The board dynamics of U.S. community banks are very distinct. Board membership can vary from business executives to community leaders to representatives of institutional or private equity investors. In addition to varied board membership, the business models of community banks can range from very traditional to cutting edge and innovative. As a result, the roles of directors, and their responsibilities and time commitments also differ substantially—relative to both fellow directors on the board on which they serve, as well as directors on other bank boards.

Just like executive compensation design, director compensation should consider the unique composition and responsibilities of the specific board. However, as with executive compensation design, organizations need to be cognizant of market practices and design principles advocated by governance leaders.

Principles of Director Compensation

The National Association of Corporate Director’s Report of the NACD Blue Ribbon Commission on Director Compensation identified five guiding principles that should govern director compensation programs:

1. Be established by the board and disclosed to shareholders;
2. Align with the long-term interest of shareholders;
3. Motivate director behavior;
4. Compensate directors adequately for their time and effort;
5. Approach on an overall basis, with an array of separate elements.

According to the recent Pearl Meyer Banking Industry Survey on Board Compensation and Governance Practices, these principles are largely endorsed in the structure of director compensation we find among public bank boards.
West Coast Bank Director Compensation

- Although variation occurs based on overall director involvement, director compensation level is highly correlated with organization size (e.g., assets). Generally, the larger, more scrutinized organizations adopt compensation design that is more typical of broader corporate director compensation trends, such as:
  - Fixed cash retainers in lieu of meeting fees, which supports the expectation that directors will attend all meetings; and
  - The issuance of a meaningful portion of compensation in stock, combined with a requirement that directors retain shares granted, or that they personally own a specified number of shares, to align directors with shareholders.

As the chart above illustrates, 50th percentile director compensation levels among west coast banks is correlated with bank size, while the structure of compensation (i.e., use of meeting fees and equity) varies between smaller banks with assets less than $1 billion and larger banks with assets greater than $1 billion.

More than 80 percent of banks with assets greater than $1 billion issue equity to directors, mostly denominated as restricted stock. Among smaller banking organizations, the use of equity is less prevalent at 45 percent, with minimal preference between the granting of stock options and restricted stock.

Establishing Director Compensation Levels

Most banks establish “normal” director compensation programs by reviewing and comparing baseline market levels of compensation and time commitments. Occasionally, directors take on significant additional responsibilities, such as M&A activity or hiring a new CEO, that warrant additional compensation. Some approaches to adjusting compensation levels to reflect additional efforts include:

- Short-term stipends (e.g., monthly retainer) for a specified period of time sufficient to complete a specific activity;
- Addition of meeting fees if board or committee meetings exceed the baseline; and/or
- One-time equity award with vesting tied to the completion of a specific activity.

In Summary

A guiding principle of director compensation is to ensure your directors are adequately compensated for their time and efforts. The compensation program should be tailored to the uniqueness of your bank and board dynamics, while being consistent with shareholder expectations.

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