COMPENSATION ELEMENTS TO ENSURE A BALANCED APPROACH TO RECRUITING, RETAINING, REWARDING AND RETIRING YOUR BANK'S MANAGEMENT TEAM

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By most indications, the dust has settled from the financial crisis of 2008-09, and we are moving ahead in our recovery. This has certainly been the case with many Florida banks as the troubled bank list has ebbed dramatically. That being said, challenges from a low interest rate environment, along with regulatory burdens from Dodd-Frank, Basel III, etc., have created a tough environment for banks that were once accustomed to producing 10 to 15 percent ROEs prior to the crisis. Coupled with the fact that, if you have a good lender, you can be assured they are getting several calls a month from headhunters trying to lure them away. As the grab for talent has intensified, the need for a bank to secure its management team by providing a competitive, comprehensive compensation plan has never been more critical.

Following are the five main elements your bank's compensation committee should address in its oversight process. Each element may have several components that can be used to ensure the bank's compensation program is serving to retain, reward and retire its management team, as well as recruit future members.

1. Salary

This is a fairly obvious component of the compensation plan of the bank, but it is critical as most of the balance of your compensation plan flows from the base salary determination (i.e., retirement plans and incentive comp/bonus plans are usually a percentage of salary, stock option awards are often a function of base salary, change in control agreements are typically a multiple of salary/bonus, etc.). Salary surveys provide a study that can benchmark salaries for your management team, and are available through the Florida Bankers Association as well as other sources. Keep in mind that these surveys are one indicator of what might be right for your bank; in the end, however, each bank must determine the appropriate salary based upon its specific metrics such as size, location, type, etc.

2. Short-Term Incentive Compensation

Most often referred to as the bank's bonus plan, a well-designed short-term incentive compensation plan should contain measurable goals for each executive that determine his/her incentive compensation award. There is nothing more frustrating for boards and executives than to get to the end of the year and try to arbitrarily determine the bonus each executive should receive. In addition, having a "Christmas bonus" structure as opposed to a well thought-out incentive compensation plan typically has little direct impact on performance.

The environment for community banks in Florida remains competitive. The need to build and retain a solid management team has never been more important. Bank management has to think smarter and more efficiently to get fair returns for shareholders.

Figure 1

	Rank & File	Executive
Final Salary	$50,000	$200,000
Social Security	$15,000	$25,000
Pension Benefit	$25,000	$55,000
Annual Retirement Benefit	$40,000	$80,000
% of Final Salary	80%	40%
Target Benefit of 70%	$35,000	$140,000
Shortfall	$0	$60,000/yr.

The best short-term incentive compensation plans have specific rewards for specific goals, with a more macro view for the president/CEO, CFO, COO and CLO, possibly tying incentive goals for this team to ROE, ROA, growth, etc. As you move down the executive list, the components of incentive measures should include macro goals, but also departmental and individual goals. Departmental goals tend to promote teamwork within the organization, and individual goals assure reward for those who deserve it. Care must be taken not to create a plan that is too complicated. Performance goals should be specific enough that the employee is able to roughly estimate whether they are meeting the goals on their drive home from work.

3. Long-Term Incentive Plans

The long-term incentive component typically grants equity awards, such as stock options, restricted stock grants, etc. For closely held banks, these may also take the form of synthetic equity plans such as stock appreciation rights, phantom stock, restricted stock units, etc. These plans tie the reward the executive realizes directly to the increase in shareholder value. Equity plans require shareholder approval. As such, most banks adopt an "omnibus plan" that allows for implementation of various equity plans as determined by the board.

Community banks in Florida have adopted a wide array of formulas for determining equity awards. As a general rule, allocations of options to employees are typically 66.67 percent to the employee team (including executives) and 33.33 percent to the director team. Some banks have provided a one-time award of options where others award them periodically based on a variety of criteria. Our observation is that CEOs typically receive 1 to 4 percent of outstanding shares in options or stock-related compensation. Percentages for the balance of the management team scale down from there. Bank option plans generally reserve options of 10 to 15 percent of the outstanding shares for their management team (inclusive of CEO options).

4. Benefit Plans

It is important that the bank provide reasonable benefits to all employees in order to provide an environment where every employee feels appreciated. Typical plans such as group-term life insurance, health insurance and qualified retirement plans cover the employee group as a whole and must be competitive with peers in order to build a stable staff. Qualified retirement plans are largely dominated by 401k plans, with typical bank contributions ranging from 2 to 6 percent of employee salary. These can be formula driven, such as a 50 to 100 percent match up to six percent on the amount contributed by the employee. They can also have a profit-sharing feature that kicks in an additional contribution based on performance of the bank.

An unintended result of qualified plans, such as 401k plans, is the "reverse discrimination" that occurs for executives deemed to be "highly compensated" by ERISA or IRS guidelines and limitations. There are caps on amounts that can be contributed into qualified plans for these executives, or their salary is capped for purposes of determining their contributions. The result is that, when looking at qualified plans and Social Security benefits, executives typically receive a lower retirement benefit as a percentage of final salary than the general employee group that does not have any restrictions (see Figure 1). This inequity can be made up through a non-qualified (NQ) defined contribution or defined benefit plan (typically known as a supplemental executive retirement plan or SERP).

A non-qualified plan is an unsecured promise by the bank to pay the executive a benefit based on the terms of the NQ plan agreement. The plan is subject to creditors of the bank, so if the bank fails, the executive will typically lose his/her benefit. It is also important to note that the bank can set the terms of the plan without ERISA guidelines, thus structuring vesting and non-compete, non-solicit clauses in a manner that retains the executive. The vesting terms provide the bank retention value, often referred to as a "golden handcuff" on the executive. The bank and its shareholders get protection because forfeiture of the benefit will result if the executive leaves and competes with the bank or solicits bank customers or employees.

5. Employment Agreements and Perquisites

Employment agreements are a critical piece of the compensation package for senior management. Most spell out the terms of each of the items

discussed above and serve to protect the bank to the extent possible from executives leaving and directly competing with the bank. In addition, executives usually have protection from unreasonable termination following a change in control (CIC). CIC payments for executive officers have typically been one to three years of average salary and bonus, but that multiple has dropped in the last few years to one to 2.5 years. With sale multiples in a much lower range in Florida historically, these agreements impact the transaction more than in the past due to the fact they can make up a bigger percentage of the purchase price. That being said, there is still great value in knowing your executive team is not worrying about a potential suitor coming into the mix and jeopardizing their jobs. In addition, management of IRC 280g "golden parachute" guidelines should be carefully considered.

Perquisites may include car allowance, country club membership fees/dues, additional life insurance or disability insurance, etc.

The environment for community banks in Florida remains competitive. The need to build and retain a solid management team has never been more important. Bank management has to think smarter and more efficiently to get fair returns for shareholders. Losing good talent in your management team can deliver a tough blow to achieving those goals. A properly structured compensation plan goes a long way in securing the team that delivers the desired performance of the bank, both today and in the future.

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