Foreign exchange: the director pay dilemma

The need for international directors has never been greater. But to attract the best candidates—and keep the entire board happy when you do—director compensation needs to effectively address foreign exchange concerns

By Ken Hugessen with Reanna Dorscher

As Canadian corporations look to diversify their boards, the need to attract international directors—most commonly from the U.S.—increases. Likewise, companies expanding operations south of the border have a growing need to attract and retain U.S. directors. Both circumstances raise the dilemma of how to fairly compensate board members while maintaining internal equity in the context of exchange rate fluctuations.

Currently, most Canadian companies compensate all directors in Canadian dollars. But as the need for U.S. directors grows (and as long as the Canadian dollar remains relatively weak against the U.S. dollar) the pressure to adjust pay levels does, too. Faced with this situation, we see issuers using several alternatives:

- **Pay all directors in Canadian dollars.** While sticking with the status quo is the simplest and most widely accepted solution, companies run the risk of losing out on U.S. directors who aren't willing to be compensated "below market" on a converted basis. A director pay philosophy that does not provide flexibility may impair the company's ability to attract and retain key board talent.
- **Pay all directors in nominal dollars.** One alternative, currently enjoying a bit of a comeback, is to pay all directors the same dollars but in their home currency (directors in Canada are paid in Canadian dollars, U.S.-based directors are paid in U.S. dollars, etc.). While it is simple to administer, this system can create a disconnect as it can be viewed as paying some directors more for doing the same job. In the early 2000s, some financial institutions implemented this policy, but when the Institute of Corporate Directors voiced disapproval, they reverted to paying in a single currency. This approach also seems at odds with guidelines provided in the document "20 Questions Directors Should Ask about Director Compensation," published by the Canadian Institute of Chartered Accountants in 2004, which says pay should be the same for board members performing similar roles. While some organizations have recently implemented a nominal pay policy without external pressures (e.g. Pembina Pipelines and Shaw), the potential internal equity issues could attract external scrutiny in future.
- **Pay all directors in U.S. dollars.** This option might appeal most to companies needing a significant U.S. presence on the board, as it ensures internal pay equity while being market competitive with U.S. firms (Gildan Activewear is one such adoptee). The downside is that it may position the company's director pay high on a converted basis, relative to peers.
- **Provide additional allowances.** Companies that are not prepared to adopt a formal policy for managing foreign exchange may provide additional allowances. These allowances provide compensation to attract cross-border directors. For example, Bank of Montreal provides an additional travel allowance of $15,000 for directors whose principal residence is across a border from Canada.

To date, proxy advisers and shareholders have not opined on how currency adjustments should be made for director pay, allowing boards the opportunity to adopt a policy that best suits their company with limited risk of unwanted commentary. Note that it is important to be consistent year over year as changing the pay practices too often may not only displease directors, but may also attract negative attention externally.

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While this article addresses North America, this pay dilemma is prevalent internationally in any organization with directors from multiple domiciles. In most markets, U.S. practices and pay levels tend to set the standard. But as there is no single right solution, companies will need to carefully consider their specific circumstances in determining their approach. Boards may consider their board philosophy and near-term talent requirements, and balance these requirements and the need for a top-performing board against the risk of external pressure to arrive at their choice.

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