COVID-19 and Executive Pay: Initial Reactions and Responses

SEMLER BROSSY
PULSE SURVEY RESULTS

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INTRODUCTION

Providing Insights to Help Boards and Management Effectively Manage Executive Compensation in Times of Crisis

The rapid global spread of COVID-19 has had incalculable impacts on society, taking both a serious economic and human toll. Many companies are faced with balancing competing responsibilities to various stakeholders. While the primary focus is on taking care of employees and ensuring business continuity, MANY COMPANIES ARE ALSO FACING NEW CHALLENGES IN APPROPRIATELY MANAGING EXECUTIVE COMPENSATION.

Though businesses have managed executive pay programs through tough economic conditions before, they now must do so under an UNPRECEDENTED CONFLUENCE OF EXTERNAL EXPECTATIONS AND SCRUTINY, from the advent of Say on Pay to increased shareholder engagement to the beginning of an era of stakeholder primacy.

Though expectations are still evolving, COMPANIES ARE EXPECTED TO DEVELOP COHESIVE RESPONSES. THOSE MAKING DECISIONS NEED TO CONSIDER THEIR BUSINESS AND THEIR STAKEHOLDERS, WHILE LOOKING TO CONTINUE TO ENGAGE AND MOTIVATE KEY TALENT. Shareholders and proxy advisory firms alike have indicated a strong preference for decisions that are defensible to all stakeholders.

To support and guide companies in these decisions, we surveyed 120 companies across the United States on the actions they are taking today and the decisions they are considering making later in 2020. Although they represent a snapshot during a time of rapid change, OUR FINDINGS PROVIDE INSIGHT INTO ADDRESSING POTENTIAL EXECUTIVE COMPENSATION CHALLENGES BROUGHT ON BY COVID-19.

NOTE | survey responses were collected from March 27th to April 7th and represent point-in-time findings as provided by our respondents. Given the evolving nature of the COVID-19 pandemic, we expect the responses of companies to change over time.

For up-to-date data, insights, and perspectives, we invite you to visit our COVID-19 landing page at https://www.semlerbrossy.com/covid-19/
TO REFLECT VARYING LEVELS OF FLEXIBILITY IN RESPONDING TO COVID-19, survey results starting on page 15 are differentiated between companies that have:

- **ALREADY MADE 2020 PAY DECISIONS AND SET PERFORMANCE GOALS** (shown in blue)
- **STILL NEED TO MAKE 2020 PAY DECISIONS AND SET PERFORMANCE GOALS** (shown in green)
Key Takeaways

While results vary across industries, findings indicate that a majority of U.S. corporations have not yet formulated a response to COVID-19 on executive pay but anticipate taking some form of action later in 2020.

What should you take away from the results of this survey?

- **There is no universal response.** Findings indicate a variety of approaches influenced by company outlook, industry dynamics and broader context.
- **That said, most companies are delaying action until there is greater clarity.** Companies that already made pay decisions are generally waiting until payout determinations to see if adjustments are necessary, and those that have not yet made decisions in 2020 are delaying until the impact of COVID-19 is better understood.
- **Companies acting now are doing so out of necessity** and are primarily in the hardest-hit industries where immediate cash preservation is a key priority.

What are key considerations going forward?

- **Timely, effective communication is key.** Shareholders, employees and customers are all closely monitoring the actions companies are taking in response to the crisis; if decisions are made, transparent and honest communication can build positive alignment and strengthen relationships with key stakeholders.
- **Align executive pay with the stakeholder experience.** Company actions are being closely monitored and the expectation is that shareholder experience should be reflected in compensation decisions (i.e., significant shareholder value losses or headcount reductions are accompanied by lower pay outcomes for executives).
- **Establish objective principles for using discretion.** While quantitative metrics may be difficult to rely on at this time, establishing a list of factors for Committees to consider if they decide to apply discretion at the end of the year will allow companies to demonstrate that decisions were made in ways that demonstrably tie back to business context.
The Business Impact of COVID-19

The spread of COVID-19 has led to substantial downward pressure on valuations for most public U.S. companies. The degree to which respondents have been impacted varies substantially by industry.

INDEX MARKET CAPITALIZATION OF PUBLIC COMPANY SURVEY RESPONDENTS VS. NEW DAILY REPORTED CASES OF COVID-19

LESS AFFECTED INDUSTRIES²
Average market cap decreases of less than 15%
- CONSUMER STAPLES
- HEALTH CARE
- UTILITIES
- REAL ESTATE

MORE AFFECTED INDUSTRIES²
Average market cap decreases of more than 20%
- INDUSTRIALS
- ENERGY
- FINANCIALS
- MATERIALS
- CONSUMER DISCRETIONARY

Source: Capital IQ, CDC, Statista.com. n=103
1. Weighted by each public company survey respondent’s market capitalization.
2. Average of each industry grouping’s indexed market capitalization.
The Breakdown of Survey Participants

**BY INDUSTRY**

- **N = 120**

- **IT INDUSTRY**: 18%
- **PRIVATE COMPANIES**: 13%
- **CONSUMER DISCRETIONARY**: 13%
- **FINANCIALS**: 8%
- **CONSUMER STAPLES**: 3%
- **REAL ESTATE**: 3%
- **MATERIALS**: 1%
- **ENERGY**: 3%
- **REAL ESTATE**: 3%
- **UTILITIES**: 3%
- **INDUSTRIALS**: 6%
- **HEALTH CARE**: 12%
- **PRIVATE COMPANIES (NO MARKET CAP DATA)**

**BY REVENUE SIZE**

1. Last twelve months reported revenue as of April 7th, 2020.

- **90th PERCENTILE**: $65.1B
- **75th PERCENTILE**: $16.7B
- **50th PERCENTILE**: $6.9B
- **25th PERCENTILE**: $1.6B
- **10th PERCENTILE**: $0.4B

Source: S&P Global Capital IQ
Executive Summary

Companies have taken or are planning to take executive pay actions resulting from COVID-19, but most are not fundamentally reworking their programs as of yet.

Most companies that have already made 2020 pay decisions and set performance goals are not making changes today, but are monitoring and considering the use of discretion when certifying performance.

Those that have not yet made or have delayed pay decisions have more flexibility but are not making wholesale changes; companies are considering adding more discretionary or strategic elements to their annual bonuses and in some cases, introducing relative long-term measures.

Continue to expect executive pay actions to be scrutinized by shareholders, employees, proxy advisors and the broader public.
EXECUTIVE SUMMARY

The Business Impact of COVID-19 to Date

81% anticipate being negatively affected in 2020
N = 116

87% have already taken action impacting their broader employee base
N = 112

The Immediate Executive Pay Actions Taken in Response

10% have cut executive pay
N = 115

5% have foregone 2020 pay adjustments
N = 115

63% that have set 2020 bonus goals anticipate using discretion to adjust payouts
N = 88

0% have made adjustments to in-flight equity awards to date
N = 72

The Impact on Executive Pay Programs in 2020 and Beyond

92% are actively assessing the impact of COVID-19 on executive compensation
N = 120

23% have already taken concrete action on executive pay items
N = 120

24% that have not yet acted are considering cutting executive pay
N = 93

6% have reduced pay for independent directors
N = 108

40% are considering making adjustments to in-flight PSU outcomes at the end of the performance period
N = 38

61% that have upcoming PSU grants are doing or are considering making adjustments to performance targets or measures
N = 28

The Business Impact of COVID-19 to Date

The Immediate Executive Pay Actions Taken in Response

The Impact on Executive Pay Programs in 2020 and Beyond
Almost all respondents reported COVID-19 having at least some impact on their broader employee populations.

- **81%** indicated COVID-19 would have a negative impact in 2020.
- **87%** have taken actions affecting their broader employee base.
  - **40%** of consumer staples respondents indicated some form of negative impact, the least of all industries surveyed.
  - **60%** of consumer staples respondents anticipate a positive impact on their business at some point in the next two years.
  - At least **80%** of respondents in all other industries indicated COVID-19 would have a negative impact on their business.
  - **84% have shifted to a “work from home” model**.
  - **19%** have taken actions to reduce broad-based pay.
  - **17%** are reducing headcount or furloughing employees (including **44%** of consumer discretionary respondents).
  - **20%** of respondents have either increased headcount or provided pay increases/one-time bonuses (or both).
The Key Findings

To-date, actions taken on executive pay levels have generally been limited to the hardest-hit industries.

- 16% have already made decisions regarding executive pay levels in response to COVID-19.
  
  - 61% have implemented pay reductions for executives.
  - 33% will not be increasing executive pay in 2020.
  - 40% indicated no changes to their regular practices.

- 84% have not yet taken action at this time.
  
  - 15% are considering pay reductions for executives.
  - 25% are (or are considering) foregoing 2020 pay increases.
  - 32% are not making changes to their regular practice (a further 41% are considering no changes).
The limited instances where changes to director pay levels have been made occurred in conjunction with changes to executive pay levels.

- **44%** indicated they have made at least some determinations for 2020 director pay.
  - **80%** are making no changes to pay levels or their standard director pay.
  - **13%** are reducing director pay; of these, **100%** have also already determined to reduce executive pay.
  - **4%** are foregoing adjustments in 2020.

- **59%** are currently considering paths forward for director pay.
  - **17%** are considering reducing director pay or foregoing increases for 2020.
Most respondents set bonus goals prior to COVID-19; making year-end decisions the focal point for addressing the impact of COVID-19

76% have already set goals for their 2020 bonuses

63% are (or are considering) applying discretion when payouts are determined

40% are considering resetting goals partway through the year once the impact of COVID-19 is better understood

24% have not yet set goals for their 2020 bonuses

69% are (or are considering) delaying goal-setting until the impact of COVID-19 is better understood

54% are (or are considering) increasing the weighting of discretion or the qualitative component in bonus design

39% are (or are considering) changes to measures in their 2020 bonuses
The Key Findings

Most companies have granted 2020 equity and do not anticipate making changes to those awards at this stage.

66% have already made equity grants in 2020

94% are (or are considering) not making changes to in-flight awards

17% are considering special top-up awards

10% are considering canceling and re-granting equity

34% have not yet made equity grants in 2020

55% are (or are considering) making no changes to their standard process

26% are (or are considering) delaying some or all their equity grants until later this year

26% are considering modifying grant practices if normal processes are overly dilutive
THE KEY FINDINGS

Respondents are leaving in-flight PSUs unchanged; those that have not yet made grants in 2020 are considering steps to manage the impact of COVID-19

68% have already granted their PSUs in 2020

- 77% are (or are considering) making no changes to in-flight PSU award measurement/outcomes

32% have not yet granted their 2020 PSUs

- 54% are (or are considering) making no changes to their standard PSUs

OF THESE:

- 19% are (or are considering) adjusting in-flight PSU goals once there is greater clarity on the impact of COVID-19
- 40% are considering making adjustments at the completion of the performance period, if appropriate
- Only 3% are considering adjusting goals now

- 46% are considering adjusting the performance targets of their upcoming 2020 PSU grants
- 29% are (or are considering) changes to PSU performance measures
- 29% are (or are considering) reducing or eliminating PSUs for 2020

n = 58

n = 93
Survey Responses
A look at the detail behind the findings
Understanding Survey Responses

SCOPE
To balance a broad set of industries and stages of company development, the survey was made available to all companies regardless of industry or size.

- 120 companies participated, including 103 public companies with median revenues of $6.9 billion
- The survey was open to respondents from March 27th to April 7th

PRESENTATION OF DATA
The following section presents responses in a manner reflective of the survey provided to respondents. Findings are summarized in graphs and charts with narrative support where appropriate. As not all survey respondents responded to every question in the survey, the actual number of companies responding to each question is provided alongside relevant data. Each question should be viewed as the prevalence of companies responding to that specific question. Survey participants had the opportunity to select multiple choices to certain questions. In certain cases, the total responses may not equate to 100%; this occurs for questions where respondents could select multiple answers (e.g., when outlining which actions were being taken or considered).
Participants generally expect the negative effects of COVID-19 to impact their business for at least a year but anticipate recovery to begin within the next 24 months.

The majority of survey respondents anticipate COVID-19 to have a negative impact on their business; perceived impact becomes more positive 24 months out.

While most companies have delayed formal action for better clarity, the majority of respondents are actively engaged in discussions on how to respond to COVID-19.

<table>
<thead>
<tr>
<th>% OF COMPANIES RESPONDING</th>
<th>N = 116</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant Negative</td>
<td>23%</td>
</tr>
<tr>
<td>Moderate Negative</td>
<td>28%</td>
</tr>
<tr>
<td>Neutral</td>
<td>8%</td>
</tr>
<tr>
<td>Moderate Positive</td>
<td>42%</td>
</tr>
<tr>
<td>Significant Positive</td>
<td>N/A</td>
</tr>
</tbody>
</table>

DISTRIBUTION OF INDIVIDUAL ANSWERS Shifts for next 24 months

<table>
<thead>
<tr>
<th>DISCUSSIONS WITH MANAGEMENT AND THE BOARD</th>
<th>N = 120</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discussions with Management</td>
<td>28%</td>
</tr>
<tr>
<td>Action Already Taken</td>
<td>23%</td>
</tr>
<tr>
<td>N/A</td>
<td>8%</td>
</tr>
</tbody>
</table>
Impact of COVID-19 on the Broader Employee Population

Companies who have already initiated or are currently considering headcount and pay-related reductions are concentrated in the severely impacted industries such as consumer discretionary and industrials.

- Nearly 50% of consumer discretionary and industrials who responded are currently considering headcount reductions for their corporate and hourly/front-line workers.
- Pay increases, such as hazard pay, are more common for industries such as health care, consumer staples, and certain consumer discretionary companies.

Survey Responses

<table>
<thead>
<tr>
<th>Actions</th>
<th>Doing</th>
<th>Considering</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shift to ‘work from home’</td>
<td>84%</td>
<td>6%</td>
</tr>
<tr>
<td>Headcount increases</td>
<td>15%</td>
<td>14%</td>
</tr>
<tr>
<td>Pay increases/one-time bonuses</td>
<td>13%</td>
<td>20%</td>
</tr>
<tr>
<td>Pay freezes</td>
<td>10%</td>
<td>15%</td>
</tr>
<tr>
<td>Base pay reductions</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Variable pay freezes/reductions</td>
<td>3%</td>
<td>13%</td>
</tr>
<tr>
<td>Variable pay elimination</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Headcount reductions (hourly/frontline)</td>
<td>11%</td>
<td>21%</td>
</tr>
<tr>
<td>Headcount reductions (corporate)</td>
<td>28%</td>
<td>7%</td>
</tr>
<tr>
<td>Employee furloughs</td>
<td>13%</td>
<td>21%</td>
</tr>
<tr>
<td>401(k) suspensions</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>No impact</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Other</td>
<td>4%</td>
<td>5%</td>
</tr>
</tbody>
</table>

N = 112
Actions on Executive Pay Levels in Light of COVID-19

For the 16% of respondents that have already acted...

- Three industries (and private companies) indicated they have taken pay reduction actions:
  - 56% of consumer discretionary companies
  - 29% of industrial companies
  - 9% of IT companies
  - 27% of private companies

To-date, pay reductions have primarily been undertaken by companies in the hardest-hit industries where cash flow preservation is an immediate priority.

For the 84% of respondents that have not changed pay levels...

- 57% of consumer discretionary companies that have not yet taken pay actions are considering doing so, compared to 15% of all survey respondents.
- Health care and consumer staples respondents are most likely to continue with “business as usual,” as determined by 93% of health care and 86% of consumer staples companies (mix of doing and considering).

A majority of respondents did not determine or consider making pay adjustments at the time of this survey.
Actions on Executive Pay Levels in Light of COVID-19 – Detail on Pay Reductions

**Population impacted by pay reductions**

<table>
<thead>
<tr>
<th>Category</th>
<th>N = 17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broader Employees</td>
<td>18%</td>
</tr>
<tr>
<td>All Executives</td>
<td>24%</td>
</tr>
<tr>
<td>All Section 16</td>
<td>24%</td>
</tr>
<tr>
<td>Certain Executives</td>
<td>18%</td>
</tr>
<tr>
<td>CEO</td>
<td>24%</td>
</tr>
</tbody>
</table>

**Time horizon for pay reductions**

<table>
<thead>
<tr>
<th>Horizon</th>
<th>N = 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open-ended</td>
<td>53%</td>
</tr>
<tr>
<td>&lt;12 months</td>
<td>13%</td>
</tr>
<tr>
<td>&lt;6 months</td>
<td>33%</td>
</tr>
</tbody>
</table>

**Intention to “make whole” impacted executives**

<table>
<thead>
<tr>
<th>Intention</th>
<th>N = 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>13%</td>
</tr>
<tr>
<td>Yes, through equity next year</td>
<td>0%</td>
</tr>
<tr>
<td>Yes, through cash next year</td>
<td>0%</td>
</tr>
<tr>
<td>Yes, through equity this year</td>
<td>13%</td>
</tr>
<tr>
<td>Yes, through cash this year</td>
<td>0%</td>
</tr>
<tr>
<td>Yes, through cash this year</td>
<td>73%</td>
</tr>
</tbody>
</table>

- In most cases, pay reductions take a ‘top-down’ approach, with all employees at/or above the lowest employee level subject to reductions impacted by pay reductions.
- Most companies that have already acted have not defined the time period of their pay reductions, indicating a longer-term impact is possible.
- 60% of consumer discretionary companies have not established a time frame of returning to normal pay levels.
- Few companies intend to “make whole” executives subject to pay reductions.
SURVEY RESPONSES

Actions on Board Pay Levels in Light of COVID-19

Actions taken by respondents on board pay

N = 108

- Pay reductions were primarily undertaken by companies in the hardest-hit industries
  - Consumer discretionary companies make up 67% of respondents who have already enacted board pay-reduction adjustments
- 100% of companies that reduced board pay also reduced executive pay
- Of those that reduced pay, 67% expect the reduction to last 12-months or less
  - 33% have not defined a time frame
Impact of COVID-19 on 2020 Bonus Programs

For the 76% of respondents that have already set 2020 bonus goals...

<table>
<thead>
<tr>
<th>Approaches of Respondents That Have Acted</th>
<th>Doing</th>
<th>Considering</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintain goals and programs as in prior years</td>
<td>24%</td>
<td>14%</td>
</tr>
<tr>
<td>Maintain goals but anticipate discretionary adjustments</td>
<td>47%</td>
<td>16%</td>
</tr>
<tr>
<td>Reset performance goals once COVID-19 impact is better understood</td>
<td>40%</td>
<td>8%</td>
</tr>
<tr>
<td>Reset performance goals now</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Change performance metrics of the program</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Respondent answers were generally consistent across industries for public companies.

However, 80% of private companies indicated they were considering applying discretion at the end of the year, and 60% indicated they are considering resetting performance goals.

Applying discretion at the end of the year, or resetting performance goals once the impact of COVID-19 is better understood are most common.

For the 24% of respondents that have not set 2020 bonus goals...

<table>
<thead>
<tr>
<th>Approaches of Respondents That Have Not Yet Acted</th>
<th>Doing</th>
<th>Considering</th>
</tr>
</thead>
<tbody>
<tr>
<td>No changes to standard process</td>
<td>12%</td>
<td>15%</td>
</tr>
<tr>
<td>Delay setting goals until greater line of sight</td>
<td>27%</td>
<td>4%</td>
</tr>
<tr>
<td>Add discretion (or increase qualitative component)</td>
<td>42%</td>
<td>50%</td>
</tr>
<tr>
<td>Change performance metrics of the program</td>
<td>4%</td>
<td>35%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Companies that have yet to set bonus goals have more flexibility to react, but many are choosing to wait until they have greater clarity.

40% of total respondents to this question were consumer discretionary companies; all indicated that they were making or considering a change to their 2020 bonus goals.
Impact of COVID-19 on 2020 Equity Grants

N = 118

For the 66% of respondents that have already made grants in 2020...

- Approaches of respondents that have acted

- 51% Make no changes
- 43% Provide ‘top-up’ or special grants
- 0% Cancel and re-grant equity
- 0% Other

- Approaches of respondents that have not yet acted

- 26% No changes to standard process
- 9% Delay performance grants until later this year
- 9% Delay all grants until later this year
- 18% Other

The few companies who have indicated that they are considering changes to their equity program are concentrated in the information technology, consumer discretionary, and consumer staples industries.

Respondents that already granted equity in 2020 are generally not making any changes.

For the 34% of respondents that have not yet made grants in 2020...

- Approaches of respondents that have not yet acted

- 29% Make no changes
- 26% Provide ‘top-up’ or special grants
- 10% Cancel and re-grant equity
- 4% Other

Approximately 20% of total respondents were consumer discretionary companies; all indicated that they were considering some change to their standard process.

75% of health care respondents indicated they do not anticipate making changes to their standard process.

Respondents that have been significantly negatively impacted are more likely to consider changes to the timing of their 2020 equity grants.
Impact of COVID-19 on 2020 PSU Grants

For the 68% of respondents that have granted PSUs...

For the 32% of respondents that have not yet granted PSUs...

Companies are generally not making changes; some are considering making adjustments to payouts at the end of the performance period, if appropriate.

Most are considering changes to their PSU program, likely in the form of adjustments to performance goals; some might eliminate PSUs for 2020.

Findings were consistent across industries—most companies regardless of the industry are erring towards maintaining the PSUs that have already been granted.

Majority of companies that have not granted their PSUs have delayed action and are still considering what may be appropriate for their programs.

Of the companies who are considering changes to their standard process, approximately 1/3rd of respondents are consumer discretionary companies whose businesses are significantly impacted.

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Of the companies who are considering changes to their standard process, approximately 1/3rd of respondents are consumer discretionary companies whose businesses are significantly impacted.
For additional considerations and up-to-date analysis of the impact of COVID-19 on executive compensation, see our other COVID-19 resources at https://www.semlerbrossy.com/covid-19/