



Compensation
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Covid-19 Impact on Executive and Employee Compensation

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The landscape is evolving rapidly as a wide variety of businesses experience the impact of the Covid-19 pandemic on their operations. Meanwhile, the equity markets are experiencing extreme volatility. The 11-year bull market enjoyed in the US ended and on March 10th stock prices tumbled yet again.

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Two weeks later, the Dow Jones Industrial Average recorded a recovery of more than 11% in its best day since 1933 on hopes of passage of a major economic stimulus package. Adding to the economic disruption, Brent crude oil prices dropped to a 17-year low due to the glut caused by the Saudi-Russia price war and expectations for lower demand given the threat of recession. The US Department of Labor reported that initial jobless claims soared to a seasonally adjusted 3.28 million in the week ended March 21st, the highest on record. On a more positive note, a massive \$2 trillion economic stimulus package, the "Coronavirus Aid, Relief, and Economic Security Act," or the "CARES Act," was passed on March 27th, offering hopes of some relief to individuals and businesses both large and small.

How Are Employees Being Impacted?

As the governors of our states issue lockdown and shelter-in-place orders across the country, lay-offs and furloughs have become commonplace. The hardest hit industries so far are consumer-facing businesses such as the airlines, retail, hospitality and entertainment. As the economy slows, some companies are experiencing sharp declines in revenue, quickly eroding available cash. Generally, larger companies have been better equipped to protect their employees, since they enjoy stronger cash reserves and readier access to credit. Here are several examples of how companies are reacting:

- United Airlines "will not conduct involuntary furloughs or pay cuts in the U.S. before September 30th", according to an internal memo.
- L-Brands (Bath & Body Works, Victoria's Secret, Pink) will pay its associates through April 4th, 2020 while its stores remain closed for an indefinite period.
- Disney's theme parks will remain closed until further notice and the company is paying its theme park hourly employees through April 18th.

On the other hand, certain essential industries, such as grocery, pharma and banking, have continued to operate. Walmart, Amazon, Target, JPMorgan Chase and others are actively hiring, with thousands of jobs open so that these businesses can continue to operate their stores and distribution centers, bringing essential goods to millions of people. These companies are frequently raising hourly wages for service employees and providing additional cash bonuses as a form of battle pay:

- Walmart's full-time and part-time hourly store employees will receive a special bonus of \$300 and \$150, respectively. In addition, the next scheduled quarterly bonus will be paid a month early. The company also increased wages by \$2 per hour through Memorial Day for its entry level employees in its e-commerce warehouses following actions by its competitors. The company announced that it will hire another 150,000 employees.
- Target is increasing wages by \$2 per hour through May 2 and offering paid leave of 30 days for U.S. team employees who are 65 years old, pregnant or have underlying medical conditions.
- Amazon is increasing wages by \$2 per hour for delivery and warehouse employees through April and hiring an additional 100,000 employees to keep up with demand.
- JP Morgan Chase is giving a one-time bonus of \$1,000 to employees staffing branches or call centers who make less than \$60,000 per year.

What is Happening with Executive Compensation?

Salary Reductions

For cash-strapped businesses, salary-reduction plans and other measures intended to preserve cash are being announced daily. CEOs in the airline industry forfeited salaries early on given the expectation of a need for government relief and employee furloughs and lay-offs. Here are several examples of salary reduction plans:

- Delta's CEO was one of the first to reduce his compensation, forgoing his salary for the next six months. The board of directors are also not taking compensation for six months. Other officers and managing directors will take salary reductions of 50% and 25%, respectively.
- L Brands' salaries for Senior Vice Presidents and above will be reduced by 20%. Its Board of Directors will receive no cash compensation as the company expects to furlough employees who cannot work from home or support the online business.
- Marriott's Chairman and CEO are both forgoing salaries and the other executive team members are taking a 50% salary reduction as the company is furloughing two-thirds of its U.S. and global corporate staff and tens of thousands of other hotel staff.
- General Motors' senior management salaries will be reduced by 25% to 30%. Salaried employees will have 20% of their pay deferred through the first quarter of 2021 with 6% interest.

Annual Bonuses for 2019

For most calendar year companies, executive and management annual incentives were approved according to the original schedule, typically February. At that time, economic disruption due to Covid-19 was centered around China and not as pronounced globally. Our research on early proxy filers indicates that most U.S. companies had solid results in 2019.

Over the last month, Covid-19 has reached pandemic proportions, causing government mandated shut-downs. Companies with fiscal-years ending in Q1 or Q2 2020 are experiencing significant economic pressure. In particular, companies whose revenue and profitability have dried up are reducing, delaying or cancelling bonus payments to preserve cash.

Annual Bonuses for 2020

Goal setting has become a significant challenge in 2020. Retailers that have closed their stores, airlines flying empty flights and companies whose supply chains are disrupted are facing huge losses in the coming quarter. At this point, it's impossible to say when these businesses will be able to come back on-line in a meaningful way. Even when Covid-19 is contained, the U.S. economic recovery could be delayed, if China, Hong Kong and South Korea economic recoveries are early indicators. As a result, we predict that companies will rely heavily on board discretion this year to make judgements on whether or not bonus plans will be funded in whole, in part or at all.

Equity Grants in 2020

Companies making annual equity grants in the February – April time frame also face challenges. Many companies are experiencing extreme swings, both up and down, in stock price from day to day. In addition, performance-based grants have come under pressure given challenges to setting meaningful financial targets. Reactions have varied and there is no one-size-fits-all approach that has come to the forefront. Boards and management teams are making judgements about how to proceed given their unique situations.

Certainly, equity remains a valuable tool right now to replace or offset cuts in cash compensation, provide hope for meaningful upside as we ride out the public health and economic crises and motivate and retain talent. Normal practice at public companies is to define equity award guidelines as a dollar value, or a percentage of salary, with the number of shares or stock options issued dependent on the fair market value of the stock on the date of grant. Our client experience indicates that many companies are continuing their normal practice for equity grants.

Alternatively, some companies have taken different approaches. Particularly in cases where employees are facing lay-offs, furloughs and salary cuts, most management teams are sensitive to avoid any appearance of enjoying a windfall from grants of large number of shares due to share price declines. Share availability within existing equity plans also constrain the ability of companies to continue normal grant practices at some companies. In these instances, we have seen companies cut back equity award guidelines or adopt a multi-day average stock price to determine the number of shares granted. We have seen companies grant options and

RSUs but delay grants of performance-based equity since credible goals cannot be established now. We have also seen companies delay grants altogether and increase the use of awards with time-based vesting to avoid setting performance targets that become irrelevant as the crisis deepens.

CARES Act

Companies receiving financial aid under the CARES Act will need to structure executive compensation to stay within the defined limits of total compensation (defined as "salary, bonuses, awards of stock and other financial benefits).

The Act establishes the following pay restrictions for officers or employees of businesses receiving financial aid and uses calendar year 2019 pay for these employees as a baseline:

CARES Act Executive Pay Limitations

Officers or Employees of Business Receiving Aid	Total Compensation Limit
Those whose total compensation exceeded \$425,000 in 2019	<ul style="list-style-type: none"> • Equal to total compensation received by the individual in 2019, or • Limit on severance pay/termination benefits of two times total compensation received in 2019
Those whose total compensation exceeded \$3 million in 2019	<ul style="list-style-type: none"> • \$3 million, <i>and</i> • 50 percent of total compensation over \$3 million received in 2019

We have established a page on our website that contains advice and information on compensation implications of the COVID-19 crisis. [You can access it here.](#) In addition to several articles, we have a tracker that contains detailed information on how individual companies are responding gleaned from press releases, public filings and the business press. CAP will also be publishing survey results from more than 100 companies on reactions to the economic and public health crises shortly.

In the meantime, we sincerely hope that all of you and your families remain healthy and safe for the duration.



Please contact us at (713) 559-2715 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com for more information on executive compensation.