Summer 2020

COVID-19 Director Pulse Survey

HUGESSEN CONSULTING

Introduction

As the acute impacts of the COVID-19 pandemic on many Canadian businesses begin to subside, boards and management teams are left, among other tasks, to assess the outstanding issues related to human capital. Many companies, particularly those most impacted by the pandemic, acted swiftly to right-size pay levels in response to diminished business prospects in the short-term. Others went so far as opening up incentive programs mid-year, most of which had been set in stone just prior to the onset of COVID-19. This director pulse survey shines a light on the nature of such changes, and captures the prevailing sentiment of Canadian directors going into year-end incentive decision-making.·

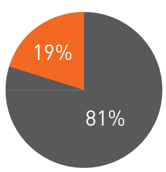
Key Takeaways

- Incentive expectations are down markedly for 2020, in close alignment with the negative financial impact experienced due to the crisis. This is particularly evident for those industries hardest hit – Energy, Industrials, Financial Services
- While a minority of companies have taken specific in-year STIP actions to date, the most common being modifying metric targets/goals, most companies expect to use discretion at year-end to right-size payouts, a discussion many boards have already breached
- In-year LTIP actions taken or being considered (i.e. PSU modification or stock option exchange programs) are notably less common

Methodology

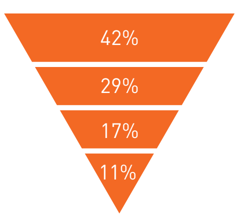
Building on broader director opinion surveys we conducted in **2016** and **2018**, this pulse survey briefing summarizes the views of 89 Canadian director respondents collected in August 2020, representing a range of company types, industries, geographies, and company sizes.

Ownership Structure



- Privately-held Companies
- Publicly-traded Companies

Size



- Large Cap (>$5B)
- Mid Cap ($1B - $5B)
- Small Cap ($250M - $1B)
- Micro-Cap (<$250M)

Geography

38% Ontario
36% Alberta
17% Quebec
7% Other Provinces

2% United States

Industry

27%	12%	18%	17%	8%	2%	6%	3%	7%
Energy	Mining	Financial Services	Industrials	Consumer Goods/ Retail	Real Estate	Technology and Telecommunications	Healthcare	Other

Taking the Temperature

As expected, the COVID-19 pandemic had a decidedly negative impact on current year financial performance at respondent companies (89% substantially or slightly negatively impacted – Figure 2), with the Energy, Industrials and Financial Services industries being the most impacted. Nearly half of all respondents do not see company performance returning to pre-COVID levels within the next 12 months (Figure 3).

The drop in financial performance has understandably impacted year-end incentive expectations to a similar degree (79% expect substantially or slightly negative impact on incentives – Figure 4).

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

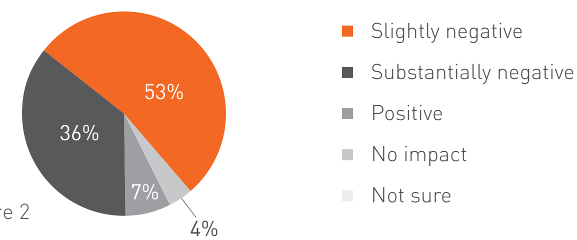


Figure 2

When do you believe performance will return to pre-COVID levels?

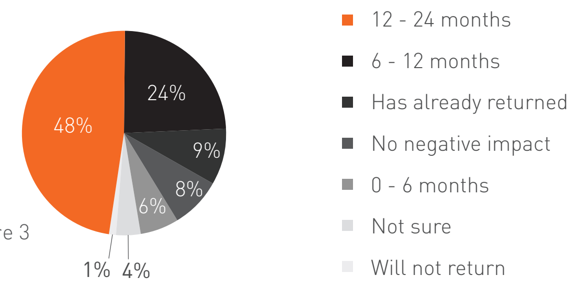


Figure 3

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

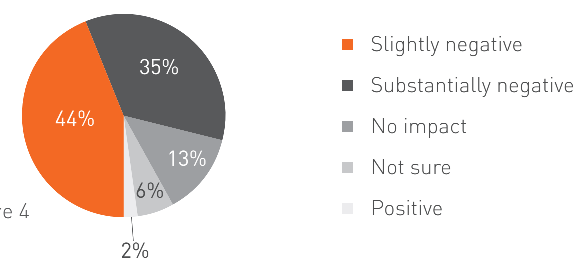


Figure 4

In-year STIP and LTIP Actions

The focus of this pulse survey is on how companies are responding, or planning to respond, to the gamut of incentive challenges resulting from this crisis. In our March 2020 briefing **Executive Compensation in Unprecedented Times**, we encouraged boards and compensation committees to exercise caution when considering material changes to compensation approaches, particularly when there was so much uncertainty at the time. By August 2020, this 'wait-and-see' approach continues to be the majority practice observed. Over 75% of respondents said that their companies had not taken any specific action to modify their STIP programs mid-year. As such, over 65% anticipate the need to modify STIP payouts at year-end, with a majority of those having already begun discussions on the process / considerations around applying discretion (Figure 5).

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

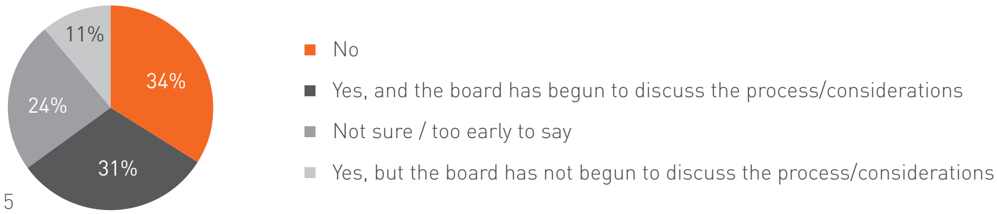


Figure 5

In-Year STIP Actions - Has your Company...

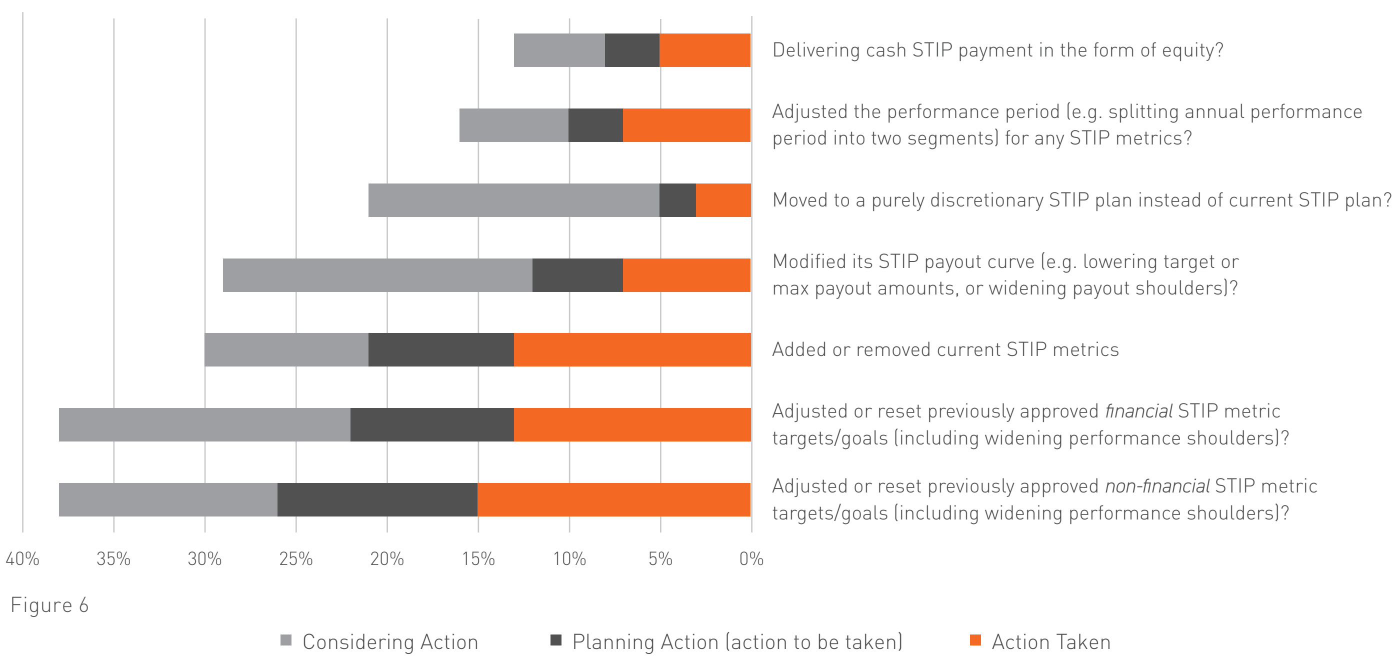


Figure 6

While companies that have made specific changes to STIP programs is relatively rare to date, we observe that planning has not subsided, and a notable minority of companies are planning action to be taken (Figure 6 above). Modifying STIP metric targets / goals (including widening performance shoulders) is the most common action taken as well as contemplated, followed by adding or removing metrics, and modifying the payout curve (e.g. lowering target or max payout amounts, or widening payout shoulders). Interestingly, multiple respondents noted that their companies made several changes to their STIP programs – nearly 50% that made changes, did so to three or more elements (Figure 7).

Of those companies that have taken in-year STIP actions (n=21), how many took multiple actions from the list in Figure 6?

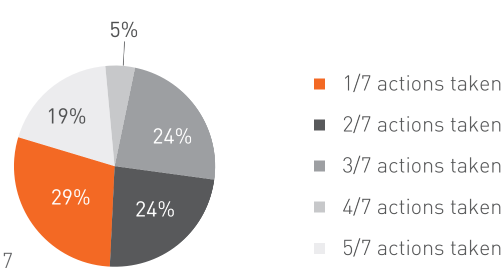
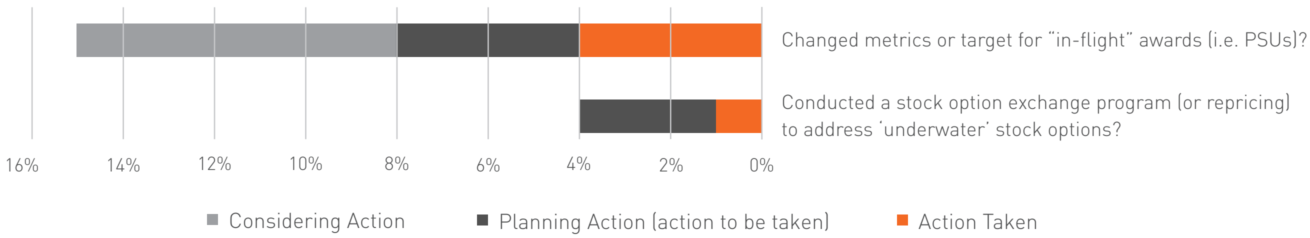


Figure 7

Modifications to 'in-flight' LTIP awards, namely performance share units (PSUs), was even less common. Less than 10% of respondent companies with PSUs have taken or are planning to take action.

In-year LTIP Actions - Has your Company...



Director's Views

We also asked directors for any additional thoughts on their COVID-19 incentive approach – here is a representative selection of what we heard:

- **"Decisions on plan modification will be made at year end. There are too many uncertainties regarding future impacts of COVID for the remainder of the year to make decisions at this time. We will likely add a new STIP metric with respect to management's response to COVID and the effectiveness of these actions."**
- **"It is too early for all of these actions. No need to rush if you have a trusting management-board relationship."**
- **"We recently developed a list of Board Discretion principles to use as guidelines for year end."**

Final Thoughts From Hugessen

While the survey results indicate limited in-year incentive actions have been taken to date, we are continuing to observe healthy dialogue between boards and management teams as they weigh the merits of further in-year adjustments, or in most cases, the potential for informed discretion to be applied at year-end. Adjudicating results at year-end will undoubtedly be challenging, and we therefore encourage compensation committees to get a head start on developing a decision-making framework. Coming to fair resolutions will require a clear understanding of the facts, and key considerations should be given to the proxy disclosure approach and implications in 2021, a year when shareholders and proxy advisors will be applying a particularly critical eye.

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

Hugessen Consulting is an independent consulting firm dedicated to meeting the executive compensation consulting requirements of boards and their compensation committees. With offices in Toronto, Calgary and Montreal, the firm's mission is to be the leading provider of advice on executive compensation, performance measurement and assessment, and related governance to the compensation committees of companies in Canada, the U.S., and the U.K