BOARDROOM COMP UNDER COVID

Director pay will, of course, be transformed in the current environment. But what that means and how it plays out will vary widely. A roadmap.

Pre-pandemic, board compensation practices had become static and homogeneous, even as the role of non-employee directors continued to expand—but that was before the pandemic launched a global economic crisis. *CBM* recently spoke with Jim Heim, a lead consultant with Meridian Compensation Partners, about how the market downturn, coupled with a clear desire on the part of board leaders to set the right tone at the top, will impact director pay practices. Excerpts, edited for clarity and length, follow.

What was the state of board pay heading into this proxy season, prior to COVID?

We've had a total pay bumping up maybe 3 percent a year, over the past eight years or so. Board members are extremely sensitive about not looking like they're allowing their own pay levels to get ahead of their skis. Over the same time period, we're asking board members to do more. ESG moved to the front burner. Investors are demanding more active oversight of human capital and many sectors are addressing disruption that relates to technology.

Meanwhile, we've got a constrained labor market for board roles, with mandatory retirement, pressure on active CEOs not to serve on more than one outside board and a cap on the total number of boards for folks who aren't active executives. That's not necessarily helpful if you're trying to recruit new directors.

The vast majority of companies are going to weight pay at least 50 percent towards equity. They're going to deliver that equity in the form of restricted stock or deferred stock. They're eliminating meeting fees. Instead, they're providing flat cash retainers for service or for leadership of different committees.

So, we have flat pay, an expanding role and a relatively limited supply of potential directors. The bottom line is the situation has been ridiculously stable and really consistent for the better part of a decade.

Do you expect a sea change in board compensation practices in light of the pandemic?

In most companies, they're going to implement their new pay programs and make their new equity grants to directors to coincide with annual meetings. A relatively small percentage of the Russell 3000—maybe 10 percent—have announced that they are cutting cash retainers, and I suspect that you'll see more than that, companies that will exercise some kind of haircut when they calibrate their new round of equity awards.

What alternatives are available for managing equity awards, given the drop in share prices?

You'll see quite a few companies decide that they're going to do something like use last year's grant back in 2019 as the price for calibrating awards. Or maybe they'll use the grant price that they use for executives or some kind of split-the-difference scenario. That's going to make year-over-year pay appear to drop.

There are two other possibilities worth mentioning: First, there may be some situations where boards would like to signal the market that they've got faith in the long-term value of the company, so they'll switch to granting stock options, which of course only have value if the stock price actually rises instead of the traditional restricted stock grants.

That kind of switch does run the risk of being viewed as opportunistic, but there will probably be some companies willing to stomach that criticism if it also means they're calming the waters by showing investors they believe a turnaround is coming.

Second, there will be companies that are exhausting the equity pool available for making these grants because they've been shoring up the management teams and employee populations first. In that situation, an incredibly powerful message might be to have boards shift their compensation mix towards cash but then encourage—or maybe even require—that board members purchase shares on the open market with the after-tax cash payments.

That's not going to make sense for everybody, but for some companies that kind of move could resonate with a lot of the different stakeholders who have been suffering.

What implications do you think this will have on board recruitment or board refreshment?

A lot of companies are recognizing that there's a lot of value in very experienced, well-connected directors who have managed through crisis. Companies have also had to slow down their ongoing searches for new directors. I think we're going to see some folks lasting another cycle or two beyond what their planned retirements might be.

Also, candidates who have a proven track record at human capital management are about to become very attractive. We have boards that are very interested in maintaining employee engagement and finding innovative alternatives to layoffs and in managing in a virtual environment, so directors who have a proven track record in those areas will be in demand. This might become the new "must have" skill—similar to how cybersecurity was really a focus in the past few years.

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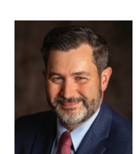

Jim Heim (jheim@meridiancp.com), lead consultant with Meridian Compensation Partners, advises boards and senior management teams on all aspects of executive and director compensation issues across multiple industries.

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