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A Backward Glance and Forward Look at Board of Director Compensation

Across the banking industry, director compensation remains subject to regulatory and shareholder scrutiny. While increases in director pay have continued in recent years, the mix of pay has also continued to shift.

Year-Over-Year Changes

Total director compensation at public banks has continued to increase following recovery from the Great Recession and once executive compensation returned to market competitive levels. This is the case on an individual director basis, as well as for total aggregate director compensation. However, the mix of pay continues to change, as equity now comprises a larger portion of total aggregate director compensation for most public banks.

Total compensation for an average director (excludes board chair, lead director, employee directors, and any individuals with unusual circumstances) remained fairly flat from 2013 to 2014 for public banks with assets less than $10 billion. From 2015 to 2016, median average director total compensation increased year-over-year with the largest increases in banks with assets of $10 billion and greater.

Equity continues to be an important element of director compensation as a result of persistent pressure to align the interests of shareholders and directors. From 2013 to 2016, the median value of annual equity grants increased for an average director serving on the boards of banks of all asset sizes. While the median value of equity awards increased for all banks over this period, median equity awards for directors at banks below $50 billion in assets decreased or remained flat from 2014 to 2015. 2016 median award values increased again over 2015 for banks with assets below $50 billion, and remained flat for the largest institutions.
Overall median cash compensation changes varied for an average director from 2013 to 2016 based on the bank's asset size. For banks with assets less than $1, $1 to $4, and $10 to $50 billion, average director cash compensation increased slightly over this period. For those institutions with assets of $4 to $10, median cash compensation decreased, and for those larger than $50 billion, it remained fairly flat over this period. Thus, any increase in median average director total compensation was primarily due to increases in equity compensation.

Total aggregate director compensation reflects a firm's total director compensation expense, and includes all elements of director compensation. This changed in varying degrees for banks of different asset sizes from 2013 to 2016, and grew dramatically for banks with assets greater than $50 billion. However, median total aggregate director compensation for these banks increased the most from 2013 to 2014, and then continued to increase annually at a more gradual rate from 2014 to 2016; it increased 9% from 2013 to 2014 and a total of 15% increase over the entire period. For banks with assets less than $50 billion, 2016 median total aggregate director compensation was higher than in 2013, but annual increases were not as dramatic over this period as in the larger institutions. For banks with $4 to $10 billion in assets, total aggregate director compensation increased from 2013 to 2014, but then decreased in 2015, and increased slightly from 2015 to 2016, with a total net increase of only 1% over this period. In banks with assets of $10 to $50, $1 to $4, and under $1 billion in assets, median total aggregate director compensation increased 12%, 12%, and 17%, respectively, from 2013 to 2016.

Median total aggregate annual equity grants for directors increased for all banks from 2013 to 2016. It is not surprising that the largest surge occurred at banks with assets greater than $50 billion, where this increased only slightly, 4%, from 2013 to 2014, and then 30% from 2014 to 2016.

Total median aggregate cash compensation grew most significantly at banks with assets greater than $50 billion from 2013 to 2016. This decreased somewhat at banks with assets of $4 to $10 and $10 to $50 billion, and increased slightly for banks with assets less than $4 billion during this same period.

2016 Director Compensation Highlights

Director compensation continues to be scrutinized and influenced by regulatory bodies, shareholder advisory firms, and shareholders. In 2016, while total aggregate and average director compensation for public banks increased at varying degrees over 2015 for most asset categories, other changes occurred to the make-up and mix of pay.

- **Cash Compensation:** Cash retainers continued to be prevalent, while per board meeting fees were less so, particularly at banks with assets below $10 billion and where participation and engagement were not an issue. Using retainers rather than per meeting fees reduces administration and helps to manage total aggregate director compensation costs, especially in times when additional meetings are necessary.
- **Equity Compensation:** For directors, the most prevalent forms of equity granted were restricted stock and restricted stock units. Stock options are no longer prevalent as a component of director compensation. Full value shares, which include restricted stock and restricted stock units, are thought to best align directors with shareholders and promote independent decision making. Across the industry, shares continue to vest over a short timeframe, one to three years in most cases. It continues to be a best practice that shares vest prior to the end of a director's term, as equity grants are considered compensation for current service and not a retention tool. Director equity ownership guidelines are still evaluated and considered a best practice, but are not as prevalent at banks with assets less than $4 billion. Ownership guidelines are typically stated as a multiple of the retainer, and range from three to seven times the annual retainer. Shareholder advisory firms vary in their approach to director stock ownership; some look to see if a guideline is in place while others do not evaluate it in their current scorecard.
- **Chair Fees:** 2016 board and committee chair fees continued to increase over 2015 levels as a result of increased workload, responsibilities, time commitment, and liability. The gap between pay for audit and compensation committee chairs continued to narrow.
- **Benefits:** The prevalence of benefits for outside directors declined from 2015 to 2016. One exception to this was the continued high prevalence of director deferred compensation or fee deferral plans.
- **Structure of Compensation:** Director compensation should not vary based on bank performance. Directors are not employees of the bank and are not eligible for incentive pay. Directors have a fiduciary responsibility to the shareholders and their role is to make sure that the bank is well run, safe, and sound.

- **Inside Director Compensation:** It remained a best practice in 2016 that inside directors were not paid for board service; such service is considered part of an executive's job duties and responsibilities. The prevalence of CEOs also serving as the board chair continues to be quite low.

Governance Issues

In 2016, an expectation of heightened corporate governance on the part of directors remained. Regulators, shareholders, and shareholder advisory firms share this common expectation. This is still the case today and anticipated for the foreseeable future. While sections of the Dodd-Frank Act that could potentially impact compensation and corporate governance requirements remain in limbo, heightened corporate governance is one of the core principles of the interagency guidance, also known as the Sound Incentive Compensation Policies guidance, which launched in June of 2010, affecting all banks.

Additionally, directors remain accountable for managing risks in incentive plan arrangements and aligning executive pay and performance. Regulatory agencies placed increased focus on this as a result of issues discovered in the industry in 2016 relative to retail incentive plan practices. As a result, regulators have increased requests to review retail incentive plan information as part of the scope of safety and soundness examinations at banks of all sizes. This is part of director oversight, particularly for those serving on compensation committees.

Shareholder advisory firms continue to evaluate corporate governance practices at public institutions, and can carry considerable weight. For example, if one of these firms does not agree with the compensation practices or decisions made by board members, particularly those serving on the compensation committee, a recommendation for a NO vote for directors on the ballot for reelection may ensue. These firms do not have specific standards relative to amounts and types of director pay, but review proxy statements for governance practices. They also identify the policies and provisions in place, determining whether or not they are adhered to. Furthermore, shareholder advisory firm criticism and negative vote recommendations can potentially result in public relations issues and even shareholder lawsuits. Such lawsuits have been more prevalent outside of the banking industry, but have increased within the industry in recent years. Many of these lawsuits have focused on levels of director compensation and what has been termed "self-dealing".

Looking Ahead

So, what exactly does this all mean? While it is impossible to predict the future with any accuracy, it is clear that director compensation will remain under scrutiny in the years ahead. Director compensation should not be performance-based, but rather established in light of market trends, regulations, and industry best practices. Directors should expect to continue adhering to strong corporate governance standards going forward. It is critical that directors remain informed about regulatory changes, industry standards, and best practices, as this supports good governance and should help to promote effective risk management. We anticipate future challenges to continue to include aligning executive compensation with bank performance and succession planning for board members. In today's challenging environment, it is more important than ever to recruit experienced, high caliber directors that possess board experience and can navigate the waters of corporate liability, risk management, security issues, and shareholder expectations.

To learn more about Board of Director Compensation Trends, please contact our team.

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