

The logo for NDI Executive Exchange. It features a dark blue square on the left containing the letters 'NDI' in white. To the right of the square, the word 'Executive' is written in a large, bold, dark blue font, and the word 'Exchange' is written below it in a slightly smaller, dark blue font.

**NDI** Executive  
Exchange

NATIONAL DIRECTORS INSTITUTE

# What COVID-19 Means for Executive Pay

*June 17, 2020*

The logo for Foley & Lardner LLP. It consists of a white square icon with a stylized 'F' and 'L' inside, followed by the word 'FOLEY' in a large, bold, white sans-serif font. Below 'FOLEY', the words 'FOLEY & LARDNER LLP' are written in a smaller, white sans-serif font.

**FOLEY**  
FOLEY & LARDNER LLP

---

# Panelists

- Leigh Riley

Partner, Foley & Lardner LLP

- Eric Gonzaga

National Managing Principal, Executive Compensation Practice, Grant Thornton LLP

- Josh Agen

Of Counsel, Foley & Lardner LLP

---

# Webinar Housekeeping

- Questions can be entered via the Q&A widget open on the left-hand side of your screen. We will address questions at the end of the program, time permitting
- The recorded version of this presentation will be available on Foley.com in the next few days or you can get a copy of the slides in the Resource List widget
- Foley will apply for CLE credit after the program. To be eligible for CLE, you will need to answer a polling question during the program
- If you did not supply your CLE information upon registration, please e-mail it to [lharper@foley.com](mailto:lharper@foley.com). Certificates of attendance will be distributed via email to eligible participants approximately 8 weeks after the web conference
- NOTE: Those seeking Kansas, New York & New Jersey CLE credit are required to complete the Attorney Affirmation Form in addition to answering the polling question. Email the form to [lharper@foley.com](mailto:lharper@foley.com) immediately following the program

---

# Today's Agenda

- Cash Flow Planning
- Impact on Incentive Compensation
- Benchmarking Pay
- Executive Equity Holdings
- LTI Vehicles
- Deferred Compensation

# Review Opportunities for Cash Savings and/or Deferrals

## Immediate

- Quickest/simplest way to save cash in the short-term is to cut cash compensation or encourage or require pay deferrals for highly compensated executives
- As with any plan involving deferrals, organizations should ensure they remain compliant with Section 409A

## Short-term (three months)

- Amending annual incentive plans to pay out in equity (or deferred cash at a later date) will help free up immediately available cash
- To “sweeten” the deal, companies could increase initial bonus payouts by 25% to 50% to soften the blow of not having incentives paid on their normal schedule, which could optimize retention and behavioral impact

## Long-term (within a year)

- Companies may decide to save cash by shifting portions of compensation to LTI or NQDC
- Organizations with a heavy reliance on stock options may consider repricing historical awards that are underwater (special Section 409A rules apply, along with accounting considerations)

---

# Deferring or Reducing Salary

- Deferring
  - Consent may be required
  - Code Section 409A timing requirements
- Reducing
  - Consent may be required
  - Consider impact on other benefits (employer contributions, severance, other)
  - Form 8-K and/or proxy disclosure
- Granting equity in lieu of cash compensation
  - Code Section 409A may still apply
  - Plan for taxes

---

# Impact on Incentive Compensation

- Adjusting Existing Performance Goals
  - Can we adjust?
    - Permitted by existing plans?
    - What approvals or consents are required?
  - Should we adjust?
    - Philosophy and precedent
    - Probability, magnitude of miss
    - Relative performance and trend before COVID-19
    - Retention and incentives
    - Disclosures and investor perception
    - Accounting impact
    - Impact on “grandfathered” status under Code Section 162(m)

---

# Impact on Incentive Compensation

- Adjusting Existing Performance Goals
  - How to adjust?
    - Change metrics to emphasize current priorities
    - Convert to relative performance metrics
    - Widen performance range or shift levels down
    - Discretionary payments
- Alternatives for Future Awards
  - Any of the Above
  - Shorter Performance Periods (e.g., quarterly)
  - Longer Performance Periods



---

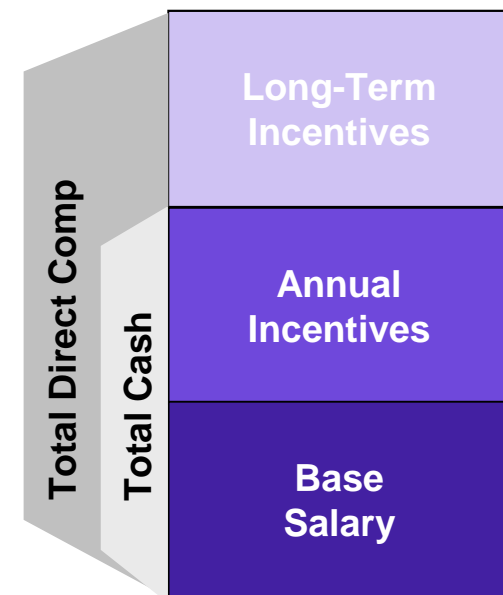
# Proxy Advisors and Adjustments

- ISS Update
  - No general relief from policy disfavoring mid-cycle changes to performance goals
  - Will evaluate changes and the company's rationale on a case-by-case basis
  - Encourages contemporaneous disclosure of the rationale for changes
- Glass Lewis Update
  - Proportionality and alignment between any changes to executive pay and the impact of the economic downturn on shareholder interests and employees

# Benchmark Total Compensation

- Benchmarking compensation may be even more important during recessionary periods
- Establishing an annual cadence ensures organizations (and compensation committees) are aware of any movements in market levels
- Organizations should also review their peer groups and market data sources to ensure constituents remain appropriate

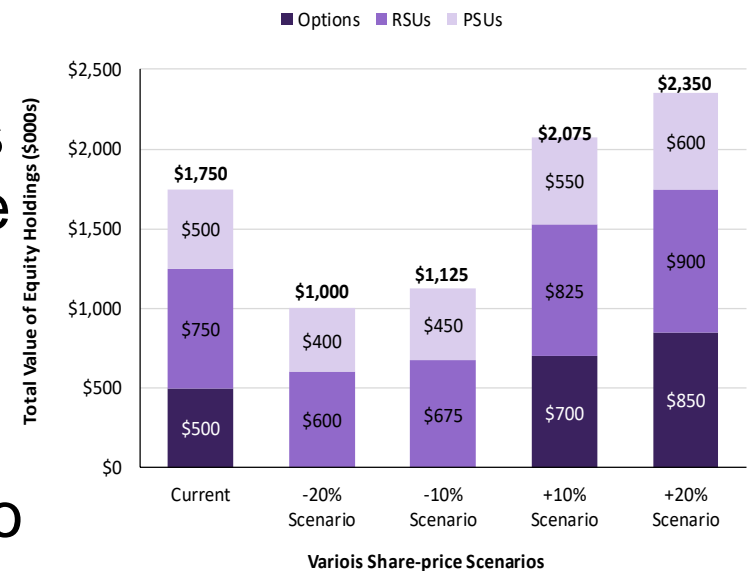
## Elements of Executive Pay



# Review Executive Equity Holdings

- Companies should review executives' equity holdings and the potential impact of volatile share-prices
- Organizations with heavy emphasis on stock options or PSUs may have greater retention risks/concerns
- Proactively testing share-price scenarios and equity outcomes can help determine if executives need to be further staked through times of financial downturn

## Illustrative Equity Holdings Analysis



# Strengths and Weaknesses of LTI Vehicles in a Market Correction

LTI Vehicle	Strengths	Weakness
<b>Stock Options</b>	<ul style="list-style-type: none"> <li>▪ Opportunity to award more shares if stock is undervalued</li> </ul>	<ul style="list-style-type: none"> <li>▪ May cause excessive dilution</li> <li>▪ Potential for underwater grants</li> </ul>
<b>Restricted Stock</b>	<ul style="list-style-type: none"> <li>▪ Provides full-value</li> <li>▪ Less shares to grant same value</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reduced "pay for performance" alignment</li> </ul>
<b>PSUs</b>	<ul style="list-style-type: none"> <li>▪ Relative performance measures</li> <li>▪ Non-standard performance periods</li> </ul>	<ul style="list-style-type: none"> <li>▪ Difficulty in setting performance goals</li> </ul>
<b>Cash-based</b>	<ul style="list-style-type: none"> <li>▪ Does not dilute shareholders or reduce the share pool</li> </ul>	<ul style="list-style-type: none"> <li>▪ Perceived lack of shareholder alignment</li> </ul>

---

# LTI Strategies

- One-Time “Top-Up” Awards
- Stock Options at Lower Strike Price
  - Furloughed employees may be ineligible
  - Watch for “spring-loading”
- Cancel and Re-grant 2020 Awards
  - Accounting impact
  - May require disclosure of both grants in proxy statement
- Avoiding Windfalls
  - Reduction in Opportunities/Value
  - Same Number of Shares as 2019

---

# More LTI Strategies

- Repricing of Stock Options
  - Design choices:
    - Value-for-value
    - One-for-one
    - Options for RSUs
  - Shareholder approval
  - Tender offer rules
- Share Pool Concerns and Conservation
  - Cash-based awards
  - Full-value awards
  - Plan for shareholder approval

---

# Deferred Compensation

- Deferral Election Timing
  - Usual rule under Code Section 409A:
    - May make or change deferral election for performance-based compensation for up to 6 months before the end of the performance period
  - Adjusting performance goals may disqualify as performance-based compensation
  - Result: no deferral election allowed

---

# Deferred Compensation

- Unforeseeable Emergency Distributions and Cancellations
  - Exception to usual rule under Code Section 409A that deferral elections cannot be changed
  - May cancel deferrals and/or take distributions if there is an unforeseeable emergency
  - Definition includes severe financial hardship resulting from an illness of the participant or the participant's spouse, beneficiary of dependent, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the participant's control
  - No detailed IRS guidance, so proceed with caution



---

# Deferred Compensation

- Preference Claims in Bankruptcy
  - Deferred compensation may be clawed back in some bankruptcy situations under preferential payment rules
  - Negative tax impact on executive possible
    - Miscellaneous deductions not available to participants if deferred compensation is clawed back
    - However, “claim of right” may provide limited tax relief
- Funding Deferred Compensation
  - Sometimes-overlooked Code Section 409A(b) may trigger early taxation if assets are restricted to pay deferred compensation

---

## Upcoming NDI Webinars

- June 24: Rethinking Your Post-COVID-19 Supply Chain Strategies
  - Ann Marie Uetz, Partner, Foley & Lardner
  - Kate Wegryzn, Partner, Foley & Lardner
  - Vanessa Miller, Partner, Foley & Lardner
  - Jim Kalyvas, Partner, Foley & Lardner
- July 1: Don't Let This Crisis Go To Waste – Think Strategically and Not Just Defensively
  - Steve Barth, Partner, Foley & Lardner
  - Barry Cain, Private Directors Association

# Thank You



---

**Leigh Riley**

Partner, Foley & Lardner

[lriley@foley.com](mailto:lriley@foley.com)

414.291.5846



---

**Josh Agen**

Of Counsel, Foley & Lardner

[jagen@foley.com](mailto:jagen@foley.com)

414.297.5535



---

**Eric Gonzaga**

National Managing  
Principal, Executive  
Compensation Practice,  
Grant Thornton LLP

[Eric.Gonzaga@us.gt.com](mailto:Eric.Gonzaga@us.gt.com)

612.677.5336