

Maximizing a Director's Ability to Enhance Stock Holdings



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MANAGING DIRECTOR

One of the enduring objectives for any [director compensation program](#) is to align the interests of those on the board with stockholders. This is commonly facilitated by compensating directors in part through stock-based awards. It is further supported by stock ownership requirements mandating that directors hold a certain amount of stock in the company over a period of time. We often hear directors request ways to further facilitate owning stock in the companies that they govern, but many companies do not have additional tools to do this outside of simple open-market purchases during open trading windows. Fortunately, there are other mechanisms available to provide directors a means to increase their stock holdings in the company, and further their alignment with stockholders.

There are two primary ways that this can be accomplished. First, a company can institute a provision in the director compensation program that allows directors to take their annual cash compensation in the form of stock or stock-based awards. This is a simple, effective method that can be designed in a number of ways. Directors can simply make elections in advance of the plan year during an open trading window, indicating they would like their cash fees in stock (or some other stock-based compensation instrument).

Similarly, companies can develop or amend their non-qualified deferred compensation program to allow directors to elect to defer their cash compensation into a deferred stock unit (DSU), which is effectively a promise by the company to pay a share of stock at some point in the future. This alternative is also relatively simple and effective, although it may not have as many design options as the previous alternative. Nonetheless, it allows directors to defer their cash into a company stock derivative, and defer the taxation of the compensation until the award is settled. Our experience is that the awards are typically settled post separation from the board, which allows the compensation to grow in a tax-deferred manner.

Within either of these alternatives, there are several design choices that will need to be made, such as:

1. Which cash compensation will be eligible?
2. In what types of stock-based awards can the cash be taken?
3. How will the awards be earned and settled?
4. When will the awards be made?

While these types of programs are observed in the market, many companies do not currently offer these choices, or may offer them in a more limited fashion than what is possible. Considering different approaches and various design alternatives allows companies to put a program in place that works in the best interests of directors within the goal of increasing stock holdings.

We do advise any company considering such alternatives to seek professional legal and tax advice on how to implement the program.

About the Author

Terry Newth is a managing director at Pearl Meyer. He consults on the design, development, and assessment of executive compensation programs that support each organization's business objectives, long term business strategy, and organizational culture. His clients range from Fortune 500 organizations to pre-IPOs to private and family-owned companies in a wide range of industries. Terry's areas of expertise include pay strategy and philosophy development, market-based pay studies, incentive plan design, severance and CIC arrangements, outside director pay, transaction-related compensation, CD&A and supporting table disclosures, corporate governance, and share plan authorizations.

About Pearl Meyer

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