



insights



REWARDING DIRECTORS FOR NON-BOARD WORK

INTRODUCTION

A key tenet of an effective board is having a diverse mix of Independent Directors, each possessing their own combination of skills and competencies and together acting in unison as stewards of the organisation. Independent Directors have a mixture of functional and firm-specific knowledge that uniquely qualifies them to undertake special company projects.

However, when considering engaging the services of Independent Directors significantly above and beyond their normal duties as Members of the Board, the following questions should be asked:

- Is an Independent Director truly the best candidate to undertake such work?
- Do we need to compensate the Independent Director for the additional service?
- If so, how and how much?

Such a decision should not be made lightly and one which the Board must seriously ponder before deciding on extra compensation.

NON-BOARD WORK

Too often Independent Directors are one of the most valuable, albeit somewhat underutilised, company asset. More and more Independent Directors are taking a larger role CEO succession, executive compensation, merger decisions, strategy implementation, risk tolerance, and other functions that have



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traditionally been under the province of management.

Boards have necessarily become more cautious in considering extra pay for non-Board services. Some companies have gone as far as prohibiting such arrangements outright under their Corporate Governance framework. However, an Independent Director can occasionally be the best resource to perform extra non-board services for a corporation. It is not unusual for a former CEO who remains on the Board following retirement to be asked to consult on extra non-board matters e.g. to lead a special project because of that Director’s special expertise.

While most corporations can likely find other qualified persons, who are not Independent Directors to perform these services, Independent Directors are sometimes uniquely placed for such roles given their institutional knowledge, their technical competencies, and their familiarity with the overall business, the Board, and Management.

REWARDING DIRECTORS FOR NON-BOARD WORK

What are the considerations and options for rewarding Independent Directors who are called to provide Non-Board services, far and beyond their normal Board responsibilities?

Before arriving at the decision to engage the services of an Independent Director to undertake extraordinary non-board work, it is assumed that the Board would have carefully considered the use of Management and/or external consultants to undertake the assignment(s). Excessive interference by Independent Directors who wander too far into day-to-day operations of an enterprise may bring about little good, or worse, may cause real damage. A useful governance principle for Independent Director oversight will likely be limited to situations requiring complex decisions which are of strategic significance relating to the company’s

business strategy, or core values.

The company may resist using outside consultants because of the confidentiality and sensitivity of the project. In a real-world instance, one major bank retained the services of a retired subsidiary CEO to undertake work related to a major acquisition via a consulting arrangement.

Options for rewarding the directors for extraordinary non-board work include:

- Additional Fees via relevant Sub-Committee
- Reimbursement of Expenses
- Consulting Contract
- Reviewing the Competitiveness of Current Director Fees

SUB-COMMITTEE FEES

Typically, existing sub-committees may not facilitate the payment of fees for special projects. In such cases, consideration can be given to the establishment of a “Special Projects” sub-committee.

The special projects fee structure can be fixed as with an Annual retainer or a Per Meeting Fee; similar to remuneration arrangements for other Sub-Committees.

REIMBURSEMENT OF EXPENSES

Reimbursement is always a better option than other compensation vehicles such as consulting fees, but this must be supported by defensible and bona fide evidence.

CONSULTING CONTRACT

In considering whether to enter into, or in structuring a ‘consulting’ arrangement with an Independent Director, organisations should be cognizant of independence, disclosure, and other related considerations. Furthermore, the ‘consulting’

agreement should not compromise the Director's independence. The associated fees should bear some relationship to the compensation paid to Directors for regular service, say 50%, and should not exceed an amount to align with what may be the SEC's related party transaction reporting threshold amount.

It is important to note that Independent Directors who are members of the Audit, Nomination, and Compensation committees - and whose independence must never be brought into question - **should not be considered** for consulting contracts.

REVIEWING THE COMPETITIVENESS OF CURRENT DIRECTOR FEES

The prior options presented regarding payment for additional Non-Board work may be deemed controversial, and questions may be asked about Director independence. We know of no situation where independent directors are paid extra compensation for Non-Board work.

Another option for consideration is to ensure that Director Remuneration – usually via an Annual

Retainer, Per Meeting Fees, or a combination of both – is competitively aligned to the market for Regular and Sub-Committee service. Independent Directors often complain that the Board compensation they receive is insufficient given the growing number of hours they are expected to work on a diversity of projects – some of which fall outside of the remit of normal board work.

CONCLUSION

There is nothing inherently improper about an Independent Director being paid for non-Board services, either via a consulting arrangement or sub-committee compensation. These arrangements often offer efficiencies and other advantages that might not otherwise be available.

However, the effect of such arrangements on the Director's independence needs to be carefully considered and should be fully and clearly disclosed in accordance with applicable requirements. We recommend that Independent Directors should be compensated fairly and competitively so that the question of extra pay for Non-Board service does not arise in the first place.

Highlights from our 2018 Corporate Directors Compensation Survey



- The average Board membership amongst the forty (40) Companies was nine (9) members, with Banks and Holding Companies having an average of eleven (11) members
- The average age of Directors was fifty-six (56) years; thirty percent (30%) of companies had no mandatory retirement age
- Regarding Board composition, fifty-six percent (56%) of companies reported having the CEO as a member of the Board
- Only twenty-two percent (22%) of Directors were female
- Three (3) companies reported having the CEO also serving as Board Chairman
- Fifty-three percent (53%) of companies conduct performance appraisals of the CEO, few companies reported Performance Appraisals of the Board, or individual Directors
- Thirty-eight percent (38%) of companies agreed that CEO and Board of Directors Succession Planning was a significant issue
- On average, Board Chairmen are paid an annual retainer of twelve percent (12%) of CEO pay - which is keeping with international trends

HRC Associates' Corporate Directors Compensation Surveys

In HRC's 2018 Corporate Directors' Survey, forty (40) leading public and private companies reported details of Board of Directors compensation and aspects of Board composition and structure.

HRC Associates' 2020 Corporate Directors' Compensation Survey is currently underway and

seeks to highlight the contemporary issues that Boards are currently facing.

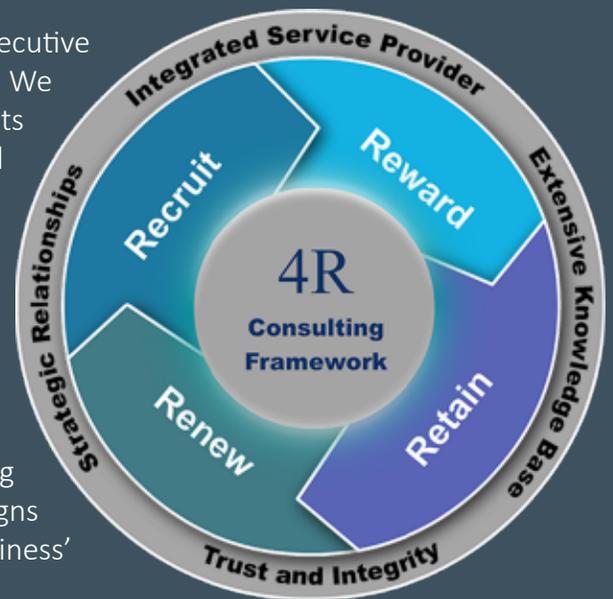
If your organisation would like to participate in the Survey do not hesitate to contact one of our Consultants at (868) 285-4472.

ABOUT HRC ASSOCIATES

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