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April 2024 - California Bankers Association Annual Conference and Directors Forum

# Directors Compensation and Compensation Committee Best Practices

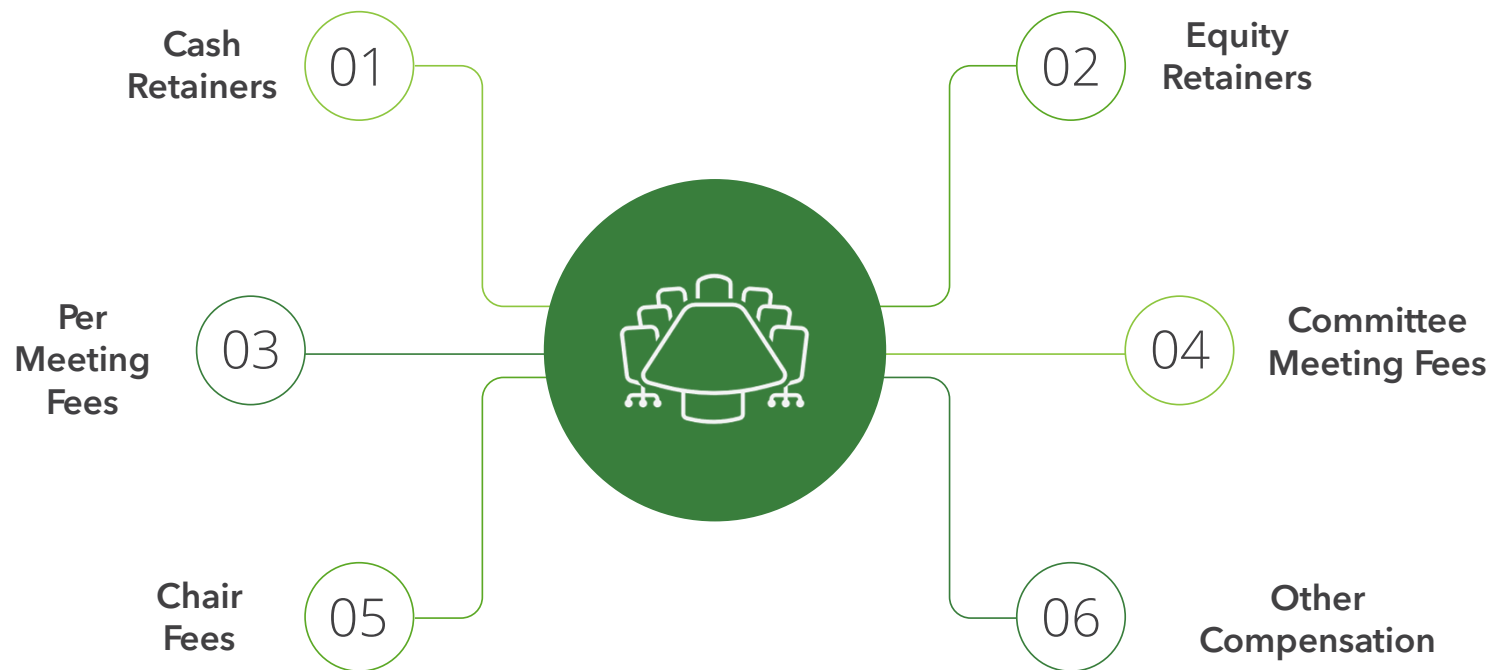


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# Board Compensation

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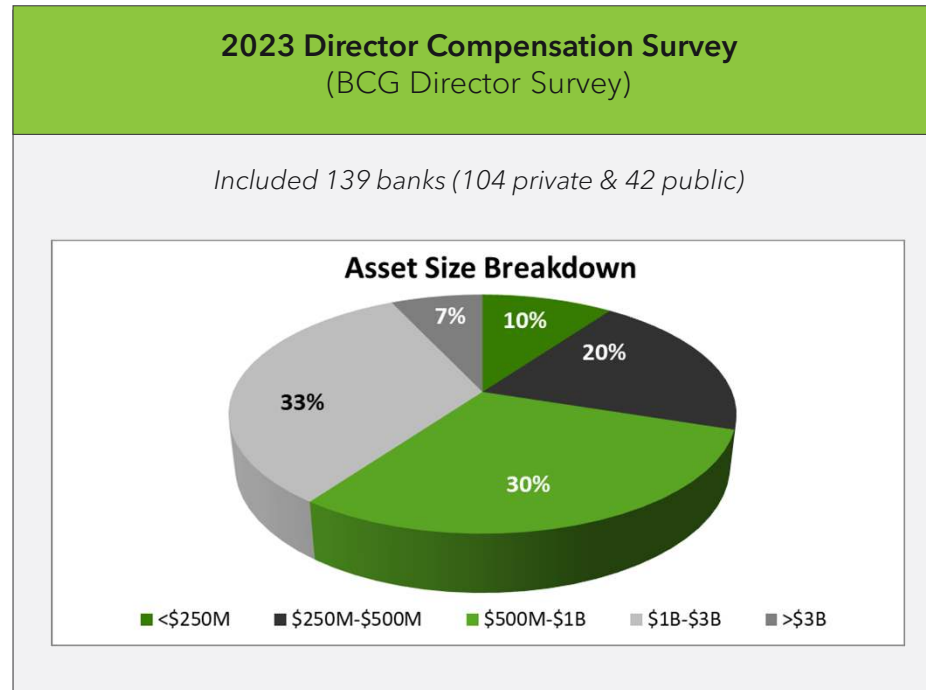
# Director Compensation



# Director Compensation Trends

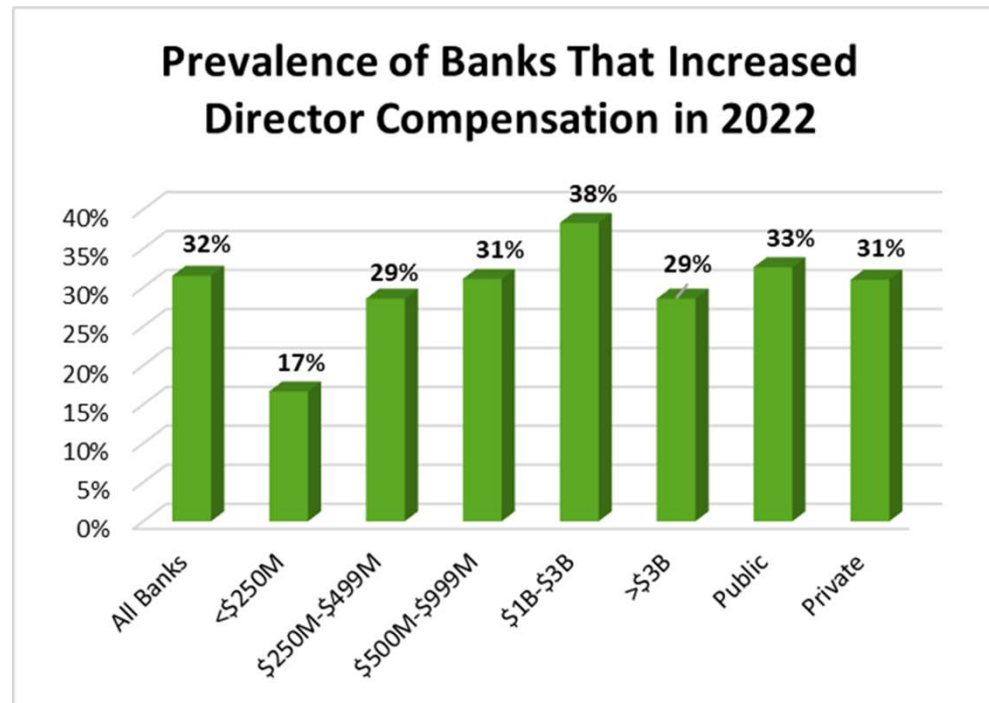
- ✓ Gradual increases in Director compensation over the last 10 years.
  - *Typically, director compensation adjustments occur every 2 or 3 years (not annually)*
- ✓ Director compensation should have a different philosophy from executive compensation.
  - **Pay for time and expertise focus**
- ✓ Director **annual incentives** based on bank results are **frowned upon by regulators**.
  - *Focus should be on long-term results and sustainability*
- ✓ **Use of equity as a component of director compensation is considered a best practice.**
  - *Typically, an equity retainer and restricted stock (vs. stock options)*
  - *Shorter vesting for director equity grants*
- ✓ **Increased focus on retainers** and a decreased focus on per meeting fees
- ✓ Director compensation differentiation for chairs versus non-chairs

# BCG Director Survey



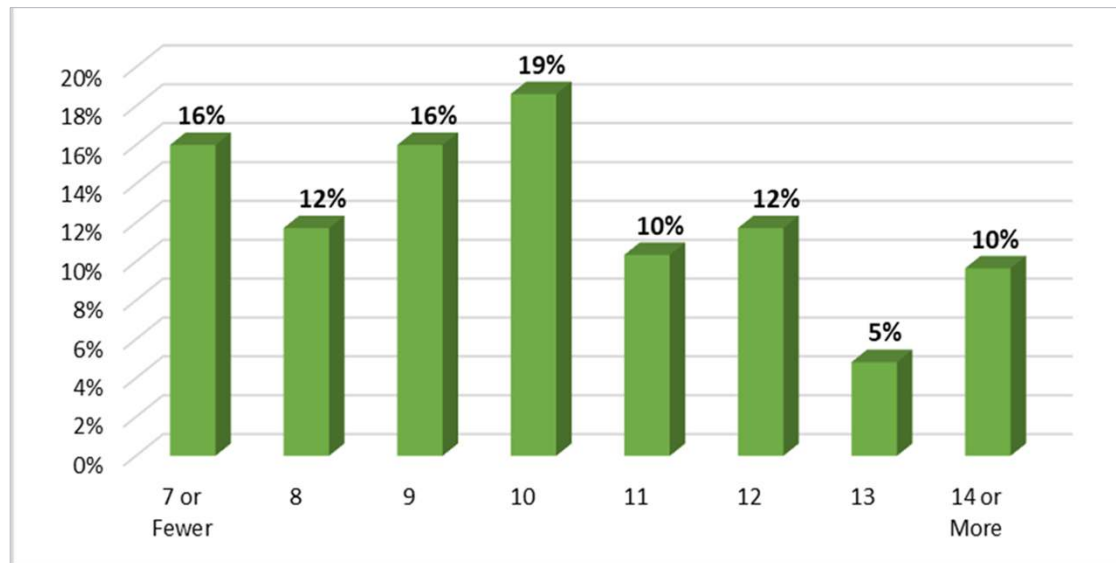
Blanchard Consulting Group conducted a survey of director trends and 2022 director compensation during the beginning of 2023. A total of 146 banks completed the survey. The respondents included 42 public and 104 private banks. The asset size of the participants are summarized above.

# Increase Director Compensation?



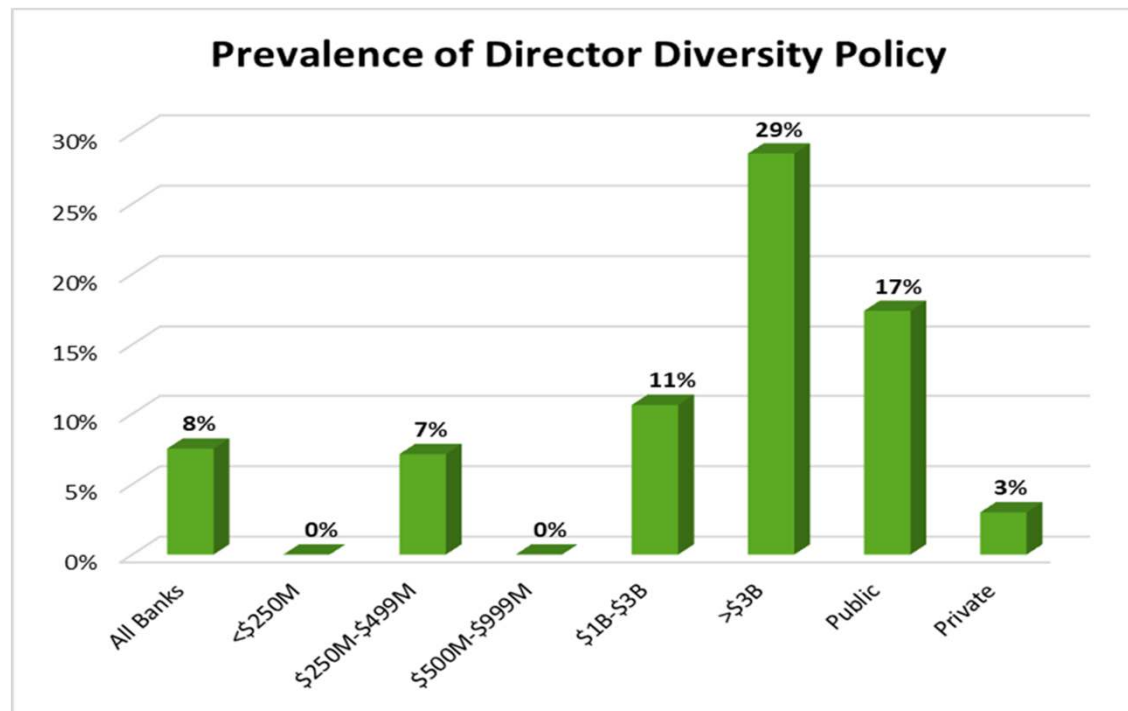
- **32%** of banks increased director compensation in 2022.
- The median increase for the banks that increased director compensation in 2022 was **10%**.
- Directors, on average, spend 8 hours per month on board activities, ranging from 2-35 hours

# Number of Directors



- The survey participants' board size ranged from 5 to 20 directors, with a median of 10 directors.
- Typically, the board will consist of one to three employee directors, while the remaining board members are outside/independent directors.

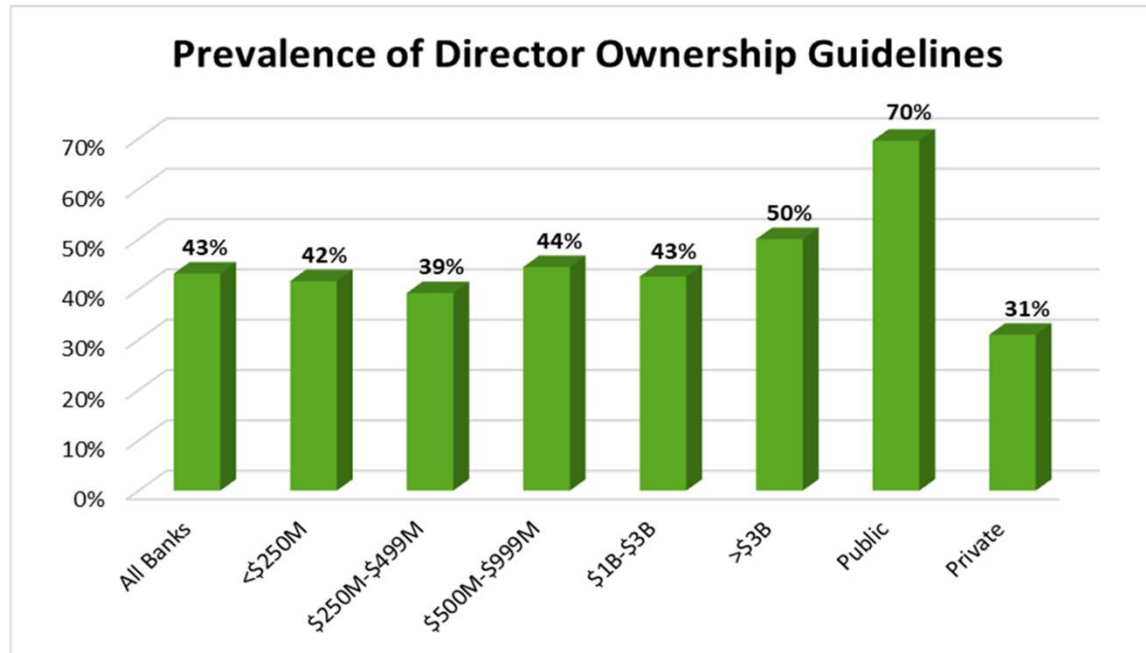
# Board Diversity



- The chart above shows there is currently a low prevalence of banks with a formal director diversity policy
- We anticipate this will rise as diversity becomes an increasingly important topic for boards to consider.



# Director Ownership Guidelines



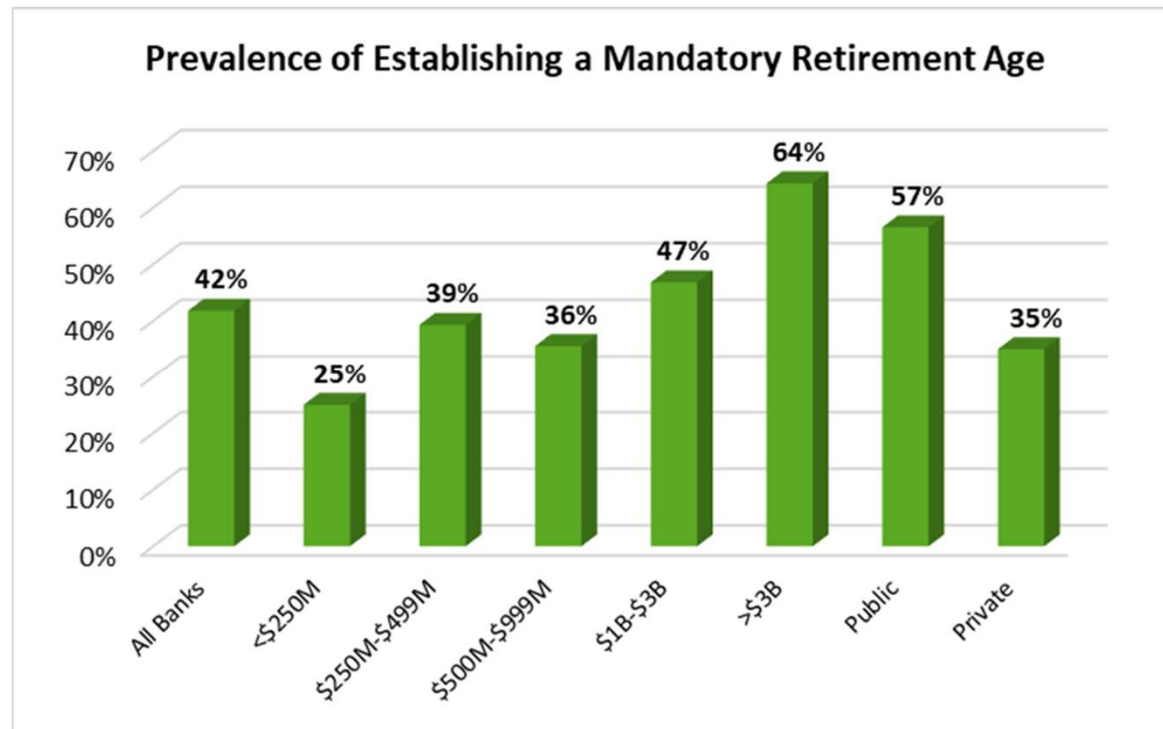
- The ownership requirements are based on:

*Defined number of shares: 51%*

*Fixed dollar amount: 33%*

*Multiple of cash fees/retainer: 16%*

# Director Retirement Age



- Almost half (42%) of the banks have a mandatory retirement age, with the age range being 69.5 to 80
- The median age for mandatory retirement is 75

# Director Compensation (Avg. Director)\* - BCG Director Survey



- Total compensation consists of fees earned or paid in cash, stock awards, option awards, non-equity incentive plan compensation, change in pension and non-qualified deferred compensation earnings, and all other compensation.
- The table below shows the total compensation paid to an average director. An average director excludes the board chair, employee directors, and any directors with extraordinary events in 2022 (i.e. retirement or partial year board service).

Data Cut	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Total Granted Equity (\$)	Non-Equity Incentive Plan Comp (\$)	Change in Retirement Benefits (\$)	All Other Comp (\$)	Total Comp Per Average Director (\$)
<b>All Banks, Med=\$780M (n=146)</b>								
Average	27,027	19,815	31,346	21,866	14,084	14,055	8,044	33,393
25th Percentile	15,000	9,712	16,819	8,730	8,194	10,848	698	17,333
50th Percentile	24,000	16,900	26,203	18,500	11,919	12,262	3,680	26,875
75th Percentile	35,603	25,575	46,313	29,137	17,809	15,469	10,651	45,000

\* Each column represents the summary statistics for the banks that have this form of compensation (0's are excluded); therefore, total compensation per average director is not a sum of the previous columns.

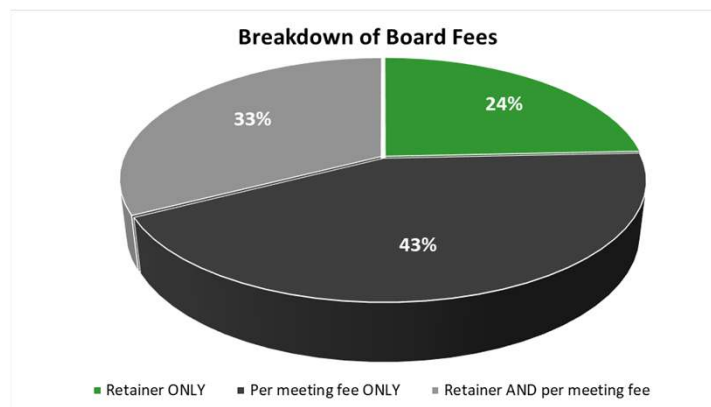
# Cash Retainer & Board Meeting Fees



- The following table breaks out the amount of the annual retainers (cash and/or equity) paid, the number of meetings, and the amount paid per holding company and bank board meeting.

Data Cut	Holding Company Board			Bank Board		
	Retainer <sup>1</sup> (\$)	Total Number of HC Board Meetings	Per HC Board Meeting Fee (\$)	Retainer <sup>1</sup> (\$)	Total Number of Bank Board Meetings	Per Bank Board Meeting Fee (\$)
<b>All Banks</b>						
Average	23,467	8	952	19,449	13	1,143
25th Percentile	4,200	5	500	10,000	12	706
50th Percentile	15,000	8	825	17,400	12	1,000
75th Percentile	40,000	12	1,288	25,875	13	1,500

<sup>1</sup>Retainers include both cash and equity retainers paid to directors.



# Board & Committee Chair Compensation



- We show the additional compensation paid to the Audit, Executive, Compensation, and Nominating/Governance committee chairs. We also provide the additional compensation paid to the Board Chair/Lead Director.
- Typically, board chairs and committee chairs earn more than other board or committee members for their additional time commitment and responsibilities.

Data Cut	Board Chair/Lead Director Fees (Additional) (\$)	Committee Chair Fees (Additional)			
		Audit (\$)	Compensation (\$)	Executive (\$)	Nominating/Corporate Governance (\$)
<b>All Banks</b>					
Average	18,695	3,759	2,446	2,709	2,647
25th Percentile	5,963	1,150	600	1,650	730
50th Percentile	15,000	2,000	1,245	2,000	1,440
75th Percentile	21,000	5,175	4,000	3,500	4,250

# Committee Meetings & Per Meeting Fees



- The table below shows the number of committee meetings held during 2022 and the amount of the per meeting fee paid for attendance at meetings.

\*\* For banks that pay an annual retainer in lieu of a per meeting fee or in addition to a per meeting fee, we convert this to a per meeting fee for this analysis.

Data Cut	Avg # Cmte Mtg	Avg Per Mtg Fee (\$)	Audit		Compensation		Executive		Nominating and/or Corp. Gov.		ALCO/ Investment		Loan		Compliance/ Risk		Trust	
			# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)	# Mtg	Per Mtg Fee (\$)
<b>All Banks</b>																		
Average	8	488	6	505	4	467	7	471	3	581	6	438	23	418	6	453	6	449
25th Percentile	5	275	4	300	2	300	3	290	1	330	4	263	12	200	4	244	4	300
50th Percentile	7	400	4	400	3	400	4	380	3	438	4	350	18	333	4	375	4	400
75th Percentile	10	550	7	500	4	550	12	513	4	550	5	500	31	500	12	500	6	500

# Compensation Committee Best Practices

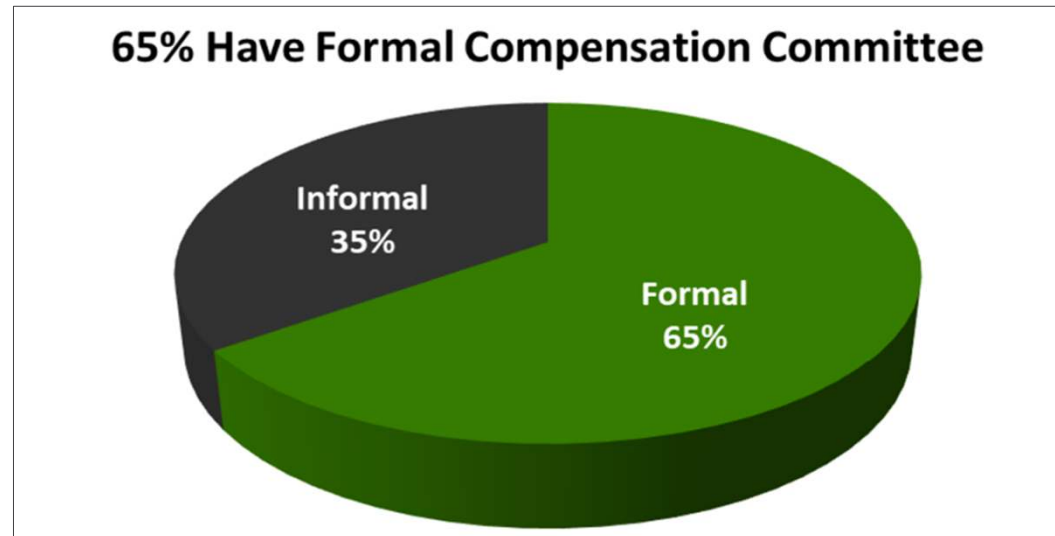
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# The Compensation Committee

- ✓ Prevalence and Purpose of Committees
- ✓ Committee Composition & Expertise
- ✓ Committee Independence
- ✓ Compensation Committee Charter & Compensation Philosophy
- ✓ Committee Calendar, Meetings, & Agendas
- ✓ Annual Evaluations & Board Evaluations
- ✓ Committee Reference Book
- ✓ Other Trends - Risk Reviews, Clawbacks, etc.



# Compensation Committee Prevalence



- Fifty-six percent (56%) of the banks reported their Compensation Committee was comprised entirely of outside/independent directors.
- Of the public banks that responded, eighty-four (84%) reported having an independent Compensation Committee.
- Sixty-percent (60%) of the banks reported that they have a formal Compensation Committee charter.

# Compensation Committee Purpose



- **Historical Definition:** The Compensation Committee exists to approve and monitor executive pay and ensure that shareholders receive an appropriate risk-adjusted return on their investment while still motivating employees to maximize performance through properly structured compensation plans.

## TODAY - THE SCOPE/RESPONSIBILITIES HAVE INCREASED!



# Committee Composition & Expertise

## *Membership*

- Typically, 3-5 outside/independent directors
- CEO is not a member, but should participate upon request
- Top HR executive and/or Sr. Risk Officer often serve as advisors to the Committee
- Rotation debate - balance between the time to gain expertise with "new thinking"/perspectives
- 2-to-3-year term was typical, but this has been increasing with expertise required

## *Nomination Process*

- Typically, outside/independent directors of full board who are nominated by Nominating/Governance Committee
- Chair requires a level of expertise in today's environment
- CEO should NOT nominate or recommend directors to serve on this committee

# Compensation Committee Independence



## How to Assess Committee Member Independence

- The SEC has rules on Compensation Committee independence. These rules mirror best practice guidelines used by the National Association of Corporate Directors (NACD) and Dodd Frank. The key factors of assessing Committee independence are listed below:

### Key Factors of Assessing Committee Independence

- Director is not an employee or affiliate of the Bank or a Subsidiary.
- Director does not receive any consulting or advisory income from the Bank for services other than participation on the board.
- Director's business does not do any work or receive income from the Bank.
- Director does not have a personal or business relationship with any employee of the Bank.

# Compensation Committee Charter



The Charter sets the “rules of engagement” for the Committee

## *Rules of Engagement*

### **Defines role, responsibility, and accountability**

- Examples: CEO Compensation, Board Compensation, Risk Reviews, etc.

### **Should have an overall mission statement**

- Short and long-term goals

### **Identifies the level of authority related to compensation decisions**

- Determine/recommend, approve, review, etc.

### **Identifies the compensation programs it oversees and reviews**

- Salary, cash incentives, equity plans, agreements, severance (CIC), etc.

### **Discusses the composition and requirements of the Committee**

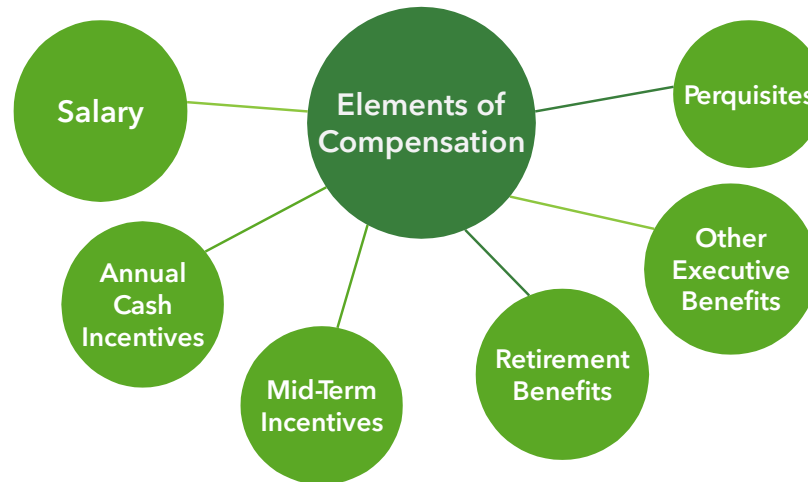
- Independence, education, attendance, etc.

# Compensation Philosophy Statement



Provides a framework to help the organization make compensation related decisions, assess the effectiveness of its programs, and communicate a consistent "message" to shareholders, management, and employees about the role of compensation.

**Defines the use and objects of each element of compensation:**

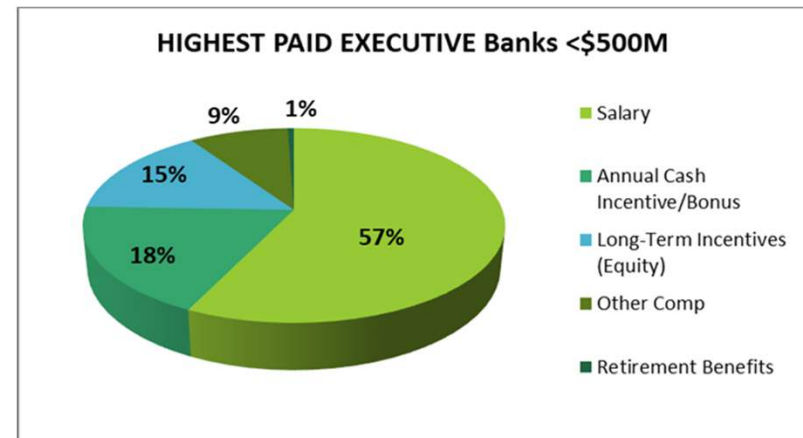
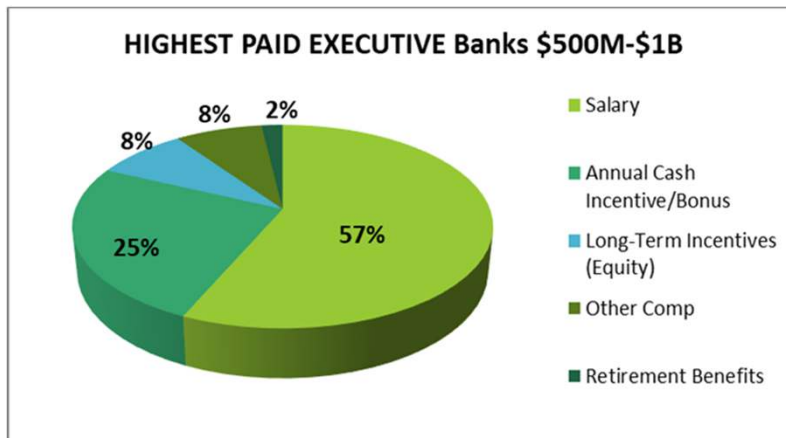
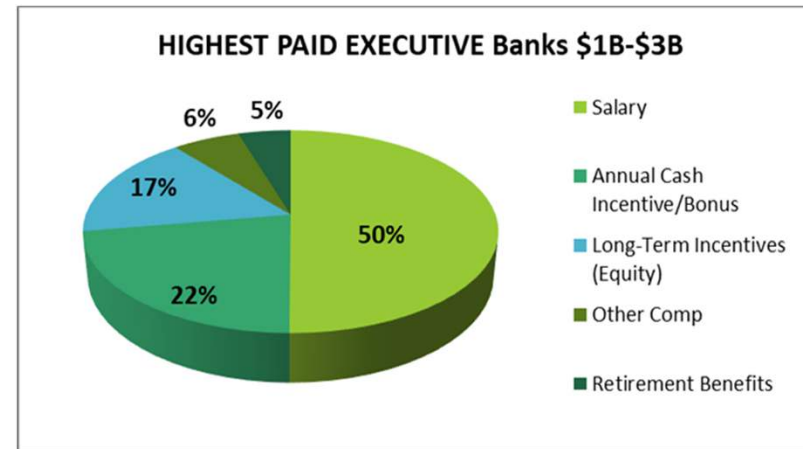
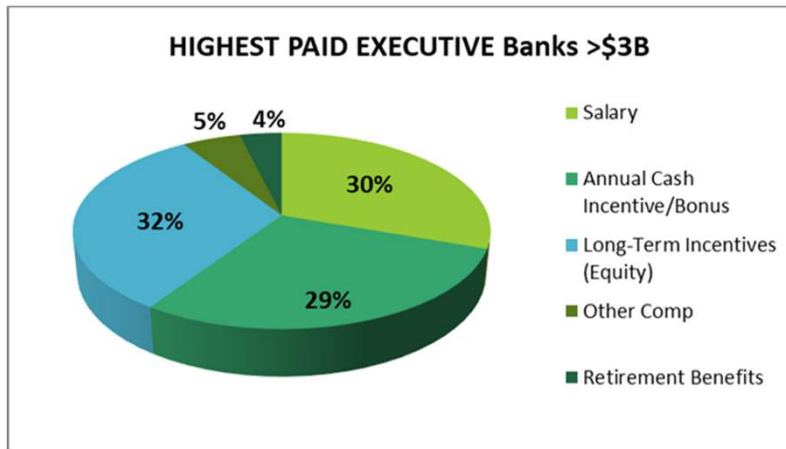


*\*\* The Compensation Philosophy should be reviewed annually and can certainly change over time*

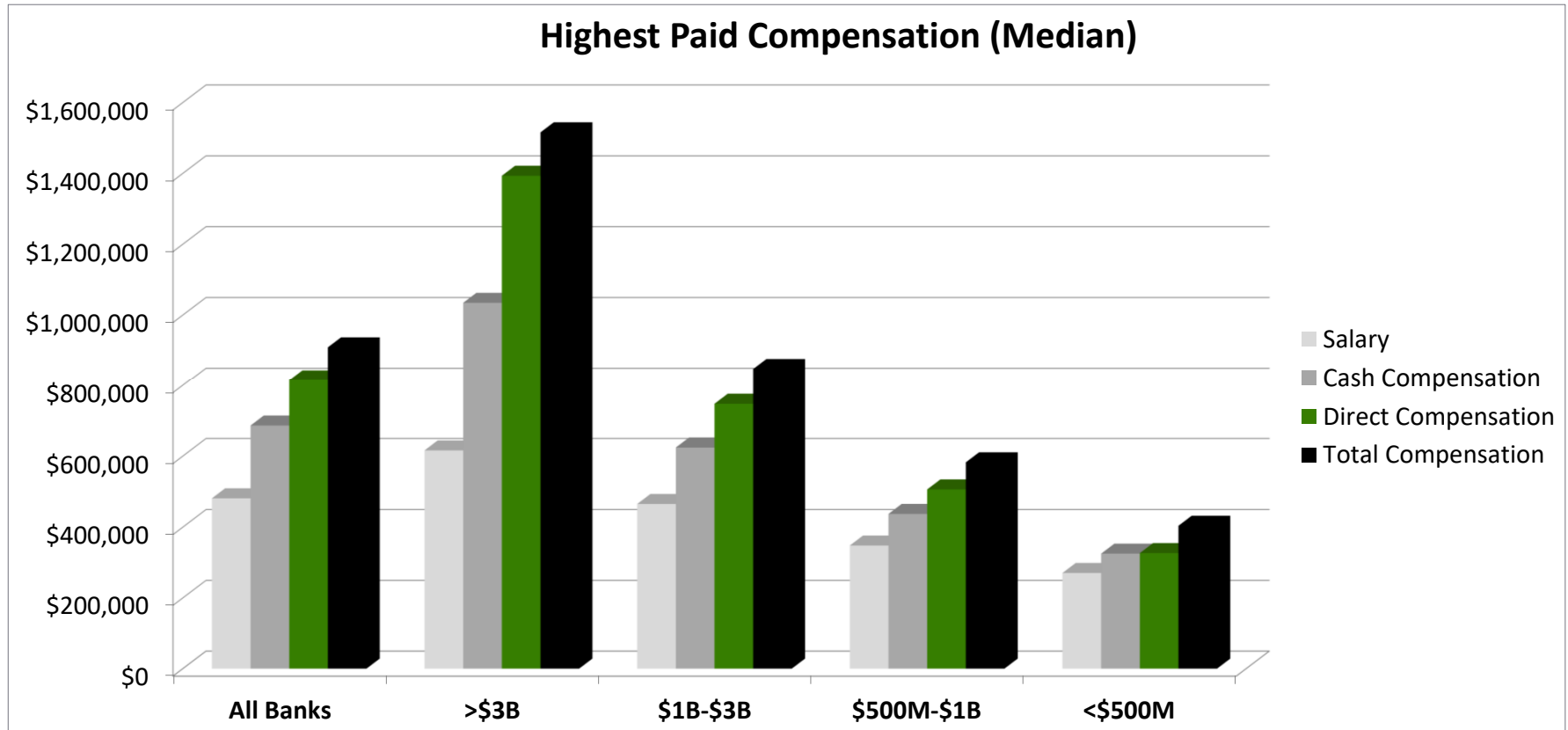
**Discusses how the pay elements should compare based on:**

- The market
- The bank's own performance

# CEO Total Compensation Mix



# CEO Total Compensation





# Sample Compensation Committee Calendar

Quarter	Activities
1st	<ul style="list-style-type: none"> <li>- Finalize CEO's performance review &amp; determine CEO salary adjustment</li> <li>- Determine/approve incentive award(s) (cash and/or equity) for prior year</li> <li>- Review top executive officers' base salary adjustments and incentive awards</li> <li>- Establish overall bank, CEO, and top executive officer performance goals for the year</li> <li>- Public filers – start CD&amp;A portion of proxy statement and committee certification</li> </ul>
2nd	<ul style="list-style-type: none"> <li>- Public filers – finalize CD&amp;A and annual proxy tables prior to disclosure</li> <li>- Ensure incentive plans are finalized and rolled out for the current year</li> <li>- Conduct risk review of compensation plans</li> <li>- Review compensation philosophy</li> </ul>
3rd	<ul style="list-style-type: none"> <li>- Compensation Committee continuing education</li> <li>- Review incentive programs, perquisites, benefits in case there is a need for adjustments</li> <li>- Conduct updated market reviews – executive and board compensation</li> <li>- Review Committee Charter, members, outside advisors</li> </ul>
4th	<ul style="list-style-type: none"> <li>- Review and recommend adjustments to director pay if appropriate</li> <li>- Approve any compensation program adjustments for the following year</li> <li>- Review preliminary performance results, discuss possible payouts, etc.</li> <li>- Review Compensation Committee performance</li> </ul>

# Committee Meetings & Meeting Agendas

Effective meetings and agendas are critical for today's Compensation Committee

## *Committee Meetings*

- Typically, there are a minimum of 3 to 4 meetings per year
- Chair leads the meeting & ensures adequate time for discussion and questions
- Advanced distribution of meeting materials is critical and essential!
- Ensure there is an executive session at each meeting (even if not needed)
- Quality minute taking and detailed minutes for every meeting
- Distribute previous meeting minutes shortly after meeting so topics are "fresh" and edits are easy to make
- Outside advisors often invited to participate (at least phone)

## *Meeting Agendas*

- Developed jointly with Committee Chair and Management
- Management often has a pre-meeting with Chair to ensure items/agenda are adequate and there are no "surprises"

# Evaluations - CEO & Directors



People who are against performance evaluations are often those who don't want to get better, or who know they are under performing.

**\* Effective evaluations should improve Company, group, and individual performance**

- Compensation Committee involved in the following:
  - Annual CEO Evaluations
  - Annual Director Evaluations
  - Annual Committee Evaluations
  - 360° & Self Evaluations

**Example areas to cover (varies by type/position):**

- Structure & Operations
- Effectiveness & Communication
- Knowledge & Teamwork

Seems like a lot?  
Is it important to get better?

# Compensation Committee Reference Book



## What & Why?

- Online resource that contains historical and current compensation related items (always easily accessible for Committee Members)
- Most Committee members have other jobs and don't focus solely on compensation

### *Examples of Items Included*

- Committee Charter & Compensation Philosophy
- Calendar, member contact information, meeting dates & times, agendas
- Compensation program plan documents and summaries
- Meeting minutes and historical risk reviews
- Compensation profiles for top executives (multi-year)
  - ✓ *Salary history, incentive payouts, performance reviews, etc.*
- Compensation studies/market comparisons (historical and current)
- Company performance vs. peer performance summaries
- Educational materials
- Regulation reference materials
- Other appropriate items

# Best Practices / Emerging Trends



## Compensation Committees Need To Be Thinking About

- CEO, Board & Management evaluations (governance)
- Equity Ownership Guidelines (executive & board)
- Standards surrounding equity grant practices (timing, methodology, etc.)
- Succession Planning (documented)
- Continuing education & orientation for Committee members
- Current market trends in executive and director compensation
- Regulations (say on pay, "clawbacks", pay vs. performance, etc.)

## Emerging Issues

- ESG (Environmental, Social and Governance)
- DEI (Diversity, Equity, Inclusion, etc.)
  - ✓ Specifically: Pay Equity (gender, diversity, etc.)

# Questions?



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Sign Up to Hear From Us

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Mr. Michael Blanchard is the CEO of Blanchard Consulting Group. He has extensive experience in the human resources field and has conducted or supported over 500 compensation planning, market research, and organizational development projects over the past seventeen years, with over thirteen years specific to the banking industry. Mike has presented to various national and state banking associations including the American Bankers Association, the Southeastern Bank Management and Director Conference, and the Western Independent Bankers association on a variety of compensation and board governance topics. With a master's degree in advanced industrial and organizational psychology, Mr. Blanchard's experience includes advising clients on assessing total compensation, incentive planning, and performance appraisals.