

Non-Employee Director Compensation

Presentation for:

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About Anthony “Tony” Eppert



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- Tony practices in the areas of executive compensation and employee benefits
- Before entering private practice, Tony:
 - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
 - Obtained his LL.M. (Taxation) from New York University
 - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
 - Editor-in-Chief, Journal of Medicine and Law
 - President, Tax and Estate Planning Society

Upcoming 2025 Webinars

- 2025 webinars:
 - Pros, Cons and Contrasting Secular Trusts and Rabbi Trusts (11/13/25)
 - Year-End Review of Any Missed Executive Compensation Items (12/11/25)
- 2026 webinars:
 - Coming! Welcome thoughts on subject matters!

Sign up here: <https://www.hunton.com/en/insights/executive-compensation-webinar-schedule.html>

Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded companies, and involve substantive areas of:
 - Tax,
 - Securities,
 - Accounting,
 - Governance,
 - Surveys, and
 - Human resources

- Historically, compensation issues were addressed using multiple service providers, including:
 - Tax lawyers,
 - Securities/corporate lawyers,
 - Labor & employment lawyers,
 - Accountants, and
 - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



Our Compensation Practice – What Sets Us Apart (cont.)

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement “best practices”
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

Standards Associated with Director Pay Decisions

- As background, directors' decisions with respect to their own compensation can be challenged as self-dealing and are subject to the "entire fairness" standard (including both fair dealing and a fair price) rather than the more deferential and director-friendly "business judgment rule" (*i.e.*, a board's decision will be upheld unless it cannot be attributed to a rational business purpose). That is, unless such decisions were ratified by the issuer's shareholders
- Should shareholders approve all or a portion of non-employee director compensation (*e.g.*, compensation caps, fixed formulas, etc.)?
- Minimally, the following should be considered when setting director compensation:
 - Develop a formal pay philosophy;
 - Ensure form, amount and timing of pay falls within market practice (*e.g.*, benchmarking surveys, advisors, etc.);
 - Develop clear proxy disclosure about the foregoing that also explains the rationale for any unique situations (*e.g.*, onboarding grants, etc.)
 - Maintain detailed minutes of the Board meeting, discussions (within reason) and rationale
 - Consider the use of deferred compensation, stock ownership guidelines or hold policies so as to align the interests of the Board members with those of the issuer's long-term shareholders

Considerations for Director Compensation

- The compensation philosophy derived from director compensation should reflect the Board's views towards corporate governance
- The compensation program should support a Board member's independence and objectivity. Therefore:
 - Vesting schedules should be short (market practice is 1 year, or paid in arrears)
 - There should be no entitlements that compromise independence (e.g., no medical benefits or perquisites such as club memberships)
 - Compensation should NOT be performance based because the Board should be encouraged to (and not inhibited from) challenge the short or long-term goals of management
 - Stock options and other price-appreciation types of awards are typically not used because such can create an incentive for the directors to support high risk/high reward behaviors
 - And too, query if such stock options become underwater (i.e., the FMV of the stock is less than the strike price). Such fact could shape (or be alleged to shape) the director's behavior since the director would not be financially impacted by further decline in stock price, and as a result could orientate the director to high risk/high reward business strategies
 - No performance-based compensation for the reasons set forth above

Characteristics of a Typical Compensation Package

- Though amounts and types of director compensation are varied, a typical director compensation practice includes:
 - Form of compensation is typically a blend of cash and equity
 - Cash typically takes the form of meeting fees and/or annual retainers (meeting fees are generally used to balance disparate workloads among members of the Board (e.g., one committee might be more active than another, and too, committee chairs tend to have heavier work loads))
 - Equity typically takes the form of fully vested restricted stock (granted in arrears at the end of the service period), or if not granted in arrears, then equity awards typically contain a short vesting schedule and take the form of RSUs
 - Though stock options continue to be used by some issuers, such awards are less prevalent
 - Entitlements and perquisites tend to be avoided
- One-time onboarding equity awards are common
- Mandatory deferrals of equity awards
 - Either through an actual deferral program, or via a stock ownership program
 - Just a note for issuers with volatile stock prices, that is, consider the length of time that is administratively required from the point when such deferral ends (resulting in the director having taxation based upon FMV at such point) and the later point when, administratively, the board member is able to actually take control of the shares resulting from the converted RSUs and sell all or some of such shares in the open market

Background: ISS and Shareholder Ratification

- ISS has a policy with respect to evaluating proposals seeking shareholder ratification of non-employee director cash or equity compensation
- Qualitative factors that will be considered include:
 - Director compensation compared to issuers with a similar corporate profile,
 - Any problematic pay practices with respect to non-employee director compensation,
 - The presence of any stock ownership guidelines (*i.e.*, at least 4x the annual cash retainer) or hold requirements applicable to non-employee directors,
 - Vesting schedules with respect to equity awards,
 - The mix between cash and equity compensation,
 - The presence of any meaningful limits on director compensation (*i.e.*, likely a result from *Seinfeld* and *Calma*),
 - The presence of retirement benefits or perquisites, and
 - The quality of the disclosure addressing non-employee director compensation
- The above last bullet is yet another reason why robust disclosure should be included within the narrative that directly precedes the Director Compensation Table of the proxy statement

Background: ISS Pronouncement

- Excessive director compensation
 - ISS has a policy to issue an adverse vote recommendation for board members responsible for approving non-employee director pay when the issuer exhibited a recurring pattern of excessive pay without a compelling rationale over a two or more consecutive years
 - Emphasis added because ISS is looking for a **pattern** of excessive compensation
- According to ISS, the following disclosed rationale generally mitigates concern around otherwise high pay (assuming not excessive):
 - Onboarding grants for new directors that are clearly identified as one-time in nature,
 - Payments related to corporate transactions or special circumstances (e.g., special committee service, transition payments for a limited period, etc.), or
 - Payments made in consideration of specialized scientific expertise (e.g., biotech or pharma)
- With respect to consultancy agreements, these are assessed on a case-by-case basis with a focus on rationale. To be considered reasonable, the issuer should disclose:
 - The services to be provided that go beyond typical director responsibilities,
 - The additional benefits conveyed to shareholders by the agreement, and
 - That the agreement has a set term which is not automatically extended

Separate Equity Plan for Directors?

- The equity plan scorecard (“**EPS**”) was adopted by ISS in 2015 and weighs the positive and negative factors around the following 3 pillars:
 - Plan cost,
 - Plan features, and
 - Grant practices
- As part of the “plan features” pillar, a certain number of points are allocated to the issuer if the equity plan has a minimum vesting feature
 - Full points within this bucket are awarded if the equity plan has a greater than 1-year minimum vesting schedule for all equity awards, subject to a 5% carve-out
 - No points within this bucket are awarded if the minimum vesting period is less
- Frequently, non-employee director awards will contain a vesting schedule of less than 1 year (e.g., grants in arrears or vesting quarterly, etc.)
- As a result, and to help ease the strain on the 5% carve-out otherwise associated with both employees and non-employee directors receiving equity awards with vesting schedules of 1 year or less (especially if the issuer has retirement eligible provisions for all of its participants which is draining from the 5%), consider moving non-employee directors to their own equity incentive plan
 - Noteworthy is that EPS does not apply to a non-employee director equity plan

Treasury Stock Purchase Program

- Consider implementing an elective program whereby non-employee directors elect to use their after-tax cash compensation to purchase treasury stock from the issuer
- Overview of the program
 - Cash compensation is deposited into a brokerage account;
 - Each director elects the percentage of the cash compensation that he or she will direct towards a FMV purchase of treasury stock (hopefully 100%, minus the monies to pay the taxes associated with the participant's receipt of the cash);
 - The brokerage shop executes the trade on the director's behalf, consistent with instructions, depositing treasury shares into their account and delivering cash to the issuer based on the FMV of the issuer's stock on the day the trade is executed (*i.e.*, no discount)
 - Brokerage fees could be paid by the issuer
- The issuer's cash outlay is essentially returned, except for the amounts used by the participants to satisfy their income tax liability
- Issues to consider include:
 - A plan document is required
 - A Form 8-K would be required
 - A Form S-8 covering the shares should be filed

Treasury Stock Purchase Program (cont.)

- [continued from prior slide]
- Advantages of a treasury stock purchase program include:
 - Shareholder approval is NOT required under NYSE and NASDAQ rules;
 - There is no draw from (or dependency upon) the share reserve of the equity incentive plan, thus such share reserve is preserved;
 - It encourages ownership in the issuer, thus serving the purpose of aligning the director's interest with those of the issuer's shareholders;
 - It can help to facilitate stock ownership requirements/guidelines, which can act as a mitigating factor to negate "materiality" in the risk assessment process;
 - It is more efficient than open market purchases since all directors would be able to satisfy their ownership goals on the same day rather than over an extended period of time (the latter of which could otherwise be required if there were low trading volume);
 - It is more equitable than director purchases in the open market because all directors will pay the same price (open market purchases could result in price disparity depending on when purchases take place);
 - Routinely scheduling of purchases shortly after earnings release provides transparency and reduces risk of allegations that the participant used insider information; and
 - Issuances from treasury stock adds a small amount to the outstanding share count, which increases market cap (thus helping to satisfy ongoing listing requirements)

Compensation to a Director's LLC

- Purpose of this slide is to address a request from a director that the issuer pay director compensation to his or her LLC and not to him or her personally
- The situation arises in two common scenarios
 - Director is serving as the nominee of the LLC (e.g., a nominee of a large shareholder or private equity shop)
 - Director is the owner of the LLC, and in this scenario there are two types:
 - Director is the sole owner
 - The LLC has multiple owners (*i.e.*, another type of the nominee scenario)
- If the LLC has multiple owners, then:
 - Assigning income to the LLC will not likely work because the director will recognize income tax upon his or her receipt of the compensation under the “assignment of income” doctrine
- If the director is the sole owner of the LLC, then:
 - The LLC would be considered a disregarded entity for tax purposes
 - As a disregarded entity, any payment of cash to the LLC would be treated as though the payment was made directly to the director

Compensation to a Director's LLC (cont.)

- Assume for this slide that the LLC is wholly owned by the director
- To get equity awards to the LLC, the award must first be granted to the director, and then the director could transfer the equity award to the LLC. This structure is necessary because:
 - Almost all equity incentive plans require equity award recipients to be “natural persons” because Form S-8 and Rule 701 are only available to cover issuances to natural persons
 - Most equity plans contain a transfer restriction that prohibits a participant from transferring the equity award prior to vesting
 - Transfers from a director to his or her wholly-owned LLC would not trigger a Form 4 (*i.e.*, his or her pecuniary interest has not changed)
 - However, future Form 4 and 5 disclosures should reflect that the director only has an indirect ownership in the shares that were transferred)
 - The compensation would be reported in the proxy statement without any reference to the LLC. Any subsequent transfer of vested equity by the director to the LLC would not have to be reflected in the proxy statement
 - The assignment of income doctrine would not be applicable because the director and the LLC are treated for tax purposes as one (*i.e.*, the LLC is a disregarded entity)
 - Put another way, a taxpayer cannot assign to him or herself something that is already assigned to him or her under federal income tax laws

Health Insurance

- Issuers have moved away from providing issuer-sponsored health insurance to its non-employee directors, but we still hear of the “ask” from time to time
- Problems with an issuer providing health insurance to non-employee directors include:
 - MEWA issues
 - Non-employee directors are considered self-employed
 - Adding them to the issuer-sponsored health plan creates a multiple employer plan
 - To eliminate discrimination issues due to excluding other independent directors, the plan would have to be amended to allow for “participating employers,” and as a result, MEWA status is created
 - If a self-funded MEWA, then ERISA preemption might not apply (though the Form M-1 that must be filed with the state would not likely be required because the number of participants does not exceed 1% of the total number of participants in the plan)
 - Without ERISA preemption, the plan is open to allegations that the plan has to comply with the funding requirements under state law Department of Insurance regulations
 - Disclosure in the non-employee director table of the proxy statement is not likely required unless access to such insurance is considered a perquisite
 - The stop-loss carrier should be notified since the class of those eligible to participate would have been expanded

Don't Forget Next Month's Webinar

- Title:
 - Pros and Cons: Contrasting Secular Trusts v. Rabbi Trusts
- When:
 - 10:00 am to 11:00 am Central
 - Thursday, November 13, 2025