AGENDA

Opinion

Balancing the Pandemic With Today's Reality of Board Service

By Mark Emanuel, Todd Sirras, Matteo Tonello May 21, 2021

- Mark Emanuel

Mark Emanuel is a managing director at Semler Brossy.

- Todd Sirras

Todd Sirras is a managing director at Semler Brossy.

- Matteo Tonello

Matteo Tonello is managing director, ESG research, at The Conference Board.

Many boards are at a crossroads with respect to their own compensation. While they may find it inappropriate to increase their compensation in the current environment, there are also very good reasons to increase or otherwise adjust director compensation. This is especially true if we adhere to the fundamental principle in director pay that board members should be compensated for their time commitment to the company.

The sheer volume and scope of board work has expanded considerably in the last few years. While the Covid-19 crisis has caused a significant increase in board workload, the increased responsibilities relating to environmental, social and governance (ESG) matters will continue. Further, companies also increasingly are searching for new directors with diverse backgrounds and specialized skill sets.

How should boards manage these challenges?

Long-Term Trends in Director Pay

The Conference Board, **Semler Brossy**, and ESG data analytics firm **ESGauge** have been collaborating on an annual review of public companies' filings on director compensation. This empirical analysis and our experience suggest that it is typical for boards to make high single-digit or low double-digit increases to non-employee director pay every two to four years. In steady-state, this translates to low- to mid-single-digit annual inflation in the market for director pay. Our review of 2020 filings — reflecting pre-pandemic actions from 2019 — validated this trend, showing a 4.6% increase in the median for Russell 3000 companies and a 1.8% increase in the S&P 500 median.

Boards also continued the multi-year journey to simplify and standardize director pay by continuing to move away from per-meeting fees and toward fixed-fee retainers. Per-meeting fees are now used by only 17% of Russell 3000 companies and 13% of those in the S&P 500. This reflects the fact that directors' responsibilities are ongoing and not just related to attending meetings.

Trends We See on the Horizon

Boards are in a bind, for both current and would-be directors. The pandemic has greatly increased the time commitment for service. While directors had less need to travel, most boards met much more regularly, especially in committees that had to work with management on the evolving crisis. The pandemic also increased awareness and heightened pressure to address social inequities and ESG concerns.

We won't know for sure until the end of the 2021 proxy season, but early indications are that director pay is likely to be flat in 2020. Whether in response to depressed performance due to, or a desire for, restraint during the pandemic, many boards opted to forgo increases to their pay in 2020. This pause on increases may even run through 2021 and not just in industries diminished by Covid. Increases are likely to be more conservative — for example, focused on only catching up to a median rather than paying slightly ahead of market.

Of course, some boards even took haircuts in solidarity with management and employees. Indeed, of the 416 Russell 3000 companies enacting a reduction in director pay during 2020, roughly 25% opted for a total forfeiture of cash retainers.

While raising the overall level of director pay may be a nonstarter, boards might explore more targeted avenues to meet the challenge of appropriately recognizing and compensating directors for their efforts.

One path is to reconsider the work required in committees and to adjust retainers paid to directors serving on committees to reflect the importance and workload of each committee. For example, responsibility for overseeing human capital management (HCM) is now often being assigned to the compensation committee and/or nominating and governance committee. Further, nominating and governance committees are assuming a broader role with respect to ESG.

The hierarchy of committee fees has historically been audit at the highest, followed by compensation, then nominating and governance. Audit committee fees increased when the Sarbanes-Oxley Act expanded the responsibilities of those committees; similarly, we witnessed a rise in the fees of compensation committees after the introduction of the more stringent Dodd-Frank requirements on compensation disclosure. Today, new HCM and ESG oversight responsibilities will likely cause boards to reconsider the retainer levels for serving on the nominating and governance committees.

To reflect the greater workloads and knowledge of broader topics required for directorship, boards may also wish to consider prioritizing increases in the base retainer for all directors over additional compensation for committee membership. More uniform retainers that compensate all directors equally would avoid trying to predict which committee or director will be working harder in any given year and recognize that all committees have significant workload and directors shoulder the burden jointly.

Moreover, the pandemic made clear the role that all directors play in offering their effort and expertise, often without regard to official committee or leadership assignments. Simplification would have the added benefits of eliminating any financial impediment to committee or leadership rotation, as well as likely being well received by investors who tend to favor more simplified director compensation arrangements.

One area where boards may wish to consider targeted compensation arrangements is in helping attract new directors. Directors from underrepresented populations are in high demand, and the search for qualified directors has extended beyond the traditional “current or ex-CEO” model and toward a broader pool of candidates, including active C-suite executives — and sometimes those who are a step below.

In this environment, boards may increasingly return to the practice of providing initial joining equity grants to accelerate a director’s progress toward any applicable ownership guidelines and to otherwise differentiate the opportunity in a competitive environment for director talent. Today, only 21.8% of the Russell 3000 and 12.3% of the S&P 500 offer such sign-on equity grants to directors.

Covid-induced pressures on directors will continue long after the pandemic subsides. Boards will need to get creative to manage their workload to meet investor and other stakeholder expectations, and pay programs likely will adapt to reflect increasing and shifting responsibilities.

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