



Western Independent Bankers

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western banking magazine

October/November 2006

Issue Focus: Directors Issues

Evolving Board Composition and Compensation Practices

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While executive compensation continues to dominate headlines, a portion of the public's attention is now shifting to the board rooms behind those pay packages. Corporate governance experts and shareholders alike are taking a closer look at board of directors' composition and compensation, where numerous changes are afoot. Board independence is attracting greater attention. The number of board and committee meetings continues to grow. Meanwhile, steady increases in total pay are accompanying a shift to simpler compensation structures, stock options are being replaced by full value shares, and premiums for certain positions are rising in prevalence and amount. For a more focused look at how these widely acknowledged trends are emerging among western banking companies, compensation research firm Equilar, Inc. analyzed SEC data for fiscal years 2003 through 2005 of 50 banks in the western United States with net assets of less than \$3 billion.

Board Composition

Though median board size for the western banks has remained static at nine members, notable trends are changing the makeup of these boards. Reflecting the widespread push for greater board independence – a standard of good governance – 46 percent of the banks increased the percentage of independent directors on their boards between 2003 and 2005. The median percentage of independent directors serving on each bank's board currently stands at 71.4 percent. The independence of board leadership has followed a similar trajectory, with the prevalence of non-executive chairmen growing from 64 percent to 72 percent.

In other areas of board composition, disclosure of at least one audit committee financial expert increased from 72 percent in 2003 to 90 percent in 2005, and the number of banks identifying more than one expert doubled to 16 percent. Additionally, the number of banks with at least one female board member crept up from 54 percent to 56 percent during this period.

Board and Committee Meetings

The median number of board meetings remained at 12 during this time. Committee meetings, however, have seen greater change due to increased workloads for certain committees. Of companies that disclosed the number of committee meetings held in both years, 57.4 percent held more audit committee meetings in 2005, and 62.8 percent held more compensation committee meetings.

Compensation

Median board pay, comprising cash retainers, meeting fees and equity awards, went up 27 percent from \$18,900 in 2003 to \$24,000 in 2005. While median per-meeting fees and median total board meeting fees* remained constant at \$800 and \$5,500, respectively, median meeting fees as a percentage of total board member pay dropped from 33 percent

to 20.2 percent. The median cash retainer climbed from \$10,000 to \$12,750. For six banks, compensation consisted solely of meeting fees.

Approximately one-third of the banks paid a portion of compensation in equity. Among such companies, the median value of these equity awards increased 14.3 percent from \$14,202 in 2003 to \$16,231 in 2005. Despite the gains, equity as a percentage of total board member pay remained flat, coming in at 51.9 percent in 2005. The number of banks granting options as the only form of equity compensation decreased 21.4 percent, from 14 in 2003 to 11 in 2005. Four banks granted only stock in 2005, compared to half that number two years earlier.

The prevalence of non-executive chairman premiums grew from 40 percent in 2003 to 50 percent in 2005, while median non-executive chairman pay surged 42.4 percent from \$23,350 to \$33,245. The median premium the chairman received over other directors rose from \$1,147 to \$4,880, representing a 325.6 percent hike.

While additional retainers for audit committee members were nonexistent in 2003, directors of three banks received an additional fee for such service in 2005. The number of banks that paid an audit committee chair premium increased 50 percent from 10 banks in 2003 to 15 in 2005. The prevalence of compensation committee chair retainers jumped 66.7 percent from six to 10 during the same period.

Conclusion

As these statistics demonstrate, trends among these Western banking companies are consistent with broader patterns of board governance. Recent corporate scandals, growing shareholder activism, and sustained attention to executive compensation have led to increased scrutiny of board conduct and decisions, while directors face heavier workloads, greater time demands and higher risks of liability than ever before. For the foreseeable future, these forces, along with new SEC rules requiring detailed disclosure of board pay on a per-director basis, will continue to shape board of directors' composition and compensation practices.

**The median number of board meetings was used to calculate total board meeting fees for banks that did not disclose the number of meetings held.*

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