Pearl Meyer

On Point

TIMELY, ACCURATE, INSIGHTFUL

Looking Ahead to Executive Pay Practices in 2023
Banking Edition

Executive Summary

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Introduction

Pearl Meyer's "Looking Ahead to Executive Pay Practices" is an annual, online survey and valuable compensation planning tool. This year's survey was conducted in August and September of 2022, with total participation of 58 bank companies, including 34 publicly traded and 24 private banks. As with prior surveys, responses are broken out separately by asset size.

This year's survey addresses key topics associated with the current environment, including perceived impact of various macroeconomic factors on businesses and their executive compensation programs, current/anticipated status of in-office vs. remote work requirements and any actions taken to encourage a return to the office, and use of retention awards. It also covers subjects such as compensation philosophy, compensation committee oversight, expected award funding outcomes and use of discretion for incentive cycles ending in Fiscal 2022, projected base salary increases for 2023, recent or anticipated incentive plan design changes, and long-term incentive award prevalence and participation.

We believe this information will serve as a useful tool as your organization prepares for year-end pay determinations and Fiscal 2023 compensation planning.

Please feel free to contact us with any questions.

Dan Wetzel
Managing Director
dan.wetzel@pearlmeyer.com
213-438-6515

Bill Reilly
Managing Director
bill.reilly@pearlmeyer.com
770-261-4082

Rhonda Snyder
Survey Account Manager
rhonda.snyder@pearlmeyer.com
984-258-2409

Key Highlights

Many expected somewhat of a return to “normal” (or at last “semi-normal”) in 2022 following pandemic-related challenges in 2020 and 2021. As prevalence of COVID-19-related serious illnesses continued to decline, more employees began returning to the office (at least on a hybrid basis), and many companies experienced a strong start in terms of financial results. Most respondents still expect overall company performance for 2022 to be at or above last year’s results, with slightly more than half projecting year-over-year improvements. Most also expect incentive payouts for performance cycles ending in 2022 to be at or above target. However, macroeconomic conditions continue to evolve rapidly, especially with regard to inflationary pressures, interest rate risk and market volatility, and it will be interesting to see how these factors impact actual performance and incentive award funding outcomes.

While front-line workers have been in the office, hybrid work policies appear to have become the new normal for half of the respondents, with many requiring or suggesting two to three days in the office per week, although practices vary with a fair amount of flexibility for employees. A limited number of companies are strongly encouraging a return to the office. With the new work environment, most also do not use or plan to add geographic pay differentials.

In response to rising wage inflation and tight labor markets, 30% of respondents provided higher than normal merit increases in 2022, and approximately 30% provided off-cycle adjustments. Most respondents expect to increase base salaries in 2023, with median projections equal to 3.5% – 4.0% across all employee categories, and 40% of companies planning to provide higher percentages than in 2022.

Key Highlights (cont.)

The application of discretion for incentive award cycles ending in 2022 is mixed with 22% expected to use discretion for the annual incentives and 24% not expecting to use discretion. Many are taking a “wait and see” approach. Anticipated use of discretion, when applicable, is more likely to apply for short-term incentives vs. longer-term incentives. Most have not made any changes to metrics or goals for in-process cycles. About half of all respondents expect similar degrees of stretch, compared with 2022, for 2023 performance goals, with one-third anticipating more aggressive hurdles.

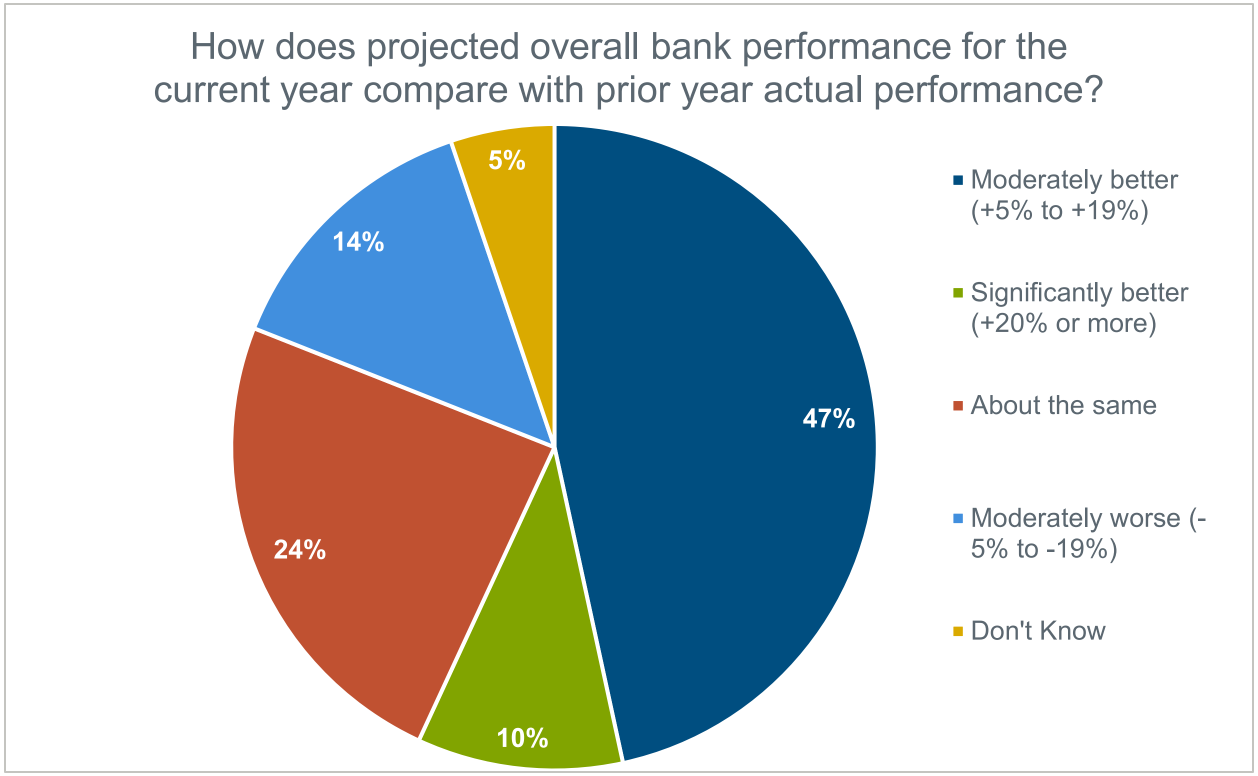
Approximately two-thirds of all respondents do not anticipate making changes to short-term and long-term incentive designs for 2023. Among those that do, the most commonly cited change is to add new performance metrics, and 14% of respondents planning to add new environmental, social, and/or governance (ESG) metrics within short-term incentive plans.

10% of respondents increased long-term incentive participation levels in 2022, and approximately 10% anticipating increases in 2023. Few respondents currently plan to modify equity grant practices in response to market volatility, although we anticipate this may change for some going forward due to the continued market downturn.

Most respondents have not provided (or currently plan to provide) retention awards to executives. When provided, recipients are typically determined on a selective basis, primarily with service-based vesting periods ranging from one to three years. These and other key survey findings are addressed in more detail on the following pages.

Overall Company Performance Projections vs. Prior Year

- Most respondents anticipate year-over-year (YOY) improvements in financial performance, with 47% projecting moderately better results (+5% to +19%) and 10% expecting significantly better outcomes (+20% or more); 14% expect YOY reductions.



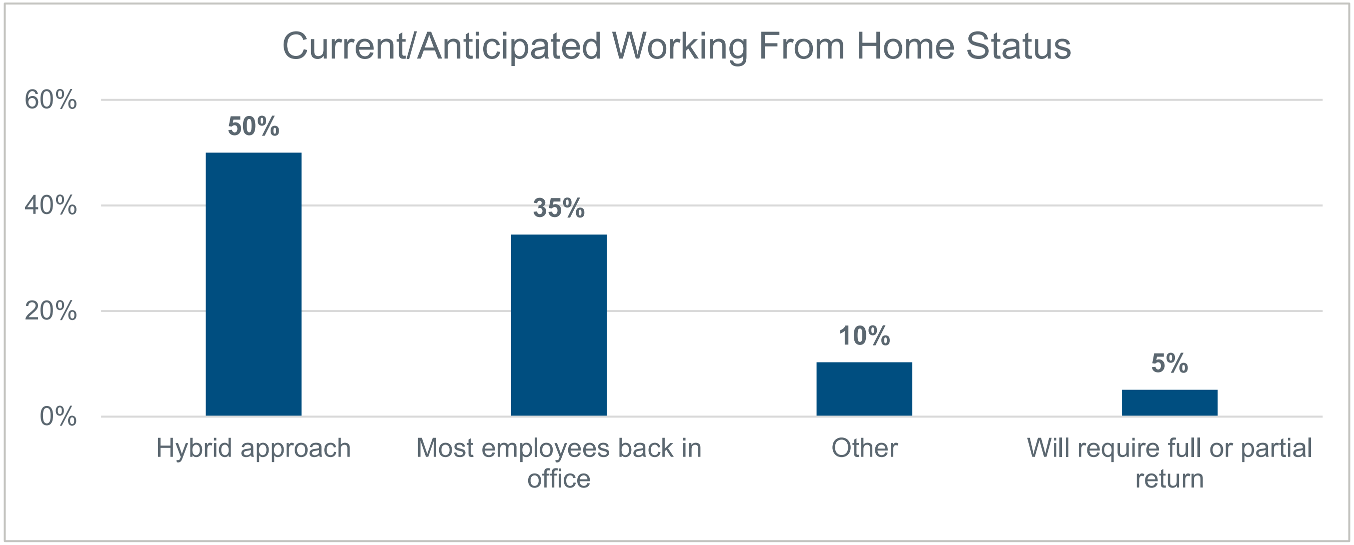
Current Year Executive Pay Actions in Response to Macroeconomic Challenges

- Economic uncertainty, inflation, and a tight labor market were the most commonly-cited macroeconomic factors having the greatest impact on company performance and executive compensation programs.
- In response to these challenges, respondents made a variety of changes to executive pay practices, especially as relates to base salaries to enhance retention and pay competitiveness, with the top three actions for each pay component shown below.
  - Changes made to salaries were fairly consistent across asset sizes.
  - Larger banks were more likely to make changes to long-term incentives and somewhat more likely to make changes to short-term incentives.

Pay Component	Top Three Current-Year Actions	Prevalence
Base Salary	• Higher than normal merit increases • Provide off-cycle salary adjustments • Increase targeted pay positioning	31% 31% 17%
Short-Term Incentives (STI)	• Increase award opportunities • Add/increase emphasis on relative metrics • Award cash retention bonuses	16% 10% 9%
Long-Term Incentives (LTI)	• Increase award opportunities • Expand executive participation levels • Provide one-time retention grants	12% 12% 9%

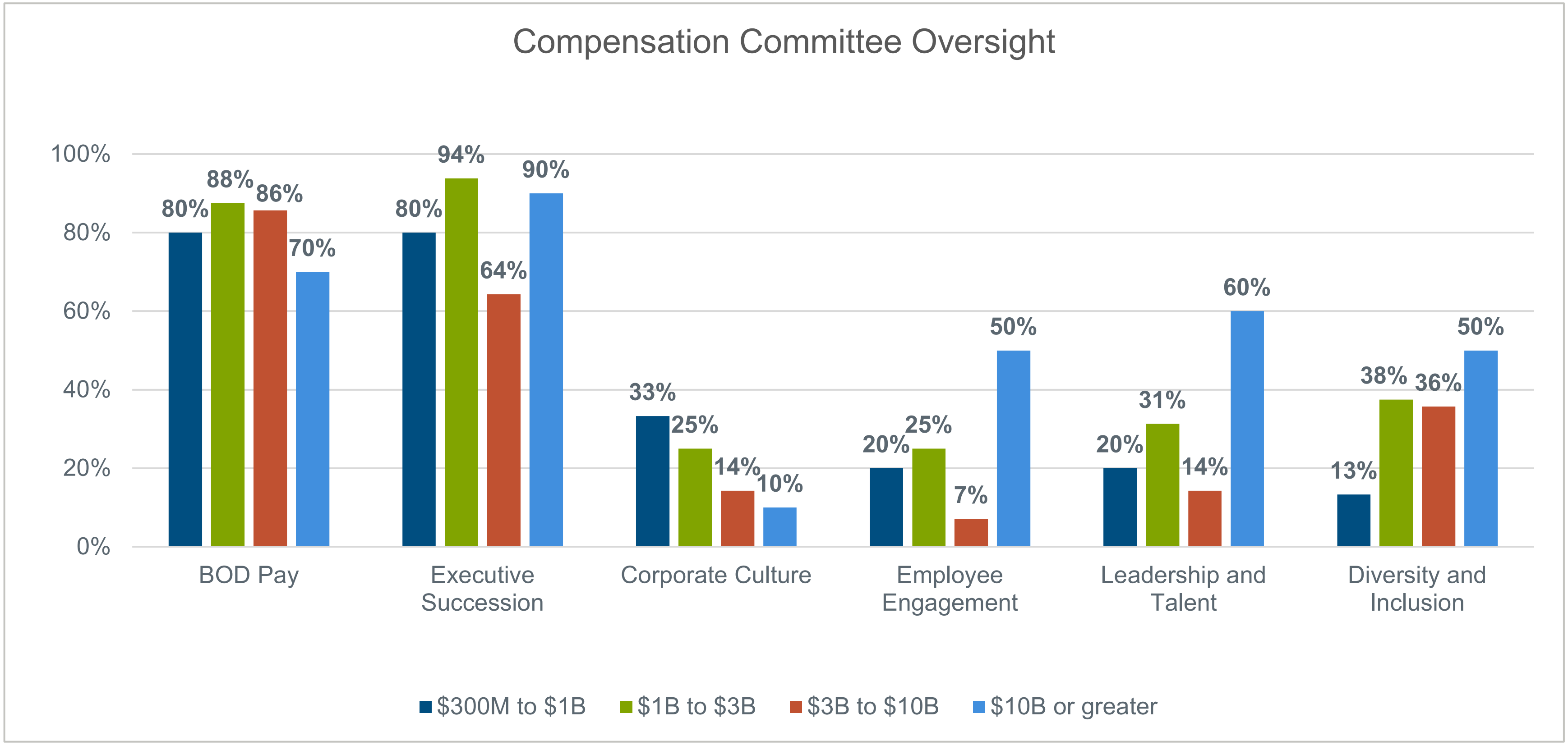
Working from Home

- Approximately 65% of respondents currently have hybrid or fully flexible working arrangements.
  - “Other” responses typically include either fully flexible arrangements or requirements that vary by employee category/function.
  - Among respondents with hybrid arrangements, employees are typically required (or encouraged) to be in the office two to three days per week (average requirement is 2.5 days).
- The large majority of respondents have not taken (or expect to take) any compensation or benefits-related actions to entice employees back to work.
  - The most commonly cited action was enhancing office perks (9% of all respondents).
  - Most respondents have not modified any existing or established new base salary geographic pay differentials to account for working from home.



Compensation Committee Oversight Roles

- Most compensation committees are responsible for executive succession planning and for non-employee director compensation at all banks.
  - Larger bank compensation committees have more expanded, explicit responsibilities in employee engagement; leadership and development; and diversity, equity, and inclusion.



Targeted Executive Pay Positioning

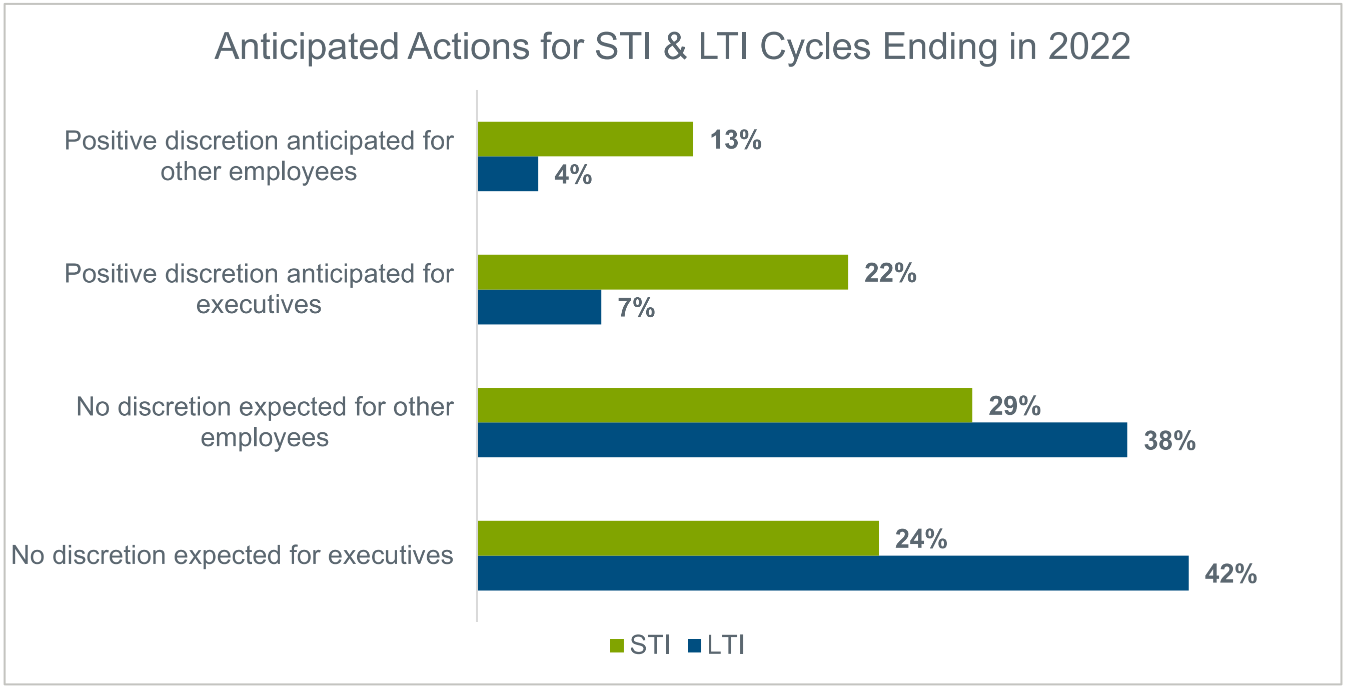
- Approximately 30% of reporting respondents target executive compensation at the market 50th percentile, with prevalence higher for base salary than variable pay (STI and LTI).
  - Smaller banks ($300M to $1B) are more likely to position pay below median (29% vs. 10% for all).
  - Large banks ($10B in assets and greater) are more likely to position salary at median (50% vs. 39%) and are somewhat less likely to position total direct compensation above median (50% vs. 62%), potentially reflecting greater external scrutiny.

Pay Component	Targeted Pay Positioning (% of Reporting Respondents)		
	Below 50th Percentile	At 50th Percentile	Above 50th Percentile
Base Salary	12%	39%	49%
Short-Term Incentives (STI)	11%	32%	57%
Long-Term Incentives (LTI)	6%	31%	63%
Total Direct Compensation	10%	29%	62%

- Approximately two-thirds of all respondents have not changed (or plan to change) targeted executive pay positioning, with 15% increasing pay positioning vs. market and 9% increasing the emphasis on variable pay (STI and/or LTI).

Anticipated Use of Discretion for Incentive Cycles Ending in 2022

- Most respondents do not currently expect to exercise positive discretion for incentive cycles ending in 2022, although many are taking a "wait and see" approach.
  - Virtually no respondents currently expect to apply negative discretion, and many (approximately 42% for STI and 30% for LTI) say its too early to tell whether discretion will be applied for cycles ending in 2022.



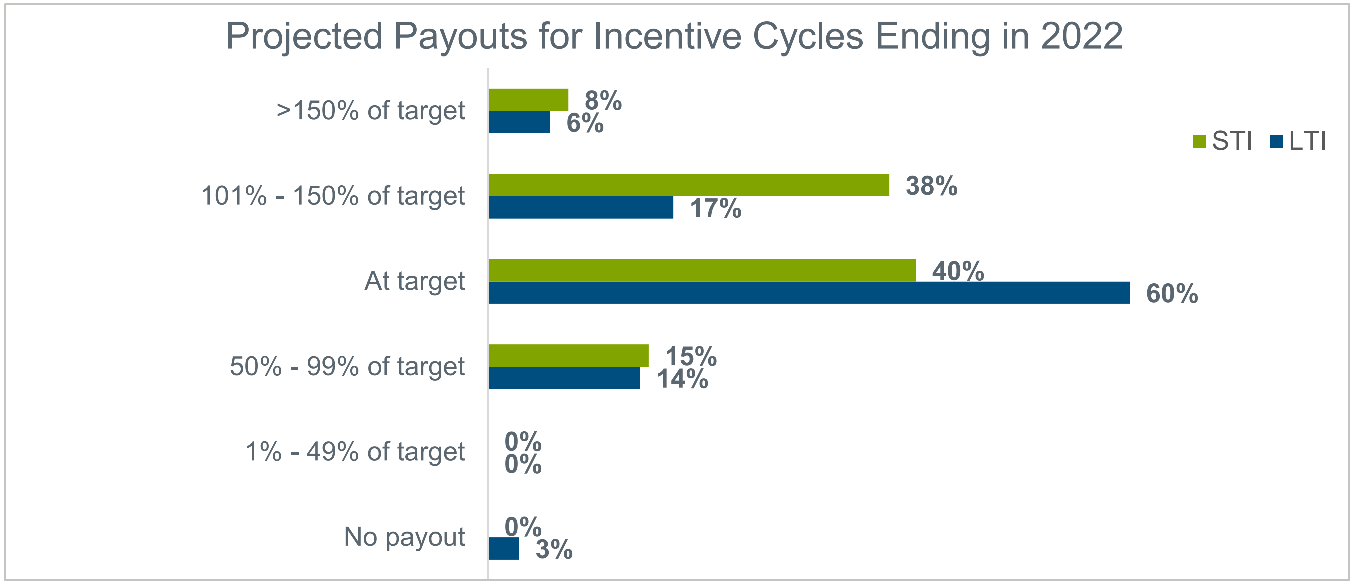
- Among respondents anticipating adjustments, the most commonly cited potential triggers include changes in business strategy/strategic priorities (37%), extraordinary changes in interest rates (21%), and non-recurring items/restructuring charges (10%).

Pay Projections

- Similar to 2022, salary increase projections for 2023 are above historical levels, with values across all employee categories equal to 4.0% at the 50th percentile and 5.0% at the 75th percentile.
  - 92% of all respondents expect increases for senior executives and all for other employees.

Employee Category	Average %	50th Percentile %	75th Percentile %
CEO	3.6%	**3.0%**	5.0%
CEO Direct Reports	3.7%	**4.0%**	5.0%
Other Employees	3.9%	**4.0%**	5.0%

- Most respondents with incentive cycles ending in 2022 expect payouts to be at or above target, with none forecasting no payouts for STI and 3% for LTI.



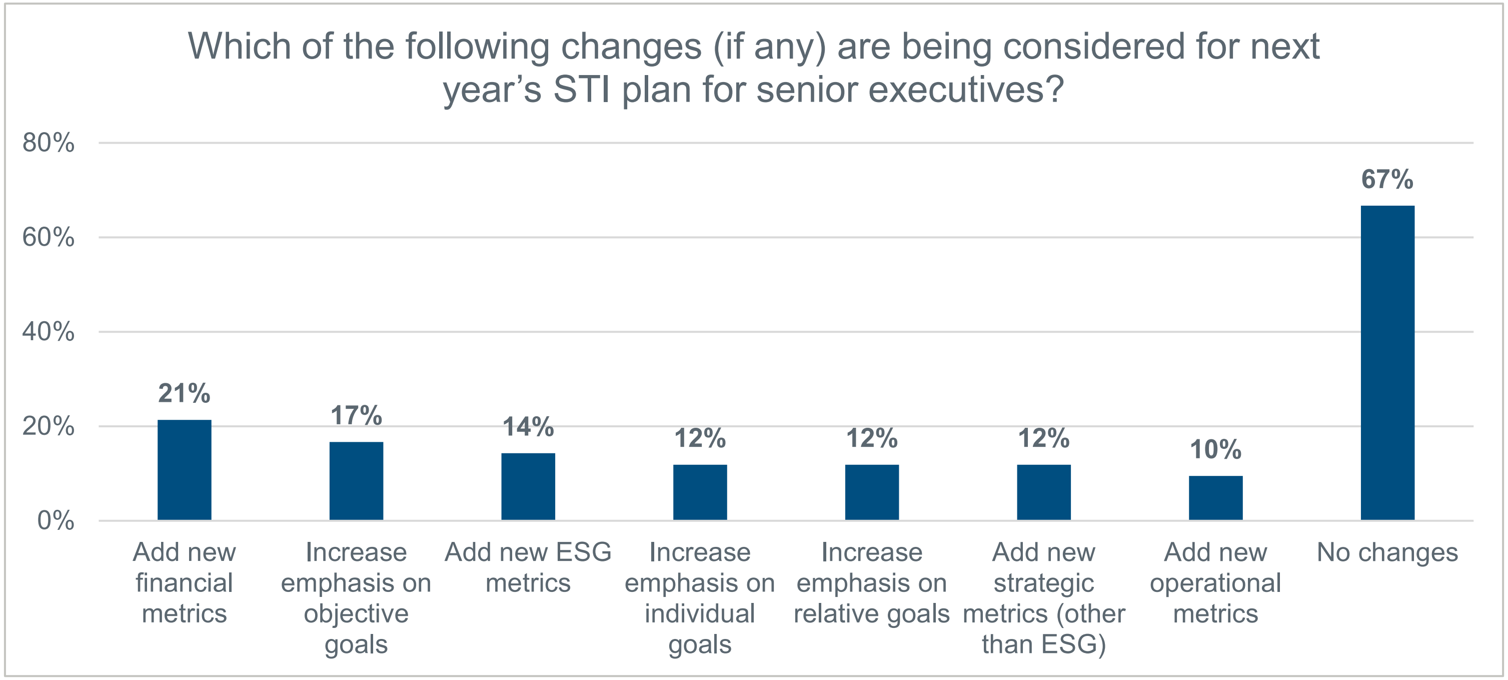
STI Performance Mix Projections for 2023

- Most respondents (60%) have formulaic STI plan designs with pre-defined weightings for metrics and award opportunities. Prevalence of formulaic plan design increases with the asset size of the bank.
- The anticipated performance mix for 2023 is very similar to 2022, with a primary emphasis on objective corporate/business unit financial goals; among the largest banks, ESG is starting to be introduced as a performance metric.
  - The focus on metric selection will likely increase going forward for public companies due to recent pay vs. performance and clawback rules approved by the SEC.

Performance Metric Category	2023 STI Performance Mix: CEO	2023 STI Performance Mix: Direct Reports
	Average Weighting (when utilized)	Average Weighting (when utilized)
Financial	79%	74%
Operational	28%	30%
Strategic	25%	18%
ESG	10%	10%
Individual	27%	27%
Discretionary	32%	18%

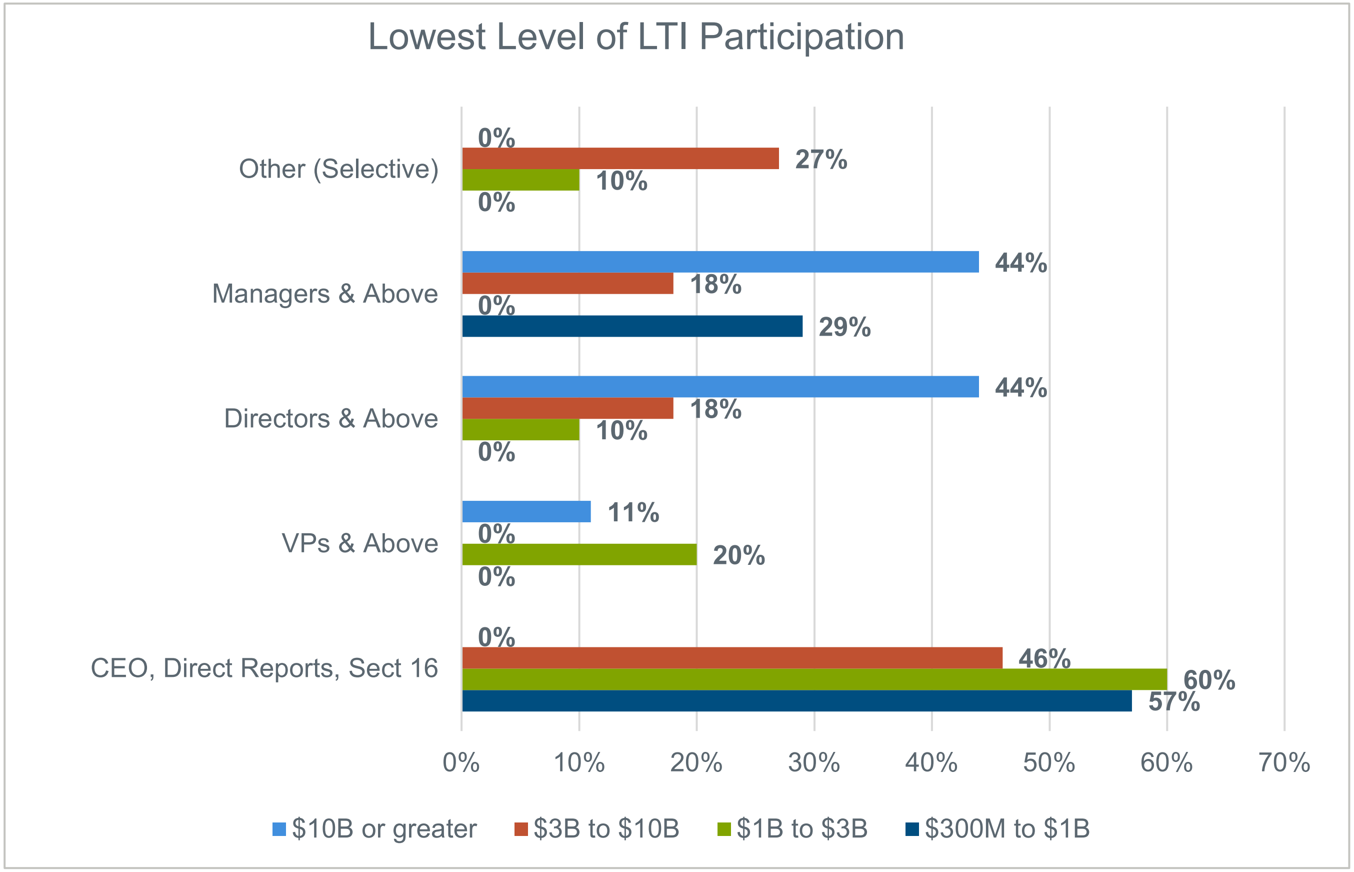
STI Plan Design Changes for 2023

- Approximately 33% of all respondents are considering making changes to senior executive STI designs for 2023, with the most common actions (expressed as a percentage of all responses, not just for those making changes) shown below.
  - 21% of all respondents intend to add new financial metrics and 14% intend to add new ESG metrics (33% among banks with assets greater than $10B in assets).
  - Prevalence of anticipated changes was lower than last year, when nearly half of all respondents were planning changes, especially for publicly-traded companies.



LTI Prevalence and Participation Levels

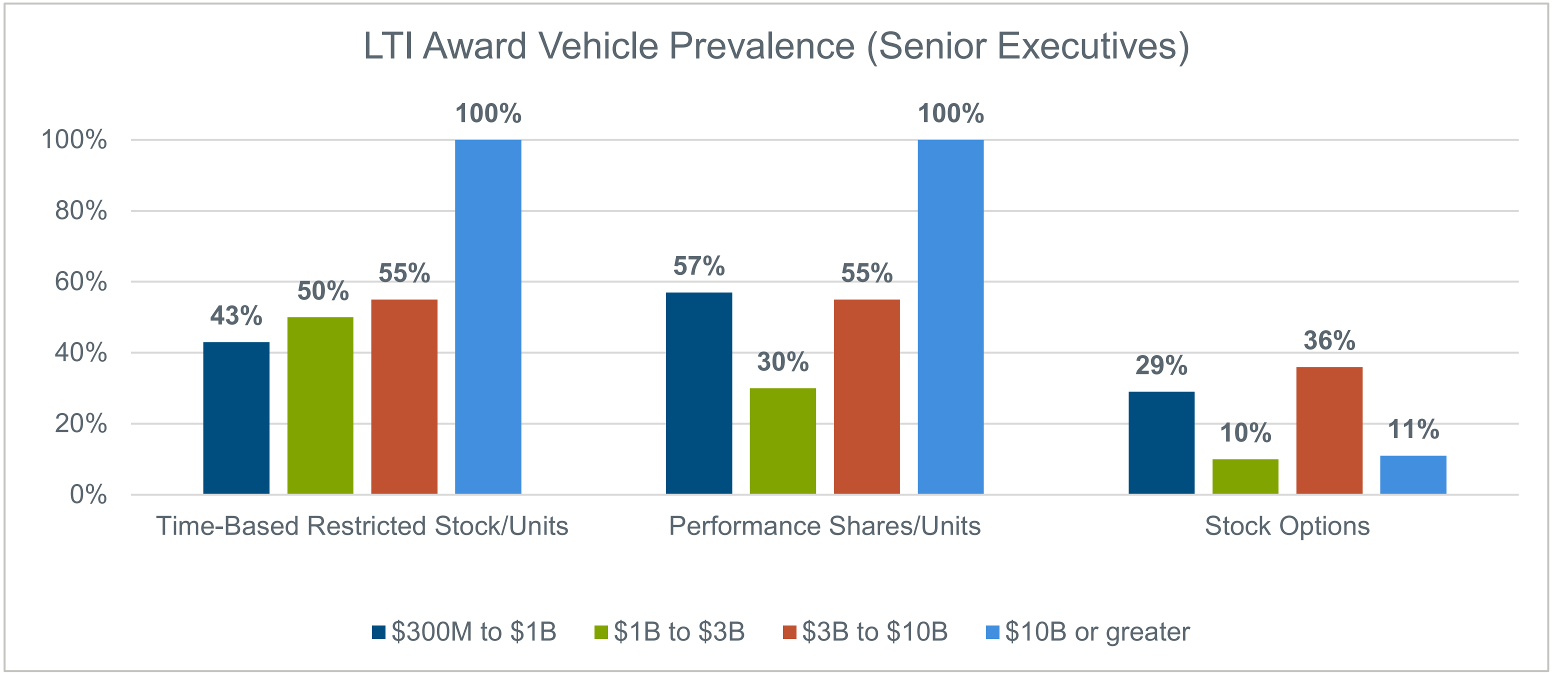
- LTI participation varies based on the size of the bank.
  - Banks under $3B in assets tend to issue awards to the senior executives (CEO, CEO direct reports and Section 16 officers) although about 1/3 also extend awards more broadly throughout the organization
  - About half of the banks over $10B (44%) in assets extend LTI awards to manager and above positions



Note: "Other" refers to other non-specified categories (e.g., SVPs & above, senior managers & above, or some other combination of roles

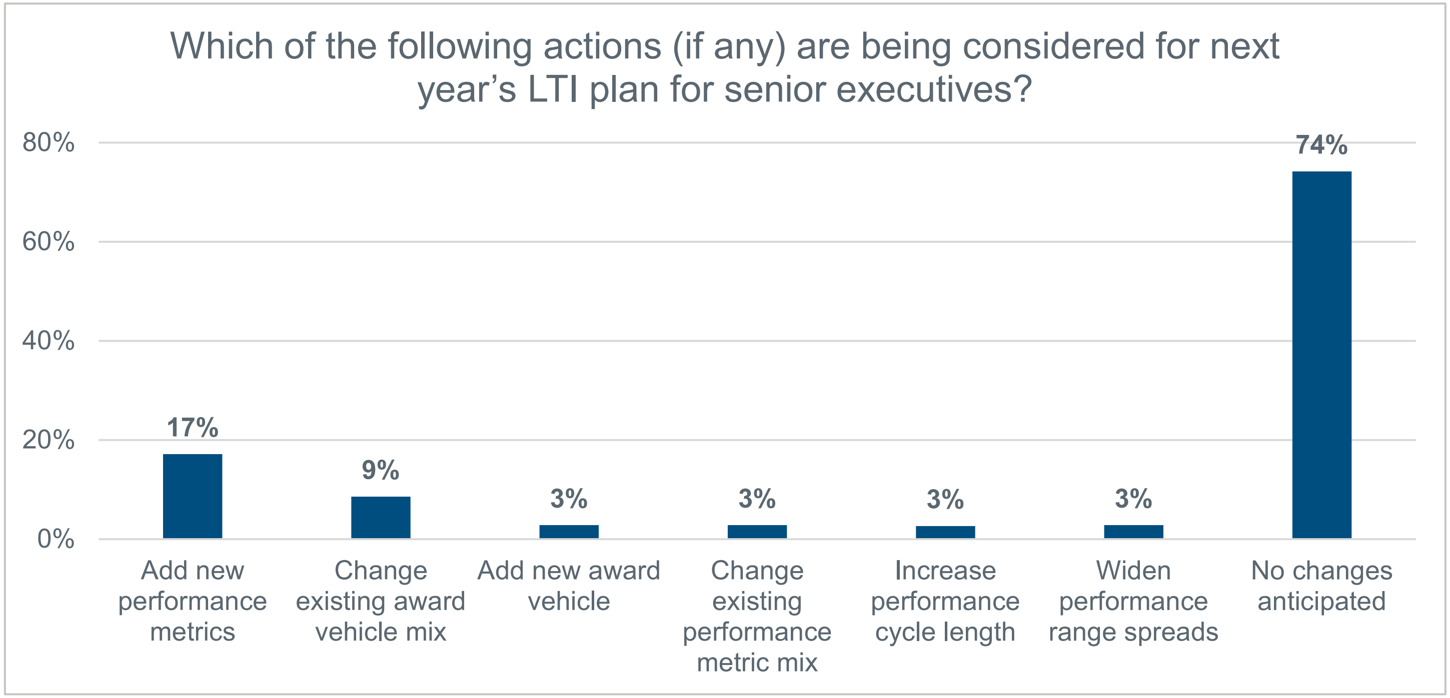
Target LTI Value Mix Projections for 2023

- Most publicly traded respondents grant time-based and performance-based equity to executives.
  - Use of performance-based equity for executives at publicly traded banks becomes universal for banks over $10B in assets.
  - For non-executives, companies rely on time-based restricted stock (51% prevalence) and less on stock options (16%) and performance-based equity (22%).
  - Most respondents (81%) express LTI award opportunities as percentages of salary or fixed target values.



LTI Plan Design Changes for 2023

- About 25% of all respondents currently anticipate making one or more LTI plan design changes for 2023, with the most common actions (expressed as a percentage of all responses including “not applicable”) shown below.
  - Across the entire sample, approximately 25% of all respondents do not currently have an LTI plan
  - Banks over $10B indicated no material changes to the current design



- Virtually none (less than 5%) of respondents currently anticipate making any change in LTI grant practices for 2023; we expect actual prevalence may increase due to ongoing market volatility.

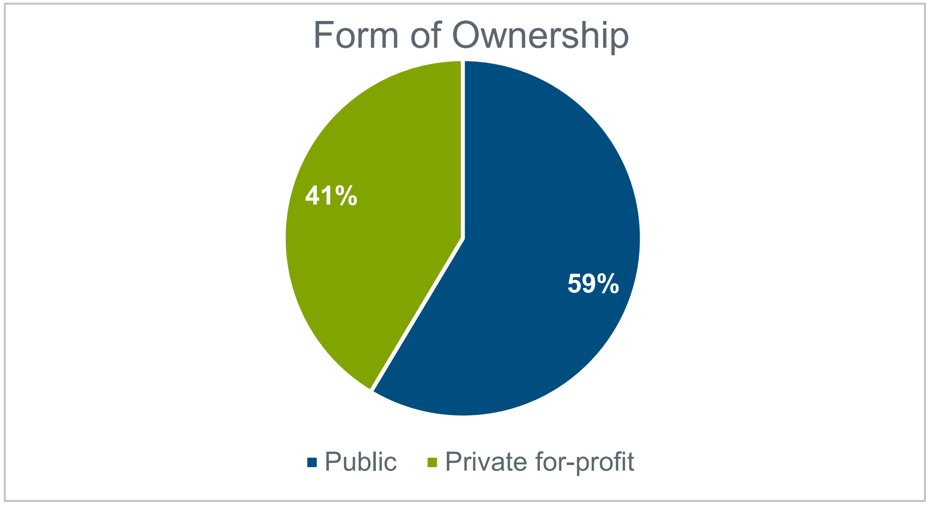
Executive Retention Awards

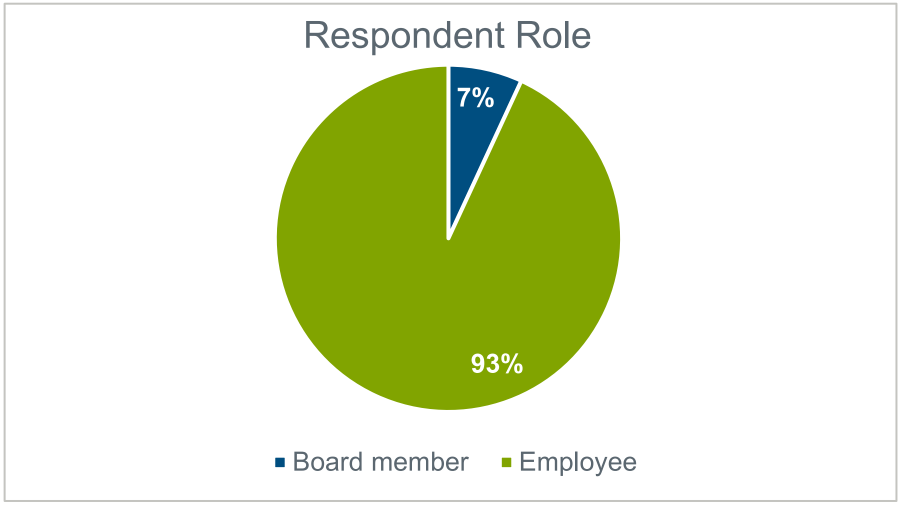
- Approximately 15% of all respondents have or intend to provided retention awards, typically on a selective basis, during the current year.
  - Award prevalence was higher for banks over $3B in assets (approximately 22%).
  - Among respondents making or planning executive retention awards, nearly half (43%) are providing in stock, with the balance providing either in stock or cash or strictly as a cash award.
  - Retention awards are typically tied to continued service (84% of all respondents providing awards), with vesting periods ranging from one to three years.
  - Among respondents providing retention awards, key participants are the CEO and direct reports to the CEO, as shown in the following table.

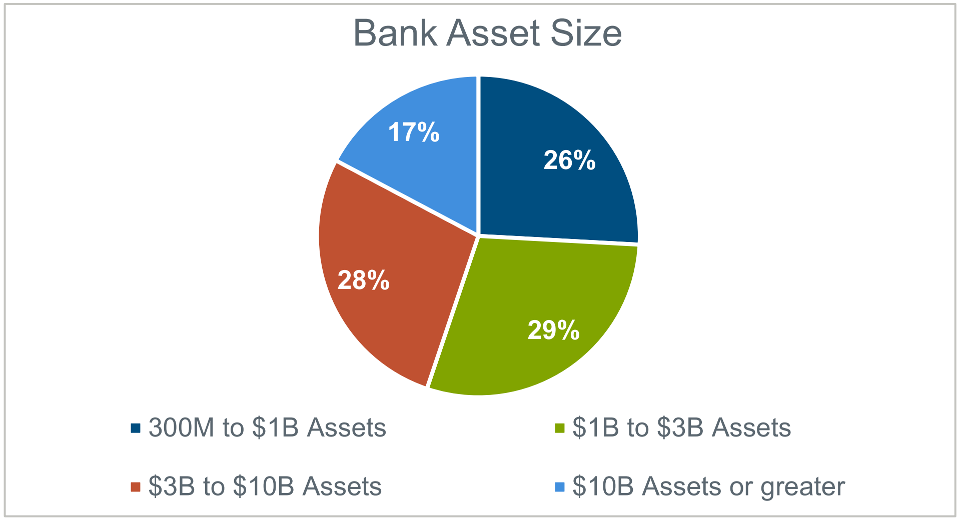
Executive Retention Award Recipients and Average Payout as % of Salary *		
	% Receiving	Award as % of Salary
CEO	29%	25%
CEO Direct Reports	57%	22%
SVPs	29%	50%
VPs	14%	40%

** Prevalence pertains to respondents that made or plan to make retention awards*

Demographics







About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's banking practice is #1 in the industry. We work with a broad range of banks, including regional, super-regional, and community banks. Our focus and industry knowledge provide the support you need across the lifecycle of your institution—whether you are expanding geographically, through organic growth, a merger or acquisition, or transitioning from private to public ownership. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles, New York, and San Jose.

Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.