November 2019

Bank Compensation Trends: You Have Questions, We Have Answers

With year-end planning in full swing, it's important to take a step back and reflect on past, current, and future compensation trends to ensure your firm is set up for a successful year ahead.

McLagan recently hosted a webinar to highlight key topics in compensation for the banking sector, providing insights and actionable tips for firms to consider. From executive compensation to director pay and regulatory issues, this article uses our 2019 survey results to answer some of your most pressing questions.

How has equity changed since the Great Recession and the advent of say-on-pay?

All asset sizes have experienced an increase in equity grants in recent years. This comes as no surprise given many firms' new focus on non-monetary incentives, with equity now serving as a favorable approach to cash for attracting and retaining employees.

In addition, the fundamental designs of LTI plans have undergone tremendous change since the Great Recession. This has, in large part, been due to say-on-pay pressures on publicly traded firms. Nearly 10 years ago, LTI plans relied upon very few performance metrics or were treated as discretionary awards. Four to five years ago, most plans had at least one metric and, depending on asset size, half of the LTI award was performance vested. Today, the majority of plans include two performance metrics and the actual use of performance goals has also evolved.

Director pay will now be consistently evaluated—what does this mean for your firm?

There has been a lot of recent activity surrounding director pay. To begin, this is the first time that both ISS and Glass Lewis will be evaluating board of director compensation based on the proxies filed for the 2020 annual shareholder meeting. While their methodologies are being reviewed, they will also be directionally looking for outliers on an individual director basis without sufficient rationale. If an issue is found, ISS and Glass Lewis will recommend against directors standing for the compensation committee or the committee responsible for compensation decisions. Second, there has been an increase in director litigation. Much of this relates to how

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directors set their own pay levels, as well as the recent changes regarding how board of director compensation is set in the eyes of the Delaware Court of Chancery. We highlight this further below.

What should directors be aware of in respect to litigation as a result of changes with the Delaware Court of Chancery?

Under the new Delaware law, there will be a heightened standard of review, including demand letters by plaintiff law firms. Businesses should take the following steps to protect themselves against lawsuits:

1. **Meaningful limit to director compensation in equity plans.** The next time you request additional shares for approval, consider adding an overall annual limit for individual director compensation in your shareholder-approved equity plan.

2. **Expanded disclosure in proxy statements.** We recommend adding language to the section covering director compensation that discusses the overall process whereby director compensation is reviewed and aligned to market.

3. **Annual review of pay by compensation consultant.** Review by an outside third-party compensation consultant is a foundational element for satisfying the business judgement rule, which is a part of the entire fairness doctrine.

Beginning in 2020, both ISS and Glass Lewis will be reviewing director pay for excessive pay levels. While the methodology will be finalized later in 2019 for the 2020 proxy season, it is important to call out a few items. First, as of this writing, ISS will be reviewing for two years of excessive pay instead of one year. Second, if ISS deems there is excessive pay, they will recommend an "against" vote recommendation for compensation committee members. It is critical to note that this does not fall under say-on-pay, which is a management vote. Any director pay concerns will be leveled against compensation committee members.

What key changes can we expect from ISS and Glass Lewis?

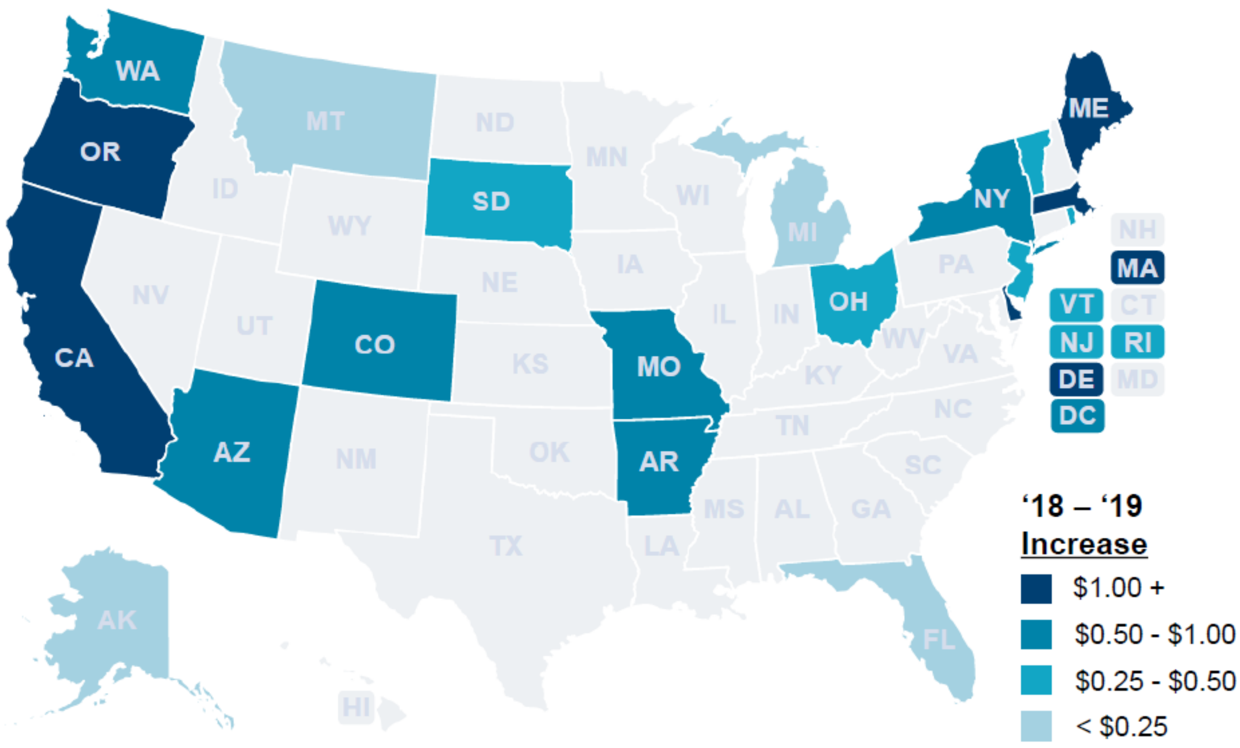
There will be annual policy updates in late November. In the meantime, here are some potential changes to be aware of for the 2020 proxy season. To start, ISS is signaling updates to its overboarding policy and both ISS and Glass Lewis are expected to make changes to their pay-for-performance (PFP) scoring systems. ISS will likely add economic value added to the PFP secondary metrics. It appears they will maintain their primary scoring metrics based upon total shareholder return. Glass Lewis will undergo a more holistic change. As a result of shifting from Equilar to CGlytics, the firm is reviewing its entire pay-for-performance methodology. It's important to note that, directionally, there may be a move for Glass Lewis to adjust its pay for performance scoring framework, making "A" the optimal letter grade and showcase scoring against two possible peer groups.

During the annual National Association of Stock Plan Professionals (NASPP) conference in New Orleans, ISS research speaker, David Kokell, also indicated that additional changes are anticipated for the Equity Plan Scorecard. Companies with evergreen equity plans (plans that state that a certain percentage of shares are always available for grant) could be at risk for against recommendations.

How have the updates to minimum wage impacted the banking industry, specifically large vs. regional banks?

Attention regarding minimum wage has been growing since the financial crisis. With no changes at the federal level, individual states are frequently taking more action, as depicted in the map below.

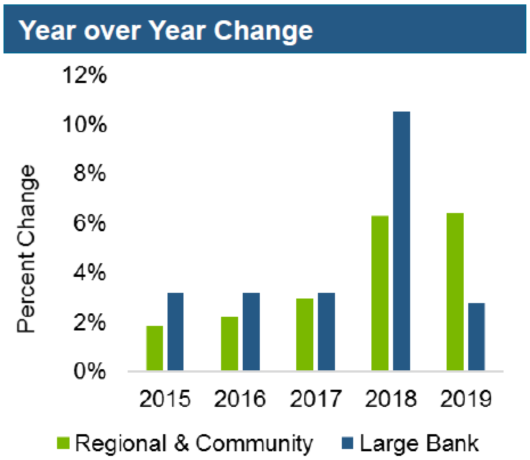
Minimum Wage – State Level Increases From 2018-2019

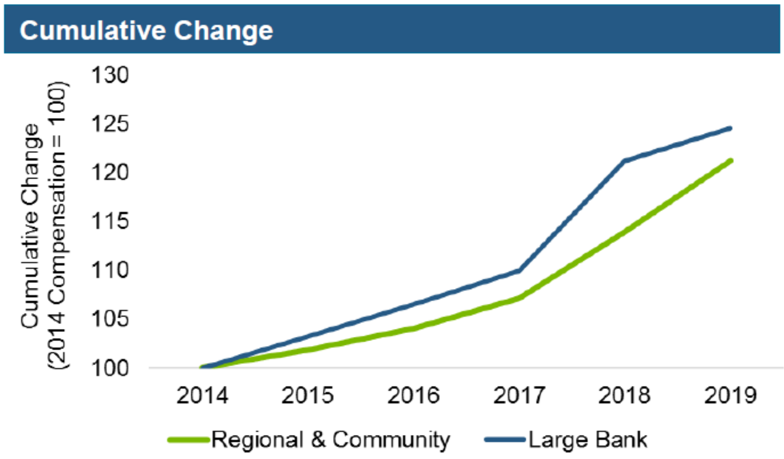


Source: 2019 McLagan Bank Compensation Trends Webinar

The trend of rising minimum wage has largely affected teller compensation for banks, with significant increases in compensation occurring for this function over the last two years. Large banks experienced big increases in 2018, with 2019 increases more in line with previous years. However, for regional & community banks, 2018 and 2019 saw larger increases than ever before. While the differential between regional & community banks vs. large banks decreased from 2018 to 2019, it is still greater than the historical trend. This potentially indicates further increases at regional & community banks in 2020, as announcements from large banks continue to be released, increasing higher levels of minimum hourly pay.

Minimum Wage – Large Banks vs. Regional & Community





Source: 2019 McLagan Bank Compensation Trends Webinar

The compensation landscape continues to evolve and present challenges on several fronts—executive, director, and staff pay. It is therefore critical to stay informed about any new, emerging developments and ensure your firm is fully equipped to respond in an appropriate, timely, and meaningful fashion.

To learn more about bank compensation trends and how to prepare your firm for the future, please contact our team.

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