Remuneration Committees - Navigating through the impact of COVID-19

What does COVID-19 mean for Boards and Remuneration Committees thinking about the 2020 performance year?

The early months of 2020 have seen COVID-19 spread across the world. Whilst countries rightly prioritise the health and safety of their people, many are also taking measures to protect businesses. Companies are also assessing the overall impact of COVID-19 on their businesses, and how they are going to adapt their strategies to survive.

As part of this business assessment, Boards and Remuneration Committees (RemCos) should consider their response to the impact of COVID-19 and what actions they should take around remuneration and incentives strategies.

Points for RemCos to consider

We set out in this article some key headline issues that Boards and, in particular, RemCos should consider over the coming weeks and months in relation to reward and incentive plans.

All of these are likely to be scrutinised by investors next year. It is therefore important for RemCos to consider them now, engage with directors, senior executives and shareholders to decide on the appropriate ways forward, and detail how they have arrived at decisions made.

Whilst this is not an exhaustive list, companies might wish to use it as a starting point for items to go on to the next meeting agenda:

- Should 2020 vesting's, payments and grants be reduced or deferred?
- Is salary reduction of relevance in the context of wider workforce sacrifices?
- Are the company's guidelines for applying discretion and clawback appropriate and robust?
- What should the messaging be, and how do we work closely with the management team to get this right?
- How will today's decisions will be communicated to shareholders next year?
- Can savings be made by reducing award sizes, transferring employer's NIC and/or making more use of tax-advantaged share plans?

More detail on some of these points is set out below.

Some more of the detail

Deferring bonus payments

If bonuses for the last financial year have not yet been paid, the RemCo might consider whether it is possible to defer payment until later in the year, or perhaps reduce the amount of any payment to the extent permitted.

This could help with cash-flow, and shareholders might view it as an appropriate response, particularly where head count has been reduced and employees placed on furlough.

Deferring future grants

RemCos could adopt a 'wait-and-see' approach, and defer granting (in whole or part), or setting performance conditions for, any new awards until later this year, or next year, when the outlook is clearer.

This would need to be permitted under the rules of the relevant plan.

Performance conditions on existing awards

In the light of the downturn in both share prices and economic activity, RemCos should review and consider the terms of any performance conditions applying to incentive awards and decide whether or not they should be amended.

RemCos should be very cautious of the likely investor reaction to any adjustments or the exercise of discretion – and should also consider the wider context of the workforce as a whole in arriving at any decision.

Determining the number of shares subject to future awards

If the number of shares subject to an award is based on a percentage of salary, RemCos should consider what share price should be used as the basis for any share awards (including deferred share bonuses) granted in 2020.

In particular, should grant values be based on a current low share price or a pre-COVID-19 price?

Investor bodies have made clear that where there are material share price reductions, award levels should be scaled back proportionately.

Caps on long term incentive plan payouts are likely to be another feature which will give investors comfort that management will not benefit from any 'windfall' gains in the future.

Salary reductions

With discussions regarding workers being furloughed, we are already seeing some Boards leading the way by agreeing to reductions in salary for a period of time.

'Sharing the pain' is an important principle in maintaining fairness across the workforce.

Share plan dilution issues

Under investor guidelines, usually, the number of shares issued or issuable in respect of awards granted under any employee share plan are limited, in a rolling ten-year period, to 10% of the issued ordinary share capital at any point in time.

In falling markets, this headroom is used up more quickly. Establishing an employee share ownership trust to satisfy awards with market purchased shares is a potential solution, although the cash requirements of purchasing shares in the market should be carefully considered.

Use of tax advantaged schemes

For many businesses going forwards, cash-flow will be tight and costs will need to be controlled.

RemCos might consider whether to incentivise employees by granting awards under one or more of the tax advantaged share plans available in the UK (CSOP, EMI, SAYE or SIP).

This could reduce employer's NIC and, where relevant Apprenticeship Levy, liabilities and help manage cash for the employer. Additionally, the potential income tax savings could mean that delivering the same net benefit to employees would require fewer shares, reducing the cash cost of purchasing shares, or the dilution to shareholders of using new issue or treasury shares.

Transfer of employer's NICs to employees

Where P&L costs are under strict control, transferring employer NICs may help alleviate some of those pressures in the short term and will also have the benefit of reduce longer term cash requirements. Transfer of NIC for 'in flight' awards will require careful consideration of the plan rules for enforceability, as well as the wider people implications of making such a decision

Employees can claim tax relief at their marginal rate on the amount of employer NICs they pay.

Share plan funding

If an employee share trust has surplus unallocated assets and loans have been made to the trustees to acquire shares, the RemCo might consider whether it's appropriate to ask the trustees to repay some or all of the sponsoring company loans. This might help where cash is required in the business.

SAYE and SIPs – treatment of furloughed employees

Many companies will be considering whether to furlough employees under the job retention scheme.

For companies operating a SAYE or SIP into which employees contribute regular monthly contributions, it is important to note that contribution reductions/withdrawal can apply whilst on furlough.

Companies contemplating furloughs which operate these plans should consider this as part of their communications to affected employees.

How we can support you

Please contact Chris Barnes (Partner) or Elizabeth Rankin (Senior Manager) if you require further guidance on understanding and addressing the implications of COVID-19 for your remuneration strategy.

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