

BankDirector.

WEBINAR

The Impact of COVID-19 on
Executive Compensation Programs

WELCOME



EMILY MCCORMICK

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Emily McCormick is Vice President of Research for Bank Director. Emily coordinates and executes research projects, including Bank Director's annual surveys on M&A, risk, compensation and growth & technology, as well as RankingBanking. Emily regularly writes for Bank Director magazine and BankDirector.com and edits Bank Director's online video content. She started her career in the circulation department at the Knoxville News-Sentinel and graduated summa cum laude from The University of Tennessee with a bachelor's degree in Spanish and International Business.



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HOUSEKEEPING

 You have all joined this webinar in listen-only mode, which means you are muted.

 Questions? Type your question in the box on the right side of your screen.

 The presentation will be shared with all attendees within 24 hours via email, and it will also be available on BankDirector.com and Meridiancp.com.

 Let us know if you have technological issues in your question box on the right side of your screen.

 There will be 5 polls during the presentation where you can share your opinion anonymously. Please be sure to participate.



Susan O'Donnell

Partner

Ms. O'Donnell has over 25 years of experience advising boards and management on all aspects of executive and board compensation and governance. For the last 17 years, she has focused on serving the banking and financial services industry where she advises clients on the many compensation challenges and emerging practices impacting the industry. Ms. O'Donnell is an experienced speaker and writer on the topics of executive compensation, director compensation, corporate governance, pay-for-performance and succession planning. She is an active participant and speaker with national and local industry associations. Ms. O'Donnell has been a certified compensation professional (CCP) with WorldatWork for over 25 years.



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Daniel Rodda

Partner

Mr. Rodda consults with compensation committees and senior management on all aspects of executive and director compensation, developing customized compensation programs aligned with business strategies and the governance environment. His consulting work includes competitive assessments, incentive plan design with appropriate risk management, responses to shareholder and regulatory feedback, compensation governance, compensation disclosures, pay and performance alignment, equity compensation plans, employment agreements and severance arrangements. Mr. Rodda has assisted clients with their executive compensation programs for over 14 years. He co-leads Meridian's financial services team, and his clients include a variety of banking and financial services organizations as well as companies in other industries.



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Bank Director Webinar ■ *August 2020*

The Impact of COVID-19 on Executive Compensation

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Banking Industry Landscape

The pandemic has presented unique challenges compared to the last downturn

Great Recession (2008 - 2010)

- Shock to banking system
- Banking seen as “cause”
- Influx of regulations including Dodd Frank Act
- Stress tests and increased capital positions

Global Pandemic (2020 - 2022?)

- Health crisis focused on lock downs of businesses
- Impact most severe in travel, retail, hospitality
- Global economic impact
- Long-term impact unknown

Impact on Bank Business



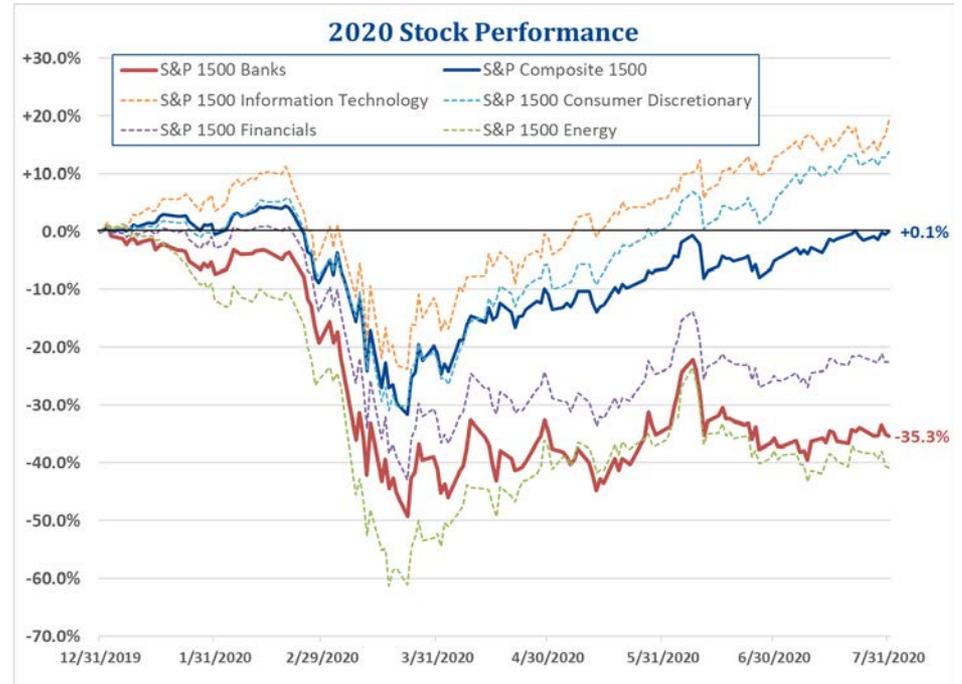
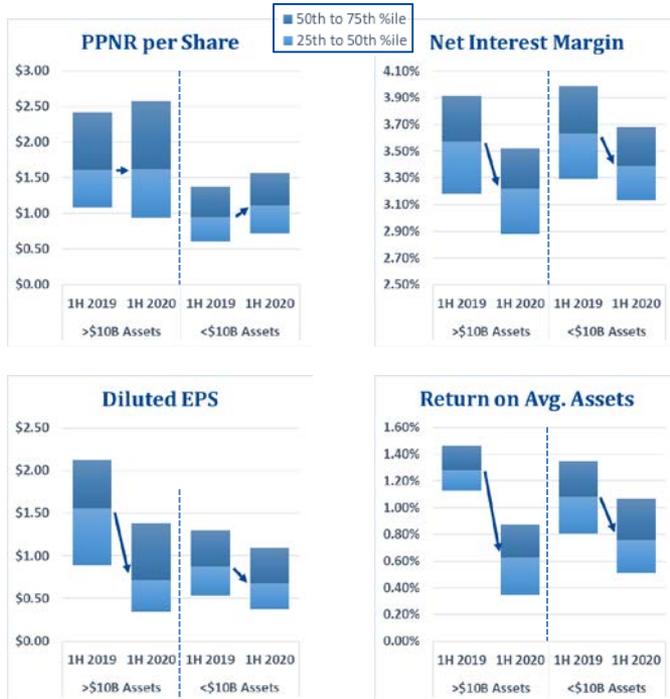
Impact on Financial Results



Impact on Compensation

Industry Financial and Market Results

While many banks have been able to maintain pre-provision net revenues, credit concerns and interest rates have reduced profitability and negatively impacted stock prices



Areas of Potential COVID-19 Impact on Executive Compensation

**Base
Salaries**

**2020
Annual
Incentives**

**Outstanding
Long-Term
Incentives**

**2021
Program
Design**

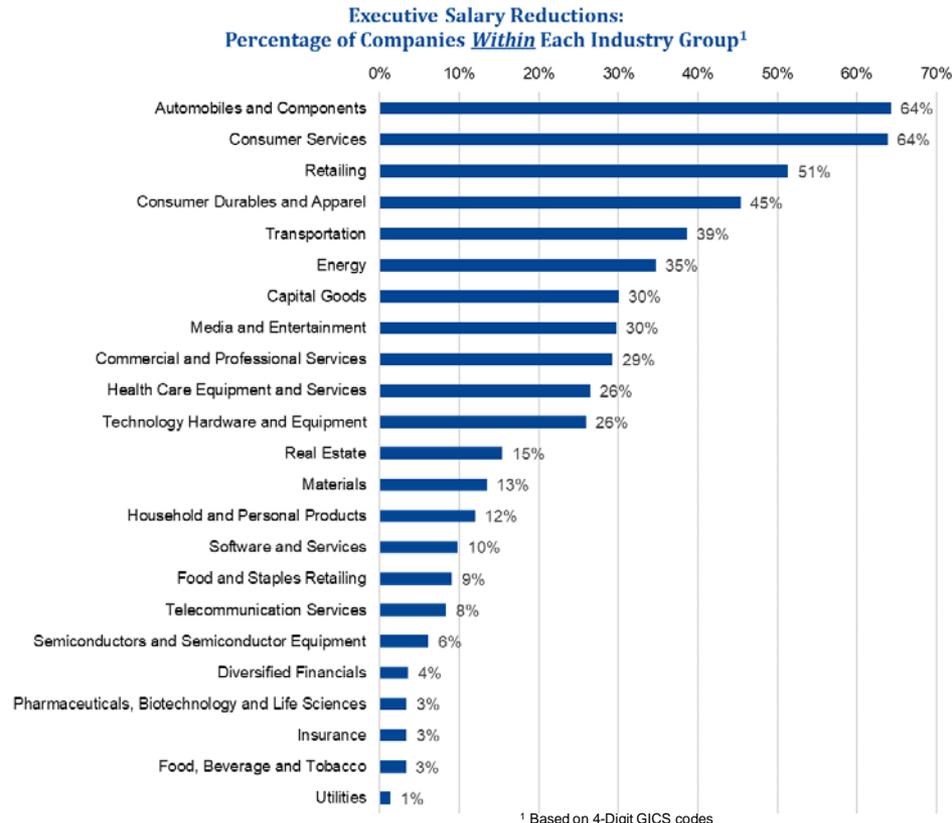
Principles Should Guide Each Bank's Response

- ✓ **Existing principles still apply** (e.g., pay for performance, drive strategic objectives, support retention, discourage excessive risk), but the application may need to change
- ✓ **Decisions should be focused on what is right for the company** while considering the optics (both internally and externally) that may result
- ✓ **Decisions should consider perspectives from a broad range of stakeholders** including employees, shareholders, consumers, communities and regulators
- ✓ **Executive pay actions should align directionally** with the impact on the broader employee population
- ✓ **Non-conventional approaches may be needed** to keep management/employees motivated, engaged, and aligned with current and rapidly changing business strategies and environment
- ✓ **The Committee will need to use its discretion** and business judgment to ensure appropriate outcomes
- ✓ **Transparency with shareholders will be important**, and the Committee should be prepared to provide robust rationale for decisions
- ✓ **Proxy advisory firms should be a reference**, but not restrict or limit the Committee from taking actions that are otherwise appropriate for their organization

Impact of COVID-19 on Base Salaries

Base salary reductions were generally limited to the hardest hit industries

- Only 18% of Russell 3000 have taken salary reduction actions
- No U.S.-based banks announced executive salary reductions
- Some companies have already restored executive salaries, typically in line with broader employee actions (e.g., ending of furloughs, restoration of 401(k) matches)



Poll Question #1

Is your bank anticipating salary freezes or reductions in 2021?

- No—planning 3% or higher increase budget
- No—planning increase budget lower than 3%
- Anticipating pay freeze
- Anticipating pay reduction

Responses On Incentive Practices Will Vary by Bank

Challenges will differ based on current compensation program designs and how payouts may be impacted by COVID-19. Banks that include some of the following design features are more “protected”:



2020 Annual Incentive Considerations

2020 incentive payout decisions are likely to face heightened scrutiny both internally and externally

All Banks

- **STAKEHOLDER IMPACTS:** Impact on employees, customers and communities served will influence perspectives on payout levels
- **PAY-PERFORMANCE ALIGNMENT:** For most banks, lower earnings suggest incentive payouts should decline from 2019 to align pay and performance
- **MARKET PRACTICES:** Most banks expect to pay out below target (even with strong performance, given significant continued economic challenges)
- **RETENTION:** The declining value of outstanding long-term incentives, combined with significant challenges faced by executives during 2020, will likely leave most banks looking to provide some value through annual incentive payouts and/or long-term incentives

Publicly-Held

- **SHAREHOLDERS/PROXY ADVISORY FIRMS:** Shareholders and advisory firms are expected to closely scrutinize payouts for a year where they see the value of shares decline; compelling rationale for payouts will be important to avoid negative Say on Pay impacts
- **MEDIA/PUBLIC SCRUTINY:** For public banks, decisions are likely to “make the news”

How to Consider Discretion for 2020

Compensation Committees should have a structured process assessing a variety of factors when considering whether and how to apply discretion when determining appropriate payouts for 2020

Potential Factors To Be Considered

- Severity of business impact (both in 2020 and beyond)
- Impact on shareholders
- Impacts of COVID-19/current environment on results (both positive and negative)
- Affordability
- Relative performance vs. industry peers
- Broader employee impacts (e.g., layoffs, benefits, expected incentive payouts)
- Effectiveness of actions taken in response to the pandemic
- Economic environment at time of payout
- External optics of payouts for Named Executive Officers



Poll Question #2

Are you considering and/or have you made change(s) to 2020 annual incentive/bonus program in response to COVID-19?

- No, plan to let our 2020 annual incentive plan operate
- Yes, plan to apply discretion when determining payouts
- Yes, plan to adjust performance metrics and/or goals
- Yes, some combination of the above or other changes

Impact of Stock Prices on Outstanding Long-Term Incentives

The impact of COVID-19 on stock prices has reduced the value of outstanding equity, though awards have recovered some value with recent price increases



Potential Approaches to Addressing Outstanding LTI (Executives)

No Action

Allow payouts to be determined based on the established goals and actual results

- Simplest approach and limits external criticism; may be appropriate if program design and expected results across all outstanding awards create general alignment with performance outcomes
- Creates motivation/morale concerns if all payout cycles are “zero”

Adjust Results

If allowed for under the award terms, adjust results based on the impacts of COVID-19

- Some plans may allow for adjustment of performance results based on COVID-19
- Requires ability to reasonably estimate financial impact; should assess with auditors and legal counsel feasibility and potential accounting impact

Modify Award Terms

Adjust performance goals to partially mitigate COVID-19 impacts

- Potential options include truncating the performance period, or resetting goals to reflect the new reality (which may be challenging given continued uncertainty)
- Potential significant accounting and disclosure impacts

Potential Approaches to Addressing Outstanding LTI (Executives)

Use Discretion at Payout

Committee evaluates at the end of the performance period whether to approve a higher payout than the formulaic result

- Allows Committee to make decision with full reflection of impact of COVID-19 on the bank and the performance results relative to goals
- Would need to consider impact on accounting, pay for performance and disclosure, and provide compelling rationale in disclosure

Enhance 2021 Grants

Provide higher grants in 2021 to “offset” a portion of the lost value from prior grants

- Avoids need to disclose adjustments to outstanding grants and potential accounting impacts
- Part of ongoing (or revised) LTI program so easier to communicate/explain; would still need to disclose rationale for higher grants and may still be criticized

Supplemental Grant

Provide an additional one-time grant separate from regular LTI program

- Could be used to enhance retention and motivation
- Shareholders and proxy advisory firms are generally skeptical of one-time grants
- Consider timing of disclosure and how it may impact ongoing LTI program

Poll Question #3

Are you considering taking action on outstanding LTI cycles?

- Does not apply
- Unlikely to take any action on outstanding award(s)
- Considering taking action on outstanding award(s)
- Will likely take action on outstanding award(s)

2021 Incentive Program Design Considerations

We expect many banks will consider changes to 2021 incentive plans given the economic environment, shifts in strategy and new compensation challenges

Base Salary

- Anticipate modest increases
- May see freezes or reductions where business challenges and expense management challenges more severe

Annual Incentive

- Review gates/triggers (i.e. are they set too high?)
- Review metrics to reflect new strategic priorities
- Review performance and payout ranges
- Incorporate discretion/qualitative metrics (e.g. strategic, individual, ESG, D&I)

Long-Term Incentive

- Review metrics as well as performance and payout ranges
- Consider relative performance compared to a broader Industry Index (e.g. KBW/SNL)
- Review mix of performance and time based components



Poll Question #4

Which of the following is your bank considering for your 2021 annual incentive plan?

- No changes expected
- Adjust performance metrics and/or goals
- Eliminate gates and/or widen performance ranges
- Add qualitative/discretionary factors
- More than one of the above (or other change(s))



Poll Question #5

Which of the following is your bank considering for 2021 long-term incentive program?

- No changes expected
- Changing mix of components (e.g. TRS, PSUs)
- Widen performance ranges
- Add relative metric(s)
- More than one of the above (or other change(s))

In Summary





Q&A

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