



Compensation
Advisory Partners

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COVID-Related Executive Pay Actions at December FYE Companies Focus on Annual Incentives

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Compensation Advisory Partners' (CAP's) analysis of 300 S&P Composite 1500 companies with fiscal year ends (FYE) near December 31 found that the most frequent recent executive pay action taken in response to COVID-19 continues to be annual incentive modification. The CAP analysis – which is part of our ongoing efforts to track executive compensation and human capital actions related to COVID-19 – shows that 50 percent, or 150 companies made COVID-related changes to their executive incentive plans. Of the companies that made incentive changes, 60 percent made annual incentive changes, 9 percent made long-term incentive changes, and 31 percent changed both incentive plans. The S&P 400 (Mid Cap) and S&P 600 (Small Cap) companies were more likely to exercise discretion to adjust final annual incentive payouts than the S&P 500 (Large Cap) companies.

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Key Findings

- 50 percent of S&P Composite 1500 companies with fiscal year ends (FYEs) near December 31 modified their incentive plans due to COVID-19, up from 42 percent of September FYE companies.
- Of companies that disclosed incentive plan changes, they were typically for the most recently completed or outstanding performance period(s) vs. prospective changes.
- Consistent with September FYE companies, modifications were more likely to be to the annual incentive plan among December FYE companies.
- Most September and December FYE companies that adjusted annual incentive payouts for the impact of COVID-19 relied on compensation committee discretion – either positive or negative. CAP’s analysis of the December FYE companies shows that Mid Cap and Small Cap companies were more likely to exercise discretion than their larger S&P 500 peers.
- The most prevalent annual incentive actions were 1) exercising or adding discretion to the plan, 2) adding or changing the performance measures, and 3) revising the payout scale.
- The most prevalent long-term incentive actions were 1) adding or changing the performance measures, 2) modifying the performance period, and 3) changing the long-term incentive vehicle mix.

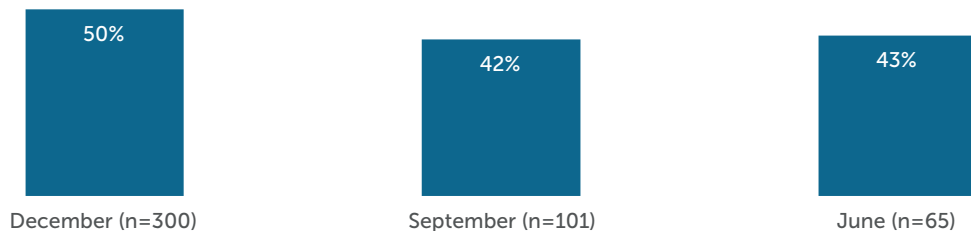
Study Sample

CAP has been tracking COVID-related executive compensation and human capital actions taken by S&P Composite 1500 companies since the beginning of the pandemic. The S&P 1500 index includes three indices: S&P 500 (Large Cap), S&P 400 (Mid Cap) and S&P 600 (Small Cap). This analysis focuses on 300 S&P 1500 companies – the first 100 to file proxies from each of the three indices. In past studies, CAP analyzed S&P 1500 companies with June FYEs (65 companies) and September FYEs (101 companies).

Findings

Among the 300 December FYE companies, 50 percent made changes to their outstanding and/or go-forward incentive plans. This represents an increase from CAP’s finding that 42 percent of September FYE companies and 43 percent of June FYE companies modified their incentive plans.

Prevalence of Companies Taking COVID-Related Actions by FYE



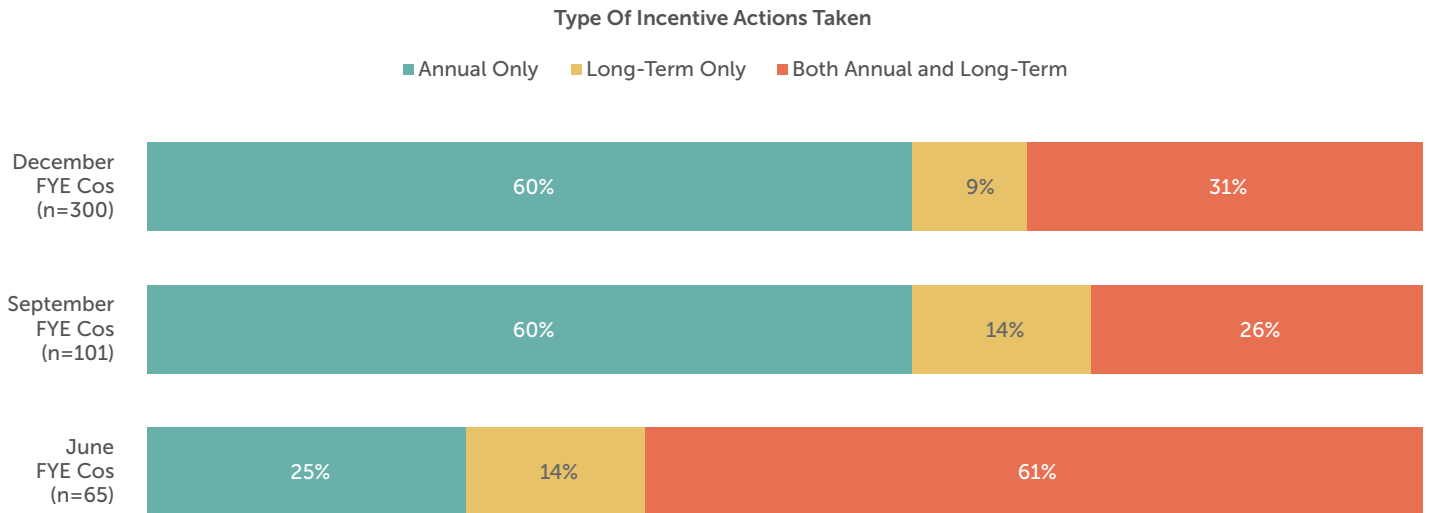
- Two to three quarters with COVID-19
- Realized COVID was longer term
- Time to hear from investors and proxy advisory firms
- Half of companies took one action; other half took two or more
- Annual incentive plan changes more common
- Hard-hit companies modified both annual and long-term plans

- One quarter with COVID-19
- COVID was new; duration was uncertain
- 79% took two or more actions; 21% took only one action
- Adjusted both annual and long-term plans

Incentive Changes

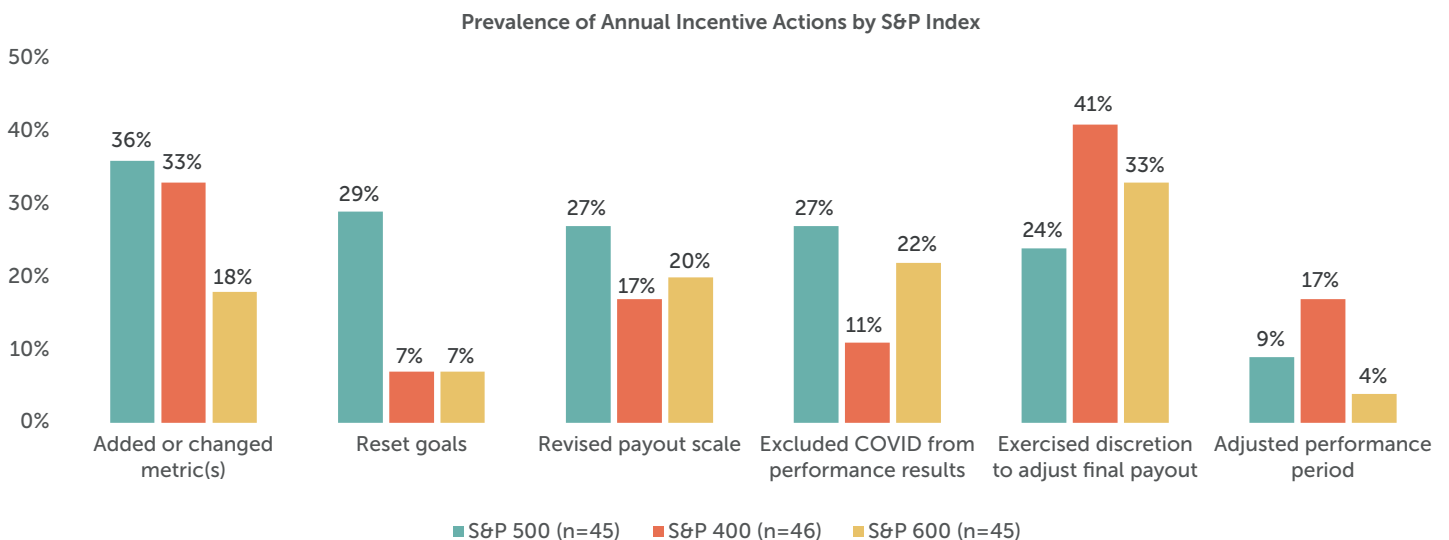
The types of incentive actions taken have varied based on the company's FYE and how much of the company's fiscal year overlapped with the pandemic.

In CAP's earlier research, the most common action among June FYE companies was to exclude one quarter of COVID-19 from their performance periods and calculations. In contrast, September and December FYE companies had to address the impact of two or three quarters of the pandemic during their fiscal years. September and December FYE companies viewed the pandemic as a long-term event. These companies had a chance to engage with investors and hear guidance from proxy advisors, who discouraged changes to long-term incentives. As a result, September and December FYE companies made fewer changes overall, and changes were more likely to be made to annual incentive plans.



Annual Incentive Changes

Of the 150 December FYE companies that made incentive changes, 136 made changes to their outstanding and/or go-forward annual incentive plans. Larger companies in the S&P 500 most commonly changed annual incentive metrics, goals, and payout scales, and also excluded the impact of COVID-19 from financial results. S&P 500 companies applied discretion to annual incentive payouts, but not to the extent of smaller S&P 400 and S&P 600 companies.



Note: Companies may have taken multiple actions and therefore percentages may not add to 100%

The three most prevalent annual incentive changes among the December FYE companies that made such changes are:

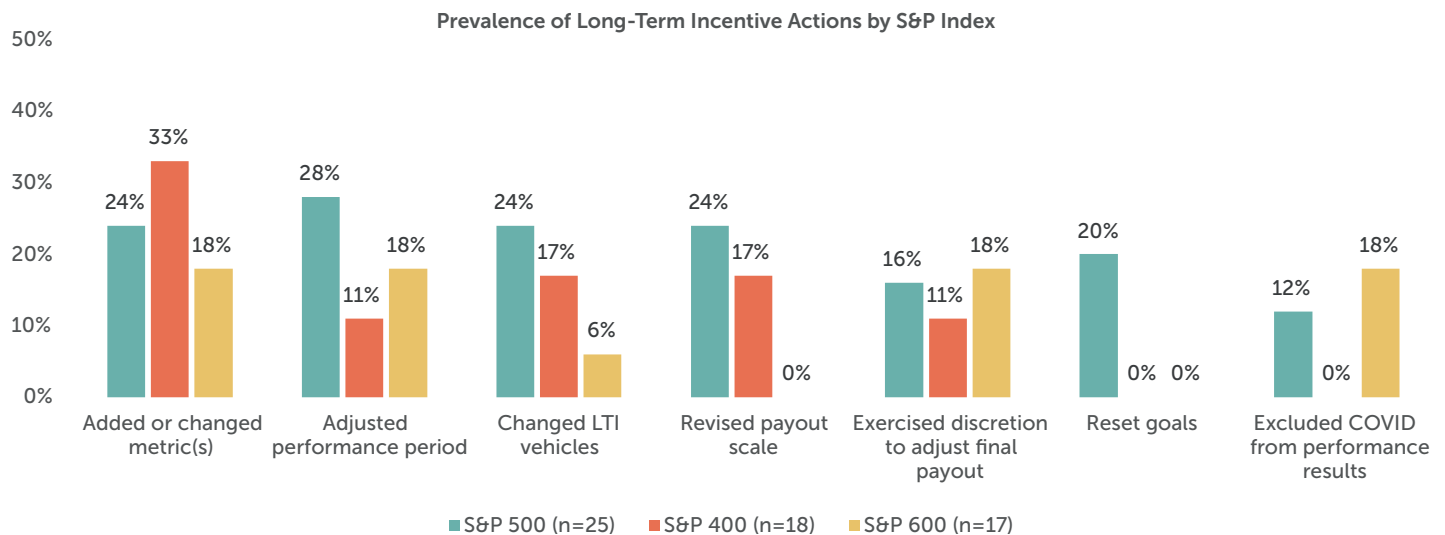
Exercised Discretion to Adjust Final Payout: Forty-five December FYE companies (33%) in the S&P 1500 exercised or added discretion to their outstanding annual incentive plans. Among these companies, approximately 75 percent exercised positive discretion. Most companies that exercised positive discretion increased the payout to between 50 percent and 100 percent of target. The remaining 25 percent of companies exercised negative discretion and typically reduced the payout to be equal to, or less than, target. Companies in the S&P MidCap 400 and S&P SmallCap 600 indices were more likely to exercise discretion to adjust annual incentive payouts vs. those in the S&P 500 (Large Cap) – 41 percent and 33 percent vs. 24 percent, respectively.

Added or Changed Metric(s): The most common structural annual incentive plan change has been to add or change metrics: 29 percent of December FYE companies (39 companies) made this adjustment. Commonly added metrics focused on operating income or liquidity, or strategic measures in the context of the pandemic.

Revised Payout Scale: Twenty-one percent of December FYE companies (29 companies) revised their annual incentive payout scales. Among these companies, approximately 80 percent revised the maximum payout down, most commonly capping the payout at 100 percent of target. Companies that reduced target payouts did so by 25 percent to 50 percent. Companies that reduced threshold payouts most commonly lowered their thresholds from 50 percent to 25 percent of target. One company increased the maximum payout for its 2021 plan to compensate named executive officers (NEOs) for the reduced payout in 2020 due to COVID-19.

Long-term Incentive Changes

Of the 150 companies that made incentive changes, 60 adjusted their outstanding and/or go-forward long-term incentive plans. Forty-six of those 60 companies also adjusted their annual incentive plans. The intent of awards covering performance over multiple years is to control for performance volatility over the short-term, so December FYE companies have been less likely to adjust their long-term incentive plans throughout the pandemic. The following chart shows the long-term incentive actions taken by December FYE companies in order of prevalence.



Note: Multiple actions may have been taken by one company, so percentages may not add to 100%

The three most prevalent long-term incentive changes among the December FYE companies that made such changes are:

Added or Changed Metric(s): As in annual incentive plans, the most common long-term incentive plan change was to add or change metrics (25% of December FYE companies, or 15 companies). The most common change has been to add, or increase the weighting of, relative performance measures, primarily total shareholder return. Other commonly added metrics focused on operating income and liquidity.

Changed the LTI Vehicle Mix: Most companies that changed their LTI vehicle mix (17%, or 10 companies) shifted away from performance-based vehicles that require goal-setting and toward retention vehicles with time-based vesting. Most of these long-term incentive plans, however, continue to be predominantly performance-based, which aligns with the long-standing expectations of proxy advisors and major investors. Select companies excluded the chief executive officer from the shift to time-based equity.

Revised Payout Scale: Nine companies revised their long-term incentive payout scales. Similar to companies that revised their annual incentive payout scales, it was most common for companies to revise the maximum payout down, capping payouts at 100 percent of target.

Looking Ahead

While the vaccination process is well under way in the United States, the economy continues to have significant uncertainty, with businesses unsure which COVID-related shifts are long-term and which will phase out as a new normal emerges. This uncertainty makes goal-setting difficult for annual and long-term incentive plans. To mitigate some of the goal-setting challenges, companies facing continued uncertainty are considering or have implemented changes to 2021 incentive designs including:

Annual Incentive Plans

- New or increased weighting of a non-financial component in the annual incentive plan, including operational, strategic, and individual performance metrics. These may be incorporated as environmental, social and governance (ESG) metrics, which provide a more holistic view of business performance and consider different stakeholders.
- Bifurcation of annual incentive performance periods (i.e., first half/second half).
- Use of wider performance scales around target goals, which may lead to less volatility in payouts.
- Delay of goal-setting to improve accuracy.

Long-Term Incentive Plans

- Use of, or increased weighting on, relative performance measures, primarily total shareholder return.
- Use of wider performance scales around target goals, which may lead to less volatility in payouts.
- Use of shorter periods for performance-based long-term incentives by companies that continue to have challenges with long-term goal-setting. (A common approach is to replace a three-year performance period with three one-year performance periods.)
- Increased use of time-based restricted stock/units for retention. CAP still expects at least 50 percent of long-term incentives to be performance-based, given the long-standing expectations of proxy advisors and major investors.

CAP anticipates that many of these incentive design changes are temporary in nature and expects companies to revert to more traditional incentive designs in 2022 as goal-setting becomes less challenging. However, CAP believes that the pandemic has accelerated certain trends that were already in progress, such as the shift to ESG measures.

Additional COVID-19 Resources – Compensation Advisory Partners

- **COVID-19 Resource Center.** CAP's COVID-19 Resource Center includes a searchable database of business actions related to COVID-19 that can be filtered on company, revenue, company type, industry, and action. [CAP's COVID-19 Resource Center can be accessed here.](#)
- **Recent Proxies Highlight COVID-Related Incentive Actions for September FYE Companies.** CAP summarizes incentive actions taken by September FYE S&P 1500 companies in response to the COVID-19 pandemic. [The report can be accessed here.](#)
- **Recent Proxies Provide In-Depth Look at COVID-19 Pay Actions.** CAP summarizes incentive actions taken by June FYE S&P 1500 companies in response to the COVID-19 pandemic. [The report can be accessed here.](#)
- **Early Filers: COVID-19 Impact on 2020 Incentive Plan Payouts.** CAP summarizes incentive actions taken by 50 companies with fiscal years ending between August and October 2020. [The report can be accessed here.](#)
- **Early Read on ISS' View on COVID-Related Compensation Changes.** CAP reviewed select broad market COVID-19 executive compensation actions and the corresponding ISS report commentary. [The report can be accessed here.](#)
- **Compensation and Human Capital Corporate Actions in Response to COVID-19.** CAP is regularly updating a report containing the findings of CAP's corporate action tracker and additional interactive visualizations of key trends across industry groups and action types. [The report can be accessed here.](#)

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