Getting Back on the Horse – Part II

An Update on Industry Executive Pay

(Part 1 can be found here and covers executive compensation)

Part I of this article discusses executive compensation within the mining industry and how it was responding to the financial upturn in the industry. Companies had their executive pay programs on care and maintenance during the down turn and now it is time to get back on the horse.

This article addresses board compensation or director pay and the emerging trends we are observing amongst industry clients and contacts.

When boards review the compensation of their executives they automatically think about their own pay and what is happening competitively. This makes economic sense. When we harvest executive data for clients it involves very little extra effort to collect board compensation whereas undertaking a separate survey would virtually double the cost. The comparator group will usually be the same as well as the philosophical pay perspective.

This is where the cost synergies end. Other than the board chair and certain key committee chairs directors tend to be paid the same irrespective of their contribution.

Boards are naturally conflicted when examining their own pay and this realisation often has a significant impact on outcomes. The stage of the company also influences how directors arrive at and review their own compensation arrangements. Our experience suggests that public mining company boards fall into one of four groups when which dictates their approach:

1. **The Established Producer** - has several active mines in different geographies with a seasoned executive team and a board of professional directors. Typically there is a strong governance ethic and schedule for comparing compensation with a strict set of comparators with policy often calling for mirroring median practice.
2. **The Evolving Producer** - mostly has a single location plus possibly some other projects (e.g. JV or royalty arrangement) being taken from discovery to production with. Public scrutiny or a major shareholder demand high levels of governance but the evolving board has not yet reached the sophistication or the discipline of the established producer. Board members often have a financial interest other than pay in the success of the project. Some board members may be founding owners.
3. **The Post Exploration Company** - almost exclusively one location that has required external funding to proceed necessitating the addition of independent directors to a board comprising original owners who may also be providing executive services.

4. **The Exploration Company** - from which almost all independent mining companies emerge usually, comprises a group of entrepreneurs who form a company to indulge their passion for adventure and discovery. Funded with external money with a future that is solely focussed on finding that major discovery and hopefully being taken over by a major.

The mining industry comprises a variety of different profiles and enormous variation ensuring that almost all participants are unique informing the compensation approach.

The first objective of executive pay is to ensure that it is within the range offered by peers to safeguard executives from being enticed away by another employer. The second objective is to assure stakeholders that the team is not being overpaid. This resulting “ballpark” pay is then customized to reflect the company’s circumstances and board philosophy on incentives, retention, and short and long term performance pay.

Board directors are not generally going to be enticed away for more pay - if it is too low then they may not join the board especially if not accompanied by adequate E&O insurance or health and safety coverage for site visits. They may quit if they can no longer commit the required time or effort or if they believe the board is heading in a direction against in conflict with their experience that may affect their personal reputation but rarely will board directors leave for higher compensation in the way executives do. While boards assess their own performance and sometimes will ask a director who is not contributing at the required level to think about retirement there is otherwise a generally accepted obligation on the part of a board member to see the job or their tenure through.

Directors also are expected to exhibit generally a higher tolerance for self sacrifice than the executive team with a number of boards amongst our smaller clients taking partial or total pay cuts during the downturn. Setting Board compensation is therefore not subject to the same considerations as executive pay.

Director pay like executive pay is established with reference to the pay awarded by similar comparators to assure stakeholders that they are not paid more or less. This is a comparator group rather than *competitors* for talent as might be the case for executives.

Director compensation amongst mining companies has followed the trend in other industries and has increased in recent years (in contradiction to industry executive pay), to reflect the increasing levels of work involved in stewardship. No longer is a director's work confined to four meetings per year plus the AGM. There are often one or more committees that require a director's involvement and non-scheduled emergency calls and video conferences. There is no correlation between the amount of work involved in

being a director which may vary from year to year and the level of compensation - total compensation is driven by the level paid by the comparator group.

Here is where the work of the Compensation Committee becomes crucial in establishing wider board expectations. For example some of our clients allow the entire board to determine the makeup of the company's comparator group with each director inevitably examining the list from a different perspective; external optics, retention, complexity of operations and so on. Changing one or two companies in a list of 15 similar companies is going to have little impact on the ultimate level of competitive pay but some boards believe that this is time well spent.

Other quite modest client companies believe that their profile is so unique that they should be able to attract the very best directors based upon that fact alone and that they would be prepared to work basically for the experience (as fees are below the market).

While director compensation doesn't fill the same function as it does with executives, pay for directors even for the most intellectually demanding projects needs to be reasonable for the time invested. Directors' only commodity other than their knowledge is time and there must be a reasonable trade off between pay and the time that they are required to commit to a company. Needless to say however the level and depth of director experience available to emerging companies is governed by the level of board compensation that they can afford.

Comparator lists are directional and in the development of compensation targets many other variables can affect the positioning of pay targets irrespective of the selected comparator list. Undertaking a philosophical discussion and securing consensus on whom and why the company compares itself to others before it commissions the work to do so, is a vital part of a Compensation Committee's role and will save time and expense. A documented philosophy and policy approved by the board will assist in this process and avoid policy reinvention every time a new study is undertaken.

Comparison of board pay is more complex then executive pay and requires Compensation Committee agreement on how elements are to be recognised. Below we list some of the considerations but before doing so we should review the typical structure of board pay which can comprise number of different elements:

a) **Retainer** - a cash fee paid monthly or quarterly with the amount dependent upon the practice of the comparator group and/or cash available to the company.
b) **Meeting Fees** - are amounts paid for attendance at board or committee meetings. Increasing board workloads and difficulties in defining what constitutes

"a meeting" have encouraged many companies to roll meeting fees into their director retainer and abandon the practice of paying for attendance at meetings.

c) **Committee Premiums** – paid to recognise the additional work of being the chair of the board or a major committee such as Audit or Compensation. Some companies although this is a declining practice pay a premium to directors who additionally sit on a committee in addition to their board role.
d) **Long Term Component** - typically paid in stock units or options and therefore linked to the value of the company this component has a variable payout. The amount of the award is determined with reference to comparator practice, available cash and potentially the company's executive long term incentive practice. Payout is often deferred and the trend is toward whole stock or unit awards which have down as well as upside exposure. Often there is a minimum shareholding requirement for a director which the long term incentive is designed to help achieve.

The interests of the board need to be aligned with shareholder interests and we encourage clients to consider distancing the type of long term incentive used for board members from those used with the executive team to achieve a degree of director objectivity.

When examining pay levels for directors it is usually the median (or mid-market) total annual compensation paid by the comparator group that is the first point of comparison; fees, premiums, meeting fees and long term payment excluding any special fees paid to a director for executive work.

Some companies dependent upon circumstance may target more or less than the median pay of its comparator group. Wherever pay policy is set the features that recognise the unique circumstances of the company are then applied to this competitive target. For example it may choose to increase the total to reflect a lower paid retainer than the comparator group i.e. a premium because a higher amount is at risk.

The circumstances of the company may require significant extra committee work warranting a premium payment for the chair or alternatively extra or extended meetings may make meeting fees a preferred alternative. An international company that has overseas directors may consider paying for travel time to be a reasonable compensatory element.

All of these considerations need to be debated regularly as part of the Compensation Committee's review process and reflected along with the business rationale in the company's compensation policy document. The document should be written in an easy to read format and serve as a reference for Committee members.

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As companies emerge from the down turn and start to get back on the compensation horse this would be the perfect time to review philosophy and policy. Many of the prior comparator group will have disappeared and the company is likely to have a very different profile from when the compensation committee last looked at board compensation.