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Directors See Pay Gains in Equity, Not Cash

By Amanda Gerut April 27, 2015

Equity has dethroned cash in board pay packages, as many large-cap company boards have begun making pay increases solely to the stock awards directors earn each year.

Compensation consultants say boards are emphasizing equity over cash in director compensation schemes and maintaining at least a 50-50 split between the two pay elements, although many of the largest companies emphasize equity to a far greater extent. Comp consultants say increasing the equity portion of directors' pay rather than cash not only looks good to investors, it also aligns directors more closely with shareholders.

"We are at a point where we have a greater value of equity delivered than cash," says **Stephen Pakela**, a partner at consulting firm **Pay Governance**. "In many cases the cash compensation is used to cover taxes [on equity grants]."

Agenda looked at the 100 largest public companies. Among the 26 companies that had filed 2015 proxies as of last week and granted pay increases to directors, nearly half a dozen left cash retainers untouched and instead increased the size or dollar value of the equity grants paid to directors annually. Boards at **3M**, **General Dynamics**, **Pfizer**, and **Wells Farg**o approved such equity increases. **Cisco Systems** and **Twenty-First Century Fox** granted equity-only increases in late 2014.

At Wells Fargo, for example, directors earn a $75,000 annual cash retainer, and directors in early 2015 increased equity retainers from $160,000 to $180,000.

Similarly, the Pfizer board increased the equity portion of directors' pay from $137,500 to $162,500. The Pfizer board also increased stock ownership requirements for directors from $550,000 to $687,500.

Other boards approved pay increases to both equity and cash retainers but made greater increases to equity. Consultants say boards are attempting to maintain greater emphasis on equity and are devising compensation increases that keep the balance of equity over cash. Boards such as **American Express**, **Boeing**, **Halliburton**, **Johnson Controls**, **PepsiCo**, **United Technologies Corp.** and **Valero Energy** made larger increases to equity grants and smaller increases to cash retainers.

Boeing directors' cash retainers rose from $120,000 to $130,000, while equity increased from $150,000 to $165,000 early this year. The PepsiCo board increased director pay for the first time in seven years and emphasized cash over equity. Cash retainers rose from $100,000 to $110,000, and equity retainers rose from $150,000 to $165,000.

Other boards currently have a cash and equity mix of 50-50 or an even greater emphasis on equity and made equal increases to both cash and equity.

At Valero Energy, for example, directors in 2015 raised cash retainers from $115,000 to $125,000 and equity retainers from $160,000 to $170,000. The Archer Daniels Midland board increased total pay for directors from $250,000 to $275,000. Directors are paid $150,000 in stock units and $125,000 in cash.

John Sinkular, also a partner at Pay Governance, says that, similar to executive pay, boards are focusing on increased alignment with shareholders, hence the greater use of equity. Sinkular says that, when he works with board clients, the analysis of board pay will give directors an idea of how their cash and equity mix stacks up against their peers'.

"There's a desire to maintain a heavier emphasis on the equity side," Sinkular says. "Most companies are close to a 50-50 mix, but you're seeing the mix get to 55%, and in some cases it's getting close to 60%."

An article co-authored by Sinkular and Pakela, published this month in **Harvard Law School**'s forum on corporate governance and financial regulation that discusses current trends in director pay, reports that equity awards typically represent 55% to 60% of total pay, similar to the mix of pay awarded to executives.

"The emphasis on equity compensation is also directionally consistent with the typical pay mix for senior executives," the article states.

On small-cap company boards, directors also often earn more equity than cash, says comp consultant **Mark Lipis**, who works primarily with companies based in southern California. Lipis, who is managing director of **Lipis Consulting**, says smaller-company boards pay directors with more stock because it's cheaper than cash.

Director Pay Raises in 2015

Equity-Only Increases	Cash-Only Increases	Equity and Cash Increases
3M	Aetna	American Express
Cisco Systems	Apple	Boeing
General Dynamics	Intel	Halliburton
Pfizer		Johnson Controls
Twenty-First Century Fox		PepsiCo
Wells Fargo		United Technologies Corp.
		Valero Energy

Source: 2014 and 2015 proxies

"One of the reasons smaller organizations may use more stock than cash is because cash is king and stock is relatively cheap," Lipis says. "So it looks good, it feels good and it might have a better impact on the balance sheet or income statement."

Ironically, *The Wall Street Journa*l reported last week that cash compensation for CEOs at the largest companies grew at the fastest rate in at least four years in 2014. Cash now represents 37.3% of total CEO pay, which is the highest it's been since 2010, the Journal reports.

Meanwhile, other large-cap company boards have long maintained high levels of equity in director pay packages. **Home Depot**, for example, pays 82% of directors' annual retainers in equity. Similarly, **CVS Health Corp.** pays directors 75% of their total pay in equity and 25% in cash. **Goldman Sachs Group** pays directors a $500,000 fixed-value grant, which is new this year, and $75,000 in cash.

In a unique way of encouraging equity ownership, the **International Paper** board pays directors a 20% premium in additional shares of restricted stock if directors elect to convert all or 50% of their cash retainer into restricted stock shares. Five of the board's 11 directors opted to receive stock instead of all or half of their cash retainer in 2014, the company's April 2015 proxy states.

Even boards that emphasize cash over equity are slowly increasing equity levels. For example, the **AIG** board in March 2015 decided to eliminate meeting fees for committee members and increase annual equity retainers from $100,000 to $130,000 to compensate for the cash retainers and "increase equity compensation to better align the total compensation and the mix of cash and equity compensation of the non-management directors with AIG's peers," the company's 2015 proxy states.

To be sure, some boards that made changes to director pay during the past year focused on cash rather than equity. The **Intel** board, for example, increased the cash retainer paid to directors from $80,000 to $90,000. Similarly, **Aetna** increased directors' cash retainers for 2014 from $75,000 to $85,000. By far, the largest cash increase among the 100 largest public companies was at **Apple**, where directors' cash retainers doubled from $50,000 to $100,000 in August 2014.