The Impact of Covid-19 on Incentive Compensation (Annotated)

Editor's Note: This checklist includes items for companies and their boards to consider with respect to incentive compensation in light of the Covid-19 outbreak and the resulting market uncertainty. Boards and management teams should consult with legal, tax, and accounting advisors before making any decisions regarding changes to equity and incentive compensation.

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Target Setting for Annual Bonus Programs

☐ If 2020 performance targets have already been set, consider appropriate and necessary adjustments to targets:

- ☐ Ensure that any adjustments made are in compliance with applicable plan documents; and
- ☐ Consult with auditors to understand the accounting impact of any proposed adjustments.

Comment: Note that adjusting too soon may necessitate further adjustments as the impact of the Covid-19 outbreak on business operations is evaluated.

☐ If 2020 performance targets have not yet been set, consider delaying target setting until more is known about the impact of the Covid-19 outbreak on business operations:

- ☐ Ensure that any delays to target setting are in compliance with applicable plan documents;
- ☐ Consult with auditors to understand the accounting impact of any proposed delays to target setting; and
- ☐ Consider employee reactions to any proposed delays in target setting.

☐ If proceeding with setting 2020 performance targets now:

- ☐ Consider using relative, rather than absolute, performance metrics to account for uncertain conditions and individual performance metrics that tie, for example, to effective crisis response; and
- ☐ Consider providing the plan administrator with sufficient discretion to adjust annual bonus targets. All discretion should be circumscribed tightly to outline when it can and cannot be applied.

☐ Provide boards and compensation committees with updated information throughout the year on business metrics, such as revenue, inventory, supply chain, human capital issues, and geographic disruptions, to ensure that any discretion is thoughtfully applied at year-end.

Target Setting for Long-Term Incentive Programs

☐ Consider delaying setting long-term performance award targets until the market is somewhat less volatile:

- ☐ Ensure that any delays to target setting are in compliance with applicable plan documents; and
- ☐ Avoid letting too much of the applicable performance period run before goal setting.

☐ If proceeding with setting long-term performance award targets now:

- ☐ Consider using relative rather than absolute performance metrics;
- ☐ Consider revisiting performance award minimum and maximum payout ranges; and
- ☐ Consider providing the plan administrator with sufficient discretion to adjust awards when ultimately determining achievement levels with respect to long-term performance targets.

☐ If considering adjusting performance targets with respect to outstanding long-term incentives granted in prior years:

- ☐ Determine whether it is beneficial to terminate longer-term awards and replace them with new grants with more achievable long-term targets;
- ☐ Ensure that any adjustments made are in compliance with applicable plan documents and are consistent with prior disclosure;
- ☐ Check for any grandfathered I.R.C. § 162(m) applicability if awards were made prior to November 2017; and
- ☐ Prepare for accounting and disclosure ramifications of any adjustments made to long-term incentives granted in prior years.

☐ Provide boards and compensation committees with updated information throughout the performance period on business metrics, such as revenue, inventory, supply chain, human capital issues, and geographic disruptions, to ensure that any discretion is thoughtfully applied.

Incentive Award Timing

☐ Consider delaying the timing of incentive award grants to reduce the effects of market volatility and business operation disruption:

- ☐ Determine which types of award grants, for example, multi-year performance awards, are most appropriate to delay; and
- ☐ Consider staggering annual equity grants to be made throughout the year, that is, semi-annually or quarterly.

New Equity Award Considerations

☐ Consider revisiting the mix of equity awards (percentage of full share awards vs. options) to address the challenge of making grants when business operations and share prices could change drastically from day to day.

☐ If required, draft plan amendments to change grant timing flexibility.

☐ When pricing awards, consider using a trailing average price rather than a spot price (such as a daily closing price) to avoid anomalous pricing on extreme up or down market days, but remain aware of I.R.C. § 409A limitations and review applicable plan documents to determine whether the use of alternative valuation methodologies is permissible.

☐ Consider the share capacity of existing equity plans, including capacity to make any upcoming automatic grants, such as shareholder approved formula director compensation grants. For public companies, if the company's proxy statement for the 2020 annual meeting has not yet been filed, consider including a proposal to amend equity plans to account for higher-than-expected burn rates.

☐ Consult with auditors to understand the accounting impact of any proposed adjustments.

Existing Equity Award Considerations

☐ Consider whether to continue to use regular broker-assisted, sell-to-cover programs for tax withholding, or to instead use company net share settlement or withholding from other income of the award holder.

☐ Review applicable plan documents to ensure the company maintains consistency with past practices in determining the date on which awards are valued for tax purposes.

☐ Evaluate whether existing awards continue to be retentive and incentivize employees. If not, consider whether an option repricing or other equity award adjustments would be appropriate.

> **Comment:** Note that repricing is disfavored by proxy advisory firms and institutional investors and is likely to require shareholder approval. Further, if structured as an option exchange, the program may constitute a tender offer by the company.

Disclosure

☐ Review prior SEC disclosures, grant policies, past public statements, and plan terms to identify any restrictions on delaying grant timing, pricing and valuation, or other proposed changes.

☐ If awards to executive officers or directors are impacted by a grant timing change, prepare current disclosure on Form 8-K if required.

☐ Consider voluntarily disclosing any timing changes, even if Form 8-K disclosure is not required.

☐ Consider whether Form 4 filings are required for new awards.

Employee Messaging

☐ Consider what information employees receive about operations, disruption, and workplace policies, as well as compensation, with greater-than-typical sensitivity.

☐ Draft and disseminate employee communication to emphasize the business importance of, and explain the reasoning behind, any changes being made.