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The Challenges of Bank Executive Compensation

Trying to balance compensation to performance and expectations

By: Timothy R. Chrisman *November, 2007*

State of the Compensation Landscape

Over the last few years, demand has exceeded the supply of the best available bank executive talent. Some of the contributing factors include:

Supply

- A lack of extensive training programs
  - Little to no credit training among executives
- The baby-boomer generation is approaching retirement
- Executives' responsibilities becoming more focused and less broad
  - Sarbanes Oxley compliance

Demand

- De novos and public companies draining the pool of professionals

Current market conditions have led to more recent cynicism on both sides of the employment equation now as compared to previous years. On the employer side of the equation, employers want potential candidates to sign-on and become a part of the team with some blind trust. On the employee side, candidates desire more absolutes from a prospective employer and are less comfortable with soft promises. A bank is required to instill confidence that it can shield potential employees from future slumps. Therefore, the climate of the market is demanding that employers pay when times are good and not cut back when times are bad.

The Ultimate Objective: Protect the Bank

While management has previously been going to their boards to sell the idea of P&L accountability and profit sharing, the realities of tightening spreads and lowering profits suggest that boards will have to recognize the ultimate objective is for executives to be compensated for protecting the bank.

In order to protect the bank, the specific performance measures for compensation incentives have changed dramatically. Over the past two years the specific needs of banks have revolved around compliance, finance, and credit. Due to this focus, it used to be that incentives were based on production, revenue, return, stock price, and spreads. Now, with the issues of asset management and loan workout looming on the horizon, the basis of compensation and incentives still includes quality asset and deposit growth but also has shifted to protection, asset quality, and loan workout.

Employers will likely attempt to push deferred compensation programs and longer term stock vesting to give executives incentive to stay longer with their banks.

Banks must be careful to evaluate salary surveys with the reality of accurate market compensation or else target hires will pass on below market packages.

Before banks establish market level new hire compensation packages they must be prepared for the parity problems this may create with the existing executives.

Due to the inequity of the supply and demand for executives, banks must approach the hiring of new executives by balancing the happiness of their existing executives with the risk of losing that new hire to a competitor.

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