INSIGHTS FROM A BOARD DIRECTOR: LORIANN LOWERY-BIGGERS

CEO and Co-founder of Bella Vaughan, Inc.

As a follow-up to the BDO 600 Board Compensation Report, LoriAnn Lowery-Biggers, who has deep expertise serving on various corporate boards of directors and chairing board committees, reflects on events that may shape future director pay and practices, touching on compensation, transparency, board structure, diversity of skills, director time requirements and risks. She shared her perspective with BDO's National Assurance Partner Amy Rojik. Their discussion probed behind the numbers to examine the realities and challenges facing board directors.

Editor's Note: This discussion occurred in 2019, but as we prepared for publication, the COVID-19 pandemic struck. Given the implications of COVID-19 for corporations, BDO asked LoriAnn Lowery-Biggers for her thoughts on how the pandemic's challenges are and will be affecting corporate boards. Her impressions have been woven into the responses and she also provides a broader commentary at the end of the piece.

LORIANN LOWERY-BIGGERS
CEO and co-founder of Bella Vaughan, Inc, an award-winning global diamond and design company.

She has over 25 years of experience in the global finance and insurance industry, notably as President of Lloyd's of London for North America. Lowery-Biggers has served on numerous boards, including as the chairperson of the PCI Underwriting and Marketing Committee and on the PCI Executive Roundtable. She is a director on the corporate board and chairperson of the Finance and Investment Committee of Copper Point Mutual Insurance Holding Company, she is the lead independent director of Brown & Riding Insurance, Inc., and she serves as a non-executive director and deputy chair of Nominating and Governance of Protective Insurance (NASDAQ: PTVCB).

DIRECTOR COMPENSATION

BDO: Director total compensation has risen by low-digit increases, as have annual board fees and retainers and the use of full-value stock awards. Do you see this as a trend going forward?

LoriAnn Lowery-Biggers: Yes, the low-digit increase will likely continue as per the trend established following the 2008 recession. Director compensation has rightly moved away from paying directors as executives to now paying directors for their contributions of time, independent purview and skill sets. Board retainers, equity grants and committee chair retainers further offset the reduction of pensions, benefits, perquisites and stock options.

I believe the COVID-19 crisis will temper the aforementioned incremental increases in director compensation for 2020. As we move through this pandemic, expect to see board compensation remain static rather than increase.

Industry sector will heavily determine reduction or deferment of board fees and compensation, particularly in hospitality/leisure/gaming, sports and entertainment, travel, tourism, brick and mortar retail, real estate, industrials, service industry, and auto manufacturers, along with oil and gas. These reductions will likely be in parity with management's compensation reductions. Many companies in these cash-strapped sectors are looking at alternative levers to director pay to help fill the gap. These include offsets to cash retainer reductions, deferments or time-specific forfeitures with increased equity grants. If additional equity grants are contemplated, impacts of market volatility and equity sufficiency must be carefully assessed in advance of taking such actions.

BDO: Board chairpersons are paid about 30% more than regular board members, but lead directors are only paid about 10% more. Given that lead directors are often pulled in many directions, is this pay disparity reasonable?

LoriAnn Lowery-Biggers: The lead director role came about as a response to the call for greater independence for companies with executive chairs. Typically, the role did not receive additional remuneration. As the role increases in significance, responsibility and time commitment, its pay is evolving and increasing. According to the data, non-executive chair pay continues to be higher than lead director pay. Further, executive chairs continue to be paid substantially more than both non-executive chairs and lead independent directors. Meanwhile, shareholders and activists continue to push for the separation of the chair and CEO roles. The key driver is independence.

On boards with an executive chair, I predict the lead director role will become more important for dealing with conflicts, independence and governance over items such as related-party scenarios. Separating the roles of the executive chair and lead director is sound governance. The rise in the lead director role ensures that board activities are handled by an independent outside board member rather than the CEO or executive chair. Companies are rightly developing additional retainers to compensate these roles as an important governance point and for the optics to the investors.

In 2020, we are seeing an appropriate call for greater independence on boards. This trend of separating the chair from the CEO role will be more resolute, and the role of the lead independent director will be crucial for independence, governance and fiduciary oversight.

BDO: A majority of companies (irrespective of industry) maintain stock ownership guidelines for directors. Do you see this practice increasing?

LoriAnn Lowery-Biggers: In order to recruit best-in-class talent and attract board-prepared diversity and inclusion candidates, certain industries need to review their practices and become more aligned with other sectors. Director stock ownership has emerged as the biggest lever for aligning directors with company performance and profitability. A number of publicly-traded companies have embraced a standalone director equity plan and are segregating the director plan from the executive plan. There's been a migration to the adoption of director equity limits for shareholder approval since 2012. Shareholders are now very focused on all components of director pay.

COMMUNICATION AND TRANSPARENCY

BDO: Are you seeing changes in communication among boards and shareholders?

LoriAnn Lowery-Biggers: Companies are setting up direct communication among board members and institutional shareholders, since shareholders want a clear path into the company. The lead director tends to be the conduit to the shareholders. Good governance requires good communication. Proxies and filings are more transparent regarding the information and data provided to shareholders and investors. In some cases, even a perceived lack of communication and lack of transparency can contribute to creating an activist shareholder situation.

BOARD STRUCTURE

BDO: Board diversity remains a major topic. Do you believe boards are "diversifying" in the right way?

LoriAnn Lowery-Biggers: Diversity currently is and will continue to be a significant issue with companies, vendors, shareholders and clients. The key is having the right people around the table, which is paramount in good governance and in good board structure. That includes every director and committee chair, including the CEO and the board liaison. Strategic selection is essential. Mining for and assessing skill gaps is the initial step to creating and fostering a healthier board. Further, board composition must reflect the organization's diversity in terms of skill sets and perspective, represent constituent voices, and align with strategic goals, values and culture. Board members must bring the expertise and capacity to ensure successful execution of strategic plans that advance the mission and are not just words on the mission statement.

Intentional diversity brings growth into the boardroom. Board composition is not just about gender and race; it includes diversity of thought, skill sets, generations, geography, operational experience and backgrounds. All these attributes create a board that is more relevant and multi-faceted than historical board composition. Now more than ever, it is not enough to have a seat at the table, but a voice.

BDO: Although numbers are rising slightly each year, women still occupy a minority of positions on corporate boards. Do you have hope for women taking more seats on boards?

LoriAnn Lowery-Biggers: Studies have found that companies in the top-quartile for gender diversity on their executive teams were 21% more likely to have above-average profitability than companies in the fourth quartile.[1] Diversity isn't just important to the board; it's now become important to the shareholders. Another survey[2] found that companies with stronger female leadership not only performed better, but also experienced less fraud, less bribery, less corruption, and less shareholder conflict, and they outperformed the companies that didn't have female leadership. The impact of women on boards is largely attributed to the independent perspective women bring to the boardroom. Board diversity is of growing interest not to just boards but also to the investors, regulators and stakeholders.

BDO: Are boards expanding, and, if so, how is this impacting committee structure?

LoriAnn Lowery-Biggers: Boards are not so much expanding in terms of numbers, but in terms of director responsibilities and time commitments. Today, most directors serve on more than one committee. Consequently, companies are rethinking how many directors are on the board, the board's composition and individual director skill sets. Rating agencies and market analysts are more focused on the robustness of governance occurring at each committee level. Audit committees of some boards are now being defined as the committee responsible for enterprise risk (ERM). The risk may range from a concern to a crisis or catastrophe. The skill sets associated with these committees are becoming more visible to the rating agencies, the investors, the management team, the analysts, and the shareholders. Boards must be cognizant and ensure they have the right skill sets to deal with ERM.

With the advancement of mergers and acquisitions (M&A) and more strategic opportunities, it is not unusual for boards to have strategic alternative committees in conjunction with the finance committee to ensure M&A expertise is on the board. A key trend that was emerging pre-COVID-19, and is now growing daily with the onset of the crisis, is the establishment of an ERM/Special Risk Committee. Its construct tends to be one representative from each committee: Governance (oversight of governance, regulatory and reputational risk), Human Resources (HR)/Compensation, Audit, and Finance/ Investment. During the COVID-19 crisis, these special committees are typically meeting virtually each week, if not more. The chair of this committee should be paid in parity as other committee chairs. Boards should carefully consider increasing committee compensation amid static board compensation and already heavy time commitments, responsibilities and liability.

BDO: Given the expanding responsibilities, etc., what is the impact on director pay?

LoriAnn Lowery-Biggers: Many companies haven't considered that directors who serve on one committee get paid the same as those who serve on multiple committees. There also is concern that flat retainers are not enough to compensate committee members in situations where a crisis creates the demand for multiple board meetings. Consider the significant investment in time required to conduct a CEO search that typically involves the nominating, governance and HR committees. Fortunately, boards have flexibility around setting director compensation. However, it requires robust action and intentionality and advance guidelines on how to compensate the directors who serve on multiple committees.

In this time of COVID-19, many directors, and therefore, committees are doing heavier lifting. Companies need to balance the economics of board and committee compensation with the imperative of attracting and retaining best-in-class directors amid the potential of greater liability for sitting on boards. The practice of former C-Suite operators looking to construct a "board portfolio" will likely become antiquated as director responsibilities and time commitments evolve.

1 Vivian Hunt, Sara Prince, Sundiatu Dixon-Fyle, Lareina Yee, "Delivering through Diversity," *McKinsey & Company*, January 2018, **https://www.mckinsey.com/~/media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx**.

2 Michael Volkov, "Increase the Number of Women on Corporate Boards," *Corporate Compliance Insights*, May 2014, **https://www.corporatecomplianceinsights.com/increase-the-number-of-women-on-corporate-boards/**.

TIME COMMITMENT

BDO: The National Association of Corporate Directors (NACD) annually surveys the hours that directors are spending in the board room, and it appears a director's time obligation continues to be an extremely significant commitment. Do you agree?

LoriAnn Lowery-Biggers: Very true. In addition, outside the board room, the amount of time for adequate preparedness coupled with director education, the volume of information in terms of pre-reads and what directors have to digest to form educated perspectives is significant. Those who serve on multiple boards need to examine the time and energy requirements and overall responsibility of today's boards, which are much higher now than in the past. An effective board member needs to understand the risks and opportunities these companies are facing, and those challenges change daily as the current pace of governance, litigation, activism and society changes.

RISKS

BDO: Can you comment on the risks facing directors?

LoriAnn Lowery-Biggers: The NACD's report[3] revealed that three of the top 10 concerns of directors were around risk and emerging risks, including disruption due to new technology. There's a huge uptick in bringing technology-savvy individuals onto boards. Twenty-two percent of the large-cap companies have brought in technology experts as directors.

Additionally, HR directors and chief HR officers are more integral to conversations at the board level than in the past. Expanding concerns around culture and attracting and retaining talent within the companies require the input of savvy HR executives.

Directors also must be aware of other HR-related concerns such as the cost of a toxic culture, employee practices, medical inflation, benefits, remote working environments, flex hours, etc. No longer can boards think about HR just in terms of the Named Executive Officers (NEOs). In addition to those dialogues, boards, the C-Suite and HR must work together on issues related to reputational and headline risk. In this world of social media, stories can get out before people have all the facts. The story outsiders initially hear is too often the one they believe. Timely communicating in a way that doesn't negatively impact share price is integral.

BOARD REFRESHMENT

BDO: Data suggests that some company boards may rely on mandatory retirement ages, rather than using evaluations to assess director fitness, as the primary mechanism for board refreshment. Your thoughts?

LoriAnn Lowery-Biggers: Board age limits can be a component of, but should not be the main path to, board refreshment. In no uncertain terms, board objectivity, effectiveness and independence, while incorporating the practice of evaluations, metrics, KPIs, director education and fitness, along with experience and evolving perspectives, are what shareholders desire and clearly articulate as their board refreshment priorities. A growing push among shareholders is to have annual elections for the full board in part to invigorate board refreshment. However, a study published by the Journal of Financial Economics[4] showed that staggered boards have a positive impact on firm value. Whether the board has age limits or the board is staggered, one thing that governance experts agree on is that board evaluations should be an embraced best practice. They create discussion and action and inform refreshment strategy.

Board refreshment will continue to be a big topic in the years to come. Refreshment, especially where committee skills are concerned, is increasingly a shareholder concern in terms of governance, risk mitigation, functional expertise and organizational focus. Tactical and purposeful director changeover promotes diversity, adds new ideas and specialties and increases director independence. Board refreshment stimulates the board to think in an enhanced way.

BDO: What works in terms of onboarding new directors?

LoriAnn Lowery-Biggers: A useful tactic is to bring in some new members while more senior directors are still onboard, so the board retains their knowledge and also transfers that knowledge to the newer members. Rigorous onboarding and orientation are big differentiators and indicators of board performance and seamless transfer of institutional knowledge. Board training also is essential. It is a difficult transition from an operating role to a board role, and appropriate training helps in making the transition.

3 "2019-2020 Director Compensation Report," NACD, https://www.nacdonline.org/insights/publications.cfm?ItemNumber=67554.
4 Cremers, K. J. Martijn and Litov, Lubomir P. and Sepe, Simone M., Staggered Boards and Long-Term Firm Value, Revisited (July 25, 2017). Journal of Financial Economics (JFE), Forthcoming. Available at SSRN: https://ssrn.com/abstract=2364165

COVID-19

BDO: What are you seeing with respect to board focus in this COVID-19 pandemic? What issues will boards be grappling with today and in the future as a result of COVID-19?

LoriAnn Lowery-Biggers: These certainly are unprecedented and unparalleled times. There are so many components to consider and many are shifting almost daily. I call it "the octopus effect": there are many tentacles to assess and reassess and each is rife with uncertainty and is continually evolving.

It is urgent that the board begin assessing the appropriate construct of directors and committees for the new reality of risk that will characterize the post-COVID-19 environment. This is highly likely the first massive global disruptor, not the last. Robust assessment and evaluation of board skills and relevancy are going to be more important in the future than ever before. Every board member must add value and bring a depth of skills to the table.

Further, given the combination of a presumed future of increased litigation and the high probability for heightened investor scrutiny and activist involvement looking to arbitrage and leverage this disruption, current and potential board members need to ascertain the risk versus reward of sitting on corporate boards. Boards will need "best-in-class" directors, but the pool of board-ready and savvy candidates will shrink, creating additional burden on future directors and boards. Consequently, the post-COVID-19 pressure on director compensation will escalate as high-caliber candidates will be more discriminating about which boards they choose to serve.

FINAL THOUGHTS

A company's commitment to transparency about board governance is the number one issue among many activist investors and shareholders. Therefore, the practices and approach to compensation around that will require heightened board sensitivity, debate and disclosure. Investor attention to board performance is significantly on the rise and boards are seriously enhancing their disclosure and transparency around board compensation and board leadership. Companies must be able and ready to answer questions, such as: Why did this director get a seat at the table? What are their skills? How do they add value? And, perhaps most importantly: What governance protocols are in place to make sure the board has the right talent and tools to continue to build better board members and allow them to engage effectively and efficiently in good governance and mission achievement?

CONTACT

JUDY CANAVAN
Compensation & Benefits
Managing Director
215-636-5635 / jcanavan@bdo.com

AMY ROJIK
National Assurance Partner
617-239-7005 / arojik@bdo.com