Pearl Meyer

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Maximizing a Director's Ability to Enhance Stock Holdings

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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 leads the Life Sciences practice and advises companies from venture-backed to multinational on executive compensation strategy, incentive design, governance/disclosure, and transaction-related arrangements.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.