Performance & Pay: 2013 HR action plan

Strategic capper for
Crowe Horwath series

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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 2012 Crowe Horwath LLP Financial Institutions Compensation and Benefits Survey provides useful insights into financial institutions' current compensation-related priorities and concerns.

Earlier articles in this series compare survey responses from the end of 2012 to comparable data from 2008. While this comparison helps demonstrate the effects of the 2008-2009 credit crisis and recession, these events are only part of the overall economic, market, and regulatory forces that affect financial institutions. Similarly, bankers must remember that compensation and benefits represent only one part of the overall human resource

(HR) domain.

Viewing the survey results in this larger context makes it possible to begin formulating a more strategic approach to pay, incentive, and compensation issues and to begin developing an action plan for addressing HR issues over the coming year.

Recurring human resource priorities

As the effects of the recession fade, broader concerns are reasserting themselves as dominant factors in financial institution planning. Chief among these is the long-term challenge of finding, hiring, retaining, and motivating the right employees--concerns that remain consistently high regardless of immediate economic issues.

When asked to rank their top human resource priorities, survey respondents repeatedly chose a half-dozen key issues as their chief concerns.

Exhibit 1: Top Human Resource Concerns

For a larger version
of the table, click on the image or click here.

An overwhelming majority of respondents chose these top six
concerns every year, and while the variations in their relative rankings
correlated with the depths of the recession, the spread between first and sixth
was actually quite small year after year.

Human resource issues
in context

This consistency in the ranking of top HR concerns is not
surprising, in view of the broader strategic, economic, and regulatory issues
that financial institutions must address. Several such topics merit special
mention:

• Changing banking
technology. Advances in technology, such as mobile and online banking,
social networking, remote deposits, and ATMs, are reshaping the fundamental
relationship between banks and their customers. The Crowe survey responses
reflected these ongoing changes in various ways, such as a 14% overall drop in
staffing in branch and call center customer service positions from 2008 to
2012. Changes in the way banks and customers interact also will affect the
design of incentive programs, particularly the types of activities and
behaviors that incentives are intended to encourage.

• Dynamic regulatory environment. As the various agencies created by the Dodd-Frank Wall Street Reform and Consumer Protection Act come into full operation, the overall regulatory environment for financial institutions is changing rapidly. In addition to specific requirements related to incentives and compensation models, Dodd-Frank regulations also affect human resource priorities in a more general way. Because financial institutions must be prepared to respond rapidly as new regulatory requirements are announced, greater flexibility in staffing will be important in coming years.

• Uncertainty over benefit requirements. Many of the most sweeping provisions of the Patient Protection and Affordable Care Act (PPACA, the Obama health law) are scheduled for implementation on Jan. 1, 2014. As individual states sort out how or whether to establish the PPACA's state health exchanges and other features, monitoring and responding to the effects on employee healthcare benefits will require constant attention and considerable resources.

• Continuing margin pressures. Cost control is always a concern for financial institutions, especially as they face ongoing margin pressures in the post-recovery economy. This doesn't only complicate the response to evolving regulatory requirements. It also means that compensation strategies in general must be reviewed with an eye toward maximizing their effectiveness and return on investment.

• Changing workforce expectations. Finally, it must be noted that 21st-century workers themselves are changing as a younger generation of employees begins to populate the work force.

The implications of these generational changes go beyond incentives alone. They also encompass more general human resource issues. They

include such matters as training, career paths, advancement opportunities, working conditions, and work-from-home and flextime policies.

And they also reach to such broader corporate policy questions as "green" initiatives and community involvement. Any HR action plan must address how an institution will respond to this changing work force.

Developing a human resource action plan

Bearing in mind that pay and incentives are only part of total compensation--which in turn is only a part of total labor cost and overall HR strategy--the specifics of any human resource action plan naturally will vary with each institution. In general terms, however, it would seem any such plan should cover at least eight basic elements:

1. Establish a salary administration strategy.

At the most fundamental level, your pay program must be compliant with employment law and must help you attract and retain employees with the specific skills, competencies, and performance levels the institution needs.

At a deeper level, however, it is wise to define the institution's overall compensation philosophy:

- How competitive do you want to be?

- Do you want to pay above-market rates to attract and retain the best talent, or will at-market rates or below be adequate for your competitive situation?

A comparison of survey responses over the past five years reveals that fewer institutions are planning to pay above-market salary ranges in the near future.

Exhibit 2: Compensation Strategies

For a larger version of the chart, click on the image or click here.

Only one institution out of every 10 in the 2012 survey reported plans to pay greater than 10 percent above-market rates--a sharp drop from the previous two years.

2. Assess salaries by position using benchmarks.

Once the guiding philosophy has been established, the next logical step is to identify salary benchmarks and define projected increases. The Crowe survey includes extensive benchmarking information, taking into account obvious variations in institution size and business focus. Survey responses also indicated that annual salary increases have settled in at a relatively modest 2.5%.

Exhibit 3: Projected Salary Increases

For a larger version of the chart, click on the image or click here.

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3. Review performance management tools.

One objective for performance management tools is to
distinguish generally "above-average" performance and increase the reward associated with it. When too many employees are rated above average, the pool of funds available for rewarding exceptional performance often is spread too thin--to the point where such rewards lose their motivational capacity.

The 2012 survey offers encouraging news in this area: 92% of
responding banks espouse pay-for-performance as a principle. The survey also shows that the differentiation in salary increases between average and above-average employees is finally widening.

Exhibit 4: Salary Increase by Performance Rating

For a larger version

of the chart, click on the image or click here.

4. Review incentive programs to assure they are motivating desired behavior and results.

The most effective incentives are those with designs that provide a direct connection between daily activities and pay. Employees can be motivated to change their daily efforts in desired ways if they see how such change gives them a realistic opportunity to earn a meaningful incentive.

According to research reported in a widely referenced article by the WorldatWork human resource association, the smallest meaningful pay increase--the amount needed to have a motivational effect--is 7%. *

Here again the 2012 survey is somewhat encouraging. Although incentives as a percentage of base pay are still down from their prerecession peaks, they appear to be settling in just under the 8% level.

Exhibit 5: Incentive Pay Levels

For a larger version
of the chart, click on the image or click here.

An important--and sometimes overlooked--aspect of any organizationwide review of incentives and compensation is the involvement of risk professionals in the design and monitoring of incentive plans. In addition to reflecting recent regulatory guidance, involving risk professionals in incentive plan design or modifications also provides a valuable check against incentivizing practices that inadvertently increase the institution's risk exposure.

5. Evaluate training effectiveness.

While not specifically related to compensation, training is nevertheless an important part of the overall relationship between the institution and its employees. Unfortunately, fully one-third of the survey respondents indicated their organizations do not regularly evaluate the effectiveness of their training programs.

Exhibit 6: Training Effectiveness

Type of Evaluation

Usage by Survey Respondents

Participant Feedback Survey

44.8%

Participant Testing

40.7%

Manager Feedback

26.2%

Tracking of Performance Change

19.8%

No Regular Evaluation

33.5%

6. Update your strategy for managing benefit costs.

As mentioned earlier, the changing healthcare environment will have a significant impact on overall compensation and labor costs, so ongoing monitoring and response to these developments must be included in any human resource plan. The Crowe survey indicates respondents expect overall benefit costs will continue to rise, with health benefit costs driving much of the increase.

Exhibit 7: Benefit Cost Trends

For a larger version of the chart, click on the image or click here.

In view of these expected increases, a wide-ranging review of benefits will be in order for most institutions in the coming year. In addition to making sure all benefit programs are fully compliant with legal requirements, this review also should look into health and financial management issues such as:

- • Using wellness and preventive benefits
- • Managing vendor performance
- • Monitoring benefit use versus cost
- • Evaluating costs and the proportion borne by employees
- • Changing vendors, if appropriate
- • Joining larger pools or other cost-containment tools

7. Reward executives appropriately.

Incentives naturally play a larger role in executives' and officers' total compensation than they do in compensation of the rest of the work force. The incentives used vary by position with a variety of approaches typically used at the same time.

Exhibit 8: Incentive Plan Usage

Type of Incentive
Executives
Commercial Officers
Retail
Nonofficers

Annual Discretionary

40.3%

28.2%

23.0%

Multiple-Factor Plan

31.9%

24.2%

20.2%

Profit Sharing

26.2%

24.6%

25.0%

Individual
Performance

22.6%

35.1%

25.4%

Sales
Commission

3.2%

16.9%

20.6%

Sound executive incentive programs will employ a balance of performance metrics including financial, quantitative, and qualitative measures. They also take a balanced approach to risk taking and controls, consistent with regulatory requirements and the policies established by the board's risk committee.

8. Review directors' roles and compensation.

The current regulatory and corporate governance environment also is increasing the demands that are placed on a financial institution's board of directors. Among other responsibilities, board members must be prepared to respond specifically to compensation-related questions, particularly questions related to incentives.

For this reason, an HR action plan should also include revisiting the compensation committee's charter, including an assessment of the number of committee meetings needed and the types of resources that must be provided so that members can perform their duties effectively.

These increased demands also could indicate a need for increased compensation for directors. Many respondents in the Crowe survey indicated that their institutions provide types of benefits in addition to retainers and meeting fees; these include stock options and deferred compensation as well as travel opportunities.

Exhibit 9: Directors’ Compensation

Compensation	Use by Survey Respondents
Deferred Compensation	27.5%
Health Insurance	12.5%
Dental Insurance	

10.2%

Life Insurance

11.4%

Convention Travel

37.0%

Stock Options

27.8%

Restricted Stock

7.4%

Nonqualified Retirement

6.7%

Strategic value of an effective plan

An effective HR action plan should review and address all necessary administrative and HR support functions, which often are the subject of regulatory scrutiny as well. As essential as such documentation and compliance issues are, however, the greatest opportunities generally will be found in addressing broad, strategic concerns such as those outlined earlier.

While developing appropriate, effective, and consistent compensation and incentive policies in today's dynamic environment is an obvious challenge, the rewards can be significant, including improved cost control, greater employee motivation, improved organizational performance, and more effective management of risk.

* Frank Giancola, "In Search of the Smallest Meaningful Pay Increase," Workspan - The Magazine of WorldatWork, March 2009.

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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