

# Getting Creative and Competitive with Lenders' Incentive Compensation

IT IS NOT news to anyone that these are challenging times for the banking industry. There are an increasing number of things to pay attention to – credit quality, profitability, deposit growth, etc, and the list just seems to be growing daily.

Some things have not changed, one of which is compensation levels paid to quality lenders. Lenders' compensation remains high. Base salary levels have not been affected by recent industry challenges. Recruiting high quality, experienced talent is still critical. Retention is a constant concern and competition is fierce. Quality lenders are a valuable asset and are called frequently by competitors.

It is important to establish a market competitive compensation program for your lenders, for now more than ever, retention of quality producers is critical. They may help an institution turn a troubled loan situation around or create a work out plan that could circumvent bigger problems.

Here are some good rules to follow when establishing competitive incentive programs for lenders. First, while base salaries remain high, be sure they are competitive but not higher than dictated by the market. Median salary levels are not adequate for most experienced lenders, however, it is important that they be set at a level so lenders are still be motivated by incentive plan award opportunities. Take a holistic approach to compensation; higher base salaries have a ripple affect, impacting all aspects of compensation.

Next, establish goals that drive desired behavior, reward results, and attract and retain quality talent. Communicate goals early in the year to maximize focus and impact.

Third, these plans should establish three to five goals that are easily understood.

And every employee should have at least one goal tied to overall bank performance. This helps to avoid a "silo effect" and places emphasis on bank performance as well as individual results. Establishing bank-wide goals creates a stake in the organization's success.

And finally, it is desirable to establish departmental as well as individual goals. This should help unify the department and create a team environment.

The list of individual goals for today's producers often includes fee income, (core) deposit growth, credit quality and net loan growth. Individual results may be weighted 60-75 percent for annual incentive plan purposes, with department and overall bank goals comprising the balance. Each goal should be assigned a weighting that takes into consideration the strategic plan, market issues and individual roles and responsibilities.

Lenders, as with all employees, should be in good standing and receive satisfactory performance evaluations in order to qualify for annual incentive awards. It is also recommended that lenders' incentive plans be uncapped with regard to individual results to promote ongoing motivation throughout the performance period; awards based on bank-wide goals should be capped.

Some lenders' incentive plans use modifiers. A modifier is not a goal but adjusts the actual incentive award as a result of other outcomes such as credit quality or deposit-to-loan ratios. Plans with modifiers can increase or decrease incentive award payouts based on individual results in critical areas. For example, awards could be increased 20-30 percent if there are no delinquencies and reduced by much more if there is an unacceptable level of delinquencies. Credit quality can be measured

solely on the current year's results or recent years can be factored into the equation whereby the current year's results bear the highest weighting (e.g. 60 percent) and the average of the prior two years' results constitutes the balance (e.g. 40 percent).

Frequency of incentive payouts varies among institutions. While most banks pay incentive awards on an annual basis, some prefer to pay quarterly or monthly. For the latter, a cap on how much will be paid before the end of the plan year should be set to allow for adjustments due to charge-offs, etc. Some consider holdback provisions where a portion of awards are released at a later date depending on future results.

With retention a key issue, it may be prudent to include key lenders in long-term performance-based incentive plans whereby they are eligible to earn awards that vest over time or when future performance results are achieved.

Lenders have to work much harder during challenging times. While loan portfolios and fee income may not be growing, it is recommended that incentive plans contain a discretionary component allowing awards for extraordinary results, such as working out difficult situations that could otherwise cost the bank and shareholders tremendously. Size of discretionary awards should be appropriate given the bank's performance results. Retaining and attracting quality lenders are essential to enduring today's challenges and having a well-designed incentive plan in place can be a great competitive advantage.

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