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Director Pay

During the past decade, we have witnessed both a dramatic increase in the demands placed on directors of public companies and the scrutiny of boards' actions. While the fundamental model of a director's fiduciary duties under state law has remained mostly stable, in other precincts – including the Securities and Exchange Commission and other regulators, ISS, institutional investors, politicians and the public – expectations about directors' involvement and influence over a corporation have increased significantly.

An engaged, skilled and thoughtful board of directors adds immense value to a corporation. It is more difficult than ever to recruit and retain directors who meet the requirements – including the increased legal and regulatory requirements imposed within the past ten years – for experience, expertise, diversity, independence, leadership, collegiality and character. Competition for the best candidates is intense, particularly in view of the fact that the ideal director candidate is often a successful, independent and prominent person who does not need the exposure to the obligations that public company directorship entails.

Director pay has historically been limited by the view of the director as holding an independent trust and, once upon a time, the relatively limited time commitment that board service was thought to entail. More recently, boards have generally been wary of increasing their own pay in light of the downturn in the economy and public perception. The result is that levels of director compensation have not kept pace with the realities of the current marketplace. While directors are not employees and compensation is not the main motivating factor for public company directors, given the importance of board composition and the competition for the best candidates, it is important to evaluate whether these programs are appropriate to the company's needs. Accordingly, as boards go through their self-evaluations, it is worthwhile to evaluate whether director compensation programs need adjustment consistent with the increased demands of board service, and whether they are adequate to secure top notch directors.

Companies should give careful thought to the mix between individual meeting fees and retainers. Business and regulatory demands have deepened director involvement and technology has changed the way directors meet. In view of this, there has been a de-emphasis of per-meeting fees and a concomitant increase in retainers. This simplifies director pay and avoids issues that arise from electronic forms of communication and frequent, short telephonic meetings. As companies move away from per-meeting fees to retainer structures, they should consider whether additional retainer pay is appropriate for directors serving on committees that impose substantial extra demands. It is also appropriate to consider the level of time commitment required outside of meetings, including for members of audit and compensation committees who must frequently review substantial written material to be properly prepared for their meetings.

The increased responsibility imposed on directors generally is especially pronounced for non-executive board chairs, lead directors and committee chairs. Accordingly, particular attention should be paid to whether these individuals are being fairly compensated for their efforts and contribution. While it is not uncommon for non-executive chairmen to be paid more than other directors generally, almost half of non-executive chairman and lead directors receive no premium for their service in these roles, and the average premium for lead directors is just 15 percent according to a recent survey from the National Association of Corporate Directors. We expect the pay of non-executive board chairs and lead directors to increase significantly as pay practices catch up to the demands of the responsibilities of these positions. Survey data will prove useful in considering appropriate director compensation.

The importance of collegiality to the proper functioning of a board of directors must be kept in mind; director compensation should not promote factionalism on the board. Differences in compensation among directors should be fair and reasonable and reflect real differences in demands placed on particular directors.

Although many companies allocate responsibility for setting director pay to the compensation committee, director pay is different from employee compensation and occupies a position of unique importance to the company. It is a fundamental element of corporate governance. It is also a good idea for director compensation to remain analytically and conceptually distinct from the question of executive pay. Companies should consider whether responsibility for director pay is better delegated to the company's corporate governance and nominating committee. In any case, the decision with respect to director compensation should always be subject to overall board of directors review and approval.

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