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COMPENSATION

What Midsized Banks Learned From 2023 Payouts

Flexibility and Resilience in Incentive Plans Is Paramount

Looking back at 2023 incentive payouts can provide midsized institutions with useful knowledge on how incentive plans can be thoughtfully designed to ensure resilient programs that operate as intended, despite macroeconomic volatility. The following provides a recap of 2023 annual and equity plans, along with strategies to ensure boards award appropriate payouts, given the changing environment.

Despite optimism in the fourth quarter, 2023 turned out to be a difficult year for most midsized banks. Institutions struggled to manage interest rate risk, reduced loan demand and the fallout from bank failures. These headwinds were evident on the bottom lines and executive pay outcomes at many midsized banks. Among 27 midsized institutions with between $20 billion and $90 billion in assets in our sample, 80% awarded lower CEO bonuses in 2023 than they did in 2022.

We also saw many compensation committees use discretion, with 35% of banks increasing payout outcomes from the quantitative results. The magnitude of adjustments ranged widely, from an additional 2% to 50% on financial results that were below performance thresholds.

Design Modifications to Address Uncertainty

During uncertain times, companies have several tools they can use to keep executive compensation programs retentive and motivating.

- *Confirm that the plan structure is straightforward and balanced.* Plans that include more than one metric, feature financial and nonfinancial goals, and provide compensation committee discretion are more resilient than plans without these features.
- *Review the performance range.* Consider whether widening performance ranges allows a committee to acknowledge uncertainty and aids in setting realistic goals in a changing environment.
- *Test the potential payout outcomes.* Compensation committees should apply conservative, expected and optimistic projections to the payout structure to ensure payout outcomes are commensurate with historical and industry norms.
- *Assess pay mix.* Compensation committees can shift the long-term incentive mix to reduce the weighting of performance shares in favor of time-vesting equity. In our sample, most banks did not employ this tool; they largely maintained the mix of long-term incentives from 2022 to 2023, with a median weighting of 60% performance-based equity and 40% time-based equity.

Impact of 2023's Banking Crisis on Equity Markets

For midsized banks, 2023 was the most volatile equity market since 2020 (Covid-19 pandemic). Heavy share usage led more midsized banks to seek shareholder approval to replenish their equity incentive plans in 2024 than in the past 10 years. Shareholders and proxy advisors supported these proposals, with an average support of 95.2%.

Historically, equity plans have been designed to last seven to 10 years. But market volatility and rising interest rates have led large institutional investors to seek shorter plan durations, with a preference of five years or less. We anticipate that the frequency of plan proposals will continue to rise.

2024 Outlook

Through the first half of 2024, the U.S. economy has defied forecasts by continuing to grow stronger with stabilized inflation. Many midsized banks have seen positive returns through July 2024 but at a lesser rate than the larger institutions.

In the second half of 2024, there are indications that the job market is softening, and there is the looming potential of interest rate cuts, which many banks factored into their 2024 goals. The environment will likely stay uncertain through the fourth quarter, given the U.S. presidential election and the subsequent regulatory environment the candidates will support.

Given recent equity market volatility and concerns as to whether the Federal Open Market Committee can achieve a soft landing, it is difficult to predict what conditions the banking industry may face through the remainder of 2024. This year, banks tended to be more conservative in goal setting, and some revised their incentive plans for more resiliency, likely resulting in payouts consistent with long-term trends. As compensation committees head into 2025, these lessons from 2023's payouts and 2024's tracked results could indicate whether these revisions to incentive plan design may provide a more accurate assessment of performance in an ever-changing economic landscape.

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As seen in the 4th Quarter 2024 issue of *Bank Director*