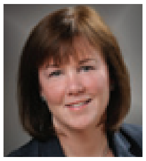

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COMPENSATION

How Pay Drives Performance

High performing banks execute customized strategies that deliver results. They have the vision, leadership, culture and incentive programs that help to attract, motivate and retain top talent. Leaders of high performing banks articulate their strategic direction with laser focus, communicate performance expectations and achieve or exceed their stated goals. Properly designed compensation programs should reward these results.

Features of Effective Pay Programs

Just as high performance banks use different strategies to drive results, their pay programs must also be customized to motivate behaviors that drive the bank's unique strategy and circumstances. They provide variable pay where strong performance results in higher pay and lower performance results in reduced compensation. The concept is simple, yet execution can be challenging. While pay programs will continue to evolve in recognition of increased scrutiny, disclosure and regulatory compliance, here are several ways banks drive and reward high performance:

- Strategic Orientation: Incentives should motivate and reward specific strategic goals and priorities. For example, highly acquisitive banks should have different compensation programs than turnaround banks.
- Holistic Perspective: Rather than designing short- and long-term plans separately, consider the total incentive opportunity and how it should be allocated; balance short- and long-term performance, cash and equity, as well as absolute and relative performance.
- Portfolio Approach: No single performance measure or pay component provides a complete picture of performance. Annual incentives typically reward short-term business goals while long-term incentives reflect metrics that represent shareholder value creation over time. The full complement of performance measures should provide a clear message about what behaviors and results are desired.
- Multi-Year Perspective: While rewarding the achievement of short-term goals is an important part of any incentive compensation program, true high performance is sustained over longer time horizons. This is a perspective shared by shareholders and regulators. A significant portion of incentives should reward long-term, sustained results.
- Shareholder Alignment: Similarly, a significant portion of pay in equity aligns executives with shareholder interests and enables them to share in long-term value they have helped create.
- Market Practice Isn't "Right" Practice: Don't follow the herd. What works for some banks may not match your strategy or align with your culture. Market data reflects historical practices, but future pay programs will continue to evolve based on new regulations and the changing industry environment.

Customizing Pay: Two Case Studies

Compensation programs should align with the bank's business strategy, ownership structure, culture and philosophy.

- Growth Through Acquisition: A merger of equals with significant expansion was challenged by increased pressures from institutional shareholders looking for more sophisticated performance-based pay programs. The compensation program was redesigned so annual incentives would reward integration results and profitable growth, while the long-term incentives consisted of performance based equity grants that vest based on three-year earnings results and are subject to a modifier based on relative Total Shareholder Return. This design balanced rewards for short-term progress with the longer-term value creation aligned with shareholder interests.
- Turnaround Scenario: A bank recently released from a memorandum of understanding with its regulator had private equity ownership seeking a three-year turnaround timeframe. Challenges included attracting top talent given the risk that the turnaround might not be successful, and having the ability to pay incentives while not profitable. The bank established a compensation program that provided highly competitive base salaries, an incentive focused on three-year performance milestones with acceleration features if profitability is achieved earlier, and stock options that reward shareholder value creation.

Ensuring Pay Outcomes Align with Performance Results

To determine if your pay program is driving the right pay-for-performance relationship, it is important to design programs where the value of pay delivered aligns with the performance results achieved over a long-term period. Rewards should be compared to performance of internal business goals and relative to a peer group or industry index. Banks that consistently outperform peers should deliver pay that exceeds peers, while lower performance should result in pay below peers.