Pearl Meyer

TRENDS & ISSUES

Bank Director Compensation: Consider Adopting These Big Company Practices at Your Bank

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The evolution of pay and governance practices tends to be led by large companies—organizations that are under the watchful eyes of institutional shareholders, proxy advisors, and the media. Smaller organizations have less visibility, fewer constituents, and can afford to take more time evaluating whether or not to adopt emerging pay practices, some of which may take years to be adopted or ultimately rejected due to unwarranted complexity, cost, or irrelevance. But certain current pay and governance trends are worth considering right away, regardless of company size.

Pearl Meyer recently completed its annual Director Compensation Report analyzing director pay practices for 1,400 public companies. We have identified three practices that are nearly universal among the largest 200 companies in the S&P 500 (we'll call them the Top 200) that we believe transcend company size and deserve consideration at banks, both large and small:

"Certain current pay and governance trends are worth considering right away, regardless of company size."

- The shift toward retainer-based pay;
- Delivery of over half of pay for board service in stock; and
- The adoption of stock ownership guidelines.

Shift from Attendance-Based to Retainer-Based Pay

The largest companies generally have the most complex compensation structures. But on rare occasions, they actually lead the way toward greater simplicity in pay practices. One example is the shift from a retainer plus meeting fees structure to a retainer-only approach. This simplification of director pay has been an increasing trend among large public companies for a decade. Today, fewer than one in five Top 200 companies now pay meeting fees for board service, while roughly 40 percent of companies with revenues of $50 to $500 million (so-called micro companies) continue this practice.

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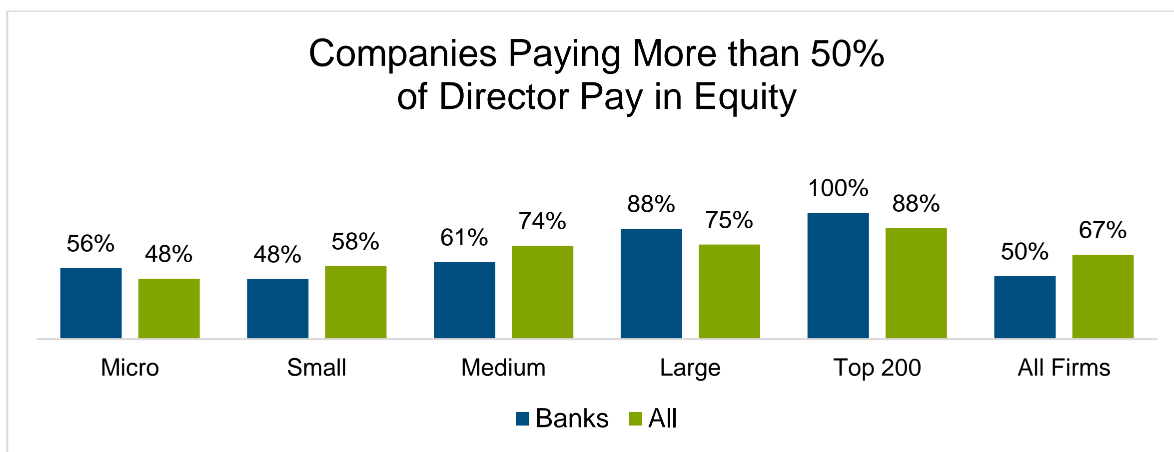
The most compelling argument for retainer-based compensation is the investor expectation that a director's full commitment to attend all meetings should be a given. A retainer structure emphasizes that directors are compensated for the skills and experience they bring to the position, an expectation just as relevant for small companies as the Top 200. A side benefit of this approach is its greater simplicity, something community banks may find attractive.

Increase in Equity Pay

A long-promoted principle of the National Association of Corporate Directors (NACD) is to align director compensation with the interests of the shareholders they represent, in part by delivering at least half of director pay in the form of stock. Two-thirds of all companies studied, and nearly 90 percent of the Top 200 companies, comply with this guideline. Practices among banks in the study were similar to the general industry. The prevalence of companies meeting this threshold generally increases with the size of the organization.



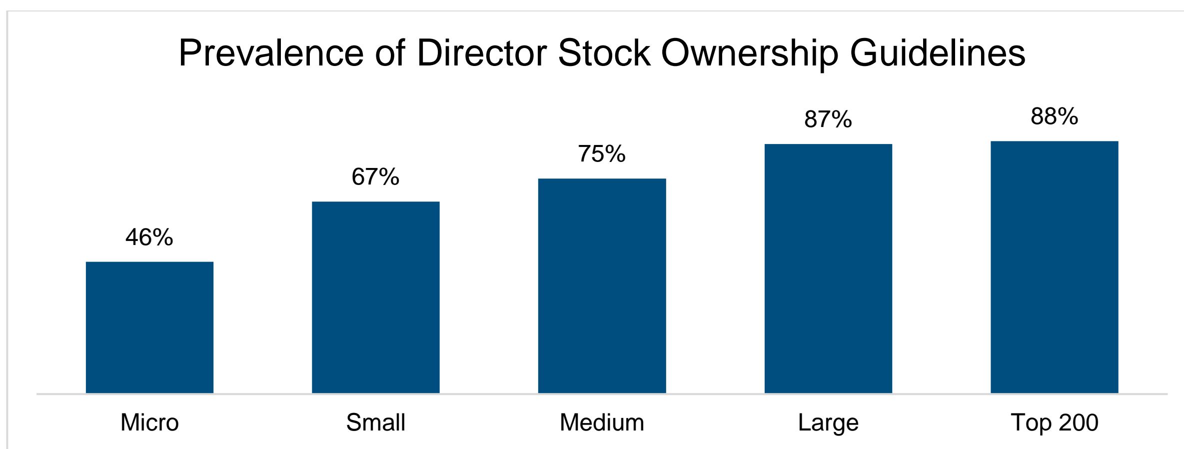
With certain exceptions (mutual organizations, family-owned, closely-held, etc.), the rationale for paying at least half of director compensation in equity is no less compelling for community banks than for large corporations:

- Directors at community banks are equally responsible for representing their shareholders;
- The governance practice of aligning director pay with the long-term interests of shareholders is universal; and
- Stock-based compensation is more capital-friendly than cash, which may add special appeal for banking organizations.

Community bank boards may include a diverse group of directors and demographics, and cash-focused director pay may at times be more appropriate. However, the benefits of a greater mix of equity-based compensation may be appropriate for your organization.

Director Stock Ownership and Retention

Larger companies have almost universally adopted stock ownership guidelines requiring directors to accumulate or retain shares received over a defined period of time. The rationale is consistent with the purpose of stock-based pay—greater alignment with the long-term interests of shareholders. This is a reasonable objective for stock companies, regardless of industry or size.



While ownership requirements vary from company to company, they are typically attainable through retention of shares received under the compensation program. A common structure might require ownership equal to a multiple of the annual cash retainer (for example, three to five times the retainer), with retention of at least 50 percent of shares until an ownership level requirement is met. For community banks looking to score points within the governance community, adopting modest, achievable stock ownership guidelines can be a relatively easy win.

Community banks aren't known to be early adopters of pay trends, and that's a good thing much of the time. But the three director compensation trends discussed above have been tested and refined at large companies for many years and they have direct and immediate applications to smaller organizations. Consider exploring the merits of these big company director compensation practices for your bank in 2016.

About the Author

Greg Swanson is a Managing Director with Pearl Meyer's San Francisco office and a member of the firm's national banking practice. He has more than 20 years' experience consulting with public and private companies on all aspects of executive and board compensation, including governance, education, compliance, communication, philosophy, design, implementation, monitoring, modeling, benchmarking, succession planning, employment agreements, and more.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.

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