

American Association of Bank Directors

Annual Directors Conference
“Doing the Right Things Right”

November 2004

Compensation Committee Panel

Panel Members

Charles J Thayer

**Chairman & Managing Director
Chartwell Capital Ltd.
Fort Lauderdale, Florida**

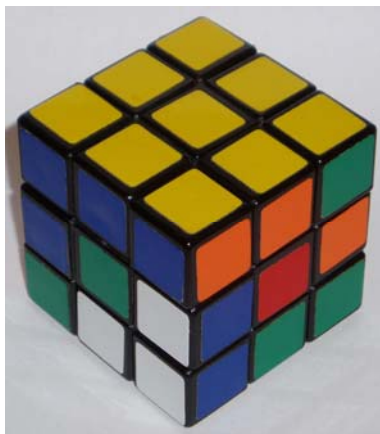
Marc R Trevino

**Partner
Sullivan & Cromwell
New York, New York**

Robert E Miller

**President, Compensation Group
Clark Consulting's Banking Practice
Minneapolis, Minnesota**

Your Bank's Compensation Committee You Face Very Complex Issues



**Your Committee's Challenge is to Make Certain that
Each Element of Your Bank's Compensation Program
Fits Together into a Plan that Works as a Whole**

Doing the *"Right Thing"* is Not an Easy Job!

Our Panel's Objective

Helping You Do the *"Right Things Right"*

as a

Member of Your Bank's Compensation Committee

- **Charles J Thayer: Board Member's Viewpoint**
 - Public Company Board Member [NYSE & NASDAQ]
 - Bank Board Member [NASDAQ & Private]
 - National Non-Profit Board Member

- **Marc R Trevino: Legal Issues & Liability**
 - Pitfalls to Avoid
 - Actions to Take

- **Robert E Miller: Compensation Design**
 - Executive Compensation
 - Board Compensation

“Good” Compensation Governance

- **The “*Right Thing*” for Your Organization?**
 - **Public Company: “Yes” - Sarbanes-Oxley**
 - **Non-Profit Organizations: “Yes” - State & IRS**
 - **Private Company: “Yes” - Reward Performance**

- **Essential for Banks**
 - **Bank Regulatory Requirements**
 - **Board Member Liability [D&O Coverage]**

- **Who Benefits**
 - **Your Management - Paid for Enhanced Performance**
 - **Your Shareholders - Receive Enhanced Performance**
 - **Your Board - Doing the “Right Thing”**

A Well Designed Compensation Plan Will Motivate and Reward Your Management Team for Enhancing Your Bank’s Performance

Compensation Policy and Perception

- *No Other Board Committee has such a Profound Personal Impact on Your CEO and Every Employee.*
- Executive Compensation is One of Your Board's Most Challenging Governance Issues.
- As a Member of Your Bank's Compensation Committee You Must Address a Wide Array of Complex Questions.
- Negative Publicity Concerning Excessive Executive Compensation has Created New Awareness of Your Personal Responsibility.

Your Bank's Compensation Committee

- **Membership**
 - **Importance of Your Personal Independence**
- **Committee Charter**
 - **Your Personal Job Description!**
 - **Review Your Compliance [every meeting]**
 - **You will be Accountable if a Problem Develops**
- **Independent Committee Advisors?**
 - **Legal Counsel**
 - **Compensation Consultant**
 - **Financial Advisor**
- **Role of the CEO & Other Executives?**
 - **Importance of Regular Private Sessions**
 - **Importance of Trust - Not "Gaming" the Plan**

Your Bank's Compensation Philosophy

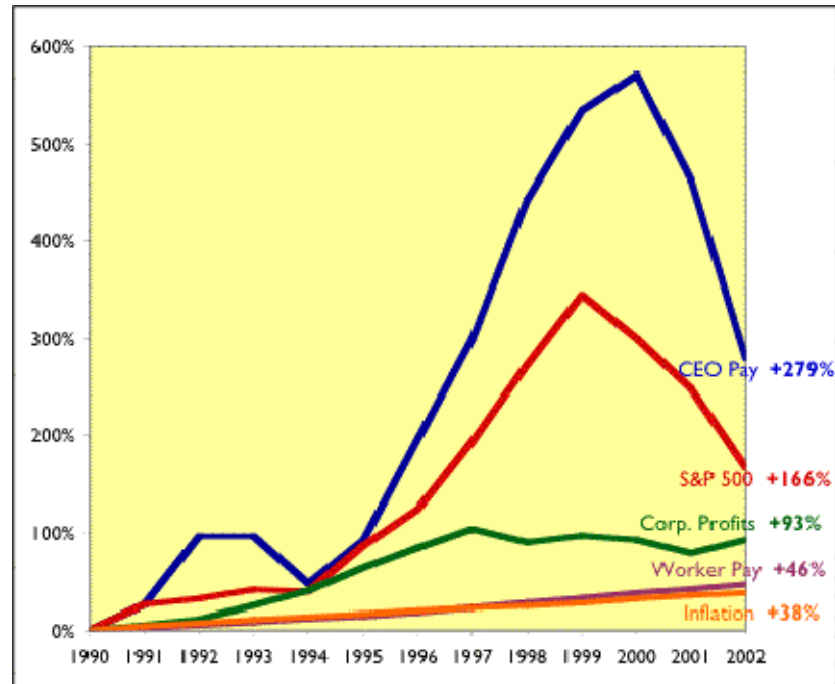
- **Shareholder Performance Expectations?**
 - Earnings per Share?
 - Return on Equity?
 - Dividends?
 - Other Expectations?
- **Compensation Plans: Linkage to Performance?**
 - Base Pay
 - Annual Incentives
 - Long Term Incentives
 - Perquisites
- **Executive & Employee Expectations/Perception?**
- **Proxy Disclosure & Shareholder Perception?**
- **Regulatory Perception?**

Executive Pay vs. Performance

- **CEO Compensation**
 - CEO Pay vs. Bank Performance? Peer Group?
 - "Peer" Performance is a "C" – Not an "A"
- **Other Senior Executives**
 - Division of Authority Between Committee & CEO?
 - Plan's Linkage to Individual Performance?
- **Executive Agreements?**
 - Executive Contracts? Term?
 - Performance vs. Entitlement?
 - Change of Control? Severance?
 - Non-Compete? Non-Solicitation?
- **Ownership Objectives?**
 - Stock Options, Restricted Stock, Stock Grants, etc?
 - Cash Investment Expectations?

Public Perception: The "Lake Wobegon" Effect

"Mythical Place Where Every CEO is Top Quartile!"



CEO Compensation: Business Week annual executive pay surveys. S&P 500 Index: Standard and Poors Corporation. Corporate Profits: Bureau of Economic Analysis, National Income and Disposition of Personal Income Data. Average Worker Pay: Bureau of Labor Statistics, "Average Weekly Earnings of Production Workers, Total Private Sector." Series ID: EEU00500004. Inflation: Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers.

Following the Crowd: Not the *“Right Thing”*

- **A Board Member’s Viewpoint**

“In my view the executive compensation conundrum hasn't changed in twenty years. The compensation committee brings ‘objectivity’ to their process by commissioning a compensation survey. The survey discloses an array of compensation valuations ordered in percentiles. The arguments are made that (1) if you pay below the median your executives will not perform or will leave; and/or (2) we are or aspire to be a top tier company so we have to pay top tier compensation. Committees and boards then award compensation above the old median. Each subsequent year this is repeated. The escalation has in mathematical terms been geometric. If that chain can't be broken the pervasive gross inequality is going to have serious political and social consequences.”

Board Member; Large Regional Bank: September 2004

- **Focus on Your Bank’s Goals & Performance Targets**
- **Establish Clear Expectations & Targets for Management**
- **Link ‘Continued Employment’ & Compensation to Results**
- **Reward Superior Performance - Not Attendance**

The Other Side of the Coin

All Executive Compensation Isn't Excessive!

- Compensation "Envy": "He/She makes more than I do!"

It may be difficult for certain board members to understand why they should pay someone else more than they earn. Personal comparisons have no relationship to performance based compensation.

- Need to Recruit: "Let's just promote Bob or Sue."

Do you need to recruit an outsider to fill an important executive position? What would happen if you had to pay a new CFO as much as your current CEO? Do you settle for "Second Best" and shortchange your shareholders?

- Production Incentives: "I didn't realize he/she could make so much!"

High payouts to commission based production people [mortgage origination] can create executive and board member backlash. Make certain you (1) understand such plans in advance and (2) your bank profits from the compensation relationship.

**Don't Overreact to Public Criticism of Executive Compensation
Your Job is to Seek the "Right" Balance – It Won't be Easy!**

Bank's Employee Benefit Plans

Scope of Compensation Committee Responsibility

- **Health Plans**
 - **Plan Scope and Coverage?**
 - **Post Retirement Benefits?**
- **Retirement Plans**
 - **Defined Benefit? [Pension]**
 - **Defined Contribution? [401K]**
- **Supplemental Retirement Plans [Tax Rules!]**
 - **Bank Owned Life Insurance? [BOLI]**
 - **Supplemental Executive Plans? [SERP]**
- **Committee/Board Oversight**
 - **Regulatory Requirements?**

Board Member Compensation

- **AABD Board Survey: Community Banks**
 - Annual Fees: \$3,000 to \$15,000
 - Board Meeting Fees: \$300 to \$750
 - Committee Meeting Fees: \$100 to \$500
 - Few Community Banks Offer Director Benefits
- **Your Board has Significant Liability & Responsibility**
 - Current Board Member Qualifications?
 - Do You Have the Right Board Members?
 - Do You Need Additional Skills & Talent?
- **How do You Align Responsibilities with Performance?**
 - Board Evaluation? Board Member Evaluations?
- **How do You Align Compensation with Responsibilities?**
 - Board Member Pay Equivalent to a Bank Teller?

Your Personal Challenge

Good Governance is a Function of Your Board's Collective Good Judgement - You can't Legislate "Good Sense".

- **Insure Appropriate Compensation Plans: Required to Recruit, Retain, Motivate and Reward a Quality Management Team.**
- **Focus on Understandable Plans: Simple Test: "Can Participants Explain Their Incentive Plan to Their Spouse Without Notes?"**
- **Avoid Financial Surprises: Understand the Total Cost [Income Statement, Cash Flow, Tax & Proxy] of Each Plan You Approve.**
- **Avoid Regulatory and Legal Surprises: Employment Law is Very Complex with Significant Penalties for Noncompliance.**

**No "Right Answer" for Every Bank
Each Bank Board is a Unique Blend of Talent and Personality**

Can Independent Advisors Help?

- Do Board Members Really Need Independent Advice?
- What are Your Legal Responsibilities?
- What Advice Should You Obtain? How Often?
 - Legal Counsel
 - Compensation Consultant
 - Financial Advisor
- How do You Select “Independent” Advisors?
- How do You Avoid Board/Management Conflict?
- How do You Measure Cost/Benefit?

Individual Presentations

Marc Trevino

Sullivan & Cromwell

Robert Miller

Clark Consulting

Questions For Our Panel?

Charles J Thayer

Charles J. Thayer is Chairman and Managing Director of **Chartwell Capital Ltd.**, a private NASD member investment firm that provides executive management and board members with specialized advisory services on governance, strategic planning, financial, investment and compensation matters.

Chartwell also provides financial institutions with analysis and advice concerning strategic alternatives. The **American Banker** and **Bank Director Magazine** both ranked Chartwell among the nation's Top Financial Advisors in 1998 and 2001.

The **American Association of Bank Directors** named Thayer to its Board of Advisors in 2004. The AABD is a national non-profit organization serving the information, education and advocacy needs of financial institution directors.

Thayer's combination of executive management and board experience brings a unique perspective to Chartwell's advisory services. He served on the board of **Republic Bank** (NASDAQ) in Florida from 1999 until 2004 and continues to serve as a board member of **BB&T Bank (Florida)** following BB&T's 2004 acquisition of Republic Bank. He currently serves as a board member of the **Louisville Community Development Bank** in Kentucky (1986-present) and for the national **Cystic Fibrosis Foundation** (1980-present).

Previous board service includes **CogenAmerica** (NASDAQ) (1996-1999), an independent multi-state cogeneration power producer headquartered in Minnesota, and **Sunbeam Corporation** (NYSE) (1990-1997), an international consumer products company. He served as Chairman and interim CEO of Sunbeam in 1993. John A. Byrne (Business Week) described Thayer as Sunbeam's "most knowledgeable director" in the book "Chainsaw". He also served as an advisory board member of **Keefe Managers** (1989-2002); a New York based bank stock hedge fund founded by Harry V. Keefe.

Prior to organizing Chartwell Capital in 1990, Thayer had a twenty year career in commercial banking. Thayer served as Executive Vice President and Chief Financial Officer of **Citizens Fidelity Corporation** (NASDAQ), Kentucky's largest bank holding company until its acquisition by **PNC Financial** (NYSE) in 1986. Following the acquisition Thayer was elected Executive Vice President of PNC (1987-1989) with management responsibility for finance, merger and acquisitions, investor relations, strategic planning, and PNC's capital markets subsidiary, serving as Chairman of **PNC Securities Corp.**

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