEC released a request for public comment on Reconsideration of the Pay Ratio Rule (currently in effect for 2018 proxy statements)

With the first disclosures for most companies set to be made in less than 6 months, this release by the commission likely represents the last opportunity to seek adjustments or delay the rule prior to the first disclosures; the SEC has the power to amend or make exceptions, but cannot revoke a rule; that power lies with Congress

McLagan Comments

- We are advising that clients begin computing the CEO pay ratio for disclosure in 2018 proxy statements

- There are rumblings that the SEC plans to release a 2nd set of Compliance and Disclosure Interpretations (C&DIs) to help guide companies through some of the gray areas surrounding the rule; we would expect these C&DIs before October 1st…the first day a company can use to identify its employee population for the calculation of the ratio
CEO Pay Ratio Disclosure
Pay Ratio – Rule Summary

The SEC implemented Section 953(b) by adding a new Item 402(u) to Regulation S-K.

**New Disclosure Items:**
Applies to executive compensation disclosures for fiscal years that start on or after January 1, 2017

- Median of the annual total compensation of all employees of the company, except the CEO (or any equivalent position)
- Annual total compensation of the CEO (or any equivalent position)
- Ratio of these two amounts
- Associated narrative disclosure (e.g., methodology, use of estimates, assumptions)
Pay Ratio – Estimates for Retail vs. Non-Retail Focused Banks

### Median Employee Compensation ($)

![Bar chart showing median employee compensation by asset size and market for retail and non-retail focused banks.]

### CEO Pay Ratio (1:x)

![Bar chart showing CEO pay ratio by asset size and market for retail and non-retail focused banks.]

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>n</th>
<th>25th</th>
<th>50th</th>
<th>75th</th>
<th>25th</th>
<th>50th</th>
<th>75th</th>
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</thead>
<tbody>
<tr>
<td>&lt;$1B</td>
<td>6</td>
<td>39,174</td>
<td>44,606</td>
<td>47,340</td>
<td>8</td>
<td>11</td>
<td>15</td>
</tr>
<tr>
<td>$1B-$3B</td>
<td>18</td>
<td>37,380</td>
<td>40,596</td>
<td>44,337</td>
<td>16</td>
<td>20</td>
<td>34</td>
</tr>
<tr>
<td>$3B-$8B</td>
<td>17</td>
<td>32,969</td>
<td>41,777</td>
<td>45,925</td>
<td>29</td>
<td>38</td>
<td>55</td>
</tr>
<tr>
<td>$8B-$30B</td>
<td>8</td>
<td>40,400</td>
<td>44,184</td>
<td>47,551</td>
<td>68</td>
<td>82</td>
<td>96</td>
</tr>
<tr>
<td>All</td>
<td>49</td>
<td>37,629</td>
<td>41,777</td>
<td>45,703</td>
<td>17</td>
<td>29</td>
<td>55</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>n</th>
<th>25th</th>
<th>50th</th>
<th>75th</th>
<th>25th</th>
<th>50th</th>
<th>75th</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$1B</td>
<td>5</td>
<td>49,855</td>
<td>56,151</td>
<td>70,154</td>
<td>6</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>$1B-$3B</td>
<td>13</td>
<td>53,173</td>
<td>57,265</td>
<td>68,495</td>
<td>16</td>
<td>18</td>
<td>24</td>
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<tr>
<td>$3B-$8B</td>
<td>16</td>
<td>55,369</td>
<td>61,628</td>
<td>73,023</td>
<td>20</td>
<td>26</td>
<td>34</td>
</tr>
<tr>
<td>$8B-$30B</td>
<td>4</td>
<td>46,136</td>
<td>48,731</td>
<td>59,812</td>
<td>34</td>
<td>42</td>
<td>49</td>
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<tr>
<td>All</td>
<td>38</td>
<td>52,847</td>
<td>57,395</td>
<td>71,065</td>
<td>16</td>
<td>21</td>
<td>32</td>
</tr>
</tbody>
</table>

Source: 2015 McLagan Regional and Community Bank Survey

- Business model has a significant impact on median employee compensation.
- Median employee compensation at retail focused banks averages more than 20% lower than non-retail focused banks.
- The CEO pay ratio is higher among retail focused banks.
Pay Ratio – Commentary

SEC Commentary

- Section 953(b) did not directly state the objectives of the provision or a specific market failure that is intended to be remedied.
- The SEC has avoided stating that this disclosure benefits investors.
- The SEC stated that it believed Section 953(b) was intended to provide shareholders with a company-specific metric that can assist in their evaluation of a company’s executive compensation practices.
- Acknowledged that cost to comply could be substantial.
- SEC drafted final rule to provide some flexibility to ease the burden.

Others

- While many members of the public, institutional investors, and others support the rule and increased transparency surrounding company pay practices, companies subject to the rule have noted concerns regarding cost, complexity, and the overall value of the disclosure to investors.
  - Difficulty consolidating information given multiple or non-centralized payroll systems.
  - Expansive definition of an “employee” (e.g., inclusion of some independent contractors).
  - Time and staff resources required to train and comply.
Pay Ratio – Commentary

McLagan

- The pay ratio may be a focus of some shareholders, the media, activists, and employees
  - Compensation Committees should be aware of how their CEO pay ratio compares to peers and how their own ratio *changes* from year to year.
  - A high CEO pay ratio relative to peers is likely to exacerbate any existing investor concerns regarding pay practices.
  - Management should be prepared to answer potential questions from employees regarding this new disclosure. Potential for surprises exists.

- Not likely to be truly meaningful or useful in understanding a company’s compensation practices or as the basis for an investment decision
  - Differences in size, business models, staffing model (outsourced vs. in-house), location, etc.
  - Similar business and staffing models across banks may make for a smaller range of reported ratios compared to companies in other industries

- ISS and Glass Lewis will *not* be incorporating the pay ratio result into their policies. However, subscribers have asked that the ratios appear in their reports as a listed data item.
Post Vest Holding Periods
Post Vest Holding Periods – Background

- ASC Topic 718 allows a company to reflect the impact of restrictions that will remain in place after an award of stock compensation has vested in the estimated fair value of the award.
  - As an example of the restriction - if a share of stock vests on a cliff basis at the end of three years, if the stock was held for an additional two years, and not tradable during this time, the additional two years would be the restriction.
  - The accounting discount is often referred to as a discount for illiquidity or a discount for lack of marketability.
    - From a market practice, this is often referred to as a “post vest holding period”.
  - The restriction must be a feature of the security rather than an attribute of the recipient.
  - The discount only applies to financial accounting (income statement); tax is not impacted.
  - Termination events: Death, disability and CIC are allowable payment events (no post-vest hold).

- Why would a company implement this feature?
  - Provides a longer time period where the officer is linked to the company stock performance.
  - It provides for a mechanism which could be utilized for a clawback feature.
    - As a result of linkage, outside shareholder advisors favor these features.
  - The accounting discount for illiquidity can be material to a company.
Many firms are not taking advantage of implicit post vest hold periods!

There are two types of post vest holding periods

- **Implicit Post Vest Holding Period**: For individuals who are retirement eligible, when they receive grants of RSUs, once they retire, the equity is settled (given) to the retiree at the first, second, third and fourth year anniversaries of the RSU grant.
  - From an accounting perspective, the full grant date value is expensed on the date of grant even though the shares are not settled until the anniversary dates; this is the “implicit holding period”.
  - This is a present practice at a number of banks!

- **Explicit Post Vest Holding Period**: For select members of executive management you can add an additional two year post vest holding period to the grants of RSUs. In this example, the equity would not be settled until two years after the original vesting dates, i.e., the third, fourth, fifth and sixth year anniversaries.
  - This is a going forward practice for a number of firms
Director Compensation Trends
Director Compensation Snapshot

- We saw slightly higher increases in director pay in 2016 compared to recent years

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>Total Director Compensation</th>
<th>% Change (Median to Median)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
<td>2016</td>
</tr>
<tr>
<td>&lt;$1B</td>
<td>27,608</td>
<td>28,227</td>
</tr>
<tr>
<td>$1B-$3.5B</td>
<td>43,838</td>
<td>46,411</td>
</tr>
<tr>
<td>$3.5B-$7B</td>
<td>75,029</td>
<td>78,631</td>
</tr>
<tr>
<td>$7B-$15B</td>
<td>94,260</td>
<td>98,928</td>
</tr>
<tr>
<td>$15B-$50B</td>
<td>117,787</td>
<td>125,112</td>
</tr>
<tr>
<td>$50B-$400B</td>
<td>208,996</td>
<td>216,349</td>
</tr>
</tbody>
</table>

Total Director Compensation over Time – Median
Banks differentiate committee fees by committee type across most asset sizes.

For banks that differentiate, Audit Committee members often receive the highest fee levels.

- In situations where this is not true, fees for the Compensation Committee and the Audit Committee are often tied for receiving the highest fee levels.
Director Cash – Per Meeting Fees vs. Cash Retainers

- We are seeing a shift away from per-meeting fees at the board level. A retainer-only approach is becoming more common. This is most prevalent at larger banks.
  - Less administrative burden/complexity. Easier to budget.
- This trend is most apparent at the board level, but we are beginning to see this change at the committee level as well.
Governance Update
Say-on-Pay Results

- **2017 Snapshot:** Year-to-date results for the 2017 proxy season, covering January 1, 2017 until August 20, 2017, show:
  - ISS is recommending against only ~12% of all proposals at this point
  - Glass Lewis is recommending against ~20% of all proposals
  - Median level of support for R3000 Say-on-Pay proposals is ~92% vs. 91% in prior years
  - 29 Say-on-Pay proposals have “failed” so far, or 1.3% of all proposals
    - Signaling a willingness from investors to increasingly support companies despite negative proxy advisory firm recommendations—at least in the short-term

- **Banks are seeing better results than general industry**
  - ISS is recommending against 10.6% of companies in 2017 versus 12.6% in 2016
  - Only 1 bank has failed to obtain majority shareholder support for say-on-pay in 2017 - due to a perceived pay-for-performance disconnect. In 2016, two banks failed due to the same issue.
  - Average say-on-pay results are higher in 2017 at 93.8% versus 91.2% in 2016
Say-on-Pay Results

- For 2017, the key driver of most negative vote recommendations has been a perceived pay-for-performance disconnect, as has been the case in prior years
- Perceived quantitative and qualitative disconnects
  - One medium or high under ISS tests triggers the qualitative review under pay-for-performance
  - D or F under Glass Lewis test triggers qualitative review under pay-for-performance
  - ISS has not used the new relative financial performance assessment to help any companies upon a qualitative assessment
- Use of lowered annual or long term incentive goals and target or above-target payouts, without what ISS or others consider to be appropriate context or rationale
  - Goes to a “rigor” analysis
  - Companies must proactively rebut a presumption that a target payout with lower goals is not rigorous
  - Additionally, we are seeing companies with adjustments getting flagged when they make target or above target type payouts due to the exclusion of items that are perceived as being within management’s control (i.e., litigation, business losses)—companies being flagged for this even if LOW concerns for all P4P tests
- Increased target incentive opportunities
  - Increasing target STI/LTI pay opportunities when elevated P4P concern
  - Increasing fixed costs, such as base (especially even when it is higher relative to ISS CEO peer median pay levels)
- Increased number of time based awards disproportionate to the increased number of performance based awards (options not considered performance based)
Equity Plan Results

- ISS and Glass Lewis have become the de facto corporate governance standard setters
  - Minimum vesting and share recycling
  - Clawback and holding period requirements
  - Companies are adopting restrictive plan changes to obtain more shares under the ISS model

- Director Comp Litigation
  - Increased scrutiny around director compensation recently
  - Avoid perception of self dealing
  - Set a limit on cash and equity compensation for NED

- Section 162(m) Compliance
  - 5-yr rule!
  - Assess whether existing limit is appropriate given the Company’s future needs

- Rise of the Non-ISS/Glass Lewis compliant share pool
Future Outlook
CEO Compensation - Looking Ahead

- Salaries – expected to remain fairly flat in the near term unless there are extenuating circumstances – asset size growth (M&A, organic), performance, expansion to new areas or lines of business

- Annual compensation
  - Target vs. Maximum payouts
  - Mandatory deferrals

- Long-term Incentives
  - Types of equity – Restricted Stock and RSUs seem to be the norm for the foreseeable future. Mix of full value and appreciation shares may continue.
  - Performance Vesting

- Benefits and Perquisites
  - Deferred compensation
  - SERPs – defined contribution vs. defined benefit
CEO Compensation - Looking Ahead (continued)

- Continued alignment of pay and performance
- Regulatory developments
- Shareholder advisory firms – expected to continue to be a significant factor in compensation decisions
- Heightened corporate governance
Q & A