Pearl Meyer

ADVISOR BLOG

COVID-19 Discussion Points for Your May/June Comp Committee Meetings

AUTHOR

Mike Esser
Managing Director

As compensation committees prepare for their next meetings and what is sure to be a robust discussion regarding the impact of COVID-19, we thought it might be helpful to share some observations from recent client discussions to create a heightened mindset around the following:

Review disclosed actions to date. There is value in understanding what other companies are doing in terms of compensation actions related to COVID-19. We have been tracking disclosed actions among Russell 3000 companies and there has been a reasonable amount activity thus far:

- 265 companies (~9% of the R3000) have disclosed material pay actions connected to COVID-19. Most of these companies are in industries that are consumer-facing (e.g., restaurants, education services, retail apparel, home furnishings, hotels, etc.), so the adjustments are unsurprising.
- Of these companies, over 220 (84%) made significant cuts to CEO base salaries, and nearly 200 also cut NEO salaries, albeit to a lesser degree.
- Over half (145) of the companies also cut non-employee director cash retainers.

However, these disclosed actions may only be the tip of the iceberg. We know from our consulting that many companies have taken pay actions that were deemed not material enough to require disclosure.

Additionally, there have been very few disclosures of adjustments to non-employee director annual equity grants (i.e., to account for the impact of a substantial stock price drop on the number of shares required to achieve “normal” annual equity grant values). While stock prices have recovered significantly from their nadir in March, we anticipate some adjustments will be made and disclosed shortly following the annual meetings in May.

Start establishing ground rules regarding 2020 short-term incentives. Most calendar year companies established performance targets for their short-term incentive (STI) plans in

February, well before the world changed. Many of these companies have goals that are now unattainable, even at threshold levels.

In early discussions, companies are considering a variety of approaches to address the potential impact, ranging from doing nothing to modifying annual goals or setting up a special 2H plan covering the second half of the year. Others are considering extending the performance-payout curve below threshold levels, to generate payouts for below-threshold performance or to use as a guideline for some level of discretionary awards. Some companies are also considering whether to de-couple the individual/strategic performance component from financial performance “gating” mechanisms that may be in place.

In their May meetings, committees would be well served by a robust discussion around the impact of COVID-19 on the business and incentive plan metrics, including potentially modeling two or three scenarios of full-year effects to the extent possible. If modeling is not practical, the discussion should turn to establishing ground rules for how performance will be evaluated (i.e., defining what “good performance” looks like post COVID-19 and how this translates [or doesn’t] to potential bonus payouts).

While incentive plans often have provisions that allow for adjustments for extraordinary items, “extraordinary” is an accounting-based concept/interpretation that COVID-19 may not meet. As a result, most committees will likely need to exercise discretion to approve any bonuses where the company did not meet its original financial or operating goals. Defining the ground rules up front in May could provide context and a greater comfort level for the committee when considering potential discretionary adjustments at the end of the year.

Tee-up a discussion about long-term incentives/equity. The focus in May is likely to be appropriately focused on the impact of COVID-19 on business results, and potential implications for 2020 bonuses. However, it also may be important to plan a discussion regarding the potential impact on the company’s long-term/equity incentives, particularly performance-based plans.

With the shift to performance-based equity over the past 10 years, many companies face a situation analogous to their bonus plans, that is to say the impact of COVID-19 on 2020 performance may result in $0 payouts for their performance-based equity grants. This impact may be felt not just for the 2018-20 performance period, but also for all performance cycles in play, including 2019-21 and 2020-22.

However, changing performance targets for these grants would have significant accounting complexities and implications. In addition, shareholder advisors such as ISS and Glass Lewis have indicated that they are not supportive of changes to mid-cycle awards and will be examining any changes to performance targets closely.

Given that in most cases these awards are for multi-year periods, there is no reason to panic just yet. Also, most companies have a balanced LTI program, including service-vested equity that was designed to provide retention hold in this situation. And while changes to in-process cycles may not be practical, keep in mind that the next grant cycle in early 2021 represents an opportunity to recalibrate awards and performance targets.

That said, if the impact of COVID-19 is projected to zero out all performance cycles in play, there may be an argument for discussing the potential need for retention awards, who would be eligible to receive them, the amounts, and the optics of such a move. It may be worthwhile to tee this discussion up in May, with the expectation that necessary performance cycle modeling is reviewed and potential retention share pool needs are covered in the Fall meeting.

Finally, while there may be parallels to the Great Recession of 2008-9, the COVID-19 crisis is different and the world has changed. There is a heightened standard of fairness and shared sacrifice in this crisis, and companies will face unprecedented scrutiny regarding how they respond. Against this backdrop, compensation committees should be especially mindful of their governance duties, and the potential reputational risk of actions taken down the road.

About the Author

Mike Esser is a managing director with Pearl Meyer in the Los Angeles office. Mr. Esser has more than 25 years' experience as an advisor to boards and senior management in executive and board compensation, compensation strategy, and annual and long-term incentive/equity plan design. His consulting experience covers a variety of industries and company organizational and developmental stages, including startup/pre-IPO, privately-held, public, cooperatives, and non-profit organizations.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.

Pearl Meyer

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

RALEIGH
(919) 644-6962
raleigh@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

For more information on Pearl Meyer, visit us at www.pearlmeyer.com or contact us at (212) 644-2300.