

Incentive Pay Trends

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Quick Poll



Incentive Best Practices – General Plan Design

- **KEEP IT SIMPLE!!!**
- Clarify the purpose of the plan
 - To share in the success of the organization
 - To drive performance
 - To reduce the level of guaranteed compensation and increase the level of pay-at-risk while remaining market competitive
- Enough pay at risk to make the plan worth the time and effort to administer it
- Incentive opportunity aligned with the position's ability to impact organizational performance

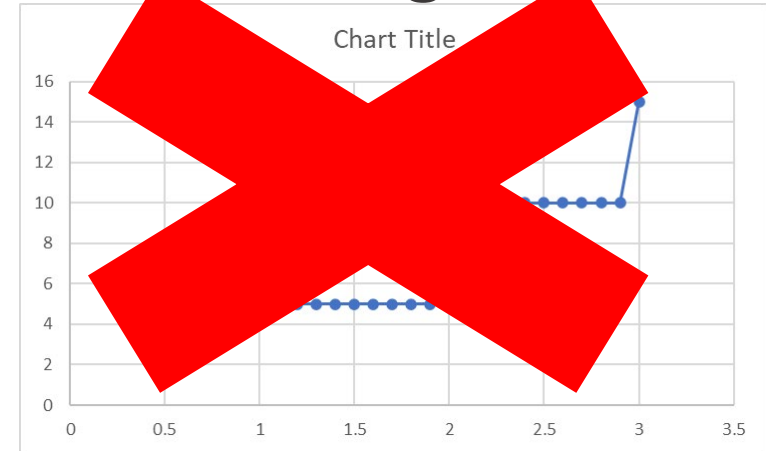
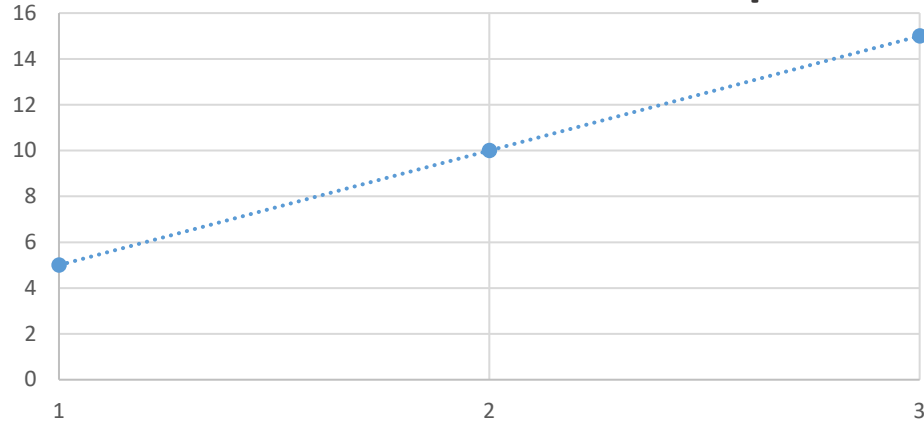
Incentive Best Practices – General Plan Design

- **Align:**

- The plan design with the organization's strategy
- Incentive potential with business goals
 - Aggressive goals support significant variable pay opportunity
 - Goals that represent incremental improvement support less of a variable pay opportunity
- Incentive performance metrics with the desired organizational culture

Incentive Plan Best Practices – Performance Metrics

- Reward incremental improvement in performance against each goal



- Performance improvement against a performance metric is materially better for the organization
 - Examples:
 - An increase in ROA is positive for the association
 - An increase in Credit Quality from 96% to 97% may not bring additional value to the association

Incentive Best Practices – Organizational Performance Metrics



Each performance metric accounts for at least 5% of base salary



Performance against organizational performance metrics results in maximum payout achieved 20% to 30% of the time

Target performance levels (generally aligned with the business plan) almost always achieved



Organizational performance metrics are:

Visible

Understandable

A measure every employee can impact directly or indirectly

Incentive Plan Best Practices – Organizational Performance Metrics

- 3-5 organizational performance metrics
- Association performance goals address:

Growth

- ADB
- Avg. Accrual Loan Volume

Capital

- Permanent Capital Ratio
- Adverse Assets to Risk Funds Ratio
- Total Regulatory Capital

Profitability

- ROE
- ROA
- Net Operating Rate
- Efficiency Ratio

Asset Quality

- Adversely Classified Asset Ratio
- Nonaccrual Loans to Total Loans
- Acceptable OAEM
- Credit Quality

Incentive Plan Best Practices – On/Off Switches

- Switches define the minimum level of performance below which no incentive is warranted or paid



Incentive Market Practices

- 3 Levels of Performance Defined

Level of Incentive Opportunity	Definition	Market Practice
Threshold	<p>The lowest non-zero payment allowable under the plan</p> <p>The lowest performance deemed worthy of an incentive</p>	<p>Generally expected to be met or exceeded 9 years out of 10</p> <p>Most common payout level for threshold performance is 50% of target</p>
Target	<p>Paid for typical, expected performance, often “budget” or “plan”</p> <p>On average and over time, companies tend to pay out near target</p>	<p>Target incentives range from about 10% of salary at the lowest levels up to 150% of salary or more for the CEO.</p>
Maximum	<p>Paid for outstanding performance</p> <p>Generally expected to be met or exceeded 1 to 2 times out of 10</p>	<p>Typically set at 200% of target</p> <p>Companies with more predictable earnings may have less leverage in their payout structures, e.g. having a 150% maximum</p>

Emerging Trends Nationally

- Incorporating elements of discretion and adaptability to address the volatility of the business landscape
- Adding metrics related to customer satisfaction, employee engagement, sustainability and corporate social responsibility
- Focus on Diversity, Equity and Inclusion with specific objectives tied to executive compensation
- Incorporating mechanisms to adjust goals within the performance cycle
- Transparency and communication with all stakeholders
- Leveraging technology to track performance metrics in real-time, provide predictive insights and ensure more objective and data driven decision making

Emerging Trends – Farm Credit

- Reviewing and updating incentive plan design and/or metrics
- Reducing incentives for entry level non-exempt roles
 - Moving compensation into base salary
- New/improved technology providing enhanced tracking and reporting of metrics, often at the individual level



Assessing your Incentive Plans

- Map alignment to organizational goals



Assessing your Incentive Plans

- Map alignment to organizational goals



Assessing Your Incentive Plans

- What is the goal of the incentive plan?
 - A single incentive plan can typically effectively meet no more than three goals
 - Typical goal(s) of an incentive plan
 - *Reward employees for organizational success*
 - *Encourage employees to achieve specific organizational goals*
 - *Reward team performance*
 - *Reward individual performance*
 - *Encourage retention*
 - *Contribute to market competitive compensation at a desired level of organizational performance*



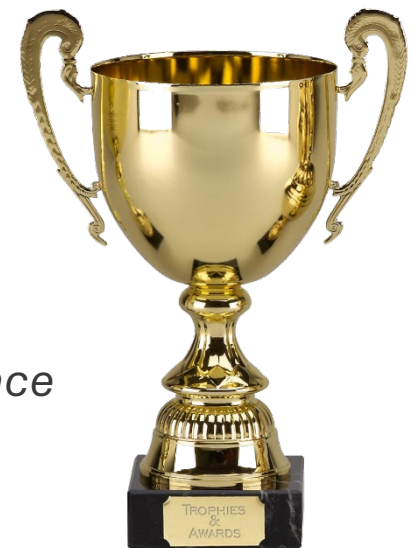
Assessing Your Incentive Plans

- Assess the extent to which the plan is achieving the goals
- If the goal is to:
 - *Reward employees for organizational success*
 - Do incentives vary in amount as organizational performance varies year to year?
 - Do employees understand the link between organizational success and incentives?
 - *Encourage employees to achieve specific organizational goals*
 - Do employees understand the goals and what it will take to accomplish them?
 - Do employees know what they, individually, can do to positively impact the goals?
 - Are the goals clearly communicated at the beginning of the incentive period and is progress toward the goals communicated on a regular basis?



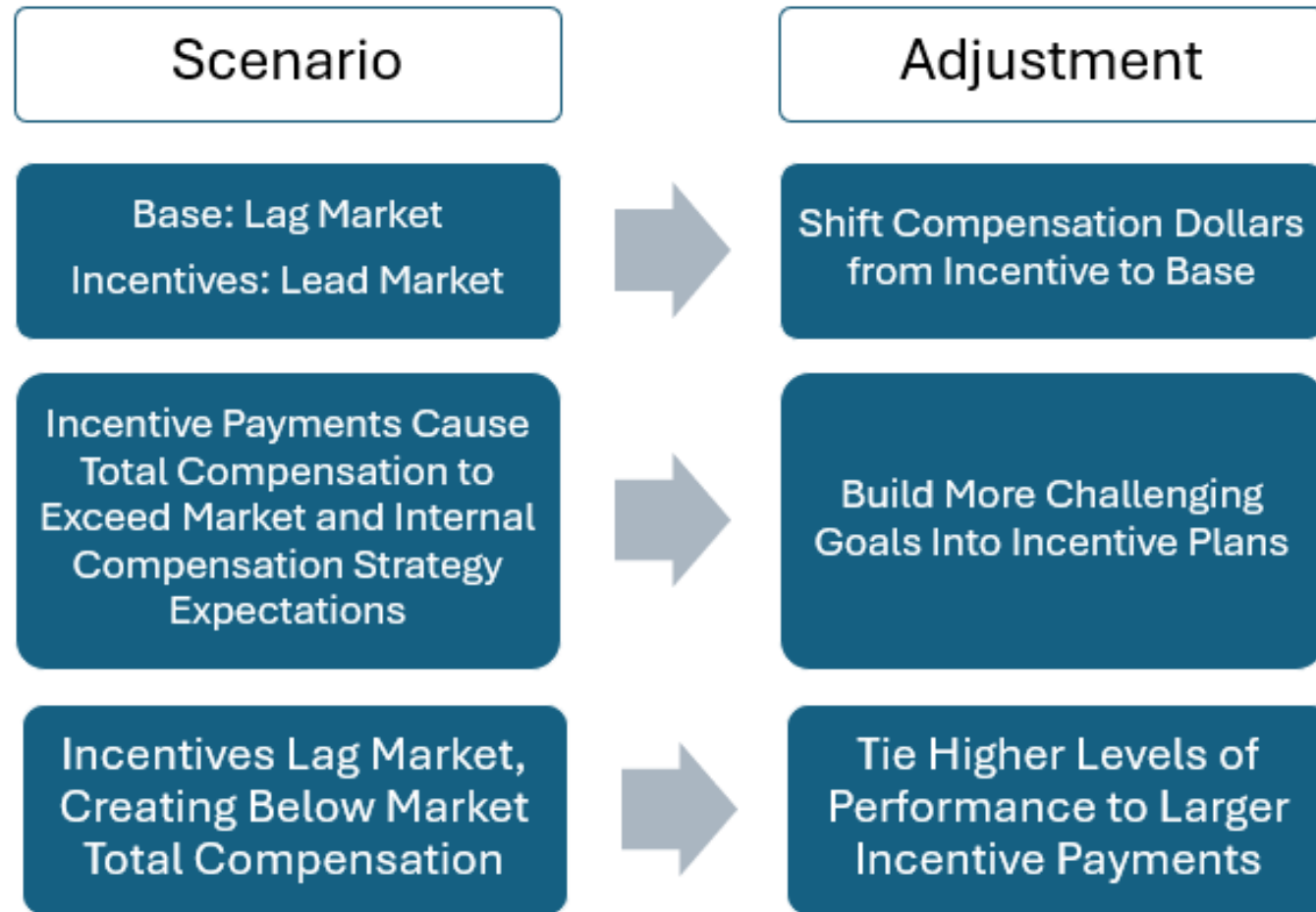
Assessing Your Incentive Plans

- Assess the extent to which the plan is achieving the goals
- If the goal is to:
 - *Reward team performance*
 - Is the team clearly defined?
 - Do all team members have the ability to impact the goals?
 - *Reward individual performance*
 - Is the organization skilled at measuring individual performance?
 - Do incentives vary meaningfully between high and average performers?
 - *Encourage retention*
 - Does turnover increase following payment of incentives?
 - Do exit interviews indicate the incentive delayed the decision to leave the organization?
 - *Contribute to market competitive compensation at a desired level of organizational performance*
 - Is compensation market competitive when organizational goals are met?
 - Is the incentive viewed as a positive component of compensation by employees?



Assessing Your Incentive Plan

- Understanding the relationship to the market



Assessing Your Incentive Plan

- Are there unintended consequences of the plan?
 - Do team incentives allow low performers to free-load off of high performers?
 - Do individual incentives reduce collaboration between team members?
 - Are corporate performance goals set so low they are seen as a given and don't inspire higher levels of performance?
 - Are corporate performance goals set so high they are unrealistic and act as a disincentive?

Wrap Up

- Incentives are changing
- Best practice to complete a comprehensive review of incentive plans every 5 years
 - Utilize data to tell the story of how the incentive plan is performing and identify opportunities for improvement
- Ensure your incentive plan is achieving its goal



Questions and Discussion

