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Managing the Current Environment Surrounding Non-Employee Director Pay

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PRINCIPAL

The following is based on a conversation with Lianne Richardson, principal in Pearl Meyer's New York office. She works regularly with boards on non-employee director (NED) compensation issues and shares her views on NED pay.

Q. Given the current environment and more scrutiny around NED pay, such as ISS' spotlight on the reasonableness of director pay and shareholder litigation, what advice would you give a compensation committee that has not raised director pay in several years and is due to consider it in 2019 or 2020?

A: There will be heightened importance of market benchmarking and disclosures for director pay moving forward. So, director compensation should be carefully benchmarked and assessed relative to survey and/or proxy peer group data to ensure the committee at least understands relevant market practices and pay levels. It is important to note that while external scrutiny has been increasing, so too have director time commitments, responsibilities, and corresponding market values, and NED pay should be set at competitive (and reasonable) levels to recognize this. ISS' new policy is intended to flag extreme high pay outliers without adequate justification, which presumably won't impact companies providing market-competitive pay.

With that said, and I can't emphasize this enough, whether the company modifies or maintains the same director pay program from year to year, disclosure of the rationale for all director payments, including benchmarking, will become a critical element for proxies moving forward. For example, if the company decides to implement an at-election grant, make sure to explain it because it could pop the director's compensation in the first year to relatively high compensation numbers.

Q. That is good advice, but what about from a shareholder litigation standpoint?

A: Well, if the company has not done so already, the compensation committee should consider shareholder approved limits on director equity and cash to reduce shareholder litigation risk. Amendments to equity plans can usually be made to include limits on director compensation and should be approved by shareholders. And while cash limits are not required, they could provide additional protection. Finally, limits should be meaningful and specific, for example, make sure to address if the limit includes cash and equity and if the limit on equity is determined with respect to number of shares, dollar amount, or grant date fair value. Limits should also be flexible enough to allow for future pay increases so the program can remain market competitive.

About the Author

Lianne Richardson a principal at Pearl Meyer, joined the firm in 2002. With over 15 years of experience, Lianne specializes in providing compensation consulting services to public and privately-held clients, including compensation market benchmarking, proxy analysis, incentive plan design, executive compensation strategy and philosophy development, and non-employee director compensation. She has worked with clients in the manufacturing, energy/utility, aerospace/defense, hospitality, insurance, banking, medical device, and healthcare sectors.

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