Revisiting Board Pay in a Time of Crisis

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Many companies are re-examining their non-employee director compensation programs in light of COVID-19-related disruptions.

There is a clear appetite to set the right tone at the top as business leaders balance (a) keeping their workforce and customers safe and healthy with (b) navigating supply chain uncertainty and weakened demand for their products and services. The timing of this crisis—just as many calendar-year companies are planning for annual shareholder meetings when non-employee director equity grants are typically made—adds a sense of urgency for those who are eager to tailor the program to these unprecedented times.

We note that in the years prior to this crisis, a growing consensus emerged across the investor community that expanding board oversight was critical to both managing enterprise risk and fostering sustainable businesses. In general, board members have been asked to do more, while board compensation programs have become remarkably homogenous and scrutiny of board compensation programs has increased. For many companies, there has simply not been the logical progression of pay opportunities that would be expected in light of significantly expanded roles over the past five years.

This trend is almost certain to continue. Our recent client experience suggests that board members accept that the times simply demand more effort and sacrifice. Below are thoughts on how companies with an appetite to do so may implement certain adjustments for non-employee director pay.

Objective: Demonstrating solidarity and shared sacrifice

In the hardest hit sectors, many companies have already disclosed base salary reductions or foregone bonus opportunities for 2020 for the executive team. These companies are also more likely to be implementing furloughs, factory closures, reduced work schedules and layoffs for broader employee populations. Companies may consider across-the-board pay reductions (to both cash retainers and equity awards) in this scenario.

Objective: Reinforce cash conservation efforts

Many companies already have programs that allow non-employee directors to elect to take all of their compensation in the form of equity. An all-equity program may also be mandated in this cycle to demonstrate that the board is leading by example in efforts to conserve cash and promote a focus on liquidity or solvency.

Objective: Mitigating windfall potential

Using a multi-day average price (e.g,, 20 or 60 trading days) to calibrate the number of shares needed to deliver a targeted equity award value has become common practice. This approach addresses concerns that awards may be in some sense “spring-loaded” if a V-shaped recovery is in the works.

A sizeable minority of companies already administer their non-employee director compensation program via quarterly grants rather than a single annual event. This quarterly grant approach also serves to mitigate the impact of short-term stock price volatility on pay outcomes.

Objective: Demonstrating faith in long-term value of company

Shifting the compensation mix towards equity is an excellent signaling mechanism. Shifting that equity instrument to stock options may be an even stronger statement, if done consistently (not just in a bear market).

While stock option usage for non-employee director compensation programs runs afoul of "best practices" espoused by some observers (the timing of stock option exercises may be criticized, and options reward risk-taking to a greater extent than full value awards), the old rules may not apply in the current environment. A switch to stock options may trigger scolding down the road relating to the supposed "opportunistic" timing of the move, but it's a price some boards may view as well worth paying if it helps stabilize investor sentiment over the next few months.

Objective: Mitigate equity burn

Many companies anticipate exhausting their existing shareholder-approved equity plans much more quickly than originally contemplated, and are concerned about the levels of shareholder dilution resulting from these higher burn rates. The multi-day average price approach outlined above may help in this circumstance. A bolder approach is to use a floor price to determine the number of shares to grant (may be prior year's grant price). Perhaps the most powerful tool available is to switch the compensation mix to emphasize cash—and encourage or require the purchase of shares on the open market with the after-tax cash payments to preserve share usage.

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Many of the solutions identified above serve competing compensation imperatives. There are trade-offs. This is a healthy dynamic, as it necessitates careful consideration relating to the Company's true priorities.

A few closing thoughts relating to dotting the i's and crossing the t's:

- Compensation-related disclosures of any pay program changes should be crystal clear with respect to the intent of the modification and how it furthers shareholder interests.
- Plan documents should be carefully reviewed to confirm that they allow for the flexibility needed to implement modifications.
- Establish a process for revisiting non-employee director compensation on a regular basis to test whether it continues to align with intended objectives.