

# AGENDA

## Director Comp Makeover Picks up Steam

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The transformation of director pay is reaching a tipping point. More boards are expected to cut meeting fees this year along with director perquisites and option grants. Meanwhile, the double-digit increases in compensation that directors have enjoyed in recent years will likely drop into the single digits this year. That's according to several compensation consultants and compensation committee members.

"We're not seeing a dramatic increase in pay, but we are seeing a steady move toward larger retainers ... and no meeting fees," says **Donald Delves**, president and founder of compensation consultancy **The Delves Group**. "Basically the nature of the job has changed."

In fact, the percentage of S&P 500 companies that offer their board members meeting fees has dropped markedly in the past five years. In 2001, 72% of boards paid their members meeting fees, according to the 2006 Spencer Stuart Board Index. In 2007, that fell to just over half, or 52%, according to the firm's 2007 report. Similarly, in 2002, 77% of companies had a stock option plan in place for directors. That has plummeted to just 42% of companies last year.

Not only has the nature of the job changed, which is forcing changes in director compensation, but new compensation disclosure rules are shining a bright light on executive and director compensation. Director perquisites, for example, now need to be clearly disclosed in an "All Other Compensation" column. That new disclosure, coupled with investor and media sensitivity to perks, has some directors choosing to scrap perks rather than disclose them.

The trend picked up last year and should continue in the New Year, says Michael Melbinger, a partner at Winston & Strawn and head of its compensation practice.

"I think the big move toward eliminating perks was greatly elevated because of the [new] proxy reporting," he says. The SEC's compensation disclosure rules require a listing of how much each director was paid, including, for the first time, a column for "All Other Compensation" which lists all of the perks in excess of \$10,000. Last year, companies such as Krispy Kreme Doughnuts, ProAssurance and Time Warner either reined in or elaborated upon their directors' use of the corporate jet.

"I see perks, particularly for directors, being gone," says Alan Siegel, a compensation committee member with Thor Industries. "If [directors] have to travel to board meetings, that's fine. But... no more country clubs, no more charitable donations. You can't track it, for one. And it's an area of abuse, for two."

Like perks, meeting fees are looking more and more like a relic of a bygone era as a growing number of boards scrap the fee in favor of a flat retainer.

In the past, much of the board's work was done at the time of the meeting. Now, serving as a director has become a year-round job, Delves says. The flat retainer better fits that change because it rewards directors for

the job they do, not the amount of activity on the board, he says. Another reason: The original purpose of meeting fees was to provide directors with an incentive to attend the board meeting.

Today, directors no longer need a financial carrot drawing them to the meeting because there is a stick in the form of groups like ISS Governance Services factoring directors' attendance records into their ratings, Delves says. Also, since Sarbanes-Oxley, committee meetings have spiked, which has made administering director comp more challenging. A retainer is easier to administer.

The size and makeup of director compensation will evolve in the coming year as boards continue a shift away from awarding directors equity in the form of options, instead resorting to time-based restricted stock. Further, a growing number of boards are adding provisions that allow their directors to cash in their restricted stock only after they have stepped down from the board. The intent of such stipulations is often to align the directors' interests with shareholders'.

“I think restricted stock units is a new vehicle that we're likely to see employed more often to strongly encourage and/or require a significant equity stake for the director,” says Charles King, head of the board services practices at Korn/Ferry International. King says that in 2008 he sees boards continuing to try to balance their cash versus equity compensation so it attains a perfect 50-50 equilibrium.

Another trend: The double-digit increases that have occurred each year in director pay since SOX are likely to level off, directors and consultants say. Simply put, the increases in years past were intended to reflect the increased workload. Now that compensation is more closely aligned with the workload, future increases are likely to be in the single digits.

For the largest 200 companies, this is already happening. Last year, median total director comp stood at \$205,759, a 0.4% increase over 2006, according to a joint report from the National Association of Corporate Directors and comp consultancy Pearl Meyer & Partners. In 2006, the growth was 12%, in 2005 it was 10% and in 2004 it was 14%.