Harvard Law School Forum on Corporate Governance

Evolving Executive Compensation Responses to the Global Pandemic

Posted by Mike Kesner, Sandra Pace, and John R. Sinkular, Pay Governance LLC, on Thursday, September 3, 2020

Editor's note: Mike Kesner, Sandra Pace, and John R. Sinkular are partners at Pay Governance LLC. This post is based on their Pay Governance memorandum.

Pay Governance has written a significant number of Viewpoints detailing the impact of the global pandemic on existing executive compensation programs as well as the issues to be considered by management teams and compensation committees as they navigate these unprecedented times. One of our guiding principles is to "put everything on the table" to ensure a full and thoughtful discussion of existing and future compensation arrangements.

Over the last several months, the global pandemic and economic slowdown has impacted people, communities, business operations, financial performance, and stock prices in varying degrees. There continues to be significant uncertainty as to when the pandemic will end and what the new normal will be. Business forecasting and planning are further complicated by the U.S. presidential election, which is less than 100 days away.

Pay Governance has been discussing multiple scenarios and potential compensation actions with our clients. We have also been tracking the disclosure of executive compensation changes made to date in order to catalog various responses and the underlying rationale for such changes.

Summary Observations

- The impact of the pandemic on company financial performance varies by industry, ranging from severely harmed to positively impacted, which will result in a wide range of pay implications.
- Companies are spending considerable time reviewing the status of in-cycle incentive awards and evaluating the potential need for changes to future years' incentive plans.
- Some companies particularly those severely impacted by the global pandemic have revised or modified in-cycle cash and/or equity awards, while others are taking a "wait and see" approach.
- Many companies, guided by their pay-for-performance philosophies, are reluctant to make changes to in-cycle awards; however, these companies also recognize we are truly in unprecedented times.

This post provides a summary of the executive pay actions taken or being considered in two extreme situational examples: companies severely harmed and those positively impacted by the pandemic. In future Viewpoints, we will conduct an in-depth analysis of these profiles and others (e.g., moderately affected companies and companies with multiple business units that are experiencing varying implications); we will also look ahead regarding design considerations for next year's executive pay plans.

Comparison of Performance Situations and Pay Actions

Pay Element	**Severely Harmed**	**Positively Impacted**
Base Salary		
Situation	Critical need to reduce cash costs and expenses	Revenues/earnings increasing along with hiring employees
Actions	• Temporary base salary reductions or salary deferrals • Considering appropriate time to restore reductions or stop deferrals	Providing annual base salary increases
Annual Incentive Plan (AIP) for Current Year		
Situation	Tracking to no payout or suspended the AIP	Tracking to above target payouts
Actions	Evaluating alternatives, including: • Setting new full-year goals • Adopting additional non-financial goals (e.g., resilience when the pandemic hit) • Creating a second-half/partial year plan • Waiting until year-end to potentially apply discretion (e.g., based on a "resiliency scorecard" that evaluates actions management has taken to help the company survive the pandemic and thrive afterwards)	Discussing formulaic payouts, based on: • Reviewing the impact of the pandemic on revenues/profits versus future/sustainable levels • Considering the team's response to the pandemic to safely meet increased customer demands while managing supply chain and other operational challenges • Evaluating if negative discretion is appropriate considering broader context (e.g., pay less than maximum to avoid perceptions of windfalls and demonstrate empathy)
Long-Term Incentives Outstanding		

Situation	• Outstanding equity awards well below grant values due to stock price decline • All performance plan cycles tracking at zero or below target payouts	• Stock price at or above grant values • Some or all performance plan cycles tracking at or above target payouts; however, some aspects of 2020 performance may be one-time in nature
Actions	Evaluating alternatives, including: • Reviewing plan flexibility to adjust performance results for the pandemic • Considering mid-cycle modifications and accounting and disclosure implications of doing so • Assessing whether off-cycle awards should be granted during the current year	• Reviewing formulaic payouts to ensure payouts are appropriate considering the broader economic and social context • Evaluating if the estimated payouts from outstanding awards provide sufficient recognition for the performance delivered, which also may be considered in developing next year's long-term incentive grants

Key Perspectives to Consider

In these unprecedented times, it is critical to analyze performance and incentive outcomes from multiple perspectives to provide the Board and management team with greater confidence in finalizing incentive payouts for completed incentive cycles and assisting with the development of next year's pay plans.

1. Review formulaic results for incentive cycles ending in the current year and, if warranted, discuss potential adjustments.
    - Consider the impact of the pandemic and review performance during the year, which may include segmenting the year into parts (beginning and end of the year).
    - Identify other metrics that became relevant during the pandemic (e.g., resilience of the team in responding to the crisis), which will be important if adjustments are being considered or discretion may be applied at the end of the cycle.
2. Review proxy-named officer pay (including potential realizable pay and mock-up of next year's Summary Compensation Table) and the history of incentive payouts compared to total shareholder return over multi- year periods (3, 5, and 10 years).
3. Consider implications of mid-cycle changes, new incentive plans, and final incentive payouts from the perspective of investors, employees, and other stakeholders (e.g., accounting cost, disclosure, Say-On-Pay, shareholder relations, etc.).
4. Discuss any potential increases to next year's target pay levels based on the foregoing factors and other typical inputs (market competitiveness, internal equity, etc.).

5. Build on actions taken for incentive cycles ending in 2020 and determine if any of these factors may be important in developing the incentive designs and goals for next year's incentive award opportunity for example:
    - Is grant documentation flexible to allow consideration of adjustments for a second wave of the pandemic or other unforeseen events?
    - Did results shift from 2020 to 2021 (or were they pulled forward from 2021 into 2020)?

Conclusion

The impact of the global pandemic varies by company, and many uncertainties remain. This crisis has highlighted the criticality of a company's human capital and the importance of protecting employees' health and well-being. As such, many companies will likely find that solely using financial results during these unprecedented times may be incomplete in assessing the company's performance. Potential adjustments or modifications to existing incentive plans to retain and motivate employees will need to be well-thought-out and measured responses tailored to each company's situation.

We expect to see a significant increase in the disclosure of executive compensation changes as those companies with fiscal years ending prior to December 31st will be reporting their decisions regarding in-cycle and new incentives amidst continued uncertainty. Their decisions and the corresponding stakeholder reactions will likely be the subject of significant discussion over the next several months, and we plan on covering these important developments in future Viewpoints.