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INCENTIVE COMPENSATION MANAGEMENT CHALLENGES & TECHNOLOGY: CONSIDERATIONS FOR THE FINANCIAL SERVICES INDUSTRY

PART 1: STRATEGY, REPORTING & ANALYTICS

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The fiduciary and risk requirements inherent in managing a customer's money provide unique challenges for the financial services industry. Coupled with the highly-regulated nature of the business climate in these markets, the responsibility for providing incentive compensation to support business objectives and growth is daunting. However, one overriding factor that impacts all areas of incentive design and management is transparency. In considering all the factors necessary to ensure that the program is aligned to the business objectives and delivers the required behaviors and results, visibility and measurement are paramount.

We have identified a great number of challenges intrinsic to incentive compensation in the financial services industry. Because of the number and scope of challenges, we have divided this report into two papers that we believe will provide you with value from both a management and administration perspective.

Both papers are organized to provide readers with insights on how Incentive Compensation Management (ICM) solutions (referring specifically to the technologies) can help resolve common challenges, faced by the financial services industry, regarding managing and paying incentives. Parts 1 and 2 of this paper offer important considerations to ensure a good fit when evaluating ICM solutions. You'll find these considerations highlighted in call-out boxes, titled *ICM Technology Alignment & Considerations*, for each of the challenges presented in these two papers.

In this paper, we'll address five strategic and analytical-related challenges, along with the accompanying considerations for securing a substantial return on an ICM solution investment. The five challenges are:

1 | Creating/Modifying Plans & Quotas

2 | Plan Design Performance Analysis

3 | Forecasting & Budgeting

4 | Payee & Manager Reporting

5 | Incentive Compensation Plan Governance (Conduct Risk)

CHALLENGE 1 | CREATING/MODIFYING PLANS & QUOTAS

The volume of different incentive compensation plan designs across a bank necessitates some form of programmed plan design capability. While this activity typically must be done annually for the beginning of the fiscal year, many banks struggle with manual or cumbersome processes to design and roll out plans sometimes two to three months after the plan year has started. This reduces the overall performance of the program and lessens the potential for goal achievement as there is no focus or influence on behavior during this period.

Also, it is sometimes necessary to address situations where plans need modifications during the plan year. This may require adjustments to targets and quotas, the ability to put a guarantee into the system or a draw to maintain employee cash flows during an unstable or uncertain period. Or it may require the introduction of strategic initiatives to position the advisor and the bank to address opportunities that will surface once the situation improves. These types of modifications are tough to effectively complete in a mainframe or Microsoft Excel program environment due to their rigidity.

ICM Technology Alignment & Considerations:

ICM structures allow management to efficiently evaluate the revenue implications and impact on pay and cash flow from difficult conditions whether on a temporary or permanent basis. Banks can also encounter challenges in adjusting and/or moving quotas for payees on an ongoing basis.

Effective ICM systems enable banks to create and modify both simple and complex plan designs that include commissions, bonuses, multiple measures, modifiers, and a variety of payout frequencies. These applications, once implemented, can facilitate the process from design development through costing and testing, modeling, online approvals, communication, production of plan documents, and finally, participant sign-off on plan and targets.

ICM automation is the essential ingredient in harnessing this efficiency. It allows for the movement of quotas from one person to another due to territory or incumbent changes. The comprehensive tracking includes the effective date of the change and complying with the fiduciary requirement for online workflows and approvals. These prove to be valuable features of ICM software applications. To help evaluate various solutions, creating a "day in the life" set of scenarios that mock current processes will provide an understanding of how well a solution supports your program/process needs.

CHALLENGE 2 | PLAN DESIGN PERFORMANCE ANALYSIS

Banks often find it difficult to assess the effectiveness of their plan designs and programs to understand if they are driving the correct behaviors. To accomplish the required analysis of year-over-year plan performance, access to historical data is a necessity for comparison purposes and baseline benchmarks. It is virtually impossible to manually appraise overall program efficiency without some form of performance automation and archiving of plans and payouts for the various roles, as well as the audit programming to conduct the evaluation.

ICM Technology Alignment & Considerations:

ICM solutions can provide analysis across several different plan metrics, ensuring stakeholders have access to data that supports decision-making on a real-time or as-required basis. Being able to see this information on a monthly or quarterly basis will also help identify performance issues or opportunities and mitigate risks.

For larger plan design efforts (e.g. redesigning incentive compensation plans for the new year), systems are created to provide and organize pay-for-performance data that facilitates a plan design assessment, ensuring quantitative data is available so that plan modifications are made leveraging relevant data.

Banking has a diversity of customer-facing roles that influence financial and investment decisions. The variety of roles often complicates or creates bottlenecks for incentive compensation management. In many organizations, the reporting and feedback on performance occur weeks or even months after the performance period has closed. This fact negates its usefulness for coaching and mentoring since by the time it is received, everyone has moved on to the next performance period and forgotten the last.

ICM Technology Alignment & Considerations:

One primary function of ICM applications is delivering real-time assessment of plan participants' performance relative to their targets. Dashboards and reporting capabilities provide participants and managers with critical feedback on areas for improvement as well as outstanding performance that needs to be recognized.

ICM systems archive historical performance and incentive payout data that is integral to analyzing individual and group performance. Only through the implementation of an ICM application can banks conduct the analytics necessary to validate if incentive compensation plans are in alignment with organizational strategy and business goals and delivering the desired results. Performance analysis requires an agile application that is responsive to change and can incorporate the performance metrics, focus, and return-on-investment capability. ICM reporting capabilities are commonly tagged as a high priority for organizations as related to automation. As such, when evaluating ICM applications, it is necessary to document future state needs for this process and request that solution providers showcase how these workflows/processes are managed in a production environment.

CHALLENGE 3 | FORECASTING & BUDGETING

While ICM is generally regarded as a compensation system for calculating and payout of incentives, it addresses much more in response to business needs and plan execution. It is not just a calculator. The data within the ICM application provides the basis for several areas of business focus that confound banks and other financial institutions.

Incentive compensation expenses, forecasting, and budgeting is an annual exercise that consumes a tremendous amount of time and resources to complete. Analysts from several business and finance areas contribute data that then must be consolidated into reports that management uses to set plans and targets for the coming year. All the data that is used to create these forecasts and budgets typically resides in an ICM system, including the historical information for conducting trend analyses and modeling individual and team performance and payouts. Banks have fiduciary responsibilities to stakeholders and investors and thus need to ensure they are not setting themselves up for issues down the road.

Before incentive compensation plans are rolled out to the field, they must be put through a financial "costing" analysis to test different business outcome scenarios and understand their impact on the organization and plan participants. In one financial services client situation, the proposed plan design and targets revealed a flaw in the payouts during testing that would have rendered one area of their business unprofitable before the end of the year and still paid out large incentives to advisors. Modeling and forecasting different pay scenarios to anticipate outcomes and conducting an assessment of risk issues are absolute necessities before plan rollout. Further, the ability for ongoing evaluation of actuals against forecasts throughout the year (to assess performance versus expectations) means that management has visibility and control to respond to risks rather than react when it may already be too late.

When banks set priorities, one of the consistent refrains is the need for "New-to-Bank" (NTB) or net new revenue. The incentive compensation plan must segregate how incentive compensation addresses this revenue from transactions and payouts that simply move money around their portfolio or other department but do not increase the assets under management. Although this is particularly important, banks often have challenges with tagging and tracking these types of transactions. Most banks are challenged with differentiating these transactions for compensation purposes. They see the transaction but struggle to track them within a spreadsheet. When the volumes increase, this becomes a bigger issue.

ICM Technology Alignment & Considerations:

ICM solutions provide a centralized system to connect all the needed variables for forecasting. They provide an environment for administrators to configure extrapolations of actual data for forecasting full-period results from partial-period performance and to load forecast data to provide insight into possible future incentive spend amounts, within any defined calendar period, for accurate results.

During uncertain times, banks need the agility to model out strategic scenarios for their ICM programs. When a program changes, an ICM solution provides the modeling capabilities to explore how a new component or entirely new plan may affect forecasting and budgeting scenarios. After plan modifications are made, tested, and analyzed, the work completed post-approval can move into the production environment for "go live".

CHALLENGE 4 | PAYEE & MANAGER REPORTING

As outlined above in the Forecasting & Budgeting section, the availability of all transactions in the ICM application provides invaluable data for management to evaluate performance, profitability, and return on investment for the compensation spend.

Organizations using spreadsheets to manage incentive compensation programs struggle with providing payee compensation statements showing what they sold and how they earned. Further, spreadsheets do little to inform them as to how incentives were calculated and what activities were credited to the payout calculation. The "real-time" aspect of the ICM system enables payees to log in to their personal dashboards to look at year-to-date versus annual targets, identify activity by product, review payouts and credited transactions, and see what they need to do to achieve their expected payout.

Without an automated application to provide this kind of reporting, it is hard to develop trust among payees. Insufficient or unreliable reporting often leads to shadow accounting, the practice of creating and maintaining a separate reporting system to validate the accuracy of incentive payouts. Conversely, accurate and reliable reporting builds trust among payees and gives them confidence that they are being treated fairly, allowing them to focus on their performance instead of wasting time on shadow accounting.

ICM Technology Alignment & Considerations:

The reporting capability is the crown jewel of the value that ICM systems bring to banks. ICM delivers a multitude of valuable reports for management. From a compensation standpoint, many banks find it difficult to roll up the performance figures from the field to higher levels of the organization to hold management accountable for their targets and payouts without a lot of time and effort spent consolidating the data and performing calculations. ICM solutions, through the internal setup of reporting relationships, can perform roll-ups in real-time and calculate management payouts with the same speed and ease as it does with payees to all levels of the organization.

In addition to facilitating compensation reports, the ICM system enables management to run reports showing activity by product, territory, and payee (or rolled up to the manager). The reporting capability in ICM systems is only limited by the data collected, the quality of the data, and the completeness of the data. Reports can be run for specific periods or on a year-to-date basis and segmented by division or across the entire organization. The capability to access this data for reporting in real-time makes it invaluable for decision-making and performance improvement.

CHALLENGE 5 | PLAN GOVERNANCE (CONDUCT RISK)

Plan governance is essential in the banking and financial services industry to leave no room for fraud. Inappropriate behaviors occur when there is inadequate oversight of the incentive compensation program and the controls are not in place to restrict the potential for conflict of interest. Unethical behaviors have a devastating impact on the trust and character of an organization. Organizations that were exposed during the 2008 financial collapse are still struggling to recover their reputations a decade later. With ICM systems, the tracking and monitoring of incentive compensation actions are included in the approvals process and transactions logs that identify who executed and approved the actions.

As industry regulations evolve, the organization's commitment to compliance must evolve with it. This necessitates flexibility, good tracking and reporting, and the alignment of processes with the technology to provide evidence of compliance.

ICM Technology Alignment & Considerations:

An ICM solution makes the audit process much easier by incorporating and automating set processes and accountability into the plan design, approvals, and administration. Each ICM solution has a varying degree of auditability, whether its historical reports that identify all objects changed, when and by whom, or a user-friendly research mechanism to trace back a potential discrepancy.

A banking client of OpenSymmetry utilized its ICM solution to support a very involved plan governance process. The incentive compensation plans required approvals from HR, Compliance, Legal, Risk Management, Employee Relations, Finance, Compensation, and the Business Leaders before being presented to the board. To create a more efficient process, the stakeholders were designated as online approvers in the ICM solution, reducing a historically lengthy process to just two days.

SUMMARY

This paper provides insight into issues and challenges unique to the financial services industry. It shows how ICM systems enable organizations to design, manage, administer, report, and oversee the incentive compensation program to deliver superior business results, uncompromising integrity, and a reputable culture.

Incentive compensation is a journey. The future points to new incentive compensation requirements that support qualitative measures of performance like customer engagement (e.g. Net Promoter Scores) and generational differences and expectations that will necessitate different types of compensation plans. Also, demographic changes in our population will make it imperative for companies to retain "key" performers and reward them accordingly. Finally, changes to processes and technology, (e.g. online purchasing, multiple channels), will continue to mandate the utilization of ICM.

If you'd like to learn more about how ICM solutions can help resolve some of the common challenges faced by the financial services industry, we invite you to read **Part 2** of this paper.

For financial services case studies that illustrate ICM solutions in action, we invite you to download the ***Huntington Bank Case Study*** and ***U.S. Bank Case Study.***

To learn more and to talk with an expert, please request a free consultation.

ABOUT opensymmetry

OpenSymmetry is a global consulting company that specializes in the planning, implementation, and optimization of incentive compensation management (ICM) solutions supported by the industry's leading technology suppliers. Since 2004, OpenSymmetry has enabled its customers, ranging in size and industry, to achieve greater operational efficiency and get better business results.