Compensation Advisory Partners

Industry Report // 2019-2020

Banking

Compensation Advisory Partners (CAP) conducted a study of executive compensation levels and design practices in the banking industry. The study includes 18 U.S. banks with greater than $50 billion in assets across three different groups: Money Center banks (n=4), Custody banks (n=3), and Super Regional banks (n=11). This report summarizes the findings of CAP's study and identifies other hot topics in executive compensation affecting the banking industry.

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Key Takeaways

- *Pay and performance:* 2019 financial performance results were generally flat relative to 2018. Despite flat operating results, one- and three-year total shareholder return (TSR) were strong for the period that ended December 31, 2019. Chief executive officer (CEO) compensation increased modestly by two percent at median, generally aligning with flat financial performance.

- *Compensation program design:* In recent years, executive incentive plan design among banks in this group has been stable. Earnings per share (EPS) is the most common short-term incentive metric and return on tangible common equity (ROTCE) is the most common long-term incentive metric. Stock options continue to be less common among banks than among companies in other industries with only 6 of 18 granting them for 2019.

- *Looking ahead:* For compensation and human resources committees of the board, a key focus for the second half of 2020 and beyond will be evaluating the impact of the COVID-19 pandemic on executive incentive plans. Many banks in CAP's study use discretionary annual incentive plans and relative incentive metrics in long-term performance plans, allowing for greater flexibility and requiring fewer adjustments to manage the unplanned impact of the pandemic. Additionally, CAP expects companies and committees to continue to focus on diversity and inclusion and gender pay equity.

2019 Pay and Performance Outcomes

2019 financial results were generally flat relative to 2018 for the banks in CAP's study. EPS growth was positive, but significantly lower than 2018. Revenue, operating income, and net income were flat after considerable increases in 2018. Banks saw significant growth in 2018 due in part to the 2017 Tax Cuts and Jobs Act. Banks faced a more challenging economic backdrop in 2019 with low interest rates and pressure on net interest margins. 2019 EPS results for the banks in CAP's study tended to be below analyst expectations set at the beginning of the year primarily due to the low interest rate environment. EPS results for the Money Center banks were less impacted because these businesses are more diverse. Despite flat operating results, one- and three-year TSR were strong for the period that ended December 31, 2019. The chart below summarizes median performance results for the banks in CAP's study:

Metric	Median Percent Change	
	Year Ended December 31, 2018	Year Ended December 31, 2019
EPS	+34.8%	+6.1%
Net Income	+29.8%	-1.5%
Pre-tax Operating Income	+ 12.8%	-0.6%
Revenue	+5.3%	+1.2%
1-Year TSR	-17.6%	+33.5%
3-Year TSR (Cumulative)	+24.1%	+25.5%

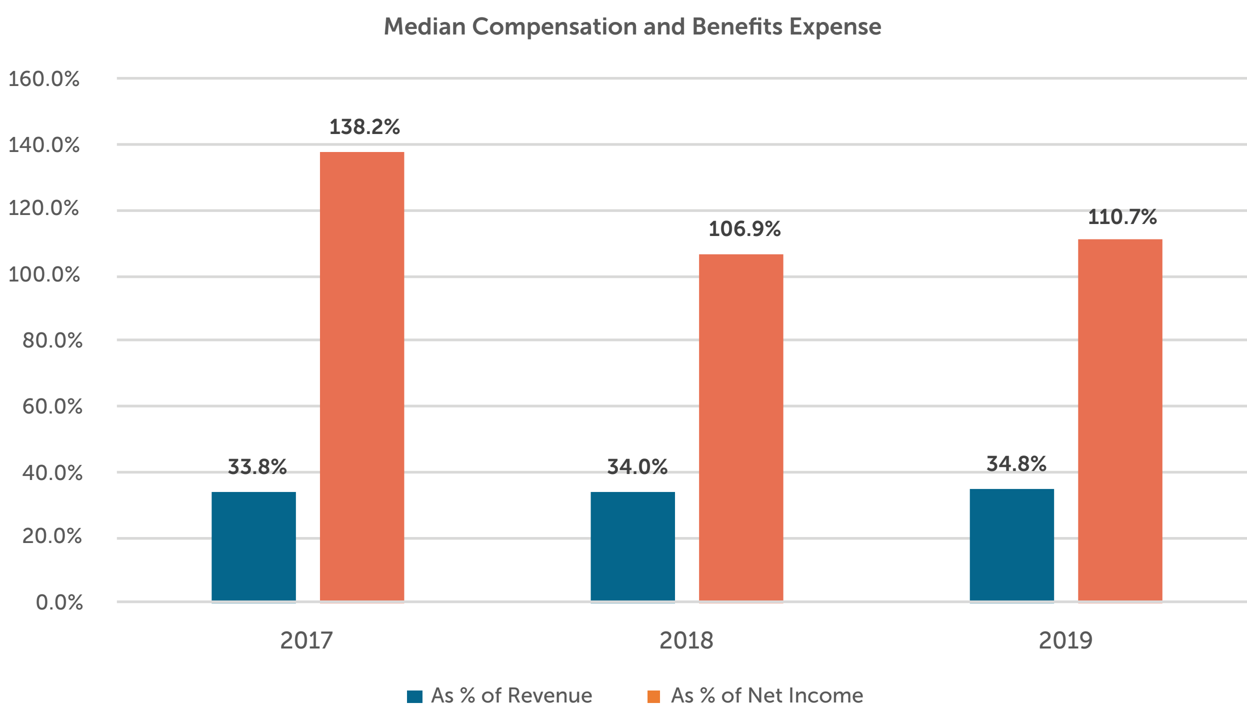
Source: *S&P Capital IQ Financial Database.*

In 2019, total direct compensation, including base salary, annual cash bonus, and awarded long-term incentives, among CEOs increased two percent versus 2018 at median. This is a smaller increase than in 2018 when total direct compensation for CEOs increased seven percent at median. 2019 annual cash bonuses were mixed among this group and resulted in no change at median, indicating that 2019 cash bonuses were aligned with relatively flat operating performance. The chart below summarizes median changes in CEO pay for the group:

Element	Median Percent Change for CEOs	
	Year Ended December 31, 2018	Year Ended December 31, 2019
Base Salary	No Change	No Change
Annual Cash Bonus	+7.0%	No Change
Awarded Long-term Incentive	+5.6%	+4.2%
Awarded Total Incentive	+8.0%	+2.7%
Total Direct Compensation	+6.8%	+2.4%

Note: *Excludes companies where there was a change in CEO.*

Compensation and benefits expense increased approximately three to four percent at median on an absolute basis in 2018 and 2019 but stayed relatively flat as a percentage of revenue. Compensation and benefits expense increased slightly as a percentage of net income in 2019 after declining significantly from 2017 to 2018 due to the change in tax rate under the 2017 Tax Cuts and Jobs Act.



Executive Incentive Compensation Program Design

Incentive Compensation Model

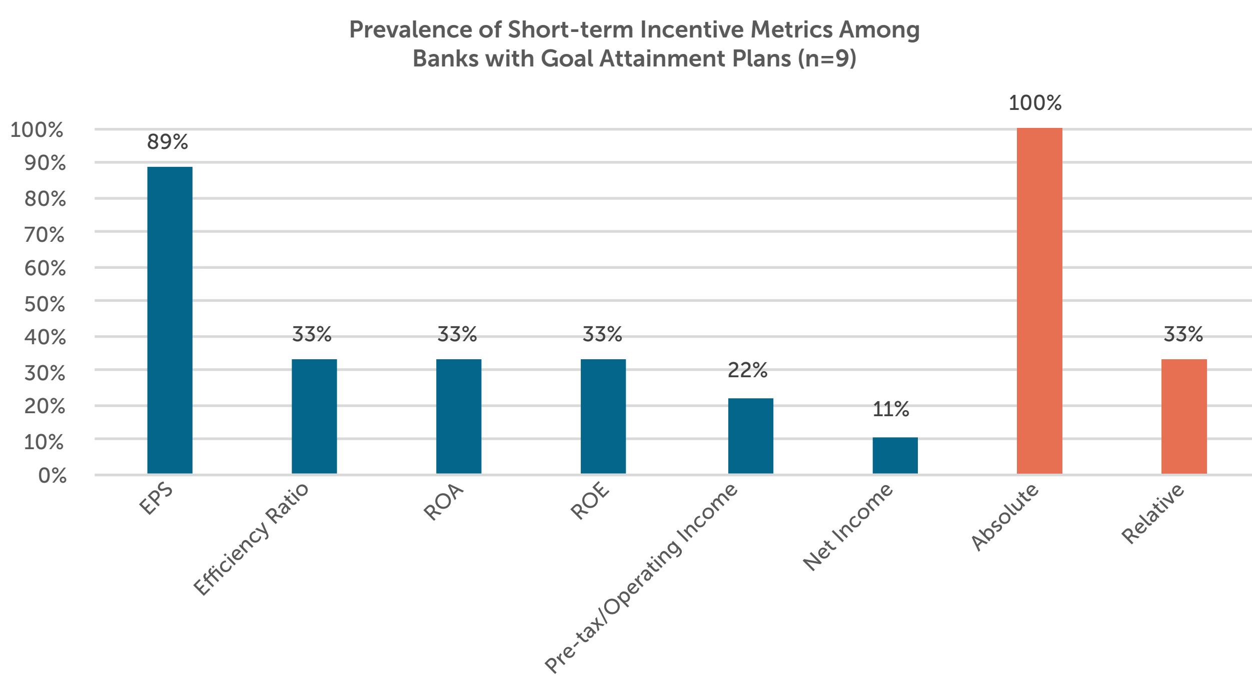
The banking industry is different from other industries in that some banks determine a total incentive award based on annual performance and then allocate the total incentive between annual cash bonus and long-term incentive awards (e.g., the total incentive award for the year is delivered 40 percent through an annual cash bonus and 60 percent through long-term incentives). Among the banks in CAP's study, 39 percent use this approach, including most Money Center and custody banks and several Super Regional banks. The remaining banks make separate decisions for the annual cash bonus and long-term incentive awards, which is consistent with general industry practice.

Short-term Incentive Plan

Half of the companies in CAP's study have primarily discretionary short-term incentive plans. This practice is more prevalent in the banking industry than in other industries.

The other half of companies maintain more formulaic short-term incentive plans, often referred to as goal attainment plans, that pay out, at least in part, based on financial results relative to pre-established "threshold," "target," and "maximum" goals. These plans most often provide for a payout of 200 percent of target for "maximum" performance or better, though several companies provide maximum opportunities of 150 percent of target, and one company provides a maximum opportunity of greater than 200 percent of target.

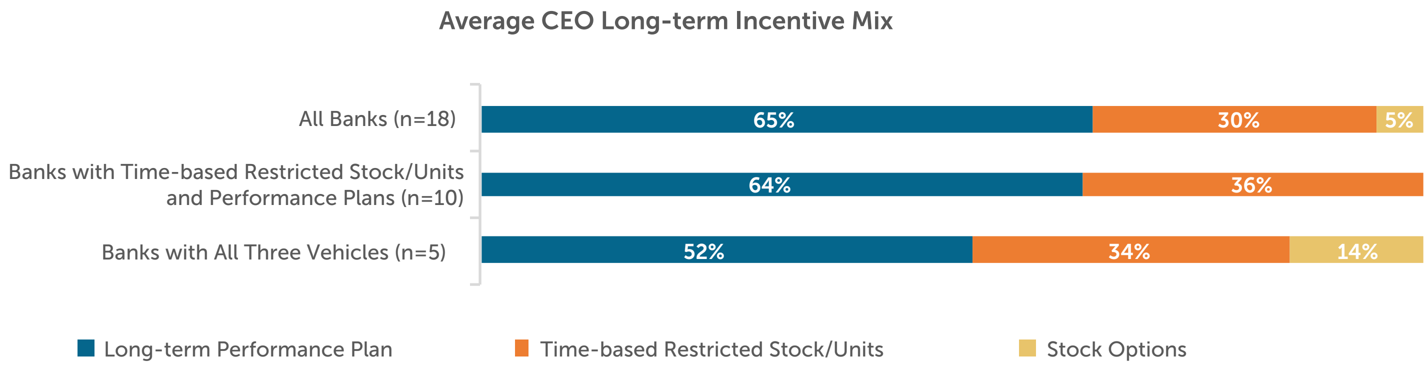
EPS is the most common financial metric across these short-term plans. Companies also use the Efficiency Ratio, return on assets (ROA), and return on equity (ROE), but they are less common in short-term plans. Most companies measure annual performance against absolute performance goals; however, several companies include a relative performance component.



Note: *Percentages do not add to 100 percent due to some companies using multiple metrics.*

Long-Term Incentive Plan

Long-term incentive programs among companies in CAP's study are most often composed of time-based restricted stock or units, and long-term performance plans (e.g., performance share units). Only 33 percent of banks in the study use stock options, making them less common among this group than in the broader market. Companies tend to weight long-term performance plans as at least 50 percent of the target total long-term incentive award. All of the banks in the study that use stock options are super regional banks. None of the money center or custody banks use stock options. Of the companies in the study, 11 percent use long-term performance plans as their only long-term incentive vehicle. The chart below outlines the average long-term incentive mix across companies in CAP's study:

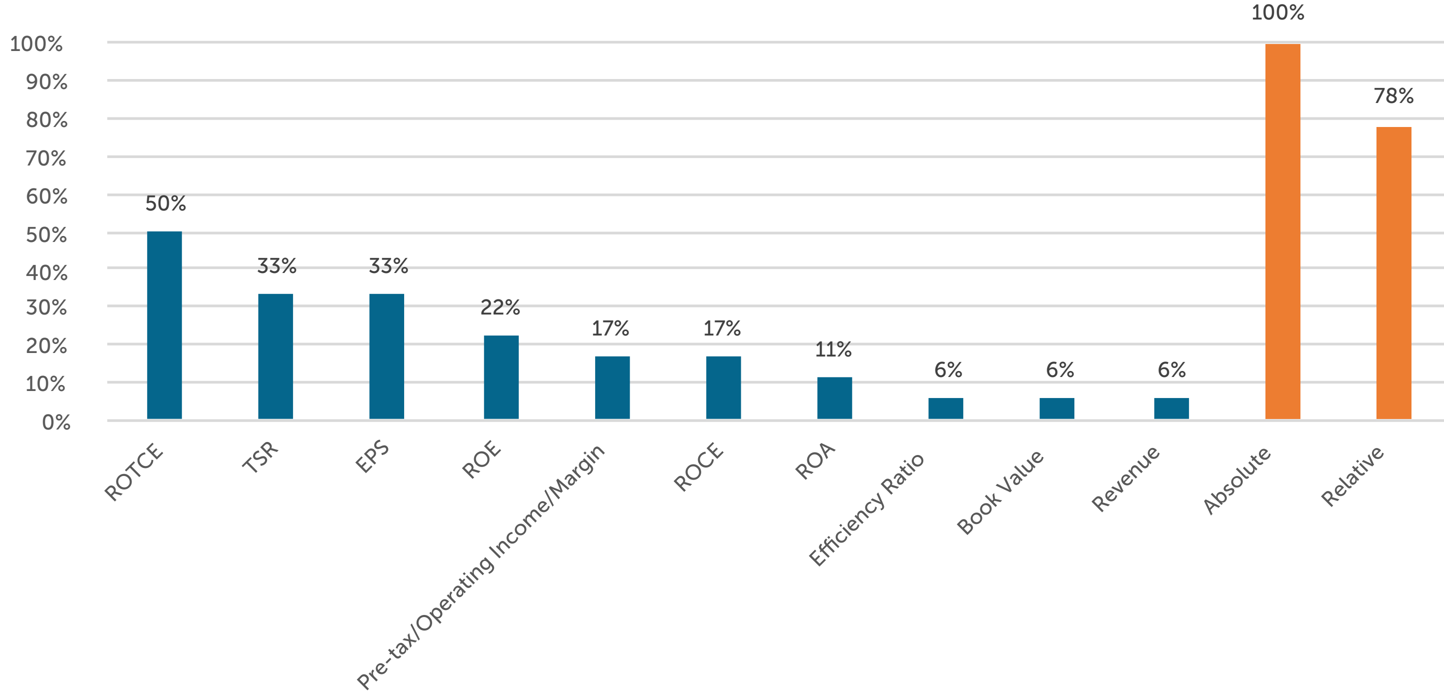


Note: *Two companies use long-term performance plans as their only long-term incentive vehicle and one company uses a long-term performance plan and stock options.*

Of the banks in CAP's study, 83 percent use return on equity (ROE) or a variant of that measure as a metric in their long-term performance plans. Variants of ROE include return on tangible common equity (ROTCE) and return on common equity (ROCE). ROTCE is the most common of these variants. EPS and relative TSR are also common long-term performance plan metrics.

78 percent of companies use at least one relative metric in their long-term performance plans. Specifically, all Super Regional banks use relative metrics in their long-term performance plans. In other industries, relative metrics are typically limited to TSR; however, the banks in CAP's study also use relative financial measures, including relative ROE variants, EPS growth, and ROA. This is likely due to the significant degree of comparability between the Super Regional banks in CAP's study.

Prevalence of Long-term Incentive Metrics (n=18)



Note: *Percentages do not add to 100 percent due to some companies using multiple metrics.*

Among banks, long-term performance plans most often have maximum payout opportunities of 150 percent of target. In the broader market, most long-term performance plans have maximum payout opportunities of 200 percent of target. Maximum opportunities tend to be lower at banks due, in part, to regulatory guidance to limit upside leverage in incentive plans to avoid encouraging imprudent risk-taking.

Looking Ahead to the Rest of 2020 and Beyond—Hot Topics in Executive Compensation

COVID-19 Pandemic: Impact and Response

The COVID-19 pandemic has impacted businesses globally. Companies in some industries have been severely impacted and have had to resort to furloughs and wage reductions to cut costs and preserve cash. Most U.S. banks have avoided such actions. Instead, U.S. banks have taken positive employee actions such as, providing additional compensation for in-person workers and additional paid sick leave or other health benefits.

Although banks have avoided cutting employee-related costs to date, bank financial results are expected to be adversely impacted by COVID-19 in 2020. Though some banks may have benefited from fee income related to Paycheck Protection Program loans, we expect the negative impact of a challenging economic environment and zero-interest-rate environment to outweigh any benefits. This could impact payouts on in-progress annual and long-term incentive plan cycles. CAP conducted a survey in the first half of 2020 to get a sense of whether companies intend to take action to address the impact of COVID-19 on incentive plans. Several of the banks in CAP's study participated in the survey and nearly all responded that it was too early to determine if or what action would be taken. CAP expects that companies will have better insight into the extent of the impact of COVID-19 on incentive plan outcomes and whether action is warranted when second quarter results are available.

Companies with formulaic annual incentive plans and absolute incentive plan metrics will likely have to make the most significant adjustments to address the impact of COVID-19, which was unplanned and not in management's control. Discretionary short-term incentive plans and relative metrics will likely not require action. Given that 50% of the banks in CAP's study use discretionary annual incentive plans and 78% use at least one relative metric in their long-term performance plan, this group may not have to make as many adjustments as companies in other industries.

Diversity and Inclusion and Gender Pay Equity

In 2019 and the first half of 2020, board human resources committees continued to focus on diversity and inclusion, and gender pay equity at companies across industries. Financial services firms are often the focus of discussions on these topics in the media, among regulators, and among institutional investors.

In 2020, Arjuna Capital, an institutional investor that engages companies on gender pay equity, published the third edition of its gender pay equity scorecard, which grades companies on disclosure of gender pay gaps and commitments to address pay inequity. Several of the banks in CAP's study are included in the scorecard. Notably, Citigroup was one of only three companies to receive the highest grade of "A." Citigroup voluntarily published its global gender pay gap and U.S. minority pay gap in both 2019 and 2020. Additionally, 22 percent of companies in CAP's analysis included shareholder proposals in their 2020 proxy statements requesting that the banks report the median gender pay gap. These proposals failed to receive majority support from shareholders.

In June 2019, Congresswomen Maxine Waters, Chairwoman of the House Financial Services Committee, and Joyce Beatty, Chairwoman of the Diversity and Inclusion Subcommittee, sent a letter to 44 bank holding companies with assets of greater than $50 billion, requesting information about each institution's diversity and inclusion data and policies. In February 2020, the House Financial Services Committee published their findings in a report titled, "Diversity and Inclusion: Holding America's Large Banks Accountable." The report found that the demographics of bank employees reflect the U.S. population; however, senior management teams and boards of directors are mostly white and male. Additionally, the report stated that not all institutions responded fully to each of the questions in the letter.

Though these disclosures are not mandatory, CAP expects that investors and regulators will continue to call for transparency around diversity and inclusion policies and gender pay equity in the banking industry and broader market. As these calls for transparency put pressure on banks to "get this right," Citigroup and Wells Fargo have publicly stated diversity goals and are considering progress on these goals as part of the compensation decision process for top executives.

Conclusion

Compensation programs among the banks in CAP's study continue to effectively tie pay outcomes to performance. In recent years, incentive plan designs among these banks have generally been stable.

However, the second half of 2020 holds a great deal of uncertainty. The full extent of the COVID-19 pandemic's duration and economic impact is still unknown, the low interest rate environment may inhibit growth, and the 2020 election may have a significant impact on the regulatory environment. CAP expects this uncertainty will likely result in decreases in 2020 CEO compensation and could result in changes to executive incentive plan designs in the second half of 2020 or early 2021. We also expect banks in our study to continue their efforts to make progress on the diversity and inclusion front.

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Banks in CAP's Study (n=18)

Money Center Banks

- Bank of America Corporation
- Citigroup, Inc.
- JPMorgan Chase & Co.
- Wells Fargo & Company

Custody Banks

- The Bank of New York Mellon Corporation
- Northern Trust Corporation
- State Street Corporation

Super Regional Banks

- Citizens Financial Group, Inc.
- Comerica, Inc.
- Fifth Third Bancorp
- Huntington Bancshares, Inc.
- KeyCorp
- M&T Bank Corporation
- The PNC Financial Services Group, Inc.
- Regions Financial Corporation
- Truist Financial Corporation
- U.S. Bancorp
- Zions Bancorporation