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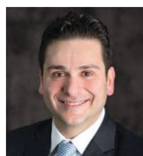

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GOVERNANCE

Board Compensation, Diversity Under Scrutiny

Similar to trends in other industries, banks have been simplifying their director pay programs. Slightly more than half of publicly traded banks with $1 billion to $10 billion in assets increased cash retainers instead of offering board meeting fees. Board meeting fees are the easiest to simplify, given the generally consistent number of meetings and their applicability to all board members. Retainers are also the most common way to recognize committee chairs for their roles and compensate committee members.

Annual equity grants are also a core element of board member pay at public banks, while stock option grants remain a minority practice. Restricted stock is the most common form of equity.

The amount of time for directors' equity awards to vest is also shortening. Of the banks we reviewed with $1 billion to $10 billion in assets, 73 percent of those using full-value awards were granted either fully vested or with a one-year vesting requirement.

This shortened vesting period for director awards parallels the declassification of board structure and use of one-year terms. Banks do not want to incentivize directors that would have otherwise resigned or not stood for reelection to remain on the board so their equity awards can vest.

Most public banks have share ownership guidelines, which often require that directors own three to five times the annual cash retainer. Most guidelines build in a fixed amount of time for directors to reach the guideline, like five years. Another recent trend is a stock ownership requirement, which requires directors to hold a certain percentage of vested shares until they reach the guideline and kicks in if they fall below the threshold.

Scrutiny and Oversight

Director compensation has been in the spotlight because of recent litigation and increased focus from proxy advisory firms.

Institutional Shareholder Services (ISS) announced it will target board members who are responsible for setting director pay when levels are "excessive," with adverse vote recommendations issued as early as 2020 where director or board chair pay is in the top 2 percent to 3 percent of a defined comparison group. This will not be an issue for most banks that pay within a reasonable range around market, but banks should be aware of this change. As a result, the industry is likely to see enhanced proxy disclosures that includes the board compensation philosophy, additional responsibilities of chair roles and communication of independent compensation reviews.

Delaware courts have recently issued a series of decisions limiting the extent that the business judgment rule protects directors when determining their own compensation. As a result, companies are being more thoughtful in establishing total limits on director compensation, establishing appropriate stock ownership guidelines and holding requirements, and closely reviewing the competitiveness of pay levels and structure. We recommend companies check their plans to ensure appropriate caps are in place.

Diversity Focus

Large institutional investors, proxy advisory firms and legislators are putting significant focus on board diversity. BlackRock's most recent proxy voting guidelines encouraged companies to have "at least two women directors" on their board. Vanguard noted that board diversity is "an economic imperative, not an ideological choice" in a 2017 open letter to public company directors.

Beginning in 2020, State Street Global Advisors, the asset management business of State Street Corp., will vote against the slate of directors on a company's nominating committee if that company's board does not include any women directors, and the company has not engaged in successful dialogue with the asset manager regarding board gender diversity for three consecutive years.

Proxy advisory firms will generally recommend voting against a company's nominating committee chair if a board includes no women; Glass Lewis started in 2019, with ISS joining in 2020.

Outside of corporations, two states are looking into gender diversity mandates. California enacted legislation that imposes gender quotas on public companies headquartered in the state; New Jersey has proposed a nearly identical law.

We expect these issues to be top of mind for the boards of many banks in the coming 12 to 24 months, along with other concerns such as director tenure, retirement age and engagement. Banks should evaluate their programs and board composition in light of these hot topics.

As seen in the 3rd Quarter 2019 issue of *Bank Director*