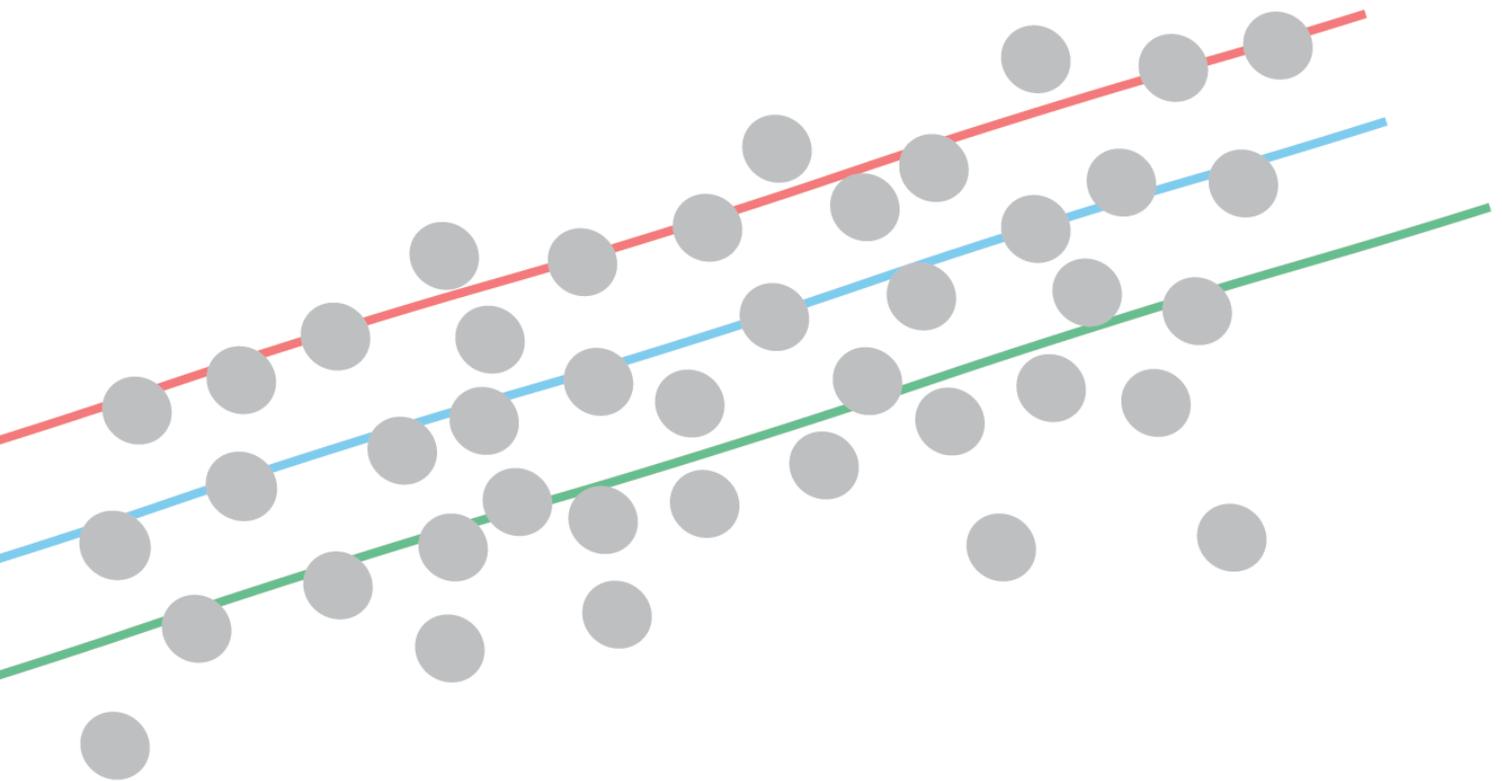


# US Board Director Compensation



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## U.S. Board of Directors Compensation

U.S. organizations, whether their business is tax-exempt, privately held, or publicly traded, will appoint a board of directors as an executive body to act on behalf of their stakeholders, such as investors, shareholders, or donors. The purpose of the board is to ensure proper functioning of the organization in the interests of stakeholders and to comply with relevant laws and regulations. Typically, the board directors will also fulfill various committee and leadership roles to more effectively provide advisement, oversight, and governance.

The research and compensation analytics in this paper present an operating framework for HR leaders and business practitioners who work with boards of directors, covering the following topics:



This paper utilizes data from 5,510 proxies from publicly traded corporations for the 2014 fiscal year (filed as of May 2015) in order to examine the complexity of board independence and compensation. All benchmark data reflect the median values analyzed.

### Committees

Board directors serve on committees, which are established to focus on mission critical functions. The Audit & Finance, Compensation & HR, and Governance & Nominating committees are mandated for most publicly traded companies. Additionally, there may be unique committees formed to serve specific business or industry needs (e.g., Science & Technology). ERI Economic Research Institute analyzed the committee composition of 5,510 companies as of the 2014 fiscal year. The most prevalent committees in the sample follow:

ERI Committee Name	Count	% of Companies
<b>Audit &amp; Finance</b>	5,435	98.64
<b>Compensation &amp; HR</b>	4,578	83.09
<b>Governance &amp; Nominating</b>	4,390	79.67
<b>Executive</b>	805	14.61
<b>Science &amp; Technology</b>	133	2.41
<b>Environmental Health &amp; Safety</b>	115	2.09
<b>Strategic Planning</b>	98	1.78
<b>Investment</b>	87	1.58
<b>Mergers &amp; Acquisitions</b>	40	0.73

The charters for the mandated committee are posted on company websites. Benchmark descriptions of the primary purpose of these committees are found below:

**Audit & Finance**

- Oversee and evaluate the internal audit function, the financial accounting and reporting processes, and the integrity of the financial statements; comply with legal and regulatory requirements; evaluate merger and acquisition transactions and investment transactions proposed by the C-Suite management; and engage with an independent audit firm.

**Compensation & Human Resources**

- Oversee and evaluate the executive compensation programs and other compensation matters; prepare the report required by the rules and regulations of the Securities and Exchange Commission to be included in the annual filings; and review directors compensation for service on the Board, recommending any changes to the board. Specific independence requirements for member majority generally stipulated.

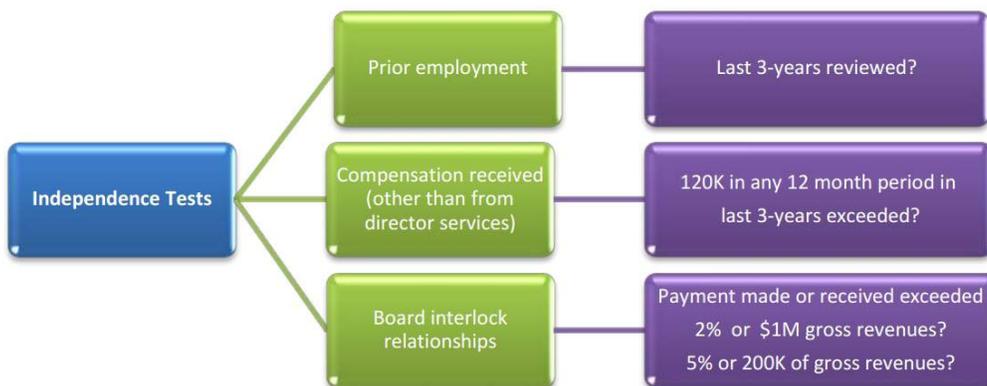
**Governance & Nominating**

- Oversee and evaluate the board's performance and the company's compliance with applicable corporate governance regulations, guidelines, and principles; identify individuals qualified to become board members; recommend membership nominees to Board; and recommend directors to serve on each standing committee to the board.

## Independence

As a result of the Sarbanes-Oxley and Dodd-Frank Acts, it is important that board directors remain independent of the organization. That is, directors are expected to carry out their responsibilities fostering arm's length transactions without impinging fiduciary, governance, and oversight requirements inherent in their roles. On an ad hoc basis, a board director can recuse him or herself from a meeting if a possible conflict of interest arises.

The Securities and Exchange Commission (SEC) regulates these acts and has delegated defining the independence standard to the relevant stock exchanges where the company's stock is traded. Despite some differences, the independence standards of the NYSE and NASDAQ are much alike. Both exchanges set thresholds for independence tests in order to meet the standard. Some of the bright line tests follow:



The intent is that board directors should have no material relationship with the organization directly or indirectly that may lead to a conflict of interest or undue influence. The relationships in the purview of the independence standard could be commercial, banking, consulting, accounting, legal, charitable, financial, and/or familial. For mandated committees, the independence standard is more narrowly defined by prohibiting interlocking relationships between current C-Suite and board directors. For example, Mark Zuckerberg, Facebook CEO, would not pass the independence test to be a Compensation Committee member of Netflix, since Reed Hastings is a board director on the Facebook board and is the CEO of Netflix. Members of these mandated committees must be independent.

The board directors and the C-Suite employees play an integral part in maintaining independence standards that require self-reporting and appropriate disclosures of the parties involved. Controlled companies (e.g., those considered closely held or at least 50% voting power by single entity) have less restrictive independence requirements and newly listed companies are afforded a phased in approach to meeting the standards.

## Board Roles

In the U.S., employee board directors (e.g., the CEO is also on the board) will generally not receive additional compensation. In Europe, employee board directors may be remunerated for their board service.) The non-employees who serve as board chairs and board directors are the most prevalent roles that receive compensation; they are the basis of research and compensation analytics that follow. Below are the benchmark descriptions:

Board Chairperson

- Incumbent directs meetings, oversees members, and manages various committees. Represents the needs and interests of shareholders. Votes on various matters; this is typically a position elected by other board members.

Board Director

- Incumbent represents and serves the needs and interests of shareholders; attends and contributes to meeting discussions and decisions. Aids in establishing, guiding, and assessing the overall direction of the corporation. Votes on various matters. Contributes to and serves on various committees.

There are two less prevalent roles in this sample. The board vice chair is a board director who also directs the meetings in the absence of the Chairman. Second is the alternate board director who “fills-in” when a board director cannot attend a meeting; this role is generally in utility or similar services entities (e.g., gas, electric, water, sanitation).

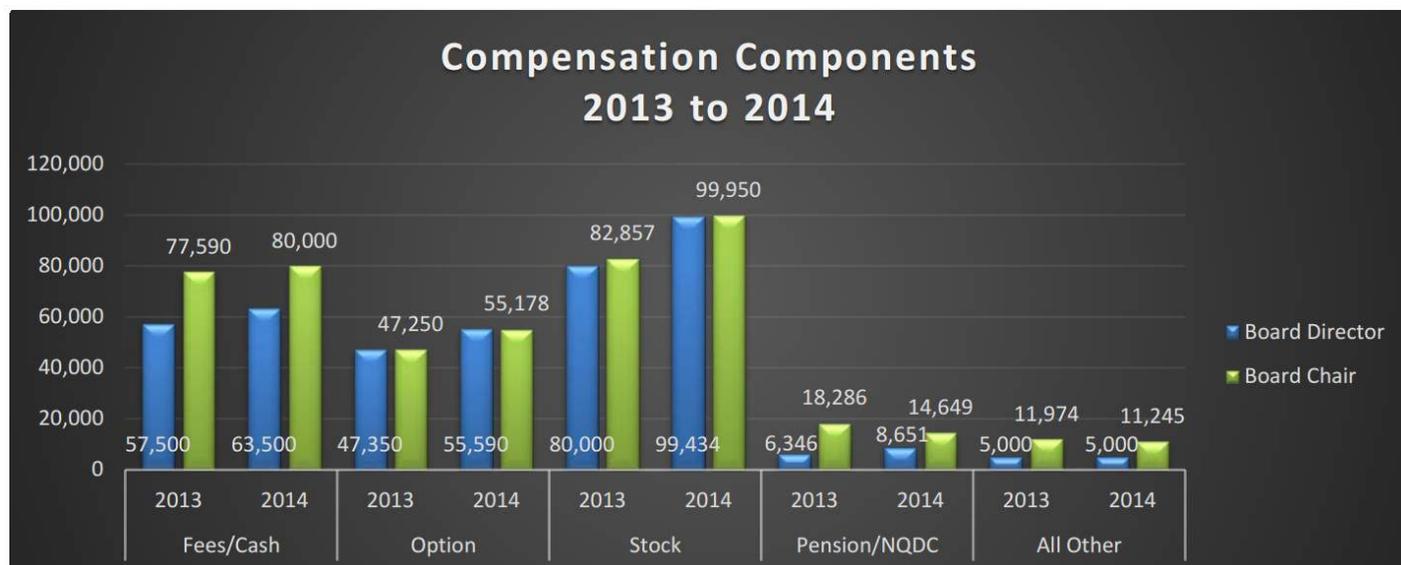
One role not in the scope of this research and growing in prevalence is the lead independent director, which is filled when the CEO also serves as the Chairman (albeit required by the NYSE). To have a governance best practice, other organizations may voluntarily require a lead independent director on their board.

## Compensation

For being elected as board director and for serving on committees, the compensation can vary depending on their level of responsibilities (e.g., earning different retainer and meeting fees and possibly more equity). U.S. board director compensation is comprised of similar compensation components to that of C-Suite employees:



None of the 5510 companies analyzed offered annual variable cash compensation, which is generally included in C-Suite programs and referred to as “Non-Equity Incentive Plan” payouts. Also, less prevalent are Pension/NQDC and All Other components. The graphs below summarize the change in compensation components from 2013 to 2014 for the board director and board chair:



The median values of the Fee/Cash component for the board chair was \$20,000 or 35% greater than the board director in 2013 and \$16,500 or 26% greater in 2014. Yet the increase in median values of the pay level for this component was 10% for the board director and 3% for the board chair. The Option and Stock components for the board director and board chair did not significantly vary from 2013 to 2014. Pension/NQDC component represents 5% and 8% of the total compensation pay mix for the board director and board chair, respectively. This component increased for the board director by \$2,300 or 36% and decreased for the board chair by \$3,600 or 20%. The All Other component represents 3% and 6% of the pay mix for the board director and board chair, respectively. This component remained flat for the board director and decreased \$729 or 6% for the board chair from 2013 to 2014.

Organizations design board member compensation by setting a total value for the package and then determining the pay mix. For example, a Compensation & HR committee is generally responsible for evaluating board director compensation and first sets a Total Annual value for the compensation package equal to \$200,000. Then it determines a pay mix of 50% cash and 50% equity. The chart below represents the change in median values from year end 2013 to 2014 of Total Cash and Total Equity (e.g., Stock plus Options) relative to the median value of Total Direct Compensation (e.g., Total Cash plus Total Equity).

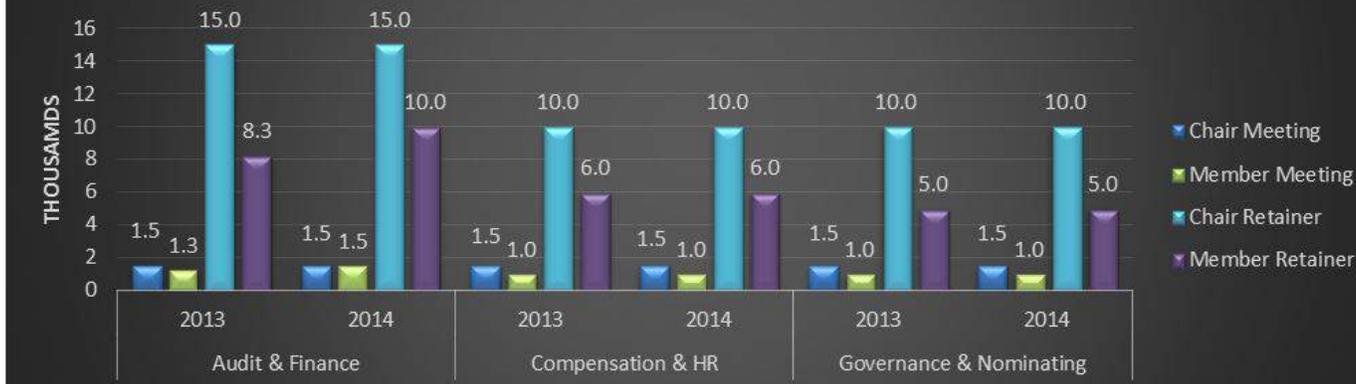
## Total Direct Compensation Pay Mix



The board chair and board director compensation increased for Total Cash, Total Equity, and Total Direct Compensation from 2013 to 2014. The increases were mostly in Total Equity, with \$16,365 or 19.5% for the board director and \$18,434 or 22.5% for the board chair. Total Cash increases in this analysis were the same as in the earlier component analysis, since Fees/Cash is the single element comprising Total Cash (10% and 3% for the board director and board chair, respectively). Total Equity represented 62% and 56% of the total direct compensation pay mix in 2014 for the board director and board chair, respectively. The board chair received 16% more Total Direct compensation than the board director in 2013, whereas this difference was only 11% in 2014.

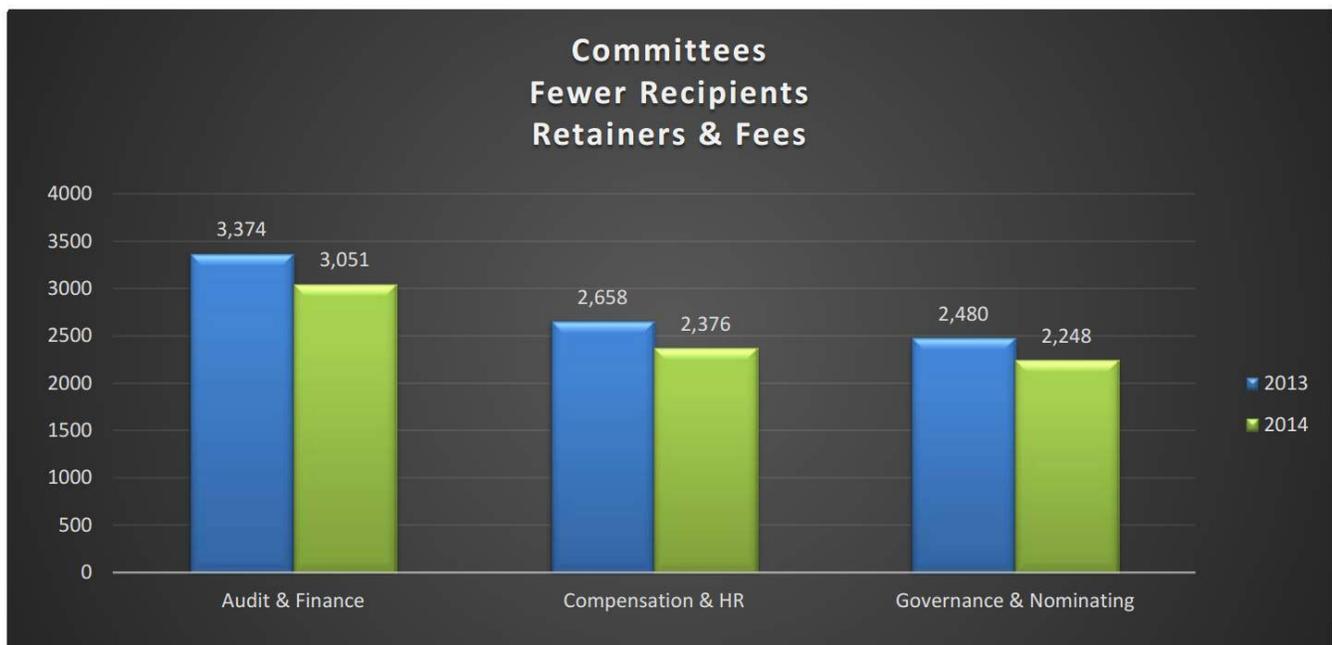
Board directors may receive compensation for being elected to the board, for their work on mandated committees, and at times for their attendance. The committee fees paid are further differentiated for the role on the committee, with the committee chair paid more than a committee member. The graph below shows the results of this analysis:

## Committees Retainers & Fees



We found little intra-committee movement for the median compensation values in the committee retainer and meeting fees for either the committee chair or committee member from 2013 to 2014. The Audit & Finance committee chair retainer was \$5,000 or 50% higher than chair retainers for the Compensation & HR and Governance & Nominating committees. In 2013, the Audit & Finance committee member retainer was \$2,250 or 37.5% more than the Compensation & HR committee member retainer and \$3,250 or 65% more than the Governance & Nominating committee member retainers. In 2014, Audit & Finance committee member retainer increased to \$10,000, while other committees remained the same.

Doing further analysis, we observed that fewer board directors were receiving additional compensation for their work on committees. The graph below shows the year-over-year decrease in median "N" observations of retainers being paid across all three mandated committees: 9.6%, 10.6%, and 9.4% decreases for the Audit & Finance, Compensation & HR, and Governance & Nominating committees, respectively.



## **SUMMARY**

Compensation components for board directors are comprehensive and have unique design, such as incremental retainers for specific roles and responsibilities or for meeting attendance fees. This research provides insight into board director pay levels based on a robust sample of 5,510 companies. More customized benchmarking by industry sector and organizations' revenue size is recommended to ensure that your board director compensation programs are competitive and well aligned with role responsibilities. Whether you need a snapshot of pay levels in a single point of time or a longer term approach based on the normalized movement of pay over time, ERI Economic Research Institute's **Executive Compensation Assessor (XA)** allows a user to integrate both types of benchmarks into the compensation design process for board directors.

Connect with us if you have any questions or want more information regarding this topic. Call 1-800-627-3697 to speak directly with Malak Kazan, CECP, CEP, or Matt Skrinjar. Visit [www.ერი.com](http://www.ერი.com) to learn more about compensation research and analytics.



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