Executive Compensation Bulletin

Annual limits for director stock awards gaining steam

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Pay for U.S. board members has been the subject of a number of shareholder lawsuits over the last few years, particularly with regard to allegations that director pay approved by the board itself was “excessive.” In two recent cases heard in the Delaware Court of Chancery (*Calma v. Templeton* and *Seinfeld v. Slager*), plaintiff claims of breach of fiduciary duty in connection with director stock grants were not dismissed by the court because the stock plans involved did not contain “meaningful” limits specific to directors.

Although these cases have not yet been decided on their merits, the decision to permit the suits to continue has put director pay under the microscope and has revealed an area of potential vulnerability to shareholder litigation. To provide insights into how companies have responded to the litigation, we reviewed compensation-limit guidelines and practices in *Fortune* 500 stock plans that include directors as participants. Our review found a proliferation of limits on director stock awards in the past few years. (For more on the litigation, see “Delaware Ruling on ‘Excessive’ Director Pay Offers Guidance for Avoiding Future Litigation,” *Executive Pay Matters*, June 4, 2015.)

Benchmarking director annual award limits

Over a quarter (28%) of the *Fortune* 500 currently include a director-specific annual award limit within their applicable stock plan. As shown in *Figure 1,* annual limits based on a fixed-dollar amount are slightly more prevalent than those based on a fixed number of shares. The median limit was 20,000 shares at companies that base limits on a number of shares and $500,000 at companies with dollar-based limits.

Figure 1. Director-specific annual award limits in *Fortune* 500 equity plans

	Fixed number of shares	Fixed-dollar value
Prevalence	43%	57%
Minimum	5,000	$200,000
25th percentile	10,000	$500,000
Median	20,000	$500,000
Average	91,616	$597,733
75th percentile	50,000	$750,000
Maximum	2,000,000	$2,000,000

Companies adding or reviewing a cap on annual awards to directors need to determine what constitutes a meaningful limit. Determining an annual award limit should be a thoughtful process that provides adequate flexibility when considering annual grant levels and overall share availability.

Figure 2 provides statistics on annual award limits relative to both the current annual stock award value granted to a company’s directors as well as to the total authorized shares in a stock plan. At the median, companies are setting the director limit between four and five times their current annual equity award values for directors (for example, a company with an annual grant of 2,500 shares might set an annual award limit at 11,000 shares).

Companies adopting or amending plans may also want to consider the potential annual director grant ceiling in terms of the number of authorized shares available under their equity plan(s). Understanding the ratio to the total authorized shares when setting an annual limit helps ensure there are sufficient shares available to provide awards to all participants without having to seek additional shareholder approval. Thus, targeting the median for the *Fortune* 500, a company with 50 million shares reserved for issuance under its equity plan might set an annual director award limit at 62,000 shares.

Figure 2. Annual award limit benchmarks

	Multiple of annual award limit relative to annual award level	Limit as a percentage of total shares authorized*
25th percentile	3.1x	0.040%
Median	4.4x	0.124%
75th percentile	8.6x	0.654%

*Total shares authorized for issuance within the applicable stock plan at the time a director-specific award limit was adopted/amended; includes additional shares requested during year of limit adoption/amendment, if applicable.

Most limits fairly recent

In response to the court cases, there's been a spike in the number of companies adopting director award limits in the last few years. In fact, nearly five out of six (82%) of the director-specific award limits currently in place among *Fortune* 500 companies have been established since 2013.

It's worth remembering that the stock plans at issue in the *Calma* and *Seinfeld* cases included both executives and directors as participants, and annual award limits for executives are typically substantially higher than those specific to directors. However, the companies we reviewed that award compensation through plans in which only directors participate have implemented annual limits at nearly the same rate as the *Fortune* 500 as a whole. Twenty-seven percent of companies with director-only stock plans also have a specific annual limit in place.

The most common type of limit remains a single limit on the annual stock award to a director. As shown in *Figure 3,* however, a few companies have adopted additional limits. For those that impose a separate annual limit for a non-executive board leader or a limit on sign-on awards for newly elected directors, the most common target is two times the annual award limit for regular directors. Limits on cash or total compensation for directors are still rare at the moment, with only 3% of the entire *Fortune* 500 having adopted such a restriction. Though the sample size is small, limits on total pay are understandably higher than those that apply only to stock grants, with our research currently showing the lowest total pay limit at $500,000 and the highest at $2 million.

Figure 3. Additional director pay limits

	Sign-on award limit	Board leader limit	Total pay limit
Prevalence of supplemental limits among companies that have an annual limit in place	9%	8%	10%

Looking ahead

Annual director pay levels are likely to continue to be closely examined in the wake of the *Calma* and *Seinfeld* cases. As such, the discussion of annual limits on director awards is likely to focus on how and when to implement them, rather than whether a limit is necessary. We will continue to monitor this topic as the 2016 proxy season unfolds.

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