



**COVID-19 Action Center**  
**An ESOP<sup>TM</sup> Association Webinar**



# Pandemic Impacts on Executive Compensation

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# Agenda

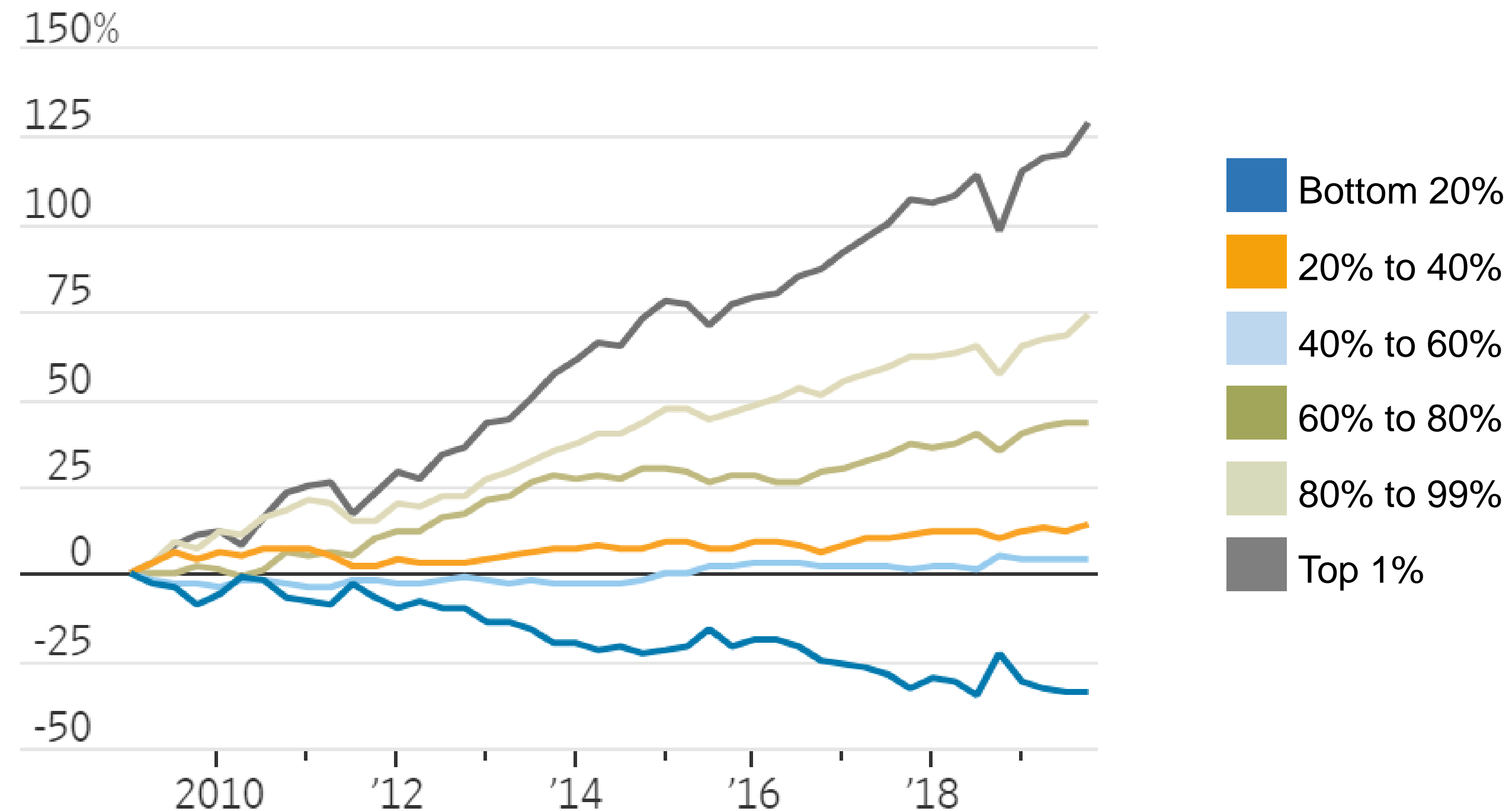
- Quarantine Impact / Introduction
- Revisiting 2008: Lessons Learned
  - Base
  - Bonus
  - Long Term Incentive Plans ("LTIP")
- Additional LTIP Considerations



# Quarantine Impact

- Half of small businesses can't afford to pay employees for a full month of quarantine
- 1 in 5 American workers say they will be unable to meet basic financial needs (e.g., rent, groceries, bills) in one week or less
- 58% say they will be unable to meet basic financial needs in one month or less

# Change in Financial Assets Since End of Recession



- As of December 2019, households in the bottom 20% of incomes had seen their financial assets fall by 34% since the recession ended in 2009

<sup>1</sup>Financial assets include cash, bank accounts, financial investments and retirement savings. Adjusted for inflation.

Source: Federal Reserve via the Wall Street Journal, April 15, 2020

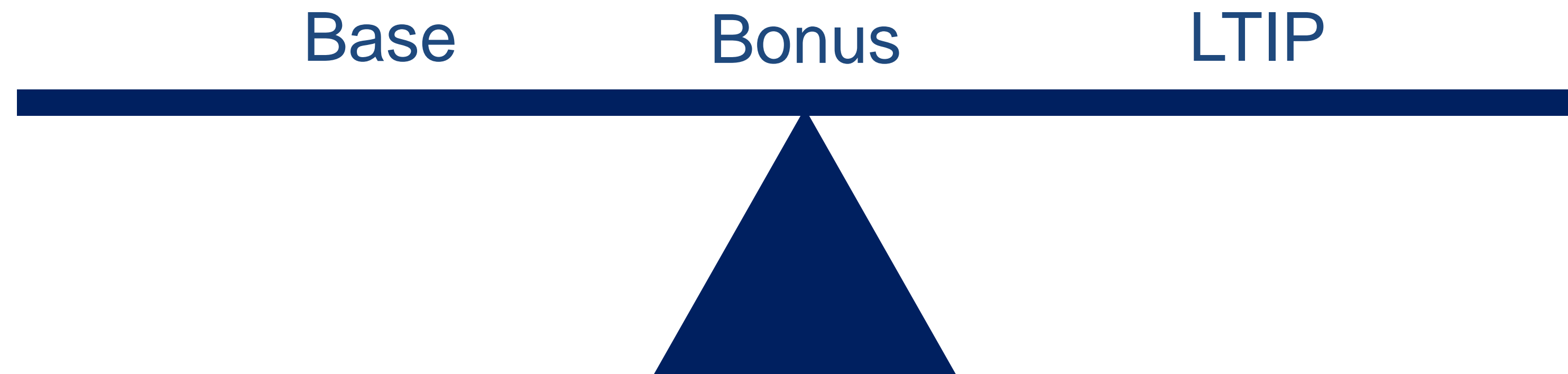
# The Case for Long-Term Compensation Planning





# Revisiting 2008: Lessons Learned

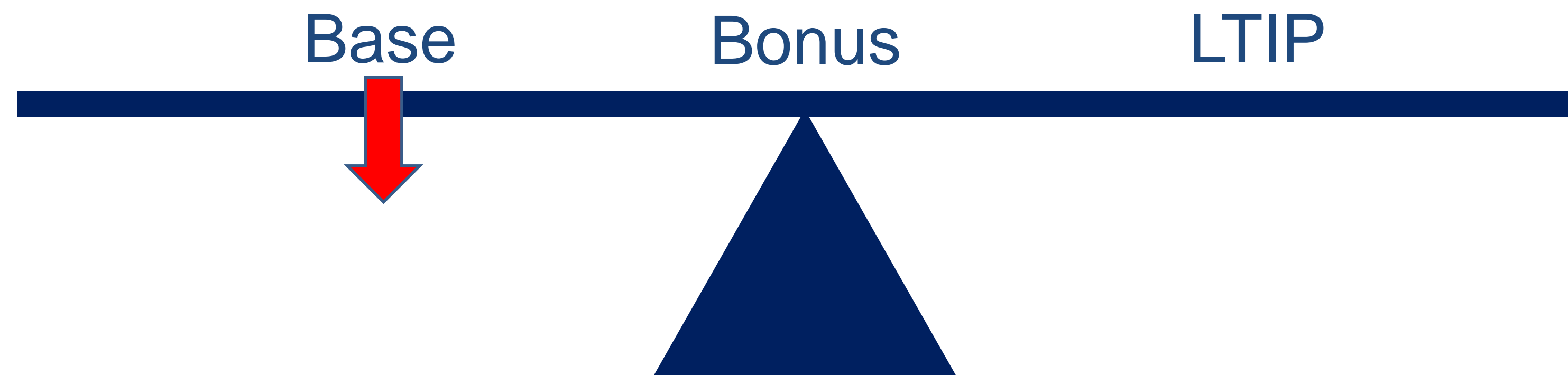
# Balanced Compensation



- Long-term incentive plan (“LTIP”): Any compensation earned or paid over a period of longer than one year
- Examples: deferred cash compensation, stock appreciation rights (“SARs”), phantom stock, stock options, etc.

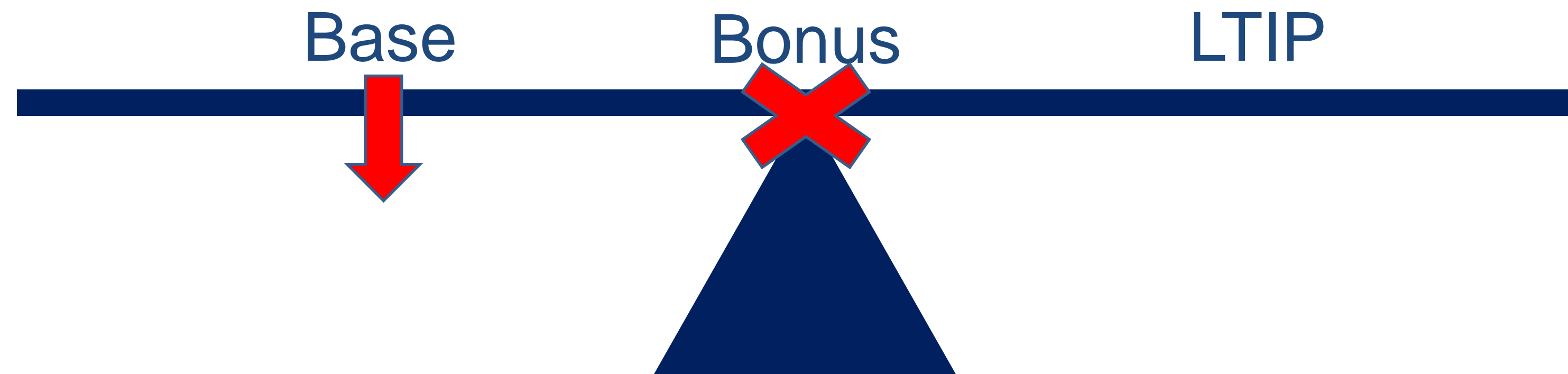


# 2008: Base Pay Impacts



- Some companies had cuts to base pay
- Clearly communicate your plan for reductions, *and* for restorations

# 2008: Bonus Impacts



- Most bonuses were reduced or eliminated
- Some bonuses had been viewed as entitlement

# 2008: Bonus Impacts

Bonus Metrics	2005 Survey	2010 Survey
<i>Cash Flow</i>	19%	26%
<i>Cost/expense reduction</i>	-	17%
<i>Working Capital</i>	-	4%
EBITDA	19%	25%
Net income	24%	24%

Source: Towers Watson 2010 Annual Incentive Plan Survey

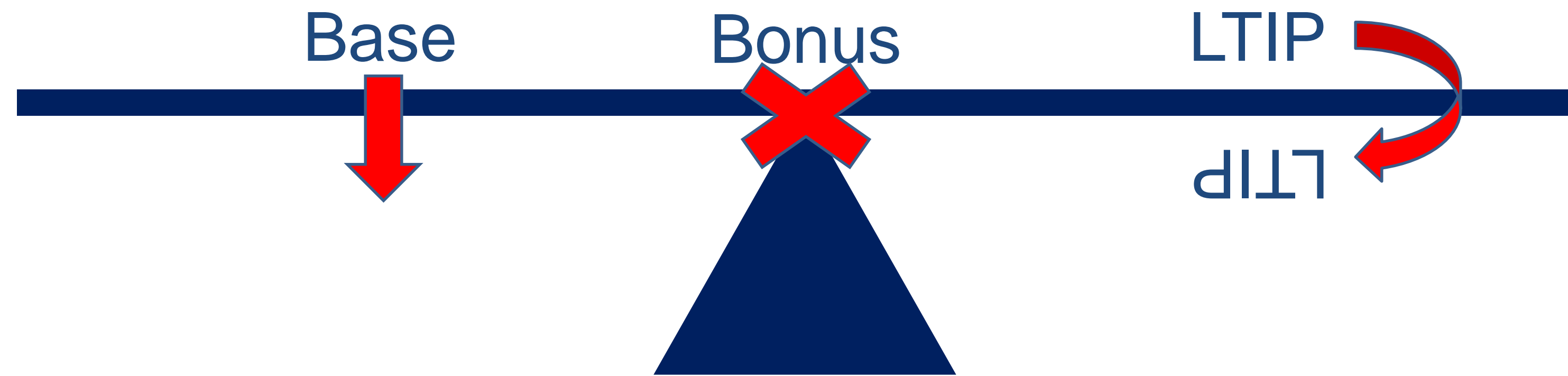
- Note the shift towards measures centered on sustainability and liquidity



# Bonus Implications

- Discretion will be required at end of year
- To the extent possible, develop a framework now for applying that discretion (e.g., track virus impacts and financial results of associated responses)
- Balance shareholder outcomes with rewarding outcomes within employees' control at a time when commitment is highest
- Where possible, recalibrate goals and reinvigorate employees
- Perhaps consider additional quarterly awards tied to virus response or critical business preservation goals

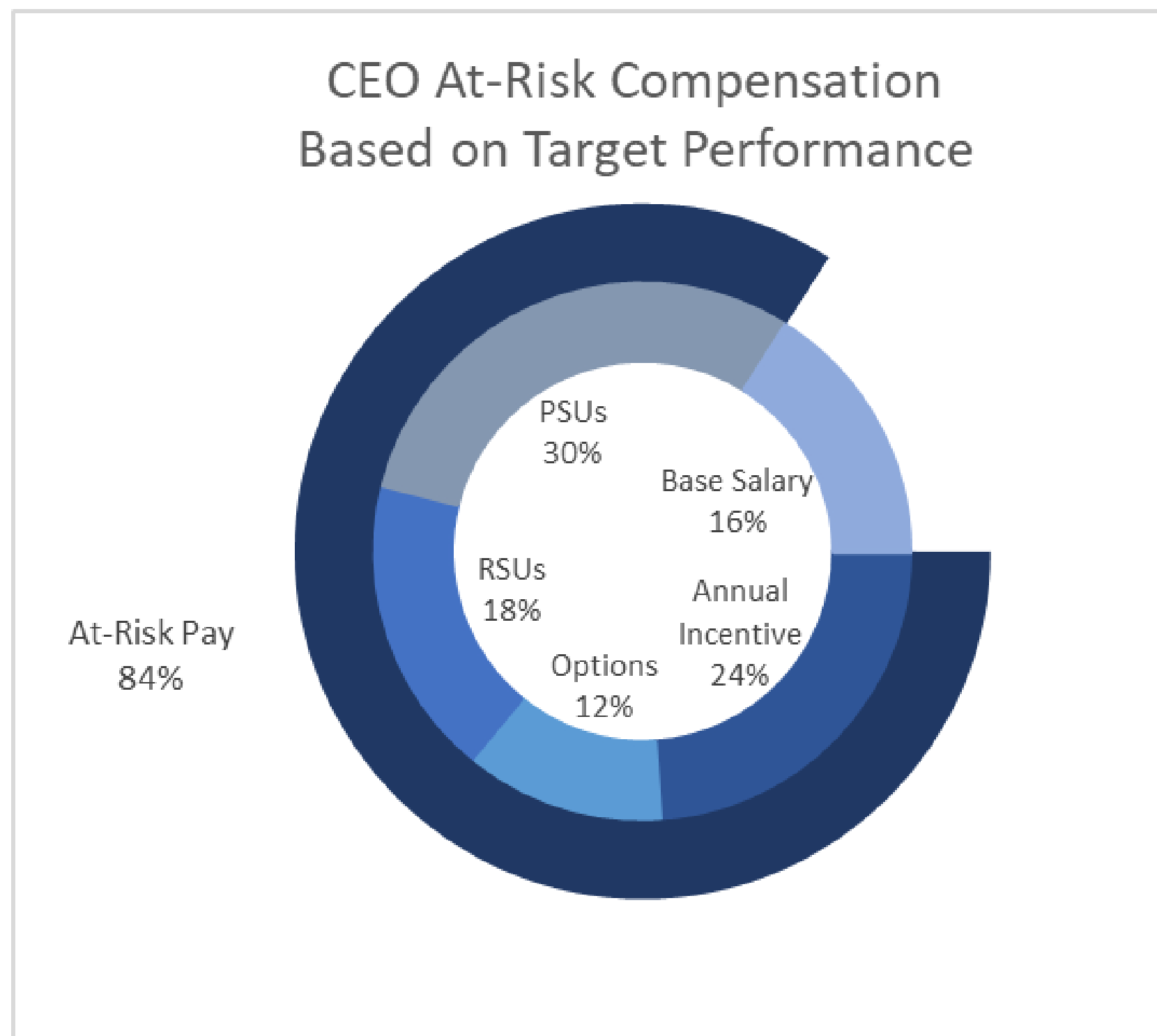
# 2008: LTIP Impacts



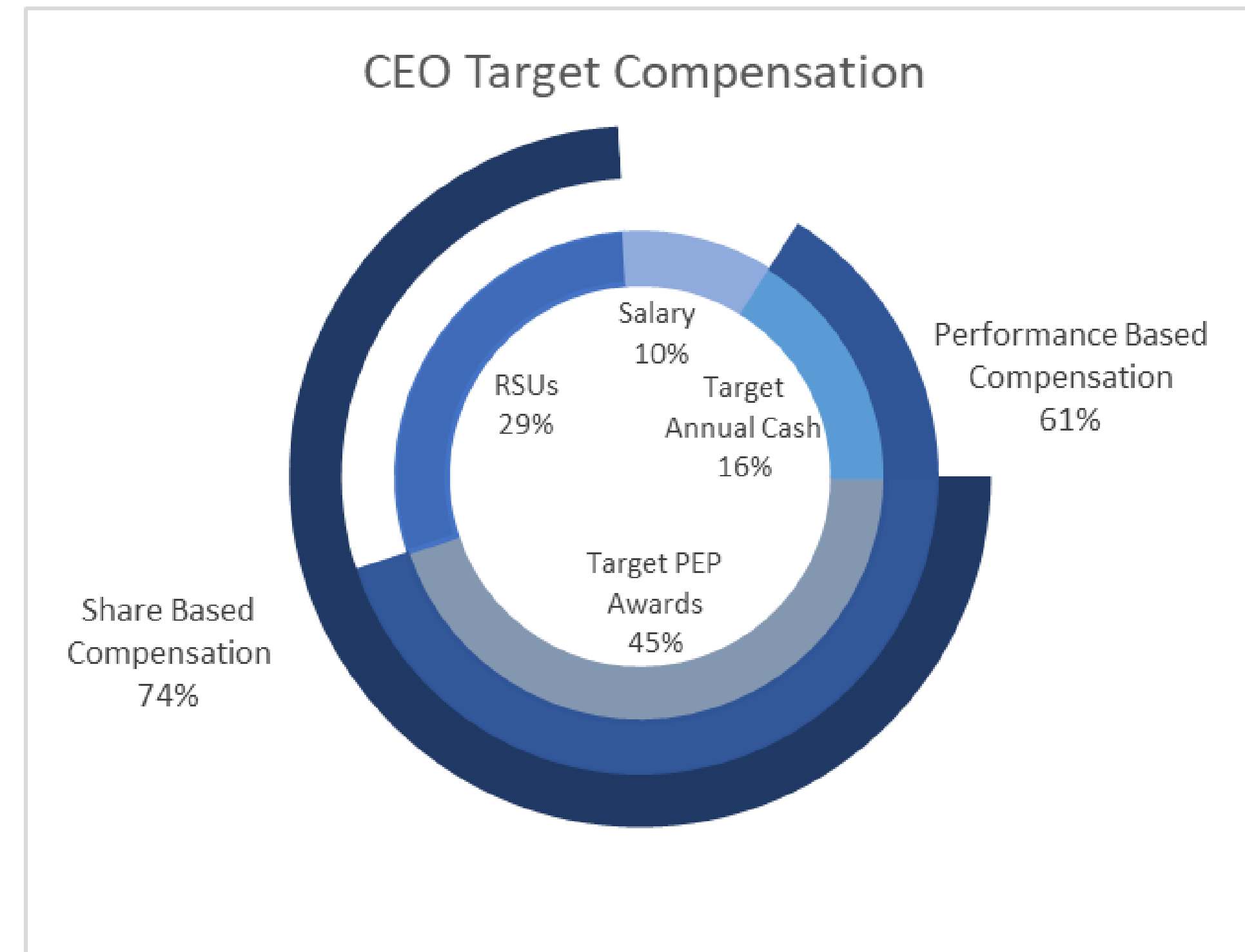
- Appreciation based LTIPs (e.g., SARs) were upside down
- Evaluate the status of the overall package

# LTIP Implications

## Company A



## Company B



- Multiple pay components promote balance

# LTIP Grant Implications

- If you use multi-year goals:
  - Consider delaying the prospective grant
  - If already granted, adjust goals once clarity returns
- If you use annual goals:
  - Consider a staggered grant (e.g., a smaller portion now for certainty, and additional grant when clarity returns)
  - If already granted, adjust goals once clarity returns



# LTIP Payout Implications

Example: Assume company stock price at 03/31/2020 is less than at 12/31/2019. What value is used for LTIP payouts?

- LTIP value is contractual: What does plan document say?
- If document says to use the ESOP value as of preceding 12/31, an interim value does not help
- If document says to use the most recent ESOP value, an interim value could help





# LTIP Payout Implications (cont.)

Example: Assume company stock price has likely decreased since the 12/31/2019 valuation. Can LTIP distributions be delayed?

- Many LTIP arrangements are subject to Code Section 409A
- Section 409A generally does not allow for changes in distribution timing
- Distributions can be delayed if making distribution jeopardizes going concern potential (note this is a higher standard than loan covenant breach)
- Separately, participants can request an accelerated distribution due to an unforeseeable emergency but this is a high bar (e.g., liquidating other resources)
- Consult with your attorney on all changes to LTIP valuation and timing



# Section 409(p) Concern

The lower the stock price, the higher the number of shares of synthetic equity that will be attributed to a deferred compensation cash award

## EXAMPLE:

- ESOP participant has cash pay LTIP award worth \$50,000 at the 12/31/19 valuation of \$10 per share
  - Equals 5,000 shares of company stock ( $\$50,000 \div \$10 = 5,000$  shares)
- Interim valuation performed as of July 31, 2020 shows per share value is \$8 per share
  - Equals 6,250 shares of company stock ( $\$50,000 \div \$8 = 6,250$  shares)



# Section 409(p) Concern

Must prevent, not correct, any violation of Section 409(p) – if correcting, penalties will apply

One option:

- Cut back SYNTHETIC EQUITY (i.e., by cancelling or distributing some or all of it – there is some relief under Code Section 409A regulations on this topic) before any interim valuation determination
  - Amount paid may not exceed 125% of the minimum amount of payment necessary to avoid the occurrence of a nonallocation year



Thank You

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