Milbank

Executive Compensation & Employee Benefits Group

Client Alert

Update: COVID-19 and Executive Compensation

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Over six months have passed since the COVID-19 virus and global pandemic disrupted businesses throughout the world and rapidly transformed the way companies operate. The summary below provides a high-level update on how COVID-19 continues to impact compensation design and disclosures.

Adjustments to 2020 Compensation Levels

Given that the height of uncertainty surrounding the pandemic occurred during the first quarter of 2020, which is the period during which most companies typically implement incentive programs, companies were forced to evaluate their compensation practices and re-balance the competing interests of employee retention, projected financial performance, and shareholder perceptions. Six months later, we have a better sense of what actions companies implemented to address the impact of COVID-19. A review of public disclosures indicates that approximately 20% of companies in the Russell 3000 reported adjustments to salary, bonus or long-term incentive programs. Changes to overall compensation programs have included reducing base salaries, delaying annual bonus payments, paying annual bonuses in stock rather than in cash, reducing target values of long-term incentives and/or using a trailing-average stock price to calculate the number of awards being granted. Instead of making real-time adjustments, many companies opted to reserve the ability to apply some level of discretion with respect to short-term and long-term incentives following the end of 2020.

New C&DI under Regulation S-K

On September 21, 2020, the SEC's Division of Corporate Finance issued a new C&DI under Regulation S-K related to COVID-19. The new C&DI provides guidance on how companies should analyze certain benefits provided to employees during periods affected by COVID-19 in order to determine whether such benefits should be classified as perquisites for purposes of Summary Compensation Table disclosure and calculating total annual compensation. The Division of Corporate Finance reiterated the SEC's two-step analysis for determining whether at item is a perquisite (i.e., if a benefit is "integrally and directly related" to the performance of the executive's duties it is not a perquisite; if a benefit confers a direct or indirect benefit and has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, it is a perquisite or personal benefit unless it is generally available on a non-discriminatory basis to all employees). However, the Division of Corporate Finance noted that benefits that may have previously been considered a perquisite in pre-COVID periods may no longer be classified as such, given the necessity of the benefit to the performance of the executive's duties in light of COVID-19. The Division of Corporate Finance cited the provision of enhanced home technology as a potential example of a benefit that could be integrally and directly related, while also noting that benefits that are less integrally related may still be considered perquisites.

The new C&DI does not change the SEC's position on how to identify and analyze perquisites, but serves as a useful reminder to all reporting companies that benefits provided to executives during 2020 should be closely analyzed on a case-by-case basis in order to determine whether such benefits should be classified as perquisites.

Compensation Design and Planning for 2021 and Beyond

As we approach the last quarter of 2020 and the commencement of 2021, many companies will be faced with two important tasks: (1) preparing proxy disclosures relating to 2020 compensation decisions and (2) designing (and, if necessary, disclosing) compensation programs for 2021. With respect to the upcoming proxy season, companies that implemented compensation adjustments during 2020 should begin to formulate a clear theme or message in order to develop useful explanations as part of their compensation disclosures. Companies that expect to exercise discretion (whether through back-end adjustments or paying additional compensation) should begin to develop rationales and criteria, which will help tell a reasoned story as to why such discretion was exercised. Transparency in disclosure will likely be very important to both shareholders and shareholder advisory firms this proxy season, and companies should plan to provide an adequate level of explanation and analysis.

With respect to designing 2021 programs, depending on the industry, some companies may find themselves with no greater level of clarity than they had in early 2020, while others will have experienced stabilized performance by the time 2021 begins. In either case, we expect that many companies will take the opportunity to re-evaluate their programs for 2021 in order to address the unique impacts of COVID-19, whether it be by addressing liquidity issues or managing dilution. Many companies may also use the events of 2020 to implement different performance metrics (e.g., ESG goals), or engage more directly with shareholders on what expectations will be going forward.

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Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any member of our Executive Compensation & Employee Benefits Group.