Don't Let Coronavirus Undermine Your Pay Program:

By: Marc Hodak, Partner, Farient Advisors

This article was originally published on agendaweek.com

The global impact of the coronavirus on health is having extraordinary repercussions on business. While we cannot predict its ultimate effect on people and markets, history is clear that any major crisis upends the normal rules on executive compensation. In fact, we can predict three changes ahead:

- While generally tolerant of good awards for strong relative performance, investors are likely to begrudge awards when experiencing unusually poor absolute performance.
- Companies that somehow minimize the pain for their shareholders with significant layoffs and other cost-cutting measures will have difficulty justifying short-term payouts to the management that made those difficult decisions.
- Companies that were kept afloat by government bailouts will likely see regulatory limits on executive compensation that may last long after the crisis has passed.
- Furthermore, given that CEO pay is a favorite campaign issue during U.S. presidential elections, these concerns are sure to be magnified throughout 2020.

As a result, your compensation committee needs to prepare itself and your management teams for these predictable side effects of this otherwise unpredictable crisis. After all, no board wants their pay practices to replace front-page news about the pandemic.

Farient's Perspective: The One Constant is Good Governance

When everything else is in flux, it is especially important to hang on to the constant of "doing the right thing." In this context, your compensation committee should let its pay program do what it was designed to do. Any exceptions should be scrutinized against the stark realities outlined above.

Let Your Incentive Plans Play Out

Your committee spent a lot of time developing your compensation plans. To the extent that the current market pressures reveal any cracks in your program, use that information to strengthen the program later. We still have a lot of uncertainty ahead.

Keep Incentive Plan Exceptions to a Minimum

Retaining critical talent is always a priority, but if it is looking as though incentive awards are going to zero, the compensation committee should be clear that exceptions will be minimal, and that the more senior the executive, the less likely that an exception will be considered.

In the hardest-hit sectors where investors and other stakeholders have suffered the most, no amount of transparency regarding special awards, or even normal awards based on non-financial metrics, will save the committee or the affected executives from the backlash that is sure to follow. The management team will have another chance to earn their incentives when business returns to normal, presumably against goals that are set relative to new economic realities.

Enhance the Resiliency of Long-Term Plans

Long-term incentive (LTI) programs are meant to transcend the ups and downs caused by the impact of externalities over time. For many companies that are experiencing relatively mild effects from the coronavirus outbreak, the current situation may highlight something generally hidden when times are good — i.e., your incentive plans may be overleveraged. When the trend is up for many years, narrower goal ranges can creep in and gain acceptance. While now is not the time to alter your in-flight plans, this could be the year to revisit your goal ranges for future plan cycles, particularly if your company is surprised with how quickly your incentives can go to zero. Perhaps you might consider lowering your leverage, i.e., widening your goal ranges up and down, instead of starting with "what we've always done" or what is common by peer standards.

Keep 2020 Disclosures Simple

When companies have difficult choices to explain, their instinct is to bulk up on disclosures. Investor patience is likely to be thin after this crisis. Committees should find ways to avoid changes that require a great deal of explanation, and instead make changes that simplify the story in a way that investors can readily understand and accept.

The Path Forward

Your compensation committee should be thinking about the following five steps:

- Communicate plainly to all your stakeholders how the company is supporting its employees and broader community, and how that support is likely to affect results, especially if it negatively impacts performance in the short term.
- With incentive plans, let the chips fall as they may, perhaps making exceptions for critical talent, but excluding the CEO.
- If, for some reason, your plan offers significant payouts in a period of poor absolute performance, prepare to consider negative discretion to the point of forgoing or deferring awards, perhaps subject to a turnaround in performance.
- f your plan is not behaving the way you were expecting, review it to see what needs to change to ensure alignment in good times and bad.
- Determine how to explain the move you intend to make before you decide to make that move. If you have a difficult time developing a simple explanation, then consider whether this is the right move. Also, be prepared to explain what you are doing to preserve or enhance alignment between management and investors in go-forward pay plans.

We are living in unprecedented times. Often, such times present an opportunity for invention and change. However, as we navigate uncharted waters, adherence to the basic principles of good governance should prevail.

About Farient Advisors LLC

Farient Advisors LLC is an independent executive compensation, performance, and corporate governance consultancy. Farient provides a comprehensive array of services to boards of directors and management including: compensation program design, goal setting and performance measurement, pay and performance alignment, board of directors compensation, and shareholder communication among others. Farient has offices in Los Angeles and New York and covers clients in more than 30 countries through our partnership in the Global Governance and Executive Compensation Group (GECN). Contact us at info@farient.com.