

Meridian Client Update

COVID Impact on Incentive Compensation

Meridian Compensation Partners' year-end study reveals that in spite of much talk about potential changes to incentive compensation in response to the COVID-19 crisis, a majority of companies made no changes in 2020 to annual or long-term incentives due to the impact of COVID, and 2021 design changes are anticipated to be modest. The likelihood of executive pay changes appears to vary significantly by the industry, and whether COVID has had a particularly lasting effect on those businesses.

Meridian's unique year-end cross-industry study of 280 client companies reveals that a majority of companies did not alter their annual or long-term incentive (LTI) arrangements mid-year in 2020, preserving their original pay and performance relationship. However, nearly half of companies expect increased discretion in the final annual incentive determination. Furthermore, most companies are implementing only modest changes to incentive designs for 2021, if any.

Five Key Takeaways

The survey revealed a number of interesting insights on incentive compensation trends – below are five key takeaways:

- **Only one in four companies (24%) made mid-year changes to their annual incentive.** However, nearly half of companies (46%) expect greater use of discretion in final funding of 2020 incentives. Of the companies considering the use of discretion, all are projecting payouts that are near or below target after discretion is applied.

Meridian Comment: *While there are examples of companies that took extraordinary actions, particularly in hard-hit industries, the vast majority of companies maintained their original incentive plan structure and goals. Approximately half of companies surveyed are considering a greater use of discretion in the final payout determination, likely considering the broader context of the management team's performance and with generally conservative (i.e., below target) payout levels.*

- **2020 annual incentive funding will likely average near target when viewed across all companies** – 32% of companies anticipate near threshold (or zero) funding and 24% project funding significantly above target. Funding will vary widely depending on the unique company circumstances, especially how COVID may have impacted the specific industry.

Meridian Comment: *While the pandemic has impacted different industries and companies to varying degrees, Meridian expects a distribution around target.*

- **A majority of companies are considering modest changes to their 2021 annual incentive in response to continued business uncertainty** – The most common changes under consideration are flattening of the performance slope (61%) or adding/increasing the use of non-financial metrics (42%).

Meridian Comment: Only a limited number of companies are considering significant changes to their 2021 annual incentive programs. However, the uncertain economic environment and the increased focus on ESG issues will likely result in wider ranges for financial performance for many companies and an uptick in the use of non-financial metrics.

- **Very few companies (7%) have made changes to outstanding performance share awards** – While some additional companies may make adjustments to outstanding performance share cycles in the future, it is likely to remain a minority practice.

Meridian Comment: The low percentage of companies considering changes to outstanding performance shares is likely due to the long-term nature of these awards, the higher prevalence of relative metrics in these awards, the adverse accounting and disclosure implications of modifying outstanding LTI awards, and concern about adverse shareholder reactions.

- **Nearly 80% of companies anticipate no material changes to LTI design for 2021** – Among those making changes, the most common action is a greater use of time-vested equity or the introduction of new metrics.

Meridian Comment: Similar to the previous observation, LTI programs tend to be structured to withstand various short-term cycles and volatility, so we do not expect many companies to change their LTI programs due to the pandemic. Furthermore, changes are anticipated to be industry-specific. For example, companies in the Transportation industry are more likely to shift pay from performance-based to time-based, whereas companies in the Energy industry are more likely to consider new financial metrics for 2021.

The survey tapped into Meridian’s extensive client network to better understand COVID’s impact on 2020 incentive actions and anticipated 2021 incentive designs. Meridian gathered information from Meridian consultants representing 280 U.S. and Canadian client relationships over the last two weeks of December, in order to capture actions from year-end meetings and to understand key trends as we head into 2021.

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