Performance & Pay Part 2: Trends in executive positions

Second in a five-part
HR series from Crowe Horwath

By Jason V. Bomers, Patrick J. Cole, SPHR, and Timothy J. Reimink. For more about the research project that articles in this series came from, and about the authors, please see the
end of this article.

The latest Crowe Horwath LLP Financial Institutions Compensation and Benefits Survey revealed several significant trends in executive compensation, with important implications for financial institutions. The annual survey collected data on senior management positions, including the top five highest-paid C-suite positions:

- • Chief
executive officer (CEO)/president

- • Chief
operating officer (COO)

- • Chief financial officer (CFO)

- • Chief lending officer (CLO)

- • Chief credit/risk management officer (CCO/CRMO)

By comparing the 2012 survey responses with those recorded in 2008, it is possible to see how executive pay and incentive compensation have evolved in the aftermath of the 2008-2009 credit crisis and the subsequent recession.

Executive concerns

Financial institutions' management teams have faced serious challenges over the past five years. In addition to struggling to manage through the effects of the lingering recession, they also have been challenged to comply with a demanding--yet still evolving--regulatory environment.

These immediate concerns were coupled with the ever-present need to provide a satisfactory return to investors and other stakeholders, while also addressing ongoing concerns regarding risk exposure and mitigation.

The survey reveals that as top executives' responsibilities and challenges have increased, so has their compensation. Significantly, the survey indicates a discernable shift toward greater use of incentive-based compensation as a means of recognizing and motivating performance.

Notable trends

A number of trends can be discerned when comparing the 2008 and 2012 survey data, but four points in particular merit special mention:

1. Modest increases in base pay and total compensation

Combined base pay for all C-suite positions increased by an average of 5.6% annually over the four-year period. While this exceeds the annual increase among the general workforce, it still is well below the percentages that were seen prior to the recession.

A similar trend was noted in total cash compensation, which includes incentives and other benefits.

2. Increased use of incentive pay

While base pay and total compensation increased moderately between 2008 and 2012, there was a more sizable increase in the use of incentives in the executive suite. The portion of total compensation that came from performance-related incentives increased from an average of 21% in 2008 to 27% in 2012, with the largest increases seen in the CEO, COO, and CLO positions.

This trend is illustrated even more clearly when the overall four-year variances in base pay, incentive pay, and total cash compensation are compared side by side. Executives' incentive-based compensation increased by an average of 57% from 2008 to 2012--more than double the rate of increase in base pay and total cash compensation.

The outcome of this trend is that a greater proportion of total compensation can now be classified as "at risk," especially in the CEO, COO, and CLO positions.

While more pay at risk can offer advantages, it can also produce a potential downside if performance falls below target levels. The picture is further clouded by the potential regulatory threat of "claw-backs" of incentive pay that is determined later to have been based on erroneous performance data.

3. The growing role of incentives in risk management

A less obvious but equally significant trend can be seen in the use of incentives to reward those executives with risk management and credit quality responsibilities. The proportion of executives in CCO or CRMO positions who earned incentives increased by 14 percentage points between 2008 and 2012, compared to only 5 points among C-suite executives overall.

This trend is mirrored in related survey responses. When participants were asked to list the factors most commonly used to determine incentive pay, credit quality moved up into the top three factors named in 2012. Conversely, new loans made dropped from the top three in 2008 to seventh in 2012.

These concurrent trends suggest growing industry recognition of the importance of risk management.

4. Movement toward long-term incentives

In addition to short-term, performance-based incentives, C-suite executives often are eligible for longer-term compensation, typically based on changes in organizational stock value. The survey revealed a notable increase in the use of such incentives--from 30.1% of all responding organizations in 2008 to 35.4% in 2012.

Moreover, the number of executives qualifying for long-term incentives increased dramatically. For example, among those organizations that provide an equity-based plan, the portion of senior management members who received incentive stock options more than doubled--from 25.1% in 2008 to 53.1% in 2012.

Conclusion:
executives and incentives

The increasing importance of incentive-based compensation seen in the survey corresponds to the generally improving health of the financial institutions industry. In the third quarter of 2012, FDIC-insured commercial banks and savings institutions reported a 6.6% increase in aggregate

net income over the same period in 2011, the 13th consecutive quarter that earnings registered a year-over-year increase.*

Executive incentives generally are based on broad organizational performance factors such as loan growth and profitability, which are comparable to the industrywide metrics cited by FDIC.

In addition, however, they should include qualifiers for specific institutional metrics, such as credit quality and regulatory compliance, along with a long-term component to encourage executive actions that are supportive of long-term value and closely aligned with shareholders' interests. Using a broad array of indicators at the institutional level makes it possible to establish a positive pay-for-performance system.

* "FDIC-Insured Institutions Earned $37.6 Billion in the Third Quarter of 2012," FDIC press release , Dec. 4, 2012..

Series highlights comp trends and strategies

Crowe Horwath LLP is proud to offer the results of its 2012 Financial Institutions Compensation Survey.

With responses from 405 financial institutions on 201 job positions, the 2012 survey offers details on the compensation and HR approaches for the entire banking enterprise. The analysis in this article and others in the series draws on results from past surveys as well to identify key industry trends in the following areas:

• Compensation, incentive pay, and benefit packages

• Salary increases and comparative analysis

• Employee turnover rates and hiring forecasts

• Cost-cutting strategies

• Board and director compensation packages

• Equity-based compensation

You can purchase a copy of the 2012 Crowe® Financial Institutions Compensation Survey. For more information read our executive summary.

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