How to Motivate and Retain Key Officers and Employees Outside of Salary and Cash Incentives

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California Bankers Association – Annual Conference

BLANCHARD
Consulting Group

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Today’s Speaker

Michael Blanchard, CEO, Blanchard Consulting Group

Mike Blanchard is the CEO of Blanchard Consulting Group. He has extensive experience in human resources and has conducted or supported over 500 compensation planning, market research, and organizational development projects over the past 25 years, with over 20 years specifically for the banking industry. Mike has presented to various banking associations including the American Bankers Association, the Sheshunoff CEO Conference, the Bank CEO Network, and several state banking associations on a variety of compensation and board governance topics. With a master's in advanced industrial and organizational psychology, his experience includes advising clients on assessing total compensation for executives and directors, incentive planning, equity plan design, salary administration, and performance management.

Key Topics To Be Covered

Total Compensation 01

Equity (Mid-Term) Incentives 02

Benefits (All Employees and Top Officers) 03

Total Compensation

01

Elements of Total Compensation

Total Compensation

Salary Compensation

- Annual Salary
- Hourly Wages

Incentive/Bonus Compensation

- Annual Bonus
- Annual Incentive Plan

Equity Incentives

- Stock Options
- Restricted Stock
- Restricted Stock Units (RSUs)
- Phantom Stock
- Stock Appreciation Rights (SARs)
- Performance Units

Benefits - Non-Qualified Plans

- Supplemental Executive Retirement Plans (SERPs)
- Salary Continuation Plans (SCPs)
- Deferred Compensation Plans (DCPs)

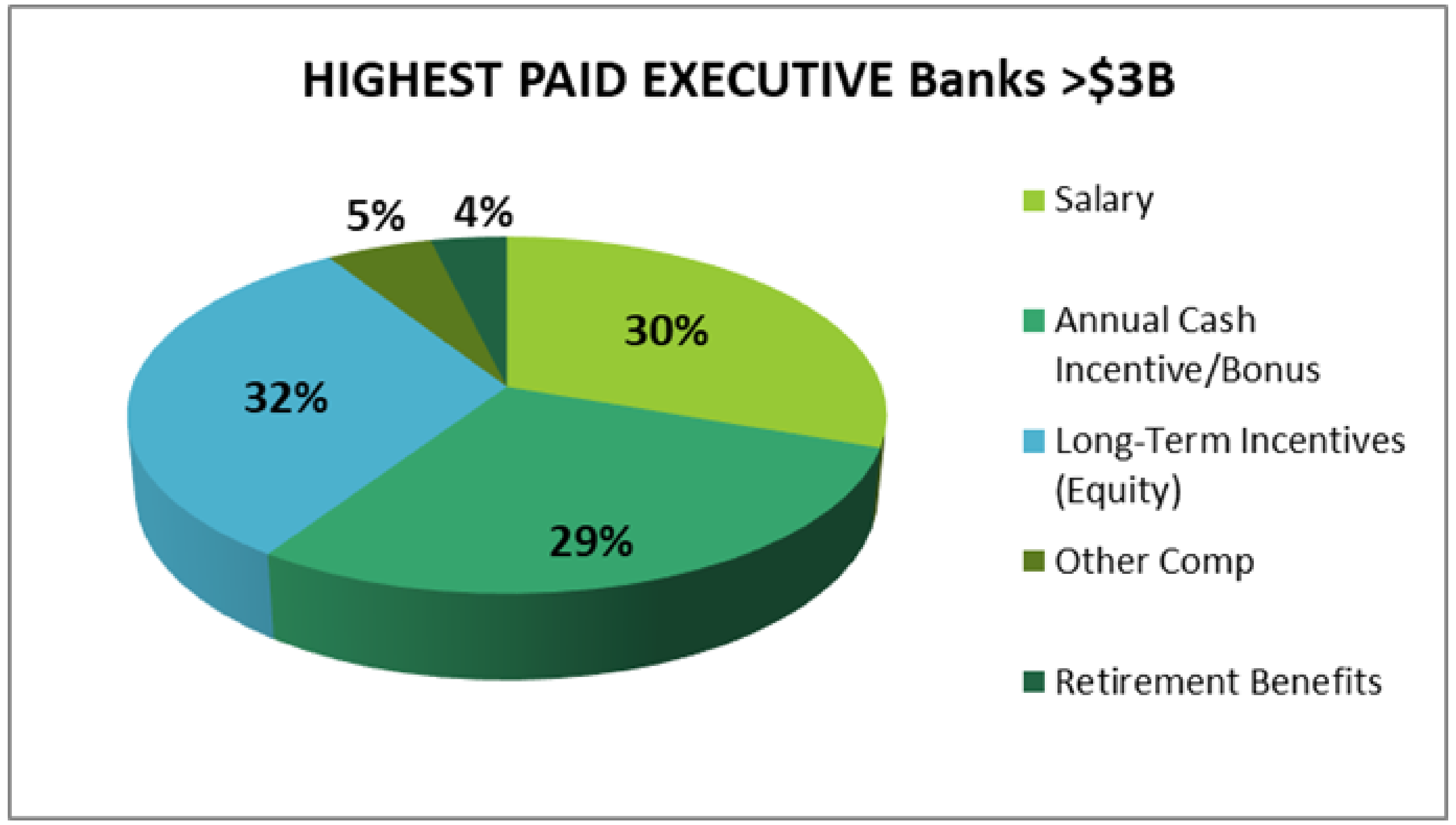
Benefits - Qualified Plans

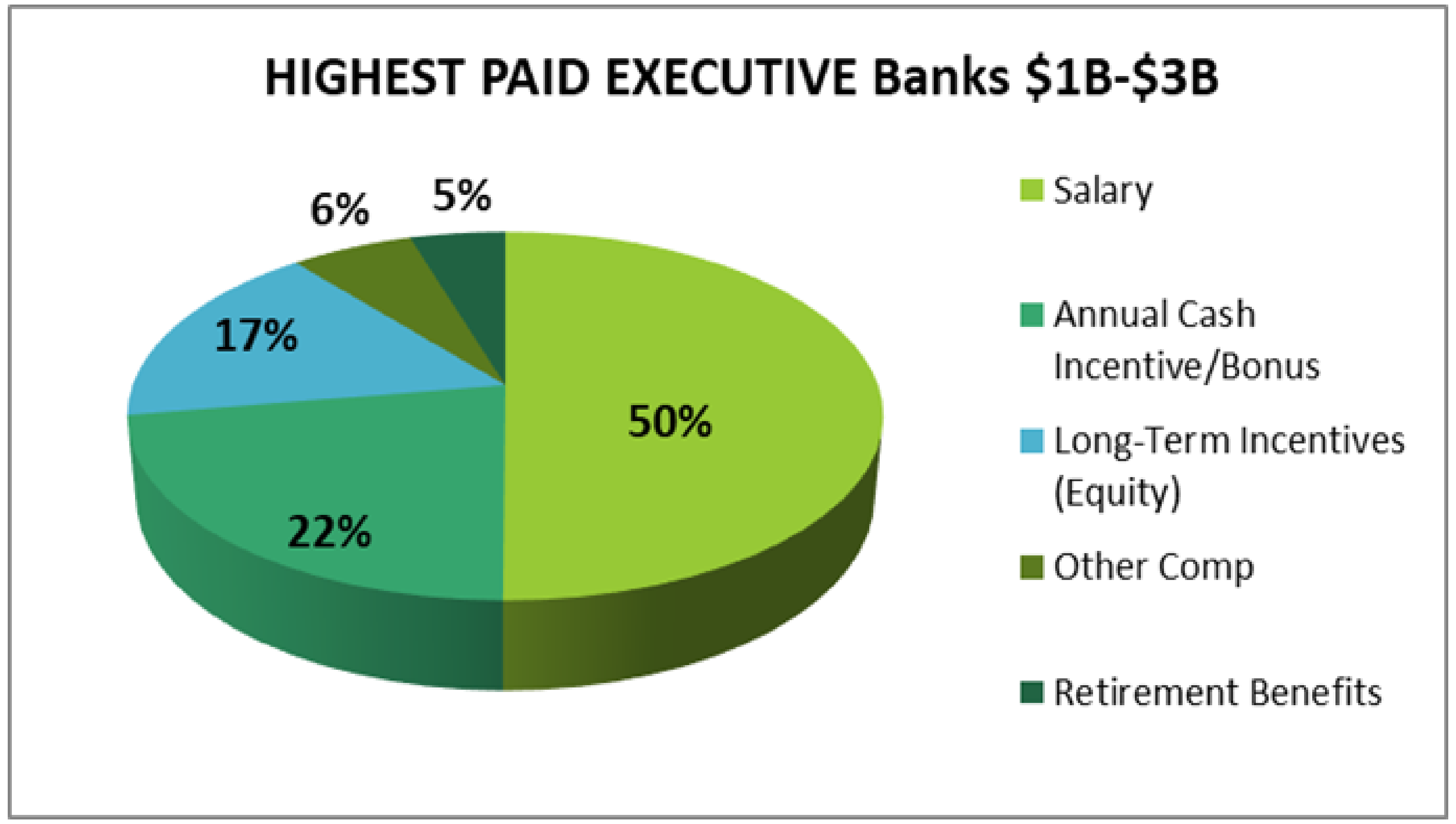
- Pension
- 401(k)
- ESOP
- Profit Sharing

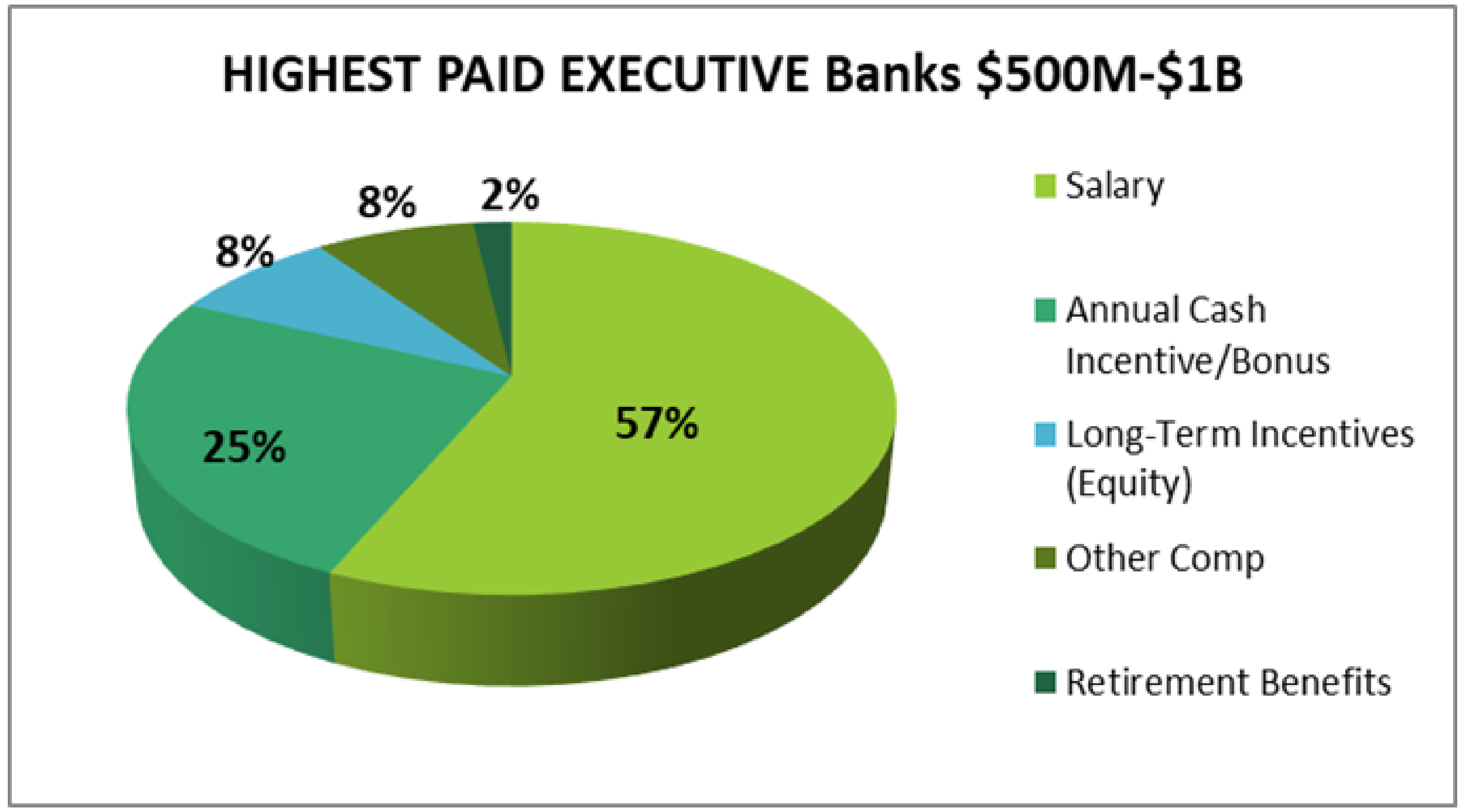
Other Benefits & Perks

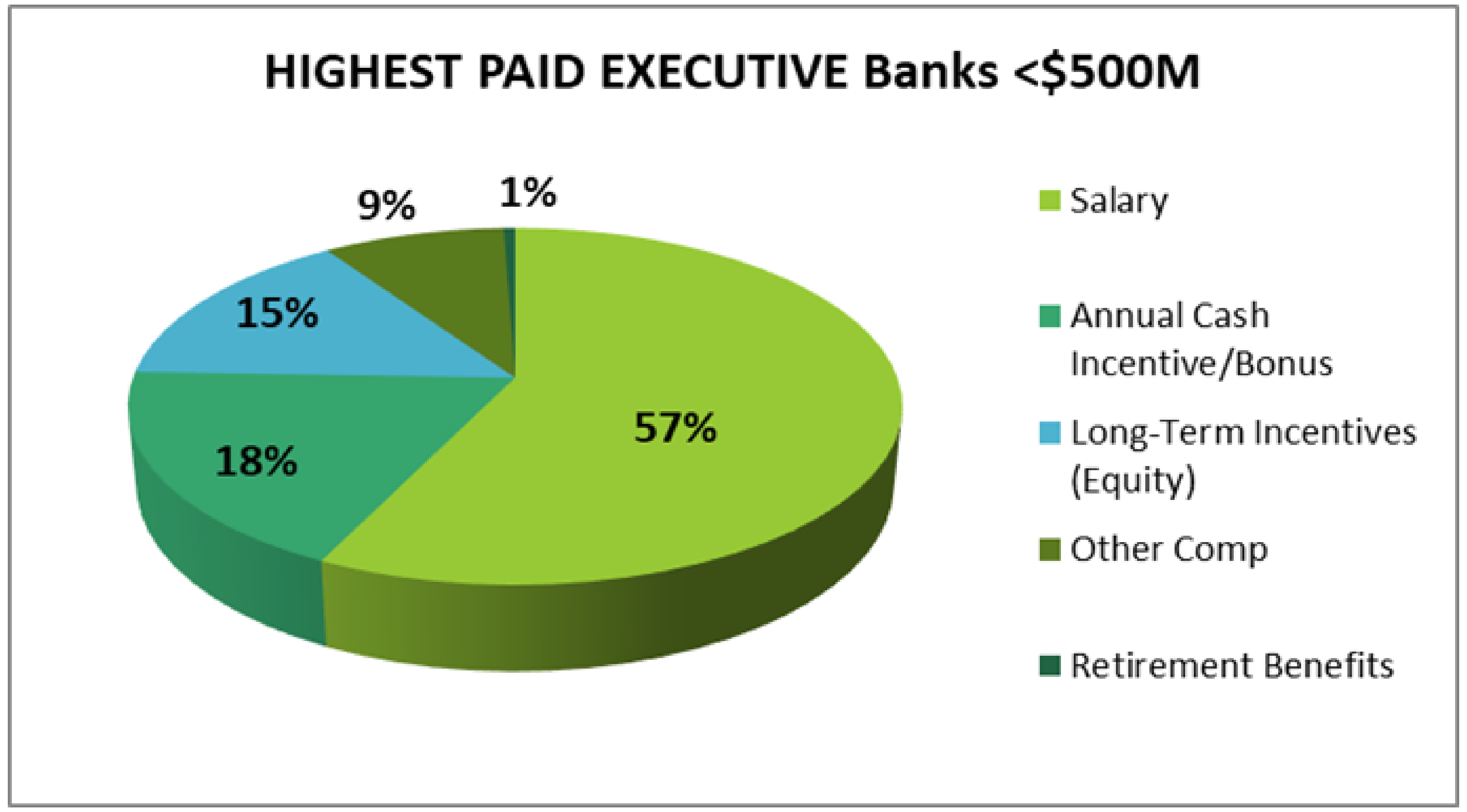
- Supplemental Disability
- Long Term Care
- Employment Agreements
- Change-in-Control (CIC) Agreements
- Country Clubs, Auto Allowances, etc.

CEO Total Compensation Mix

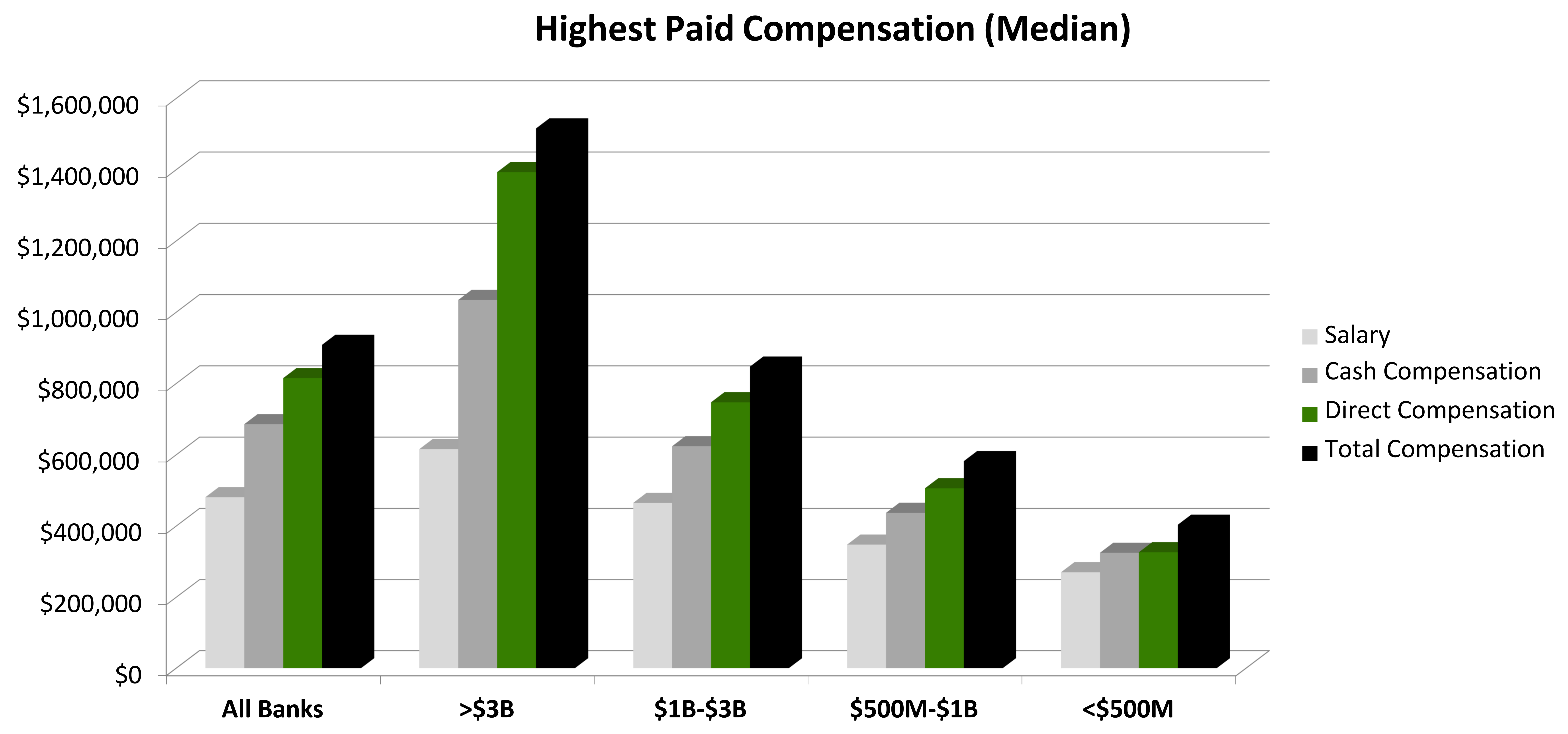








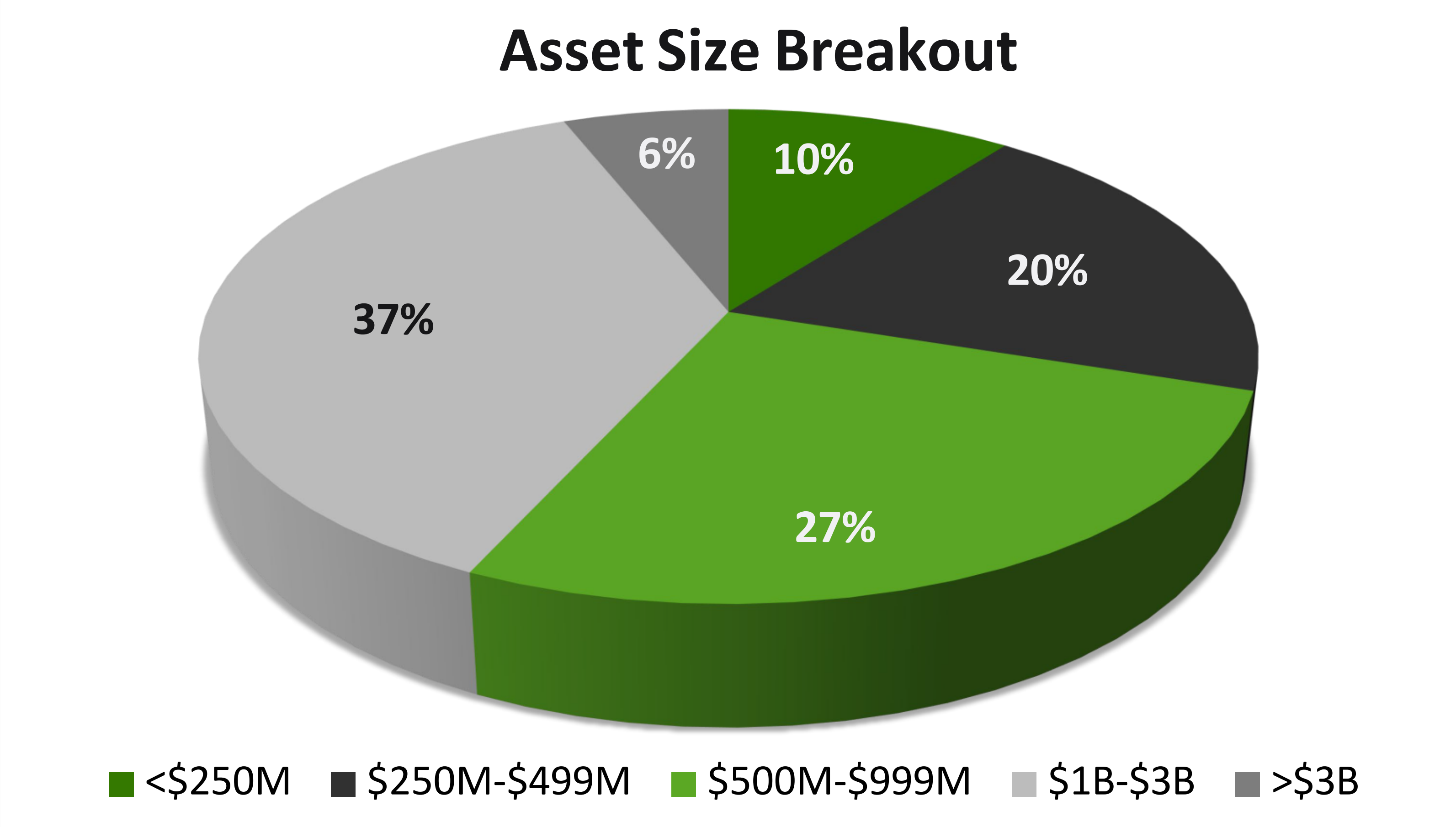
CEO Total Compensation



Survey Findings Included Throughout

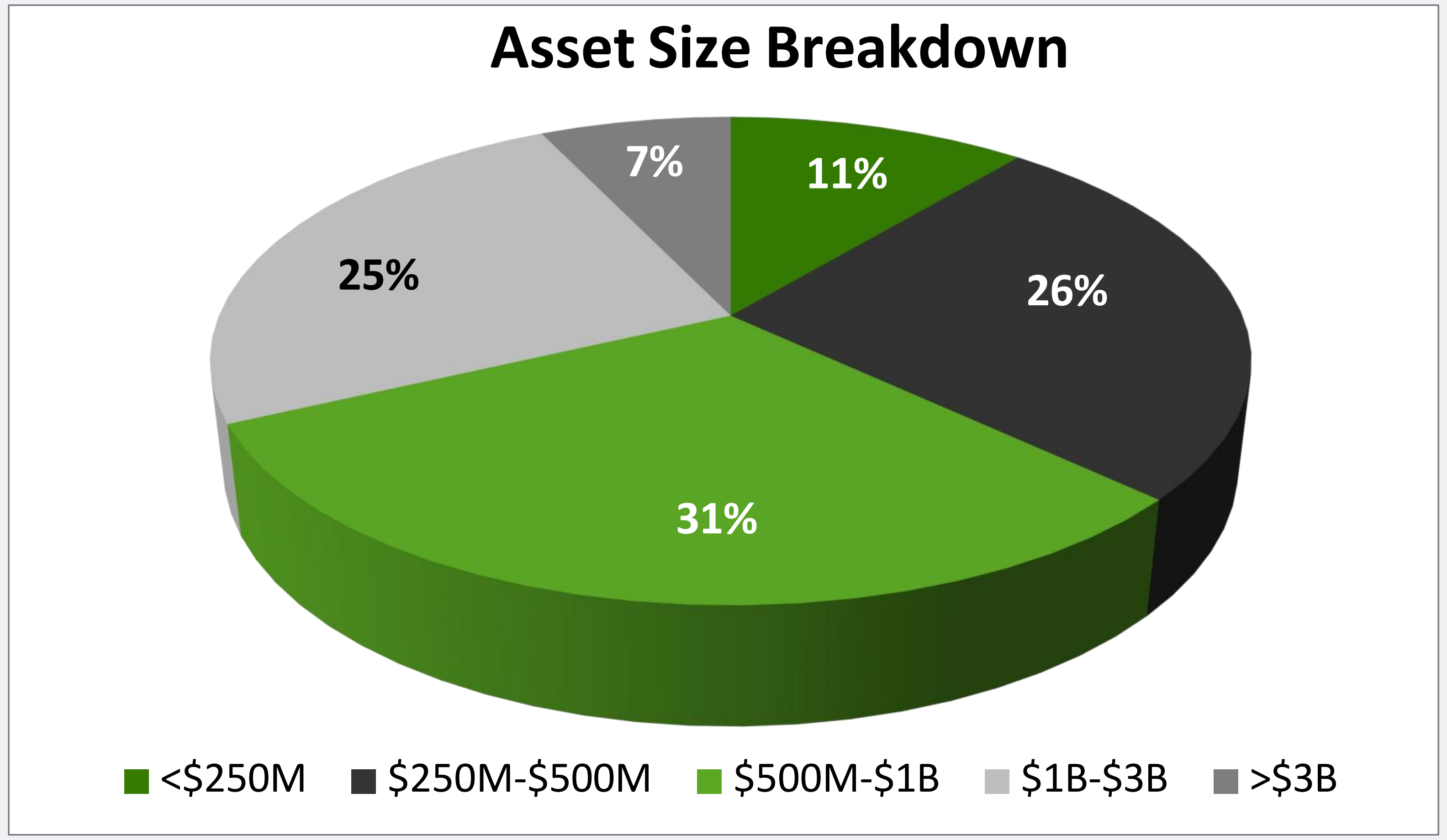
2024 Compensation Trends & Employee Benefits Survey
(BCG Trends Survey)

Included 184 banks (128 private and 56 public)

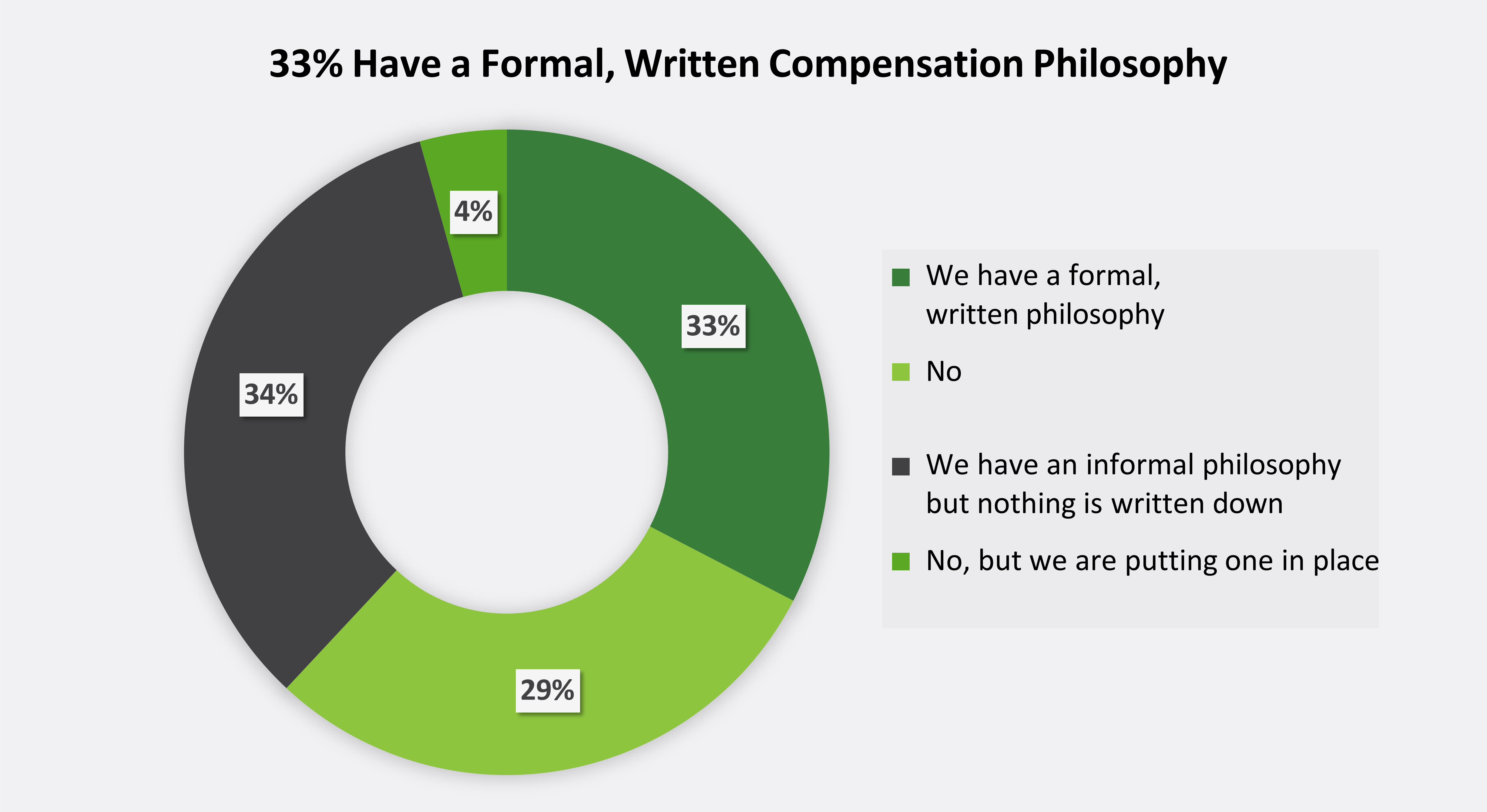


BCG 2023 Salary & Cash Compensation Survey
(BCG Salary Survey)

Included 224 banks



Compensation Philosophy – BCG Trends Survey



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

Equity-Based Incentives

02

Common Types of Equity-Based Incentives

Real Equity

Definition: *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
- Restricted stock units – stock settled

"Synthetic" Equity

Definition: *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

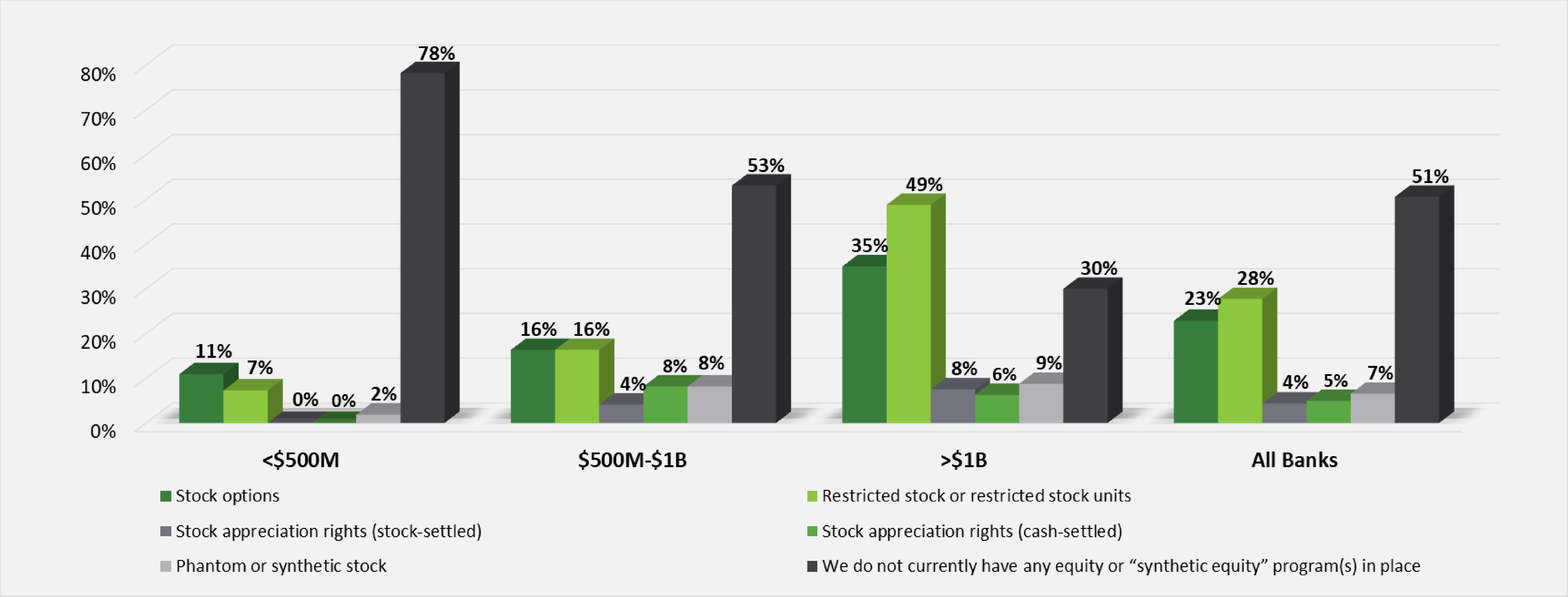
Reminders:

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

** Full-value vehicles (example: restricted stock) – value is immediate and remains if the underlying share continues to have value

Equity-Based Incentives (Prevalence) – BCG Trends Survey

- The table below from the BCG Trends Survey shows the prevalence of equity-based compensation programs/plans.



- (49%) of participating banks offer some form of equity/mid-term incentive program. As shown in the chart above, the prevalence of banks utilizing equity/mid-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.	- Taxed on appreciation - Capital gains eligible - Taxed at sale	- 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.	- Taxed on appreciation - Ordinary income - Taxed at exercise	- Impacts fully diluted EPS calculation - Non 409A treatment[1]
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.	- Taxed on appreciation - Ordinary income - Taxed at settlement	- Earnings dilution - Non 409A treatment[1]
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.	- Taxed on appreciation - Ordinary income - Taxed at settlement	- Impacts fully diluted EPS calculation - Non 409A treatment[1]
		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.	- Taxed on full value - Ordinary income (or 83(b)) - Taxed at vesting (or grant)	- Earnings dilution - Non 409A treatment[1]
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.	- Taxed on full value - Ordinary income - Taxed at vesting	- Earnings dilution - No voting or dividends - Non 409A treatment[1]
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.	- Taxed on full value - Ordinary income - Taxed at settlement	- Earnings dilution - Non 409A treatment[1]

Equity-Based Incentive Plans – Usage Trends

Prevalence[1]	Equity Prevalence in Public Banks		
	Restricted Stock	Stock Options	Blend[2]
All Banks (n=419)	77%	16%	13%
Banks that Granted Equity (n=337)	96%	20%	16%

[1] Represents publicly traded banks in Blanchard Consulting Group's internal database using 2022 proxy statements.

[2] Blend indicates that the bank granted both restricted stock and stock options in 2022 (not necessarily to the same executive).

Full-value shares are more prevalent than stock options.

Equity-Based Incentive Plans – Vesting

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

Ratable Vesting	Cliff Vesting
Definition: Awards vest in tranches over the vesting period (i.e. ¼ per year in each of four years)	**Definition:** Awards vest entirely at the end of the vesting period (which is typically a specific time-frame or after meeting performance criteria)

Performance-Based Grants vs. Performance-Based Vesting

General Industry

Frequently uses performance-based vesting with equity-based plans.

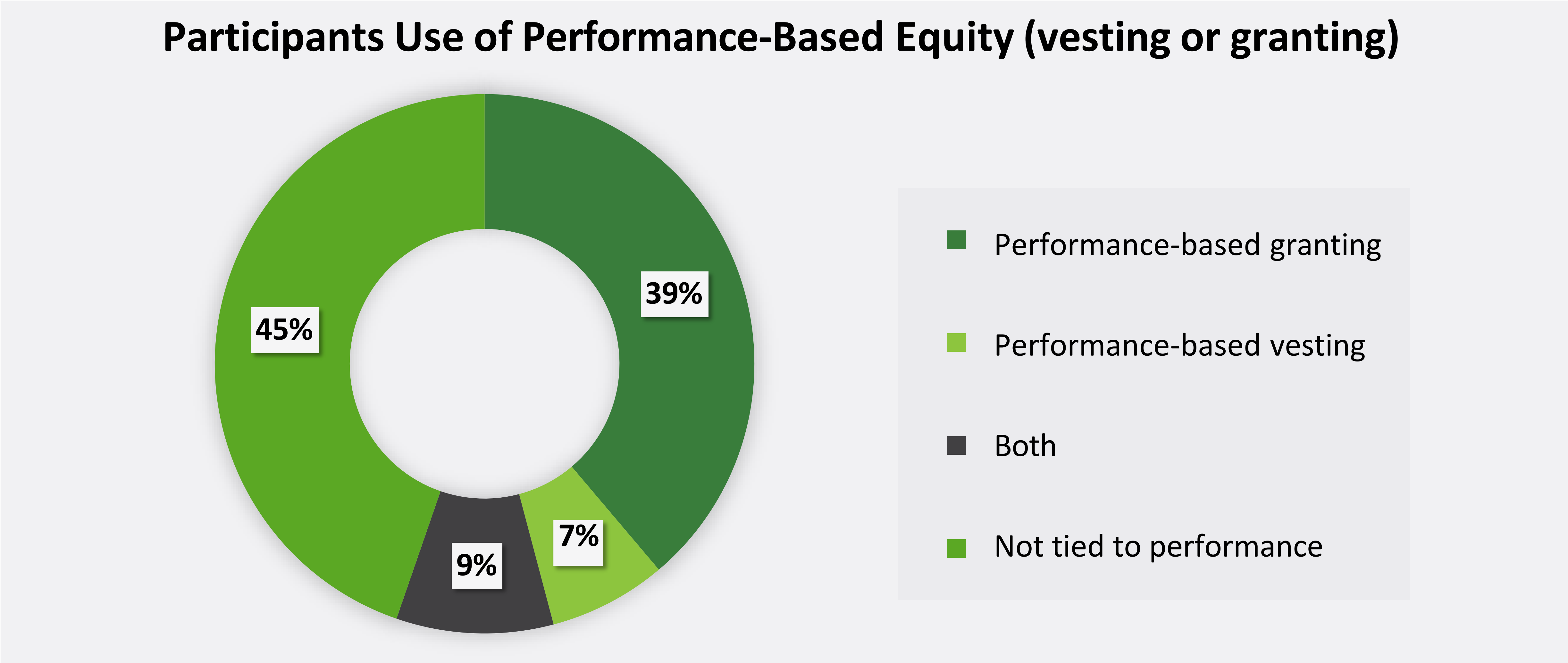
- ✓ **Performance-Vesting Methodology:** Maximum grants are made at the beginning of a performance period and vesting only occurs when pre-defined performance metrics are met.

Banking Industry

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

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

Performance-Based Equity – BCG Trends Survey



The most prevalent performance metrics utilized in determining the granting or vesting of equity awards are:

- Net income (43%) / ROA (38%) / Board discretion (36%) / Strategic planning goals (30%).
- 85% of participants with an equity plan have a minimum of a 1-year vesting period.
- 61% of banks that maintain an equity plan still allow for accelerated vesting of outstanding equity grants in the event of a change-in-control (without a termination event – “single trigger acceleration”).

Equity-Based Incentive Plan Goals – General Industry

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

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

General Industry: Total Shareholder Return (TSR) is the most common "Relative" measure used in equity-based plans, while earnings is the most common "Absolute" measure used in equity plans.

Equity-Based Incentive Plan (Example)

Sample Performance-Based Equity Incentive Plan Design

		Equity Award (% of Salary)		Equity Allocation	Number of Shares	
Tier	**Title**	**Target**	**Max**	**Restricted Stock**	**Target**	**Max**
I	President/CEO	25%	50%	100%	1,500	3,000
II	Chief Lending Officer	20%	40%	100%	1,173	2,343
II	Chief Financial Officer	20%	40%	100%	1,081	2,164
II	Head of Retail Banking	20%	40%	100%	879	1,760
II	Chief Compliance Officer	20%	40%	100%	854	1,707
II	Head of HR/Marketing	20%	40%	100%	807	1,617
II	Senior Lender	20%	40%	100%	772	1,543
III	SVP/Commercial Lender	15%	30%	100%	533	1,071
III	SVP/Mortgage Lender	15%	30%	100%	309	615
	Discretionary Tier	1,500 shares/yr.		100%	1,500	
Total # of Shares					**9,708**	**19,408**
Total Estimated Expense					**$536,024**	**$1,064,514**

Equity-Based Plans – Typical Payout Opportunities

The following table shows typical ranges for mid-term incentives as a percentage of salary for banks with assets between $250M and $1B and between $1B and $10B. The data is based on market research and BCG's databases.

Industry Data – Typical Mid-Term Incentive Payouts as a Percentage of Base Salary

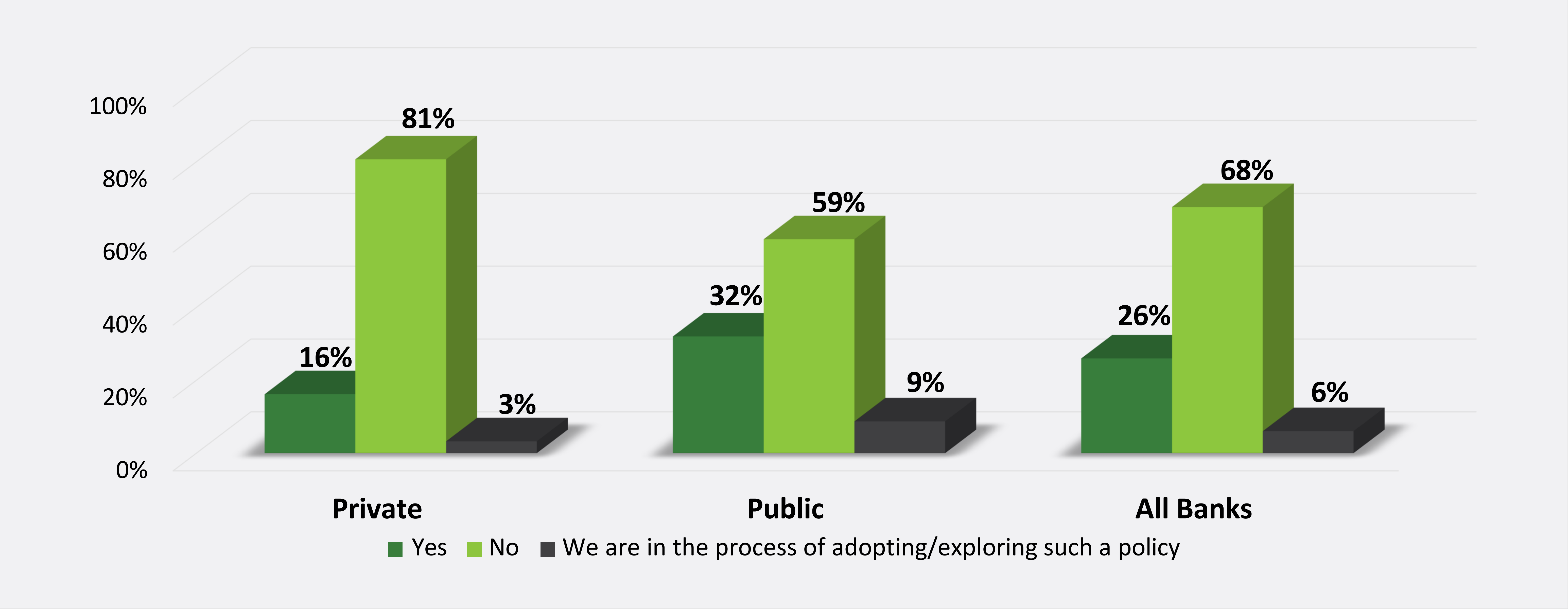
	Annual Award as a % of Salary			
	(Assets $250M-$1B)		*(Assets $1B-$10B)*	
Executive	**Target**	**Maximum**	**Target**	**Maximum**
CEO	10% - 30%	20% - 50%	25% - 60%	50% - 100%
EVP	7.5% - 20%	15% - 40%	20% - 40%	40% - 80%
SVP	5% - 10%	10% - 20%	15% - 30%	30% - 60%
VP/Producer	0% - 7.5%	0% - 15%	0% - 15%	0% - 30%

Equity-Based Incentive Plans (Ownership Guidelines) – BCG Trends Survey

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.

Executive Ownership Requirements

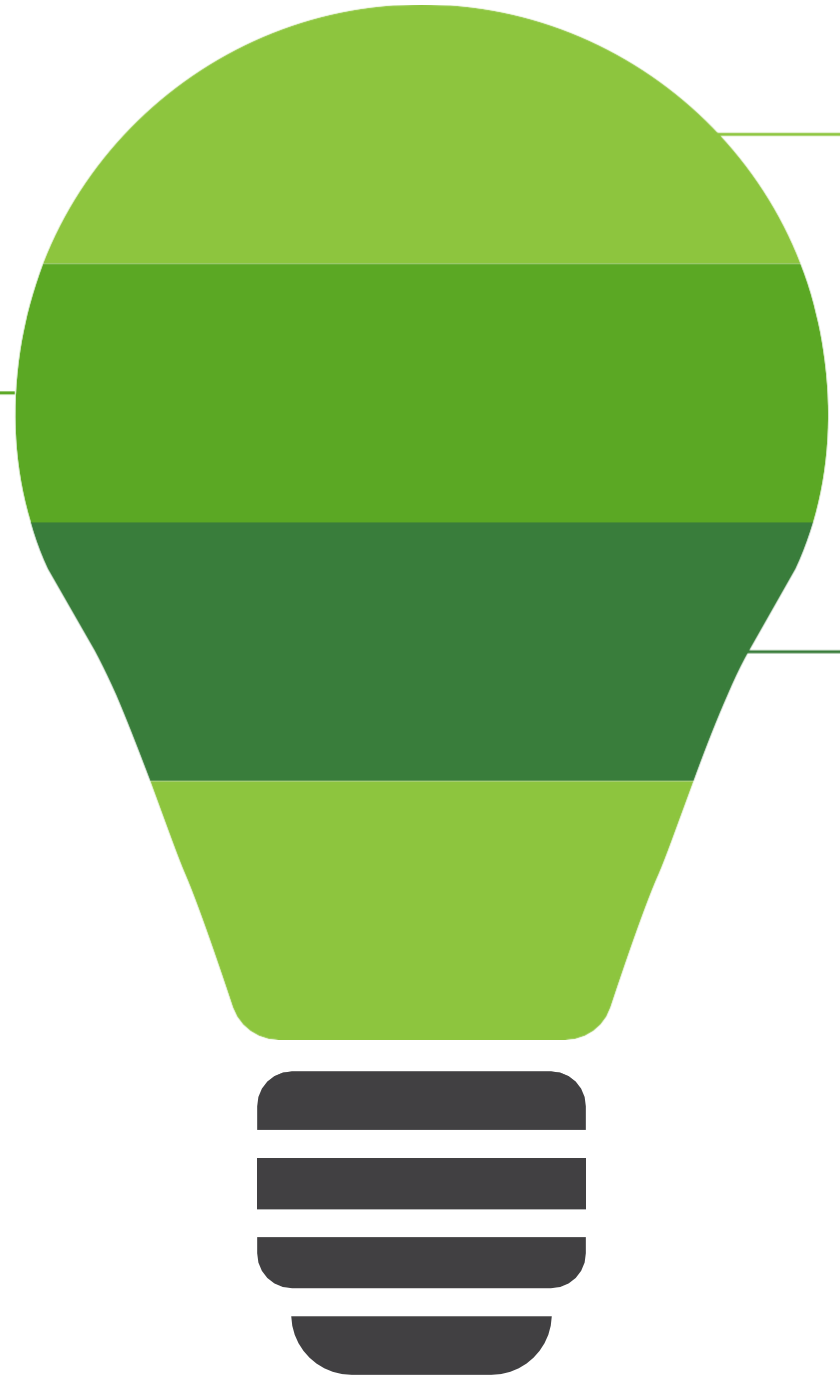


Institutional Shareholder Guidelines for Equity Plans

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 to shareholders (shares available to grant + unvested/unexercised shares to total common shares))
  - Plan Duration (estimated time that the share reserve will last)

Equity-Based Incentive Plan Objectives



Focus executives on a multi-year performance period and assist with executive retention.

Create executive ownership in the Bank.

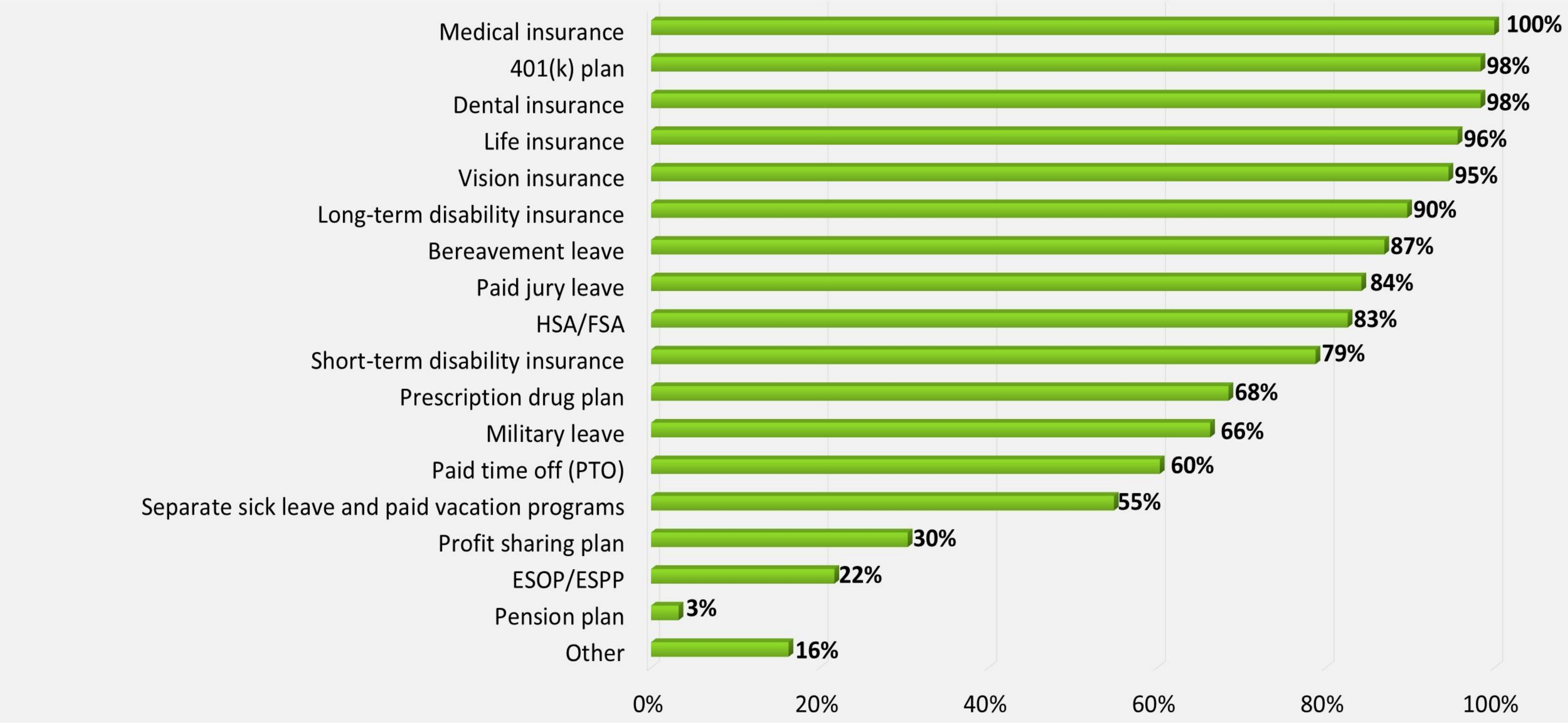
Link a component of Senior Management’s compensation to the long-term success of the Bank.

Benefits

03

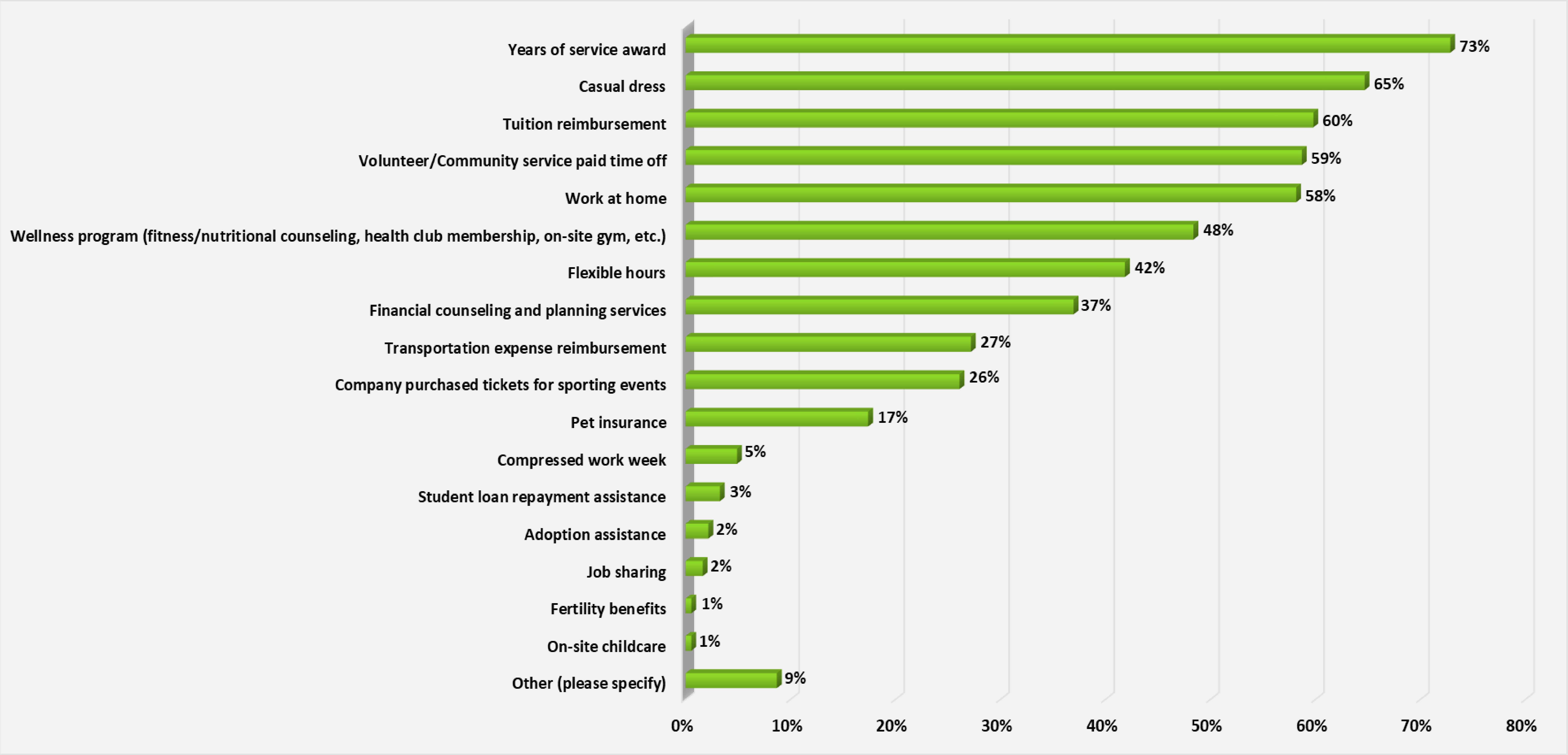
Employee Benefits – BCG Trends Survey

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



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

Non-Traditional Benefits



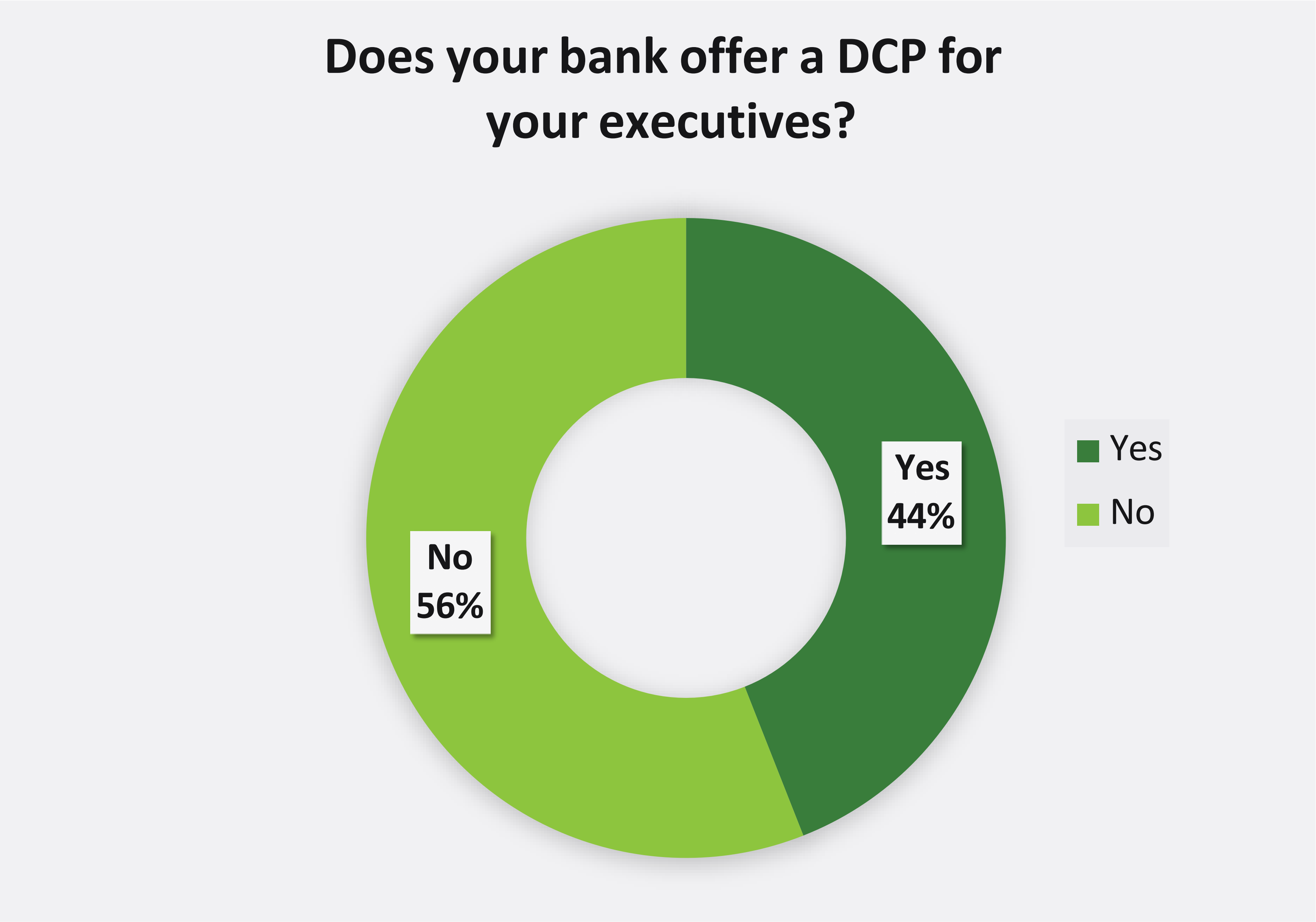
Other Trending Benefits

Executive Benefits

- This table provides industry prevalence information on various compensation and benefit plans. This information is from BCG's internal database of publicly-traded banks.

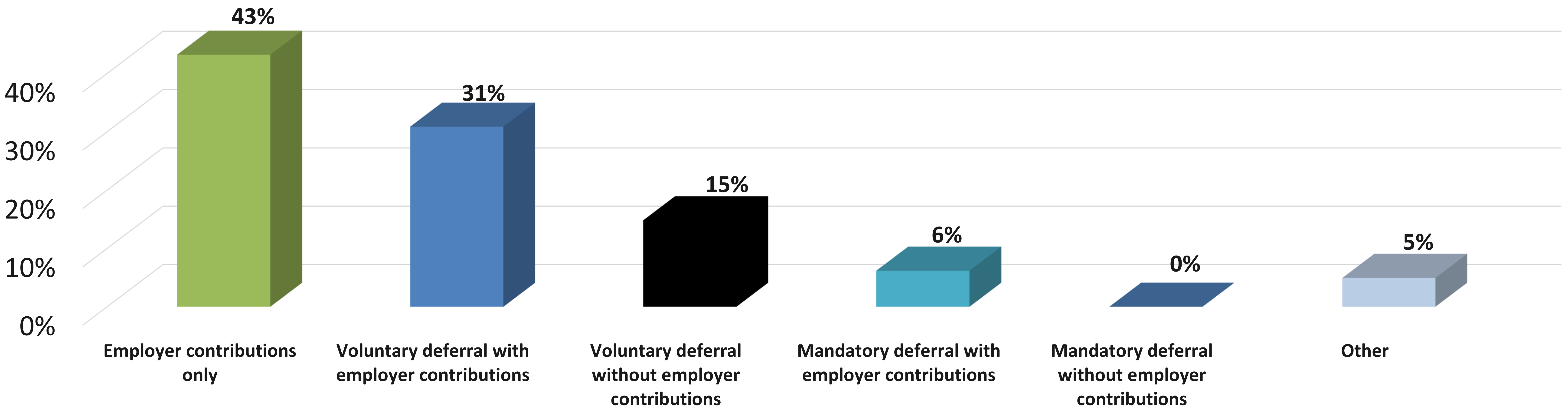
			Agreements		Retirement					
Assets	N	Median Assets ($000)	Employ-ment	Change-in-Control	401(k) Plan	Qualified Profit Sharing	Qualified Pension Plan	Deferred Comp. Plan	SERP	Deferred Comp or SERP
All Orgs	221	1,964,229	73%	86%	99%	61%	9%	36%	47%	67%
<$500M	20	342,964	80%	80%	95%	60%	5%	20%	25%	35%
$500M-$1B	34	795,447	65%	76%	94%	68%	6%	15%	62%	71%
$1B-$3B	93	1,816,386	75%	88%	100%	55%	13%	33%	53%	68%
>$3B	74	5,346,664	72%	91%	100%	66%	7%	53%	39%	73%

Executive SERP/SCP and Deferred Compensation Prevalence



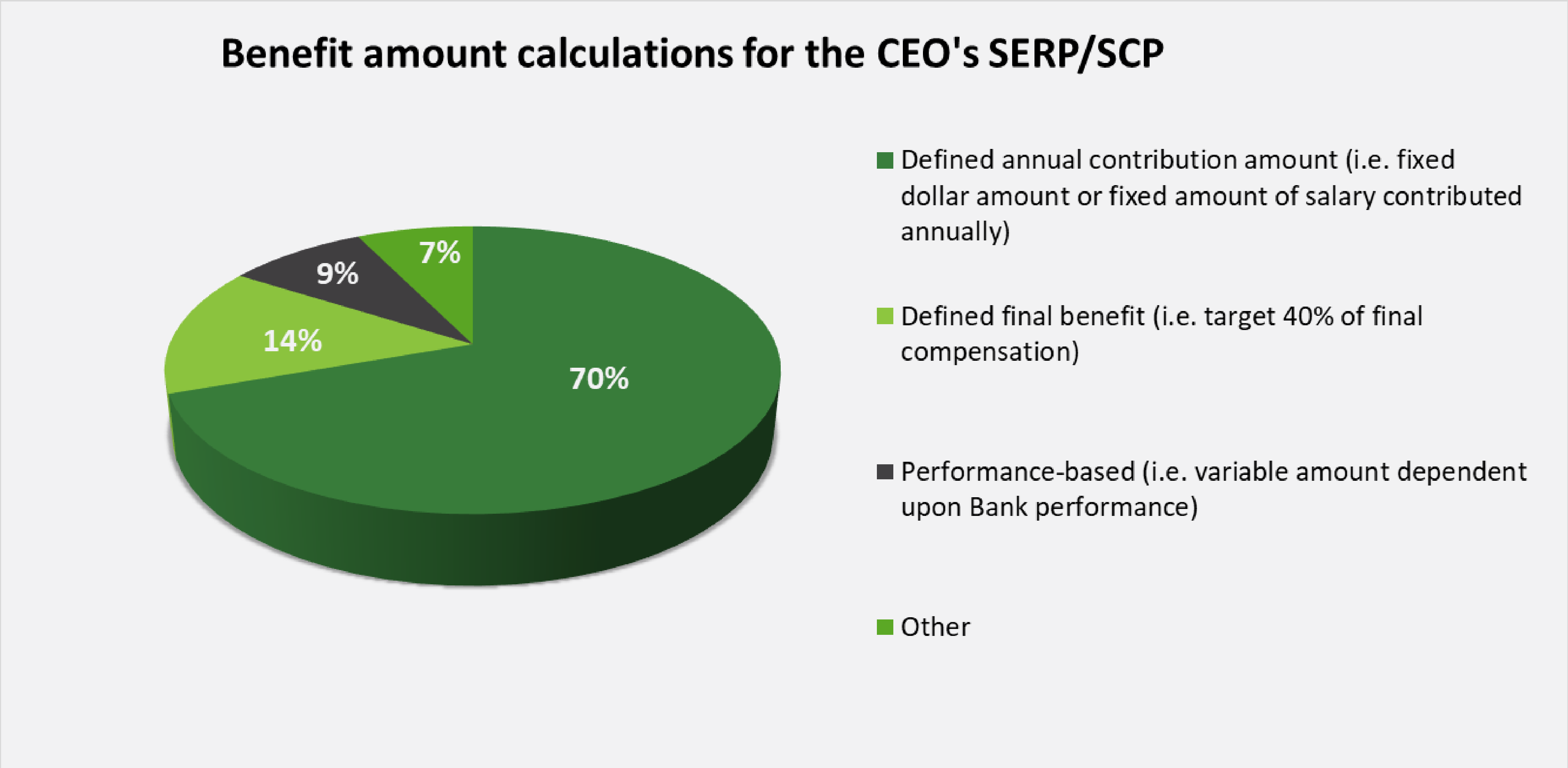
- 44% of the responding banks offer a deferred compensation plan to executives.
- Approximately 40% of the responding banks offer a SERP/SCP to at least one executive.

Deferred Compensation Details



- Deferred compensation plans can allow for voluntary or mandatory deferrals (by the participant/employee) with or without an employer match/contribution.
- Forty-three percent (43%) of the deferred compensation plans have an employer contribution.
- Thirty-one percent (31%) of the banks with deferred compensation plans (voluntary or mandatory deferral) utilize ratable vesting (i.e. 20% per year over five years) for the employer contribution.

CEO SERP Benefits – BCG Trends Survey



Prevalence of the typical annual contributions/defined benefits for the CEO's SERP/SCP:

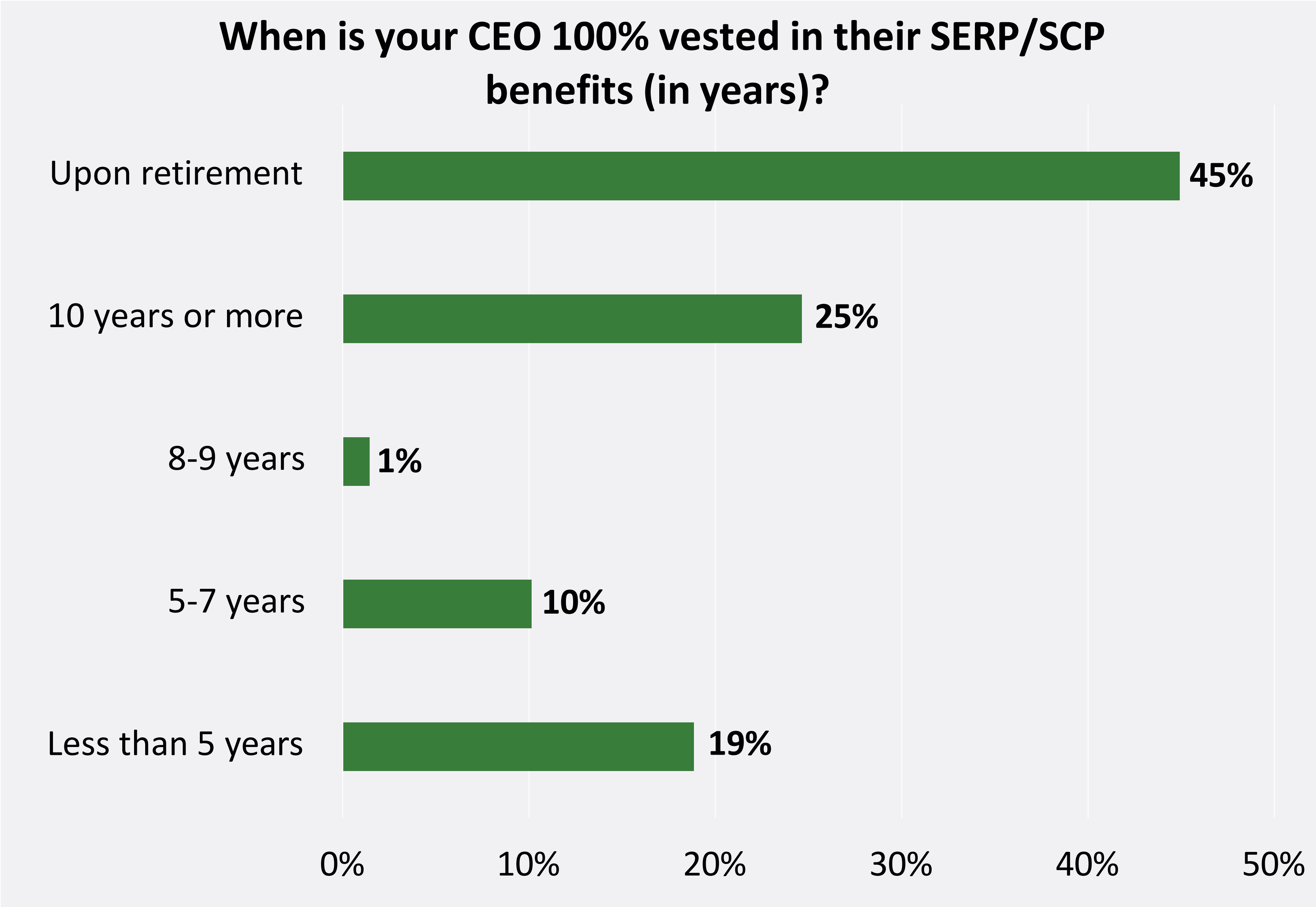
Annual Contribution (fixed dollar amount):

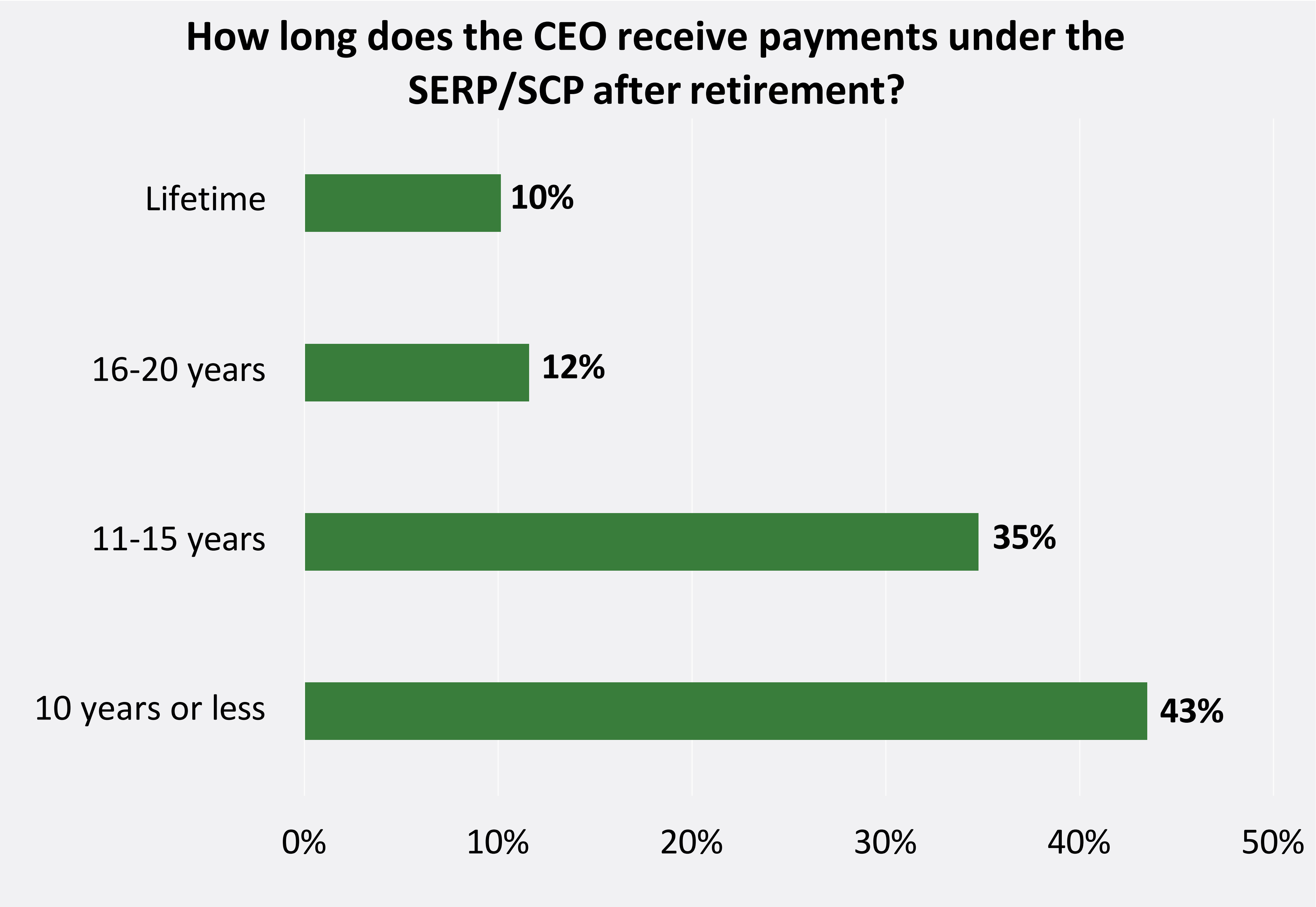
- Greater than $300,000 (19%)
- $200,001-300,000 (15%)
- $150,001-$200,000 (6%)
- $100,001-$150,000 (21%)
- $50,001-$100,000 (29%)
- Less than $50,000 (10%)

Defined Final Benefit (target percent of final comp)

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

CEO SERP Vesting and Length of Benefit – BCG Trends Survey





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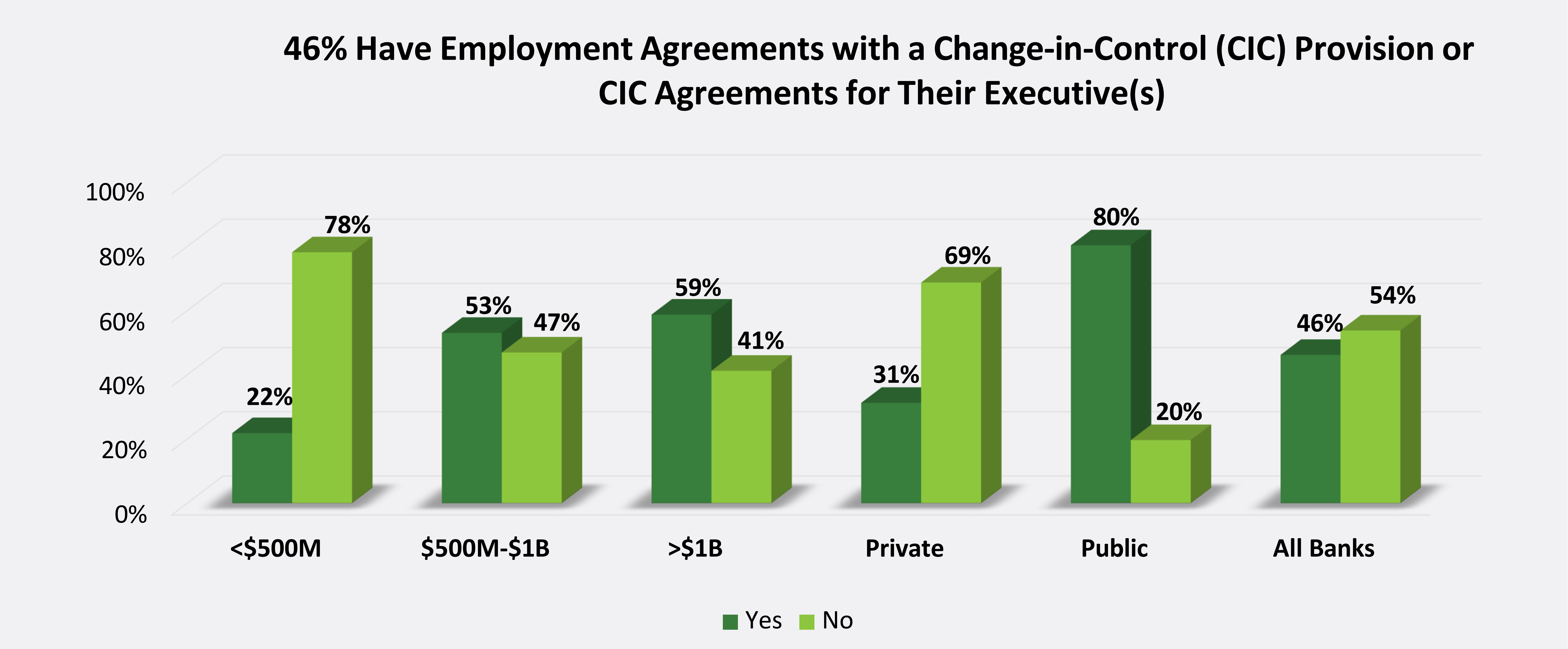
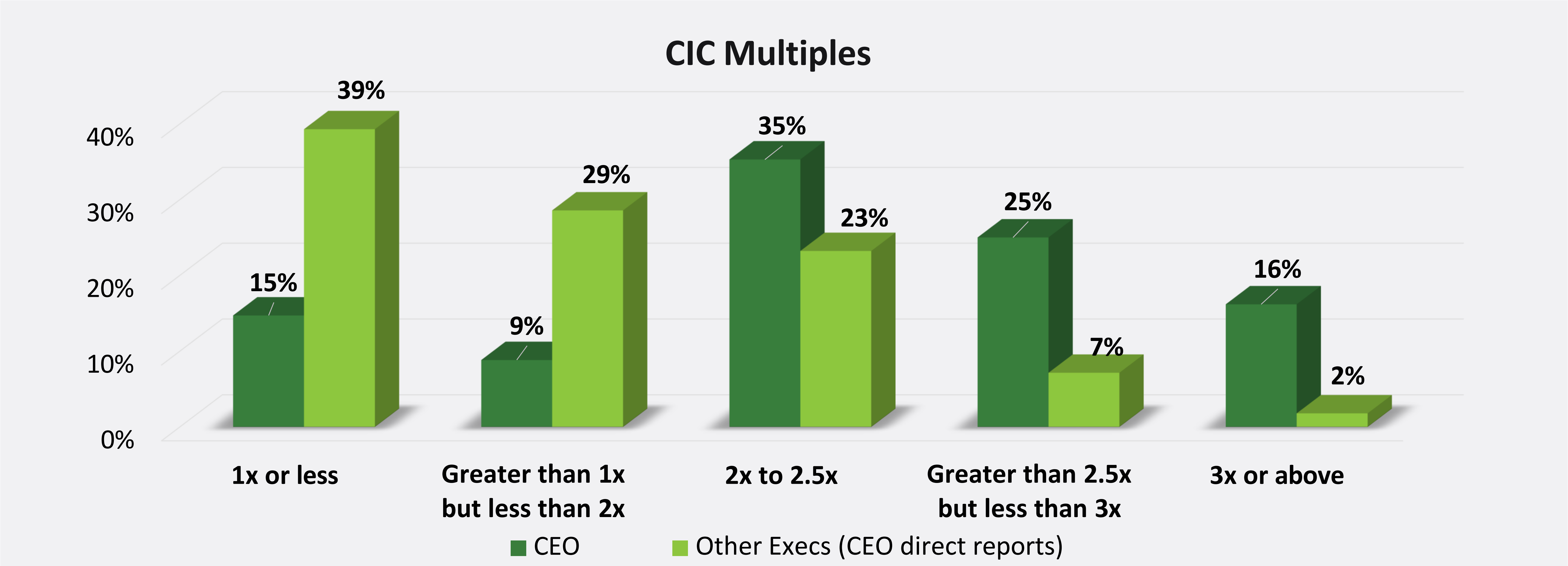
Employment/Change-in-Control (CIC) Agreements – BCG Trends Survey



- Public Bank prevalence is much higher for CIC provisions (80% vs 31%).
- 72% of respondents had a non-compete in place for their CEO.

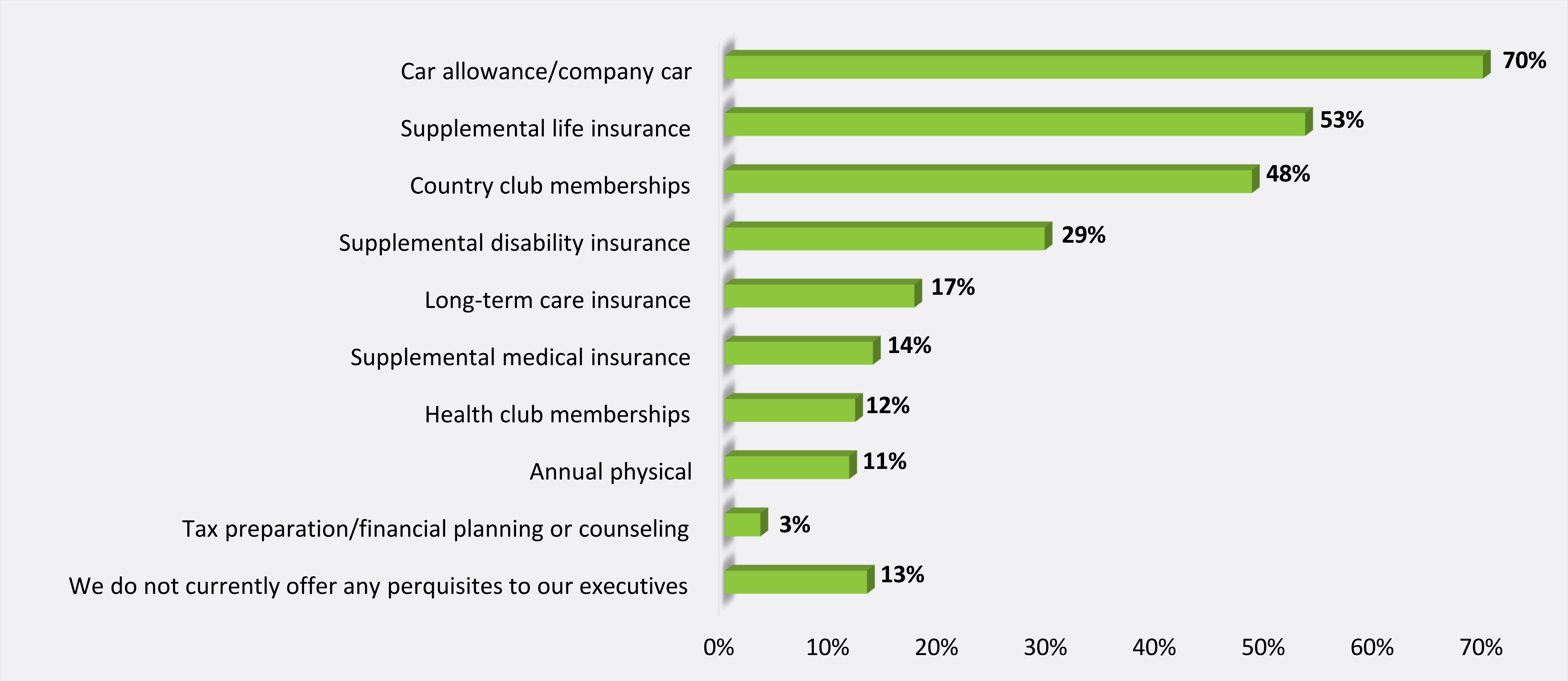
Change-in-Control (CIC) Severance Multiples – BCG Trends Survey (Cont.)



- The amount of the CIC severance benefit will vary upon several factors, including the officer's title, the size and location of the bank, the tenure and equity holdings of the officer, and the performance of the Bank.
- 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.
- 40% of respondents who pay CIC severance benefits to the CEO determine the benefit based on the CEO's salary and 46% determine the benefit based on cash compensation.
- *Gross-Ups for 280(G)* are no longer prevalent as 79% of participating banks <u>DO NOT</u> provide a gross-up.

Executive Perquisites – BCG Trends Survey

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



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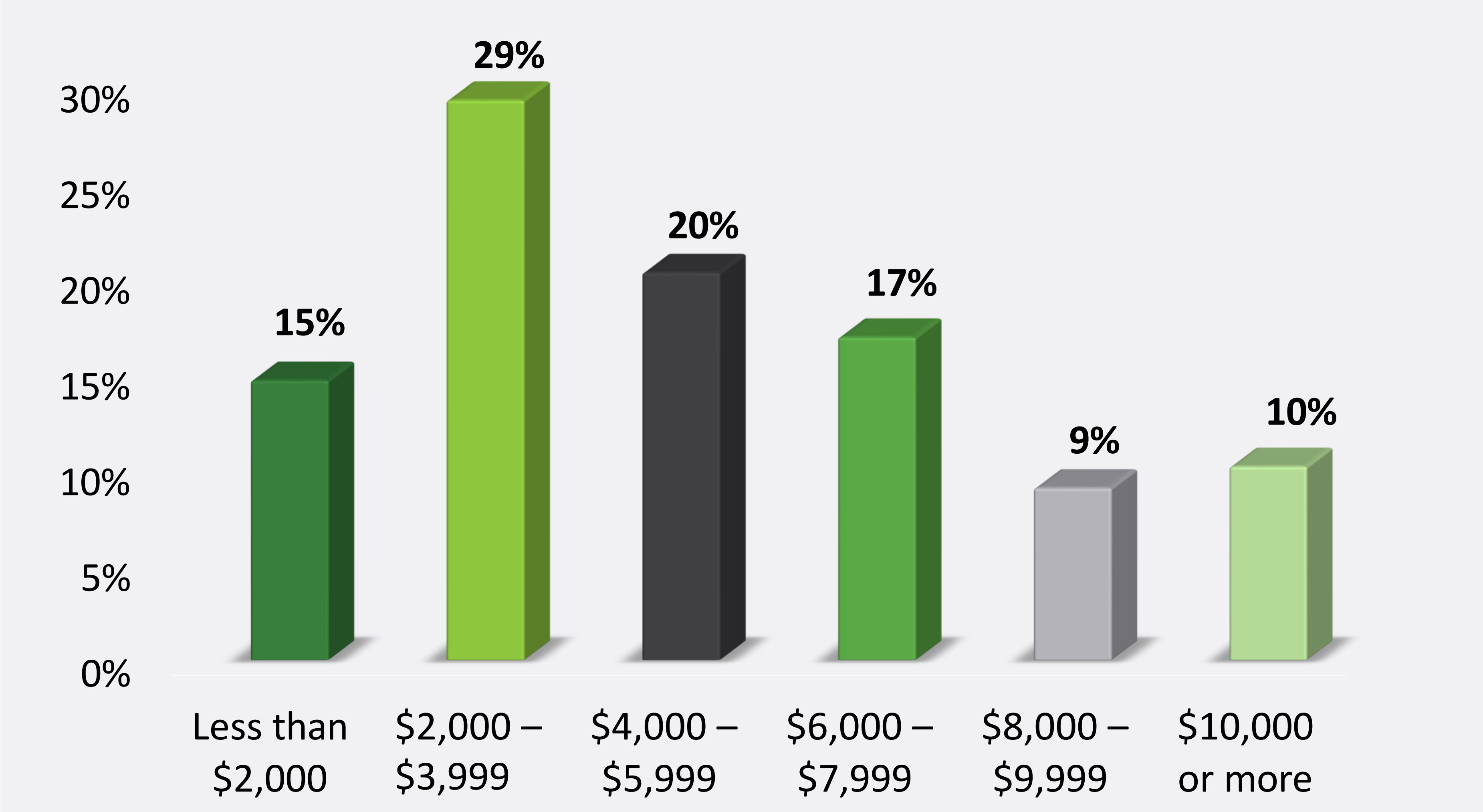
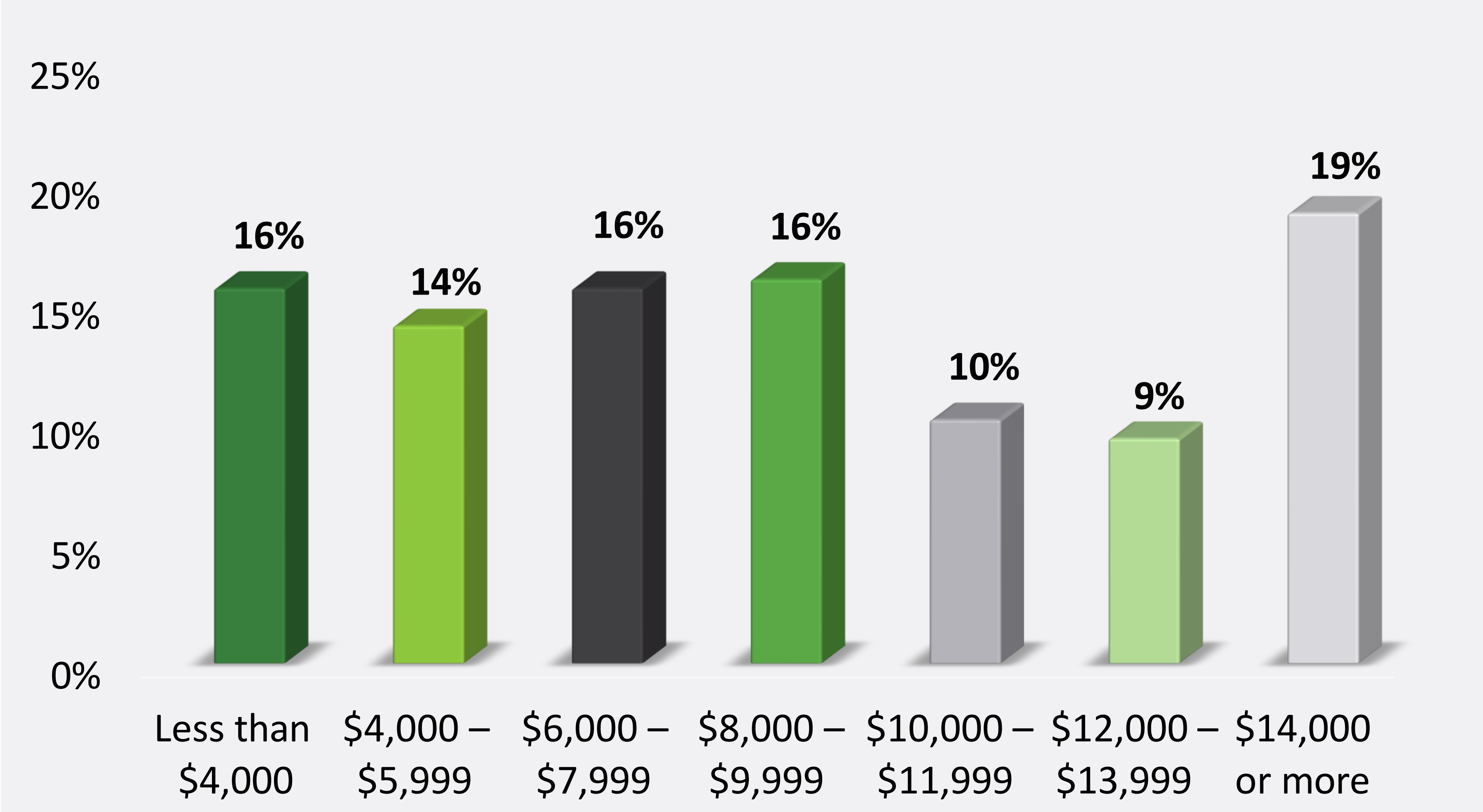
Executive Perquisites – BCG Trends Survey (Cont.)



Average Annual Auto Allowance/ Company Car (Per Officer)



Average Annual Club Membership Costs (Per Officer)

Questions?

Email: info@blanchardc.com

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