GODFREY KAHN S.C.

Bank Strategy Briefing

Ideas and analysis for community bank executives

Dangling the carrot

Patrick Murphy
414.287.9222
pmurphy@gklaw.com
LinkedIn

With the dearth of talent at many community banks, particularly in the executive suite, it has become increasing important to make sure that key employees are appropriately incented to stay put and not pack their bags for the competitor down the street. Adopting a carefully drafted incentive compensation plan can have the benefit of not only incenting executive loyalty, but also driving revenue-enhancing or other desirable behaviors.

Cash or equity?

Each employee may be motivated by different things, so it is often difficult to gauge what will have the biggest impact from an incentive perspective. Cash has the advantage of immediate gratification, whereas equity awards are often subject to vesting requirements and can be difficult to monetize due to the virtually non-existent markets for most community banks' stock. However, equity awards have the advantage of providing a longer-term benefit to the bank, in that executives will be loath to leave while they hold unvested equity awards. If you do choose to issue equity awards, be aware that any stock issued must be issued pursuant to a registration statement with the SEC or an appropriate exemption must be available.

Appropriate triggers

There are endless creative ways that community banks and their compensation consultants have employed to determine when and how many incentive compensation awards should be earned by their executives. So much of this is driven by the types of behaviors that the bank desires to drive. However, there are a few things to keep in mind as you decide how to design your particular plan.

- Beware of the Wells Fargo Effect – While it is not uncommon to tie awards to achieving certain revenue/sales metrics, it is important to have appropriate controls and/or claw backs in place to avoid encouraging overly aggressive sales practices;
- CSI Taboo – No, not the popular crime CBS crime drama, but Confidential Supervisory Information. Many banks want to tie incentive compensation to achieving certain examination findings or CAMELS ratings. However, regulators have consistently stated this is inappropriate on a number of levels, not the least of which is that they do not appreciate being one of the deciding factors in whether an executive gets a bonus or not.

Other dos and don'ts

- Section 409A – Revisit plans that have been in place for a while to ensure that they are Section 409A compliant. Non-compliance could have significant negative tax consequences on the employee and, potentially, the bank.
- Plan Ahead – The worst time to adopt a new incentive compensation plan, particularly one that contains change-in-control provisions, is right before the board decides to put the bank up for sale. Doing so may be perceived by shareholders as a breach of the Board's fiduciary duties.
- Mortgage Loan Originators – If any of the bank's mortgage loan originators are included in the pool of executives entitled to participate in the executive compensation plan, additional attention will need to be given to ensure that any awards granted under the plan do not run afoul of the loan original compensation restrictions set forth in Regulation Z.

Banking & Financial Institutions Practice Group Members

PRINCIPAL CONTACT

Thomas R. Homberg
thomberg@gklaw.com

MILWAUKEE OFFICE

Kathryn R. Allen
kallen@gklaw.com

Benjamin J. Clarke
bclarke@gklaw.com

Jason E. Kuwayama
jkuwayama@gklaw.com

Richard S. Marcus
rmarcus@gklaw.com

Patrick S. Murphy
pmurphy@gklaw.com

Joshuah Torres
jtorres@gklaw.com

Peter Wilder
pwilder@gklaw.com

Shirley J. Huntemann
shuntemann@gklaw.com