Pearl Meyer

TRENDS & ISSUES

Greater Scrutiny Surrounding Director Compensation

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Annual total compensation increases for directors have generally stabilized at the 3–4% range over the past several years. However, director compensation is likely to be subject to greater scrutiny going forward, since certain shareholder advisors recently indicated that they will be monitoring it and ultimately may issue adverse vote recommendations for board members at companies exhibiting a "pattern of excessive director compensation."

There are a variety of reasons why director compensation levels at an individual company may be higher than those of its peers or the broader marketplace:

- Equity compensation is delivered as a fixed number of shares; while the vast majority of companies denominate annual equity grants as a fixed dollar value, roughly 18% use a fixed number of shares approach. This can result in outsized compensation levels over time as the company's stock price increases.
- Recently public companies (IPOs) often continue their legacy practices for a time after going public, including fixed option/share grants to directors. This may lead to high compensation levels relative to other companies of similar revenue size.
- Technology companies have historically used stock options as their primary equity vehicle, often using a fixed number of options approach for grants to directors.
- Special circumstances, companies undergoing significant transitions, a CEO transition/search, significant acquisitions/divestitures, exploring strategic alternatives, or dealing with activist investors/proxy contests often lead to the formation of special committees and/or result in significantly more board meetings (and potentially additional meeting fees), boosting pay on a temporary basis.

June 2018

To avoid inadvertently showing up on shareholder advisors' radar, or worse yet receiving an adverse vote recommendation, consider taking the following actions:

- Conduct a review of director total remuneration relative to your company's peers/comparator group. Knowing whether you have a problem or your compensation levels stand out is the first step toward either mitigating the issue or being prepared to defend it.
- Ensure your program complies with NACD's "best practice" of delivering at least 50% of annual compensation in the form of equity.
- If you use a fixed share approach to annual equity grants, protect against "excessive" pay due to a stock price run-up by adding a dollar-value "cap" to the annual grant.
- Adopt market-level ownership guidelines for directors (and senior executives) to ensure long-term alignment with shareholder interests.
- Review any special committee pay structures to ensure they are reasonable relative to general board service and anticipated time requirements. Paying per-meeting fees can add up quickly; consider limits.

Finally, be sure you get a return on this investment of time and effort by disclosing details of the review process, results, and rationale or actions taken in the proxy—tell your story before others tell it for you!

About the Author

Mike Esser is a managing director with Pearl Meyer in the Los Angeles office. Mr. Esser has more than 25 years' experience as an advisor to boards and senior management in executive and board compensation, compensation strategy, and annual and long-term incentive/equity plan design. His consulting experience covers a variety of industries and company organizational and developmental stages, including startup/pre-IPO, privately-held, public, cooperatives, and non-profit organizations.

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, and Los Angeles.

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