



**October/November 2005**

*Issue Focus: Directors Issues*

## **Modern Board Composition and Compensation**

*By Jeff Hopkins*

Recent corporate scandals and the passage of the Sarbanes-Oxley Act of 2002 have cast a spotlight on board members. As a result, the composition, practices and compensation of each company's board is more important than ever. The increased scrutiny facing directors and their decisions has translated into greater time requirements and a concomitant increase in board pay. To analyze these trends, Equilar conducted a study using SEC data for 2002 and 2004 at a sample of 59 banks located in the western United States with net assets of less than \$5 billion.

### **Board Composition**

Gone are the days when the CEO could handpick the directors to sit on the board. Both the NYSE and NASDAQ now require a majority of the board to be independent directors, and nominating committees have been created to institute an independent search process for these directors. The median percentage of independent directors serving on each bank's board is currently 71 percent. And, the trend has been towards increasingly higher levels of independence. Between 2002 and 2004, 44 percent of companies increased the percentage of independent directors serving on their boards. Boards also made strides towards creating a more diverse setting. For instance, the number of banks with at least one woman on the board increased during this period from 44 percent to 51 percent.

Boards have also increased the independence of their leadership. In 2002 just two of the companies disclosed a director serving as the lead independent director. This number rose to 14 in 2004. The number of non-executive chairmen remained relatively constant, decreasing slightly from 34 to 33.

The presence and disclosure of audit committee financial experts has also changed. In 2004, 93 percent of companies disclosed at least one expert, whereas in 2002 the position was virtually nonexistent. Four of the companies surveyed (7 percent) disclosed that they did not have such an expert, while eleven companies (19 percent) named more than one.

### **Board and Committee Meetings**

Although the median number of full board meetings remained constant at 11 over the period, the median number of audit and compensation committee meetings both increased. Of those companies disclosing the number of committee meetings held in both years, 66 percent held more audit committee meetings and 68 percent held more compensation committee meetings.

### **Board Pay**

Median board pay, consisting of cash retainers, meeting fees and equity awards, increased

36 percent from \$26,400 in 2002 to \$36,000 in 2004. The percentage of total board level pay attributed to meeting fees remained constant over the period at a median level of 14 percent. The percentage of retainer fees awarded in cash and equity also remained relatively constant. The median cash retainer rose from \$15,000 to \$20,000, and the median equity fees increased from \$3,830 to \$6,288. The median total board meeting fees grew from \$3,000 to \$6,000.

The percentage of total board level pay attributed to equity awards rose slightly from 25 percent to 28 percent. The number of banks awarding only options dropped from 23 to just 18, but the number of banks granting stock or unit awards rose from 10 to 15. Only 46 percent of the companies awarded equity in 2004 and four banks paid solely cash meeting fees.

The pay to board leaders has grown as the responsibilities have increased. Only four lead independent directors received premium pay in 2004, but just under half of the banks analyzed paid a premium to a non-executive chairman. The median non-executive chairman pay increased from \$36,730 to \$47,905. More significantly, the median premium the chairman receives over other directors increased from \$6,600 to \$12,000.

Although often receiving meeting fees similar to those of other committee members, the audit and compensation committee chairs have seen an increase in the prevalence and amount of the retainers they receive. In 2002 only one in four audit committee chairs received a retainer for such service, and the median retainer was \$5,000. In 2004, nearly half of the audit committee chairs received a premium, and the median value of the retainer increased to \$10,000. Likewise, five more compensation committee chairs received a retainer in 2004, with the median value of the retainer increasing from \$3,000 to \$5,000.

## **Conclusion**

Boards today are more independent, more professional, harder-working and better paid. Boards in the banking industry are no different. As long as corporate governance issues remain important, one can expect to see these trends to continue in both the banking industry and beyond.

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