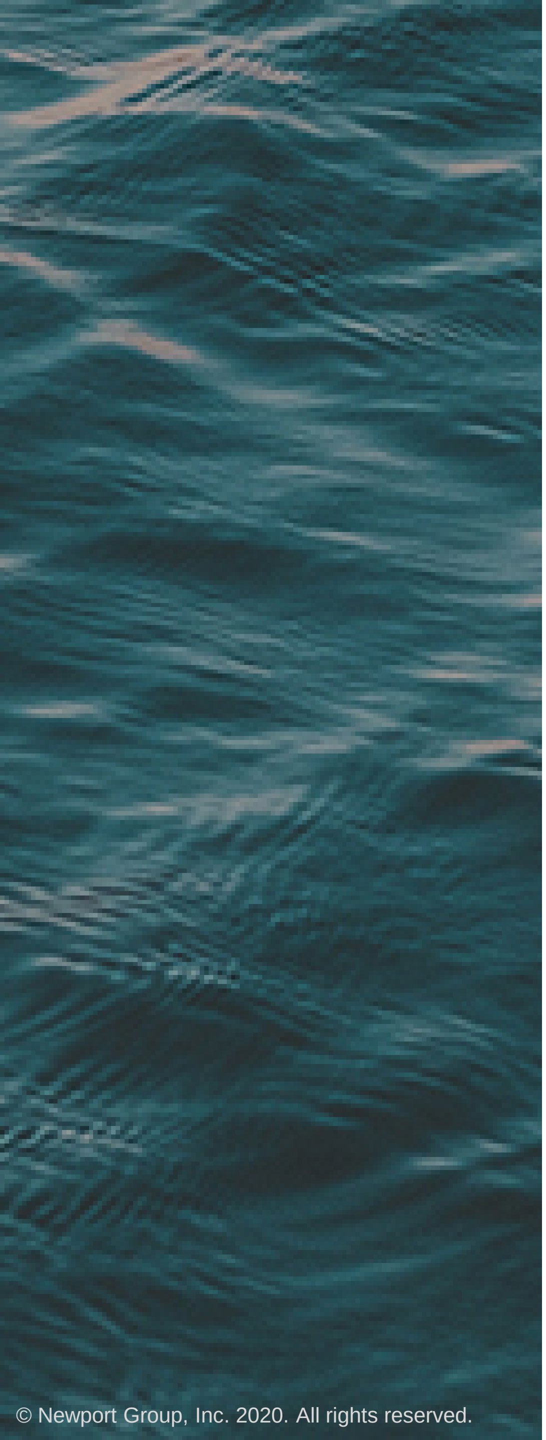
MCA

Milwaukee Area Compensation Association

Virtual Roundtable – 6

Executive Compensation in the Age of Covid-19

4.21.2020



Executive Compensation in the Age of COVID-19

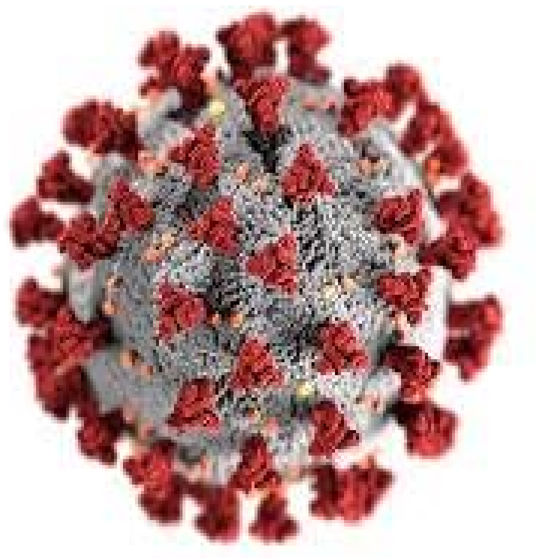
April 21, 2020

Dennis Koletsos, M.B.A.
Engagement Leader

© Newport Group, Inc. 2020. All rights reserved.

Agenda

- COVID-19 Business Impacts – Recent Headlines
- 2020 Newport Survey –Coronavirus Impact on Rewards and Staffing
- 2020 Annual Incentive Programs
- 2020 Long-term Incentive Grants
- Potential LTIP Silver Linings
- Change-in-Control Provisions
- Executive Pay Transparency – Shareholder Concerns
- Public Company Disclosure Requirements in L of COVID-19
- Presenter Bio



NEWPORT retirement services

COVID-19 Business Impacts – Recent Headlines

The impacts of COVID-19 transcend industries and geographies. Nearly every sector of our global economy has been impacted. Some of today's headlines:

One of the largest pork processing facilities in the US is closing until further notice

Deloitte and EY Join Rivals in Cutting Pay During Pandemic

Harley-Davidson CEO forgoes salary while other execs, salaried staff see pay cuts during COVID-19 pandemic

By Margaret Naczek / Like other major Wisconsin companies, motorcycle manufacturer Harley-Davidson announced salary reductions and other operating actions in response to the COVID-19 pandemic.

Milwaukee Public Museum, Art Museum closing to public

COVID-19: US universities scramble to arrange campus closures

Newport Survey – Coronavirus Impact on Rewards and Staffing

Executive/Management Roles

	Already Implemented	Considering	Not Implementing or Considering	Don't Know	Not Applicable
Base freeze	10%	10%	57%	10%	13%
Base cuts	2%	5%	67%	15%	12%
Base increases	2%	8%	68%	10%	12%
Annual merit increases delayed	7%	18%	50%	8%	17%
Short-term Incentive/Annual Bonus modified	7%	18%	43%	10%	22%
Long Term Incentive modified	0%	12%	53%	10%	25%
Voluntary Leave (Unpaid)	20%	3%	45%	18%	13%
Involuntary Leave (Unpaid)	7%	5%	58%	18%	12%

This survey was launched on March 30, 2020, in response to the COVID-19 pandemic of 2020, and participation closed on April 6, 2020. Responses were received from 60 organizations with responses required to each question. The purpose of this survey was to see what type of compensation and staffing measures organizations have taken as a direct result of the 2020 COVID-19 pandemic.

NEWPORT retirement services

2020 Annual Incentive Programs

Presenting Issues

- The potential impact of COVID-19 to executive annual incentive programs (AIPs) is becoming apparent as the virus continues to spread and business conditions deteriorate.
- In many cases, AIP goals that were finalized in Q1 before the onset of the pandemic may no longer be realistic or attainable, even at threshold performance levels.

Potential Remediation Strategies

- Companies might consider revising their metrics to attainable levels, or implementing additional metrics that are aligned with current priorities, to ensure that executives are appropriately incentivized.
- For some companies, it may make sense to defer revising goals until there is more stability, or to rely upon Board discretion to create flexibility in terms of payouts.
- Consider shorter performance periods (e.g., 6-months as opposed to 12 months).

Considerations

- Any payouts should take into account decreases in shareholder value/returns caused by COVID-19. (What is "appropriate" given the business climate?)
- Certain executives may elect to forgo 2020 payouts to preserve liquidity to prevent RIFs, job eliminations, and/or unpaid furloughs for non-executive staff, particularly at closely-held firms.

2020 Long-Term Incentive Grants

Presenting Issues

- For companies that granted equity awards in Q1 – reduction in market value may have resulted in accelerated depletion of the available share pool to arrive at target award amounts (e.g., **1,000 shares** at $50/share = $50K vs. **2,000 shares** at $25/share = $50K award).
- For "performance-based" LTI grants (both equity and cash-based): Extreme market volatility may result in lack of vesting (and zero payouts) for FY 2020.

Potential Remediation Strategies

- Consider delaying grants until a period of greater stability resurfaces with a commitment that delayed grants will vest according to the customary grant schedule.
- Consider time-based vesting for 2020 LTI grants (in lieu of performance-based vesting).
- Consider using relative performance criteria (as opposed to GAAP) for the 2020 performance period.
- Give the Board or the Compensation Committee the discretion to settle awards in shares or cash at the end of the performance period.

Considerations

- Consider limiting upside opportunity if companies implement strategies that provide downside protection. Consider appropriateness of target grant award amounts in current business climate.

Potential LTIP Silver Linings

Long-term Performance Orientation

- For LTIPs that feature multi-year performance periods, extreme volatility in one year can be “smoothed out” in subsequent years, provided the performance in those years exceeds target performance levels.
- Here is an example of a cash-based LTIP with a multi-year performance period (i.e., performance unit program):

	2020	2021	2022	2023	2024	2025
Grant Amount (units)	100					
Unit Value (at target)	$1,000	[Performance Period]		Payout		
Total Award Value (at target)	$100,000			**$100,000**		
Grant Amount (units)		100				
Unit Value (at target)		$1,000	[Performance Period]		Payout	
Total Award Value (at target)		$100,000			**$100,000**	
Grant Amount (units)			100			
Unit Value (at target)			$1,000	[Performance Period]		Payout
Total Award Value (at target)			$100,000			**$100,000**

Change-in-Control Provisions

Presenting Issues

- Depressed stock values and lackluster company valuations could lead to takeover activity (hostile bids or voluntary combinations).

Considerations

- A potential bid could disrupt a target's employees and damage the target's business irrespective of whether a transaction materializes.
- To maintain business continuity in the event of a hostile bid, ensure that executives have appropriate CIC provisions memorialized in their employment agreements.
- Double trigger provisions have become widespread in executive employment agreements.

Executive Pay Transparency – Shareholder Concerns

- Institutional shareholders and the proxy advisory firms are watching the steps that companies take regarding compensation to ensure that good governance practices are maintained and executives do not receive windfalls in the face of severe shareholder losses.

- One way to strike the appropriate balance for performance goals based on peer group comparison criteria may be capping payouts at **<u>target</u>** regardless of performance relative to peers if shareholder return is otherwise flat or negative during the applicable performance period.

Public Company Disclosure Requirements in Light of COVID-19

- If a company is making changes to its annual or long-term 2020 incentive compensation program, the following considerations will be important in determining whether the changes will need to be disclosed on a Form 8-K:
  - As a general matter, the terms of incentives do not need to be disclosed unless they are material and are not within the terms of the company’s previously disclosed plans and programs.
  - A company’s historical disclosure practices often influence its ongoing disclosure decisions and should be taken into account. Whether or not disclosure is made may also have a precedent-setting effect, which companies may wish to consider.
  - Companies will want to consider in advance whether additional disclosure would be required if discretion is exercised at the end of a performance period. If performance targets are completely missed and a company uses its discretion to provide for significant payouts, a Form 8-K will likely need to be filed disclosing that discretion was exercised and the ultimate payout amount.
  - If only minor changes are made to the payout amounts, whether or not disclosure is required will be based on the particular facts and circumstances of the payout, including the company’s historic Form 8-K filing practices.
  - Any changes to short or long-term incentive compensation will need to be disclosed in the company’s Compensation Discussion and Analysis section of the proxy statement for the year in which such changes occur.

Dennis Koletsos
Engagement Leader
Newport Group
Chicago, IL
847.668.3482
Dennis.Koletsos@newportgroup.com

Summary of Experience

Dennis is an Engagement Leader in Newport's Compensation Consulting Practice. Dennis has more than twenty years of executive and workforce compensation experience servicing clients across myriad industries in both the for-profit and nonprofit sectors.

Dennis specializes in the design of executive compensation programs with emphasis on long-term cash and equity-based programs, deferred compensation arrangements, and board of director pay programs. Other areas of expertise include executive compensation strategy development, annual incentive program design, succession planning, and performance management programs. Dennis also has significant experience designing, managing, and implementing workforce compensation programs.

Industry Specialization

- Manufacturing
- Non-profit
- Healthcare
- Consumer Goods
- Professional Services
- Financial Services
- Banking
- Energy (oil & gas)
- Cooperatives
- Distribution & Supply Chain
- Food
- Insurance

Education

- M.B.A., Lake Forest Graduate School of Management
- B.A., English, Northern Illinois University

NEWPORT™
retirement services