

Director Compensation and Board Assessment: Two Tools for Driving Board Excellence

A Compensation Committee Series Webinar

Presented by NACD and Pearl Meyer

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Presenters



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Housekeeping



- Submit a question and receive your answer directly from the presenters, either during today's webinar or as a follow-up. You will also be opted-in to receive future executive compensation thought leadership from Pearl Meyer.
- Presentation slides are available today at www.pearlmeyer.com/driving-board-excellence and within the webinar console.
- The replay will be available early next week at www.nacdonline.org/webinars and www.pearlmeyer.com/driving-board-excellence.

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1. The significant influence of director compensation philosophy and programs; and
2. Structuring and executing a fulsome, formal process for board and committee evaluations.

Compensation Decisions That Can Affect Board Culture

Board Responsibility is Ever-Expanding



- Mix of institutional knowledge, evolving experiences and skills, and fresh insights
- Starting to form new types of committees

~75% of S&P 500 firms have **more than the three committees required** by stock exchange listing standards: 36% have four, 21% have five, and 13% have six

Virtually all S&P 500 firms disclose assignment of **ESG responsibilities** to the **full board and/or one or more committees.**

Board Turnover Can be Useful

How does a board...

- encourage and support a culture of routine refreshment?
- increase more frequent rotation of committee members?
- fairly treat individual directors who will be leaving as the result of a turnover exercise?
- attract non-traditional director candidates?

Board Compensation Can Evolve Too



- Attracting best-in-class nominees in an environment where there is competition for the best director candidates is increasingly difficult.

Market Practices Today are Generally Consistent
• Nearly all public companies (98%) use an annual cash retainer .
• Use of board meeting fees continues to decrease
• Nearly all committee chairs receive additional compensation • Additional pay for committee members is decreasing • Differentiated pay among committees
• The majority of public companies rely on restricted stock vs. options . • Annual grants typically determined as a dollar value • Grants often made at annual meeting date with one-year vesting
• Share ownership guidelines are used by most of the Top 200 • Some companies have holding requirements, limiting a director's ability to sell all or a portion of shares during their tenure.
• NACD standard is >50% of director pay should be equity

Using Compensation as a Tool for Change



If the board wants to:	Consider:
Attract non-traditional directors	<ul style="list-style-type: none">• Offer relatively higher cash compensation• Include initial equity awards• Include annual stipend for director education• Adopt modest share ownership guidelines
Encourage tenured directors to retire	<ul style="list-style-type: none">• Set minimal vesting periods for equity grants• Implement hold-until-retirement requirements for equity
Retain tenured directors with key institutional knowledge	<ul style="list-style-type: none">• Provide share ownership guideline relief for directors who reach either a certain age or years of service
Increase formal and/or more frequent rotation of committee members	<ul style="list-style-type: none">• Eliminate committee member compensation and increase board cash retainer

Communicating the Board's Worth



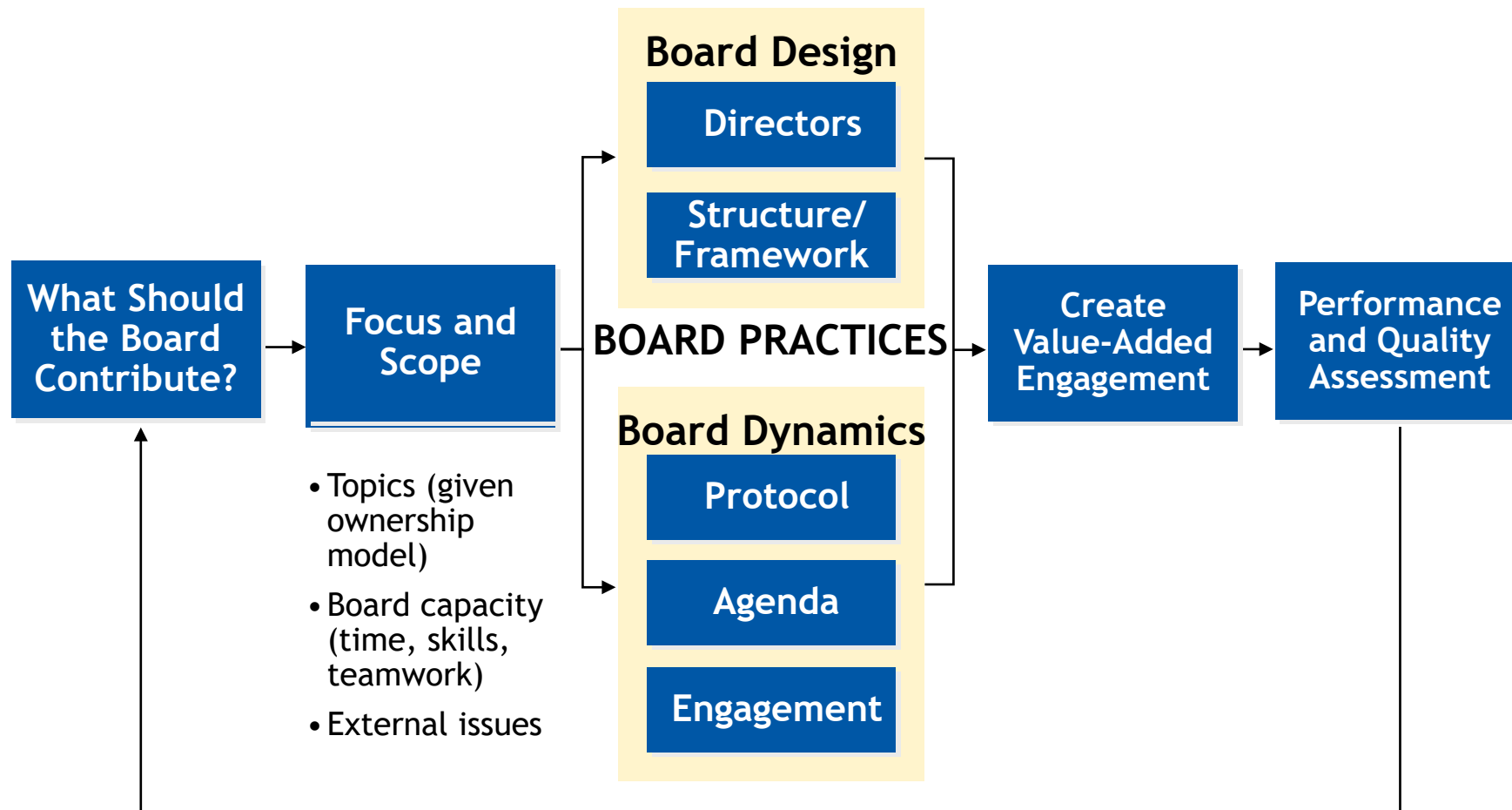
Follow the core guidelines used when disclosing executive compensation in the CD&A

- **Goals:** Outline the philosophy, guiding principles, and objectives that drive the program design
- **Design:** Provide an overview of the pay mix structure; explain why it aligns with shareholder interests and how it supports a positive board culture and optimal refreshment cycles
- **Rationale:** Summarize the guiding feature of the program (i.e., what we do and why, and what we don't do and why)
- **Governance:** Explain how decisions are made

Private Companies, too!

Thoughtful Board Assessments Can Drive Continuous Improvement

Board-Building Framework: Understanding Board Performance



Building Board Capability: What Kind of Board do We Have and Want?



- Functions at discretion of CEO
- Limited activity and participation of board
- Limited accountability
- Ratifying management preferences

- “Certifies” to shareholders that CEO is doing what board expects and management is capable of taking corrective action when needed
- Emphasizes outside/ independent directors; meets independently
- Informed of current performance; designates external board members to evaluate CEO
- Establishes an orderly succession process
- Willing and able to change management to be credible to shareholders

- “Partners” with CEO
- Recognizes boundaries in overseeing CEO and company performance
- Meetings are useful, two-way discussions of key issues/decisions facing the company
- Sufficient director industry and financial expertise adds value to decisions
- Emphasis on defining role and behaviors required of board members

- Typical mode during a “crisis” situation
- Intensely involved in discussions about key decisions
- Frequent and intense meetings, often called on short notice

- Makes key decisions and management implements
- Not uncommon in early “start-ups” Filling gaps in management experience

Poll Questions 1 and 2

- Describe the **current** operating environment of your board at this time:
 - Passive
 - Certifying
 - Engaged
 - Intervening
 - Operating
- Describe the **ideal** operating environment of your board:
 - Passive
 - Certifying
 - Engaged
 - Intervening
 - Operating

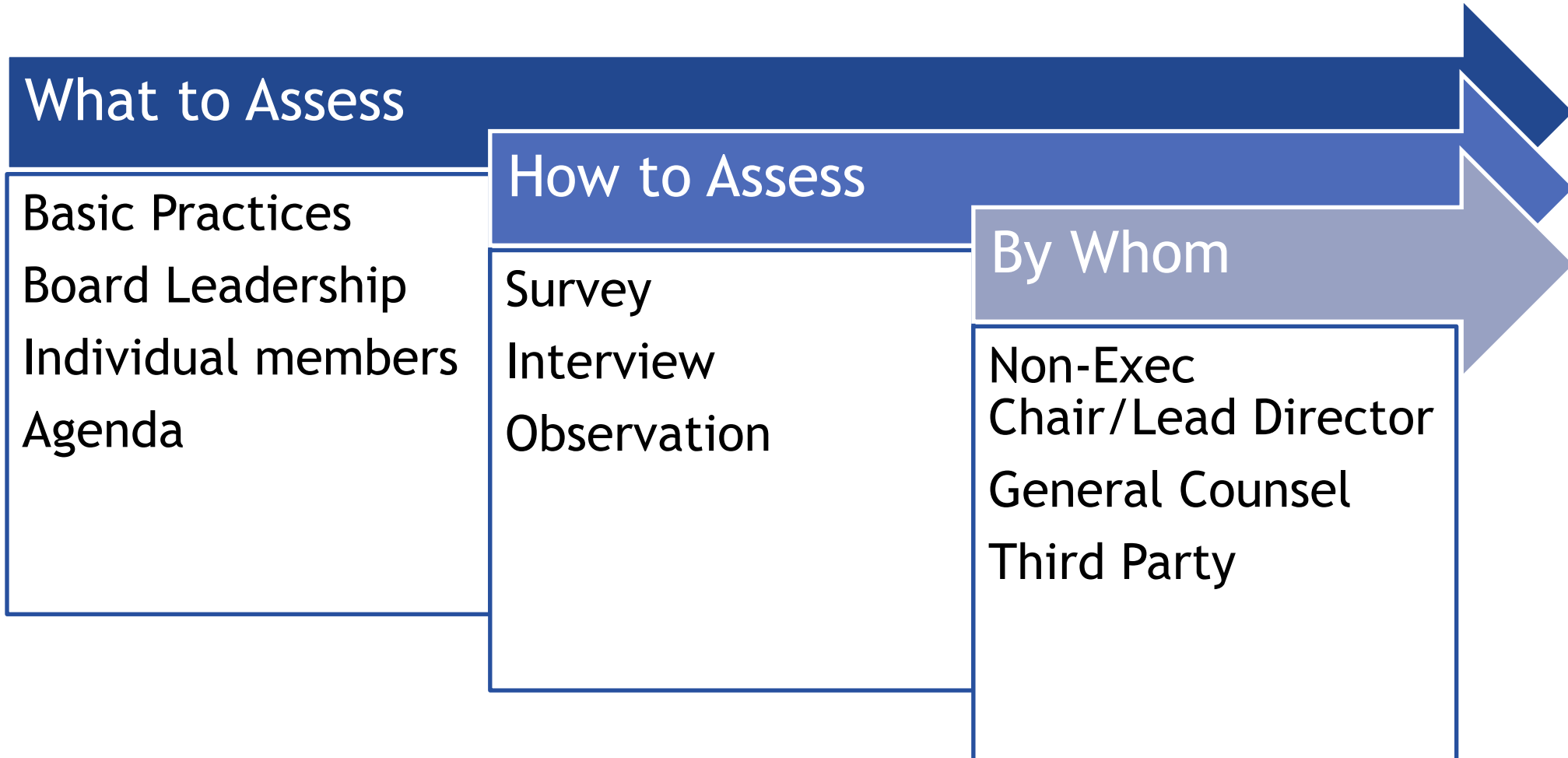
Board Capability: How Boards Are Evolving



Building a Culture Fit for Purpose

- Realizing your board's potential requires a culture fit for purpose
- Boards should explicitly consider desired cultural norms and expected director behavior
- Board members must all actively live and champion the culture





Polling Questions 3, 4 and 5



- What do you assess? (choose all that apply)
 - Board basics (scheduling, timing, prep, etc.)
 - Board leadership
 - Board members
 - Agenda content and emphasis
- Who conducts your assessment?
 - Board leader
 - Management support (General Counsel)
 - Lawyers
 - Third party
- Do you solicit opinions from executive management?
 - Yes
 - No

Building the Experience Curve: Using Feedback to Improve Performance



Takeaways



- **Chairs must champion board assessment to best practice**
 - To build the culture fit for purpose
 - To drive continuous improvement the maturational process
 - To build and take advantage of “collective intelligence” and team wisdom
 - Use the data collection/assessment as a counterweight to the natural information asymmetry faced by boards
- Chairs should **use the assessment to lead improvements** in board functioning
- Board assessment **should be closed loop learning-action process**: the board must always receive and discuss results, agree on indicated actions; take action and re-assess later
- **Chairs should evaluate their own effectiveness** and should **ensure that there is another party and independent process** for evaluating their own performance. Chairs should not conduct their own self assessment.
- **Director evaluation should be included annually**. Leverage the **process to improve contribution and role of each director**, include an individual development focus complete with **individual feedback discussions**
- **Management opinion should be solicited**; ideally a minimum of five C-suite executives should participate on a confidential basis
- Boards should **use a third party every three years**; where there is concern, confusion or contention, a third party should be strongly considered

Q&A

Please submit your questions in the Q&A box below.

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