Fall 2020

COVID-19 Director Pulse Survey

HUGESSEN CONSULTING

Introduction

As Boards and Management teams of companies with December 31 year-ends discuss and finalize 2020 pay decisions in the coming months, we will begin to gain clarity on the actual impact of COVID-19 on executive compensation. Until then, as a follow-up to our **Summer 2020 Director Pulse Survey**, we sought to take the temperature of Canadian directors' thoughts on year-end compensation decisions, with a focus on the anticipated use of discretion on 2020 incentives. The results of our Fall 2020 Director Pulse Survey broadly indicate that many respondent companies are likely to apply some form of discretion at year-end, and that it will most likely be applied to short-term incentive plans (STIPs) versus long-term incentive plans (LTIPs). Other insights gathered relate to base salary decisions, modification to 2021 incentive designs, and incorporation of ESG (Environment, Social, and Governance) metrics into incentive structures.

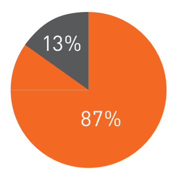
Key Takeaways

- **The application of STIP discretion among the respondents is anticipated to be widespread (68% plan to apply discretion), with the prevalence highest amongst those in the Energy sector (82%). LTIP PSU discretion is expected to be significantly less prevalent at 11%**
- **Approximately half of respondents anticipate modifications to 2021 STIP and LTIP design; at least partly in response to lingering uncertainty going into the new fiscal year**
- **ESG considerations continue to receive increased airtime in incentive discussions. Over half of respondents plan to incorporate ESG metrics in the upcoming year or the following year. Of these respondents, 33% said that COVID has accelerated implementation**

Methodology

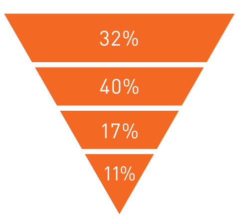
This pulse survey briefing summarizes the responses of 53 Canadian director participants collected in the final two weeks of November 2020, representing a range of companies' Boards they sit on, in terms of ownership, industry, geography, and company size.

Ownership



- Public issuer
- Privately-held, for-profit company

Size



Large cap (greater than $5B)
Mid cap (between $1B and $5B)
Small cap (between $250M and $1B)
Micro cap (less than $250M)

Province

40% Ontario
38% Alberta
11% Quebec
11% Other Canadian Province or Territory

Industry

41%	7%	23%	6%	6%	9%	1%	7%
Energy	Mining	Financial Services	Industrials	Consumer Goods/ Retail	Real Estate	Healthcare	Other

Taking the Temperature

The COVID-19 pandemic has had a decidedly negative impact on current year financial performance at respondent companies (81% substantially or slightly negatively impacted – Figure 2), though this is slightly improved from 89% in our Summer survey. As the calendar year draws to a close, it is important to note that many public issuers have seen share price appreciation resulting from improved operational and financial results and prospects.

That said, compensation impacts persist as Boards begin making year-end incentive pay decisions. The drop in financial performance is still significantly impacting year-end incentive expectations (72% expect substantially or slightly negative impact on incentives – Figure 3).

What has been the impact of COVID-19 on current year financial performance?

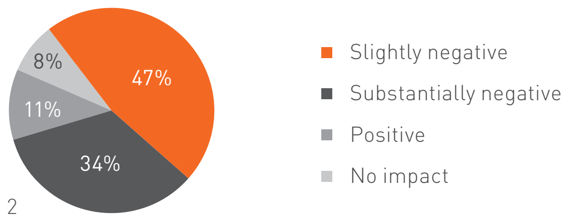


Figure 2

What is the expected impact of COVID-19 on year-end incentive payouts to executives (if no special action is taken)?

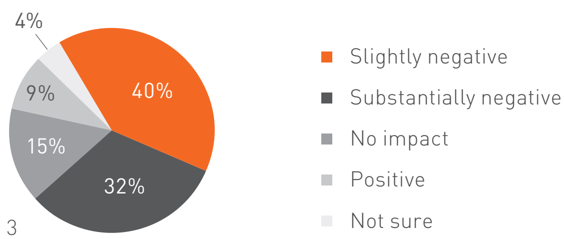


Figure 3

Use of Discretion on 2020 STIP & LTIP

As we outlined in our recent briefing **Performance Evaluation For 2020: Where To Start?**, 2020 will undoubtedly be a challenging year for Boards and Compensation Committees to assess corporate and individual performance and make incentive determinations. In response to diminished 'formulaic' incentive expectations, Canadian boards appear to be getting comfortable with discretion. (See Figure 4 on the following page.)

- 68% of respondents anticipate the use of STIP discretion in the current fiscal year (Figure 4), 85% of which will be positive in nature. Energy companies are driving this result, with 82% anticipating discretion (interestingly, 18% being negative in nature).
- The most common application of discretion will be to all employees (43%), followed by only senior management (25%) and only lower / mid-level (8%) (the remainder said it was "too early to say").
- Most respondent companies (45%) will apply judgment as overarching discretion on the plan result (45%), as opposed to 20% modifying the formulaic result to adjust out the COVID impact (which can be challenging), or utilizing the individual plan component (15%).

Anticipated need to apply discretion to modify STIP payouts at year-end?

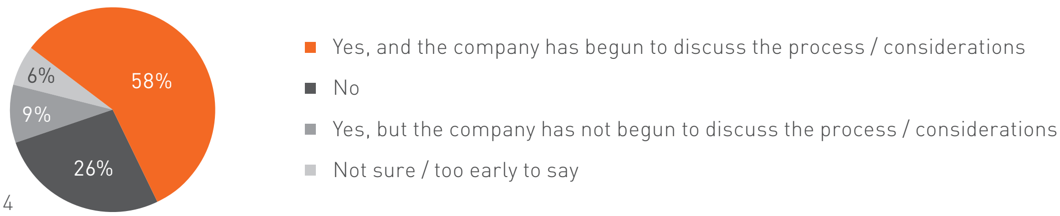


Figure 4

Driving force / primary rationale for the application of STIP discretion (of those that anticipate using discretion)?	
38%	Recognition for COVID response not currently captured in STIP framework
31%	Talent retention and motivation needs
23%	Realignment of pay outcomes with company performance
8%	Realignment of pay outcomes in light of COVID-related impacts on staff (i.e., layoffs, terminations, pay cuts, etc.)

Largest risk associated with / argument against the application of STIP discretion (of those that anticipate using discretion)?	
40%	Shareholder and / or proxy advisor reaction
32%	Weakening the integrity of the incentive framework
13%	Confidence in process / information available to fairly apply discretion
13%	Affordability considerations
2%	Other

Directors appear to be much more hesitant to apply discretion to PSU payouts within LTIP programs, at only 11%. We attribute this to the potential for shareholder and proxy advisor scrutiny associated with modifying LTIP payouts (see updated 2021 proxy voting policies by **ISS** and **Glass Lewis**), and better anticipated performance outcomes given 3-year performance measurement period.

Base Salary Changes

Shortly after the onset of the pandemic, many Canadian companies implemented temporary base salary cuts in response to diminished business prospects and affordability constraints. We observed over 60 Canadian public issuers disclosing such cuts, primarily at the executive and board level, and nearly half within our survey sample. As the year closes, 31% of respondent companies that made salary cuts have returned salaries to pre-COVID levels or plan to do so before the end of the fiscal year. A larger portion (35%) do not expect salaries to return until the new fiscal year, while 31% said it was "too early to say" (Figure 6).

Anticipated timing for the return of executive base salaries to pre-COVID levels?

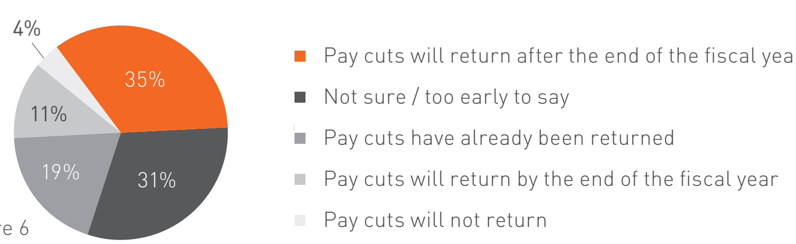


Figure 6

Salary increase expectations for 2021 are also expected to be muted, with 65% not expecting to increase executive salaries in the upcoming year (Figure 7). Of those that still expect increases, 76% anticipate they will be below pre-COVID expectations.

Meanwhile, the prospects of raises for the broader employee base are rosier, with over 60% of directors responding that an increase in the annual salary budget is expected, 59% of which are estimating the budget will increase by 2%.

Anticipated salary budget increase for the upcoming year?

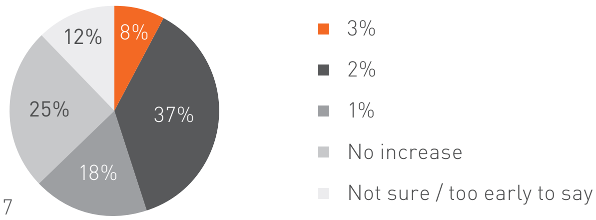


Figure 7

2021 STIP & LTIP Modifications

While many of these survey results herein underscore the short-term impacts of COVID, we also sought insights into the anticipated forward-looking design effects on their incentive pay programs. 47% of respondents indicated that they anticipate the need to modify the existing STIP structure as a result of COVID, while 28% of respondents anticipate modifying the LTIP structure. These changes will likely take a variety of forms, as shown in Figure 8. The most common anticipated STIP change is modifying the payout curve (56% of those anticipating changes), while the most common LTIP change is modifying target grant levels (47% of those anticipating changes).

Anticipated modifications to the upcoming year's STIP plan due to COVID?

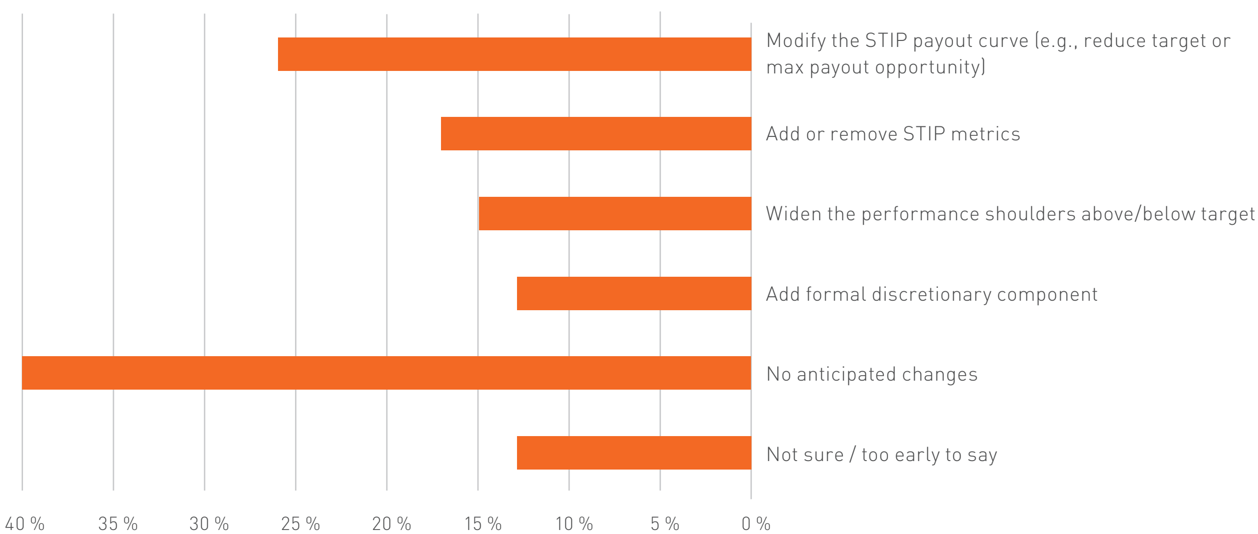


Figure 8

Anticipated modifications to the upcoming year's LTIP / equity granting approach due to COVID?

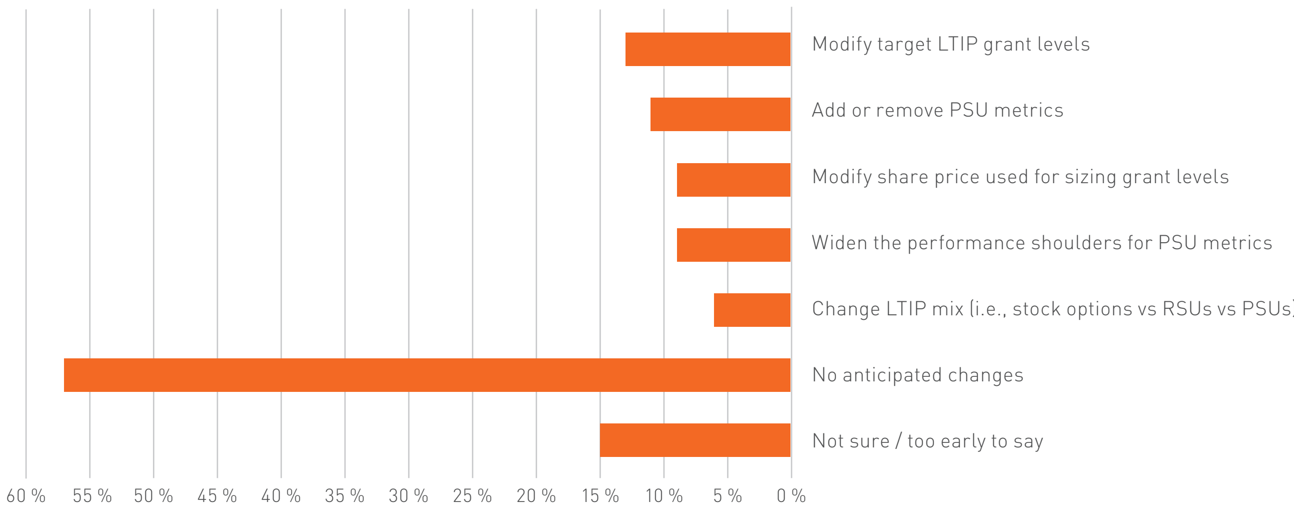


Figure 8

ESG Metrics

ESG continues to be a growing trend in pay programs, and the director community at large. 55% of respondents indicated that their companies are likely to implement ESG metrics (e.g. environmental sustainability, diversity & inclusion, etc.) in the upcoming year (32%) or the following year (23%) (Figure 9). Interestingly, of those adopting new ESG metrics in 2021 or 2022, 33% said COVID has accelerated implementation.

Is your board considering the use of ESG metrics in the incentive program for senior executives? (excluding safety)

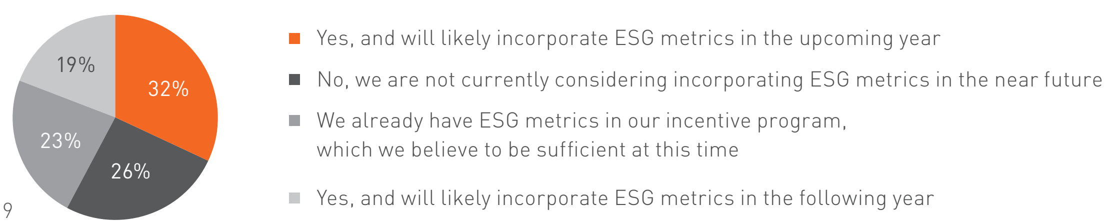


Figure 9

Conclusion

As 2020 draws to a close, market uncertainties persist. Despite COVID's continued impact on almost every industry, Boards will have to continue to make important decisions that appropriately retain and incentivize executive talent. Amid an environment of heightened shareholder and proxy advisor scrutiny, the Board's approach to compensation decisions must be particularly thoughtful and defensible. A continued focus on the facts, and a disclosure-sensitive approach to pay decisions, will serve directors well in this uncertain time.

For those with questions or who are interested in more in-depth and customized analysis, please contact John Skinner—jskinner@hugessen.com.