TK: TK Kerstetter
MT: Matteo Tonello

This Week in the Boardroom brought to you by Corporate Board Member and host NYSE Euronext, along with governance knowledge partner Paul Weiss and contributing partners National Investor Relations Institute and the Society of Corporate Secretaries and Governance Professionals.

Welcome to this edition of This Week in the Boardroom. I'm TK Kerstetter with Corporate Board Member and it's my pleasure this week to welcome a new guest. This is Matteo Tonello, who is the managing director of corporate leadership at The Conference Board. Welcome, Matteo.

Thank you, TK. I'm glad to be here.

Well, we have an interesting topic, and you're the expert on this topic, and we're going to be talking about this report that you have done in collaboration with the NYSE Euronext and with NASDAQ called the 2011 U.S. Director Compensation and Board Practices Report. And we'll let people know at the end here where they can get this. I think a good place to start is maybe talk just a little bit about The Conference Board and make sure everybody understands that, and then a little bit about this collaboration and the final product.

So about The Conference Board, we are a business association. Our members are primarily public companies. We're based in New York, but we have members and offices in Europe and Asia as well. Among the services that The Conference Board has been offering to its members is the assistance with respect to a variety of matters in corporate governance, especially in the form of information and research on emerging trends and regulatory developments and best practices. The Conference Board has been documenting director and executive compensation for a very long time, since the 1950's. More recently, in response to the development of corporate governance into an extensive and increasing complex body of research, we have decided to introduce this benchmarking tool to provide data on evolving board practices, and some of this data is actually found in proxy statements and all reports filed by companies, and that is the case for director compensation data. But in other cases, it's not typically disclosed by corporations. So think, for example, of the educational programs that are offered to directors, or think of online board portals or other technologies that are being used to facilitate the communication among directors. All this information is included in the report. We have more than 120 benchmarking data points tracked through the reports, and they are searchable by industry and company size. And this is a survey based study, so we were obviously delighted to join forces with NYSE to expand the survey outreach.

Well, we were happy to be a partner this year, and we think that the information is going to be good and useful for any of those that want to sort benchmark their own performance against maybe a nice group of other companies that are also in their

size, and we'll talk about that in a minute. The first thing I want to talk about, which is always an interesting topic, is compensation. Specifically, one of the major parts of this is director compensation. So talk to us a little bit about what the findings were relative to that. Director compensation isn't talked about as much as executive compensation is, but nonetheless important, particularly if you're serving on a board.

Absolutely. And I think this is an ideal time to actually be examining director compensation, after the enactment of the Dodd-Frank Act and the expansion of the responsibilities of directors that followed the federal statute, especially with respect to oversight of executive compensation and oversight of risk. In the few years after the Sarbanes-Oxley Act of 2002, we had observed double digit increases in director compensation and recognition of the new compliance related duties of directors, the additional risk exposure that resulted from SOX. So it's quite interesting to look at how companies are now, after Dodd-Frank, adjusting their compensation offerings to directors to make sure that they continue to remain competitive and attract talent to the board. I think that Dodd-Frank is clearly the most significant piece of federal legislation affecting director responsibility after the Sarbanes-Oxley Act. And in the last couple of years, we've seen an extensive discussion about say-on-pay and pay-for-performance, and the major focus of the discussion seems to be on the voting results and the consequences of a failed say-on-pay vote. Sometimes we forget that these requirements translate into a significant additional workload for board members. So what we essentially found is that in 2011, the median total director compensation for the largest companies in our sample of 335 companies that we surveyed is just shy of $200,000.

And that's the largest companies?

This is the largest companies with typically an annual revenue above $5 billion. This seems to be about 9% higher than the value that had been found before 2010, and 13% higher than the value for 2009. Between 2007 and 2009, at the peak of the financial crisis, what we have seen is that director compensation remained quite flat. The figures for 2011 indicate a reversal of this type of trend.

Well, I would think that after SARBOX, people were sympathetic to directors with all the new things that had to come out. After Dodd-Frank and the financial crisis, you don't see the same sympathy from the investor's point of view. So I'm not expecting double digit, even though there's been some suppression on director's pay, I'm not expecting to see double digit like we did after Sarbanes.

Absolutely. And we haven't seen it yet. I mean it's 9%, and the figures that we found in 2011 reflect really the adjustment to the Dodd-Frank legislation. And also, we should keep in mind that there's been a recovery of the stock market as a factor of the equity based component of compensation.

In director comp, did you find anything special as far as industries go, or company size, or the relationship between retainers and equity?

Yeah. When you actually delve into this type of information, and you analyze it by industry and company size, you find that the differences can be quite meaningful. So in the smallest companies, companies with less than $100 million in annual revenue, we found that total director compensation is about $45,000, so about one-fourth of the figures for the largest companies. When you look at industries, the best paid directors are in the technology sector and in retail trade, whereas the lowest paid directors are in the banking sector, especially in commercial banks. The low numbers for the banking sectors, I think, are probably reflecting some resistance on the part of that industry to award significant increases at a time of increased scrutiny of the practices of the industry. As far as the high numbers in technology, we should keep in mind the inclination of that sector to include valuable compensation components in their compensation packages, including, for directors, stock awards, and to a lesser degree, stock options. We found that in technology about two-thirds of the value of total compensation package is represented by equity based compensation. But you were referring to another important point, another important finding, which has to do with stock option awards.

Or restricted stock.

Or restricted stock. What we've seen is that there's been a gradual disappearance of this component from director compensation packages. In fact, you can find that stock options still represents about 23% of the total director compensation in the technology sector. But as far as the other sectors are concerned, the inclusion of stock options of director compensation packages has been reduced significantly or discontinued altogether. It seems to be related to another phenomenon, which is the gradual shift towards a declassified board and the system of annual director election that seems to be incompatible with the longer vesting periods of stock options.

It's interesting. Ten years ago, there was such a movement.

It was the opposite.

Yeah, to have directors sitting in similar positions as shareholders, but I think now they're worried that some of those holdings are so significant does it naturally shade anything, and now we see a movement back to retainers versus equity. But let me ask you. Compensation wasn't the only finding in this report. What were some of the other major things that sort of jump at you?

Right. So, as I said, there are 120 data points, which offer a quite comprehensive portrayal of the state of corporate governance in this country. By repeating this study on an annual basis, we can obtain a series of snapshots of the developments of corporate governance. And the general observation from looking at these snapshots taken over time is that changes in corporate governance are actually taking place at two different speeds depending on the size of a company. So when we talk about the shift from priority voting to majority voting, when we talk about the increasing declassification of boards and the increasing diversity of boards, or if we're referring to new executive compensation practices such as bonus banking policies or new types of clawbacks, what we need to keep in mind is that these types of changes are actually observed in a more predominant way among the largest companies, and only more recently are they starting to trickle down to the smaller companies. There are exceptions. For example, the smaller companies seem to be more prone to the separation of CEO and chairman positions. But I think overall the general rule is smaller companies have been slower in adapting to corporate governance new elements.

Well, that's not a surprise when you figure that activists start at the top and work their way down. So it seems like the larger companies always set the pace, and then come mid caps, and then come small caps.

There are several factors. Activists are one of them. There is actually research that shows that smaller companies, when they under perform, tend to be more subject to activist shareholders and are more likely to become the targets of an activist campaign. And the data from the 2011 proxy season shows record high numbers of shareholder proposals on majority voting and on declassification. So that's definitely one factor, but you should also keep in mind the resource factor because governance policy changes do require significant investment in time of resources, and you need a proponent from within the company, senior executive or more likely an independent director, to champion a certain issue. You need to be able to educate board members about the issue and the implications of a certain change in the policy. You need to ensure full discussion at the board level so that everybody is on board. Ultimately, when the decision is made, you may still need to articulate it in writing. You may need to communicate it to shareholders, or you need lawyers and investor relations involved. So it's a process. If a resource is attached to it, and obviously the process is lower when the resources are more limited like in small organizations.

Well, we don't have that much time left, but I do not want to let you out of the studio here without us talking about CEO succession, which I know is another part of that. So give us a short synopsis of sort of what's in the study that people will find.

CEO succession is definitely, I would put it together with risk oversight and the role of a board on risk on top of a list of emerging board practices. And what proved to be a game changer with respect to the CEO succession subject is the change in the SEC staff policy that took place in October of 2009 with respect to the excludability of shareholder proposals in CEO succession from the proxy voting ballot. Until then, the SEC had essentially granted no actual relief to management wishing to exclude these proposals based on the consideration that CEO succession is an ordinary business matter and pertains exclusively to the area of responsibilities and competence of senior management. This has changed now, and the SEC recognizes the important strategic value and business risk that is associated with CEO succession. And this determined two important consequences. New shareholder proposals are being filed on CEO succession planning, especially with respect to disclosure, and there are emerging practices that are starting to show that we are beginning to document in our report. Among these practices I would identify three primarily. One has to do with the frequency of the review of succession plans. It used to be that companies would review it in situations of crisis or emergencies or under specific circumstances, and now instead we find a larger number of companies that are indicating that they review their CEO succession plans at the board level at least on an annual basis with regular updates. The second one is the assignment of responsibilities with respect to CEO succession planning, even to the compensation committee and not only to the nominating and governance committee. This seems to be happening especially among financial companies that are recognizing the link between CEO succession planning objectives and the compensation policy. We found that about 20% of financial companies are starting to do so and have a formal assignment of this responsibility to the compensation committee, but the percentage can be as high as 35% in the largest companies with asset values of $100 billion or more. And the third practice has to do with disclosure, which is slowly becoming a little more thorough, from the boiler plate language where a company simply reassures an investor about the existence of a succession plan, that information is increasingly being integrated with information on the criteria used by the company to select candidates, and the leadership development initiatives that are being set up to prepare internal candidates.

I know it's always been a fine line on not disclosing something that will give away competitive advantage either. So it seems like a lot of the disclosures do walk that fine line.

Absolutely. Things are starting to change.

Well, listen, tell our audience how they can get a copy of this cause I think certainly you see tidbits of this in the press; there's things happening. But if somebody was interested in this report, how could they get a copy?

It can be found online at *www.conference-board.org/boardpractices*

Okay, and that would be a website that would both have a recap of this and tell people how they can get a hold of it?

The entire report can download it from the website.

Matteo, thank you for a very thorough discussion. It was pleasure being part of the process to make this report happen.

Thank you.

We appreciate you giving the time to come on this week in the boardroom. So we'll have you back again once you collect some new information that we can pass along to our group. And that will conclude this week's edition of the show. We hope you found this interesting and found the research interesting. We'll be back again next week where we'll look at another important issue that will help make you a better committee member and board member. So we'll see you then.

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