Compensation in times of coronavirus

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Organizations were concerned about how the coronavirus crisis would impact compensation from a relatively early stage. Surveys by HCM International Ltd. show that companies are reluctant to make adjustments to compensation and want to keep it in line with corporate development.

It was around one year ago, in March 2020, that Switzerland first went into lockdown. Many companies immediately started thinking about how the pandemic might affect their own business and earnings in the short and longer term. In assessing the situation, they often explored whether compensation systems would need to be adjusted. These discussions put pressure on many a board of directors, especially where companies were directly affected by the pandemic. The board's conundrum, put simply, is that if they neglect to exercise their discretion and raise management salaries when business performance is poor to prevent a low payout, there is a risk that good employees will leave. On the other hand, if salaries are not reduced at companies that are doing well despite coronavirus, the organization's reputation could be damaged. Most companies adopted a wait-and-see approach and continued to observe business development.

Restraint required

In the early summer of 2020, voting advisors also expressed their views on the subject of coronavirus and compensation for the first time. For example, Glass Lewis[1]: "oppose the adjustment of targets for ongoing plans". Adjustments to long-term compensation plans already in place should be avoided in particular. In this regard, Institutional Shareholder Services (ISS)[2] states that "benchmark voting policies generally are not supportive of changes to midstream or in-flight awards since they cover multi-year periods." Banking regulators in Europe also responded, including the European Central Bank who clarified that they expect institutions "to adopt extreme moderation with regard to variable remuneration payments … especially for ... 'material risk takers'". Shortly thereafter, the Swiss banking regulator FINMA also issued a recommendation calling for restraint in dividends in 2020.

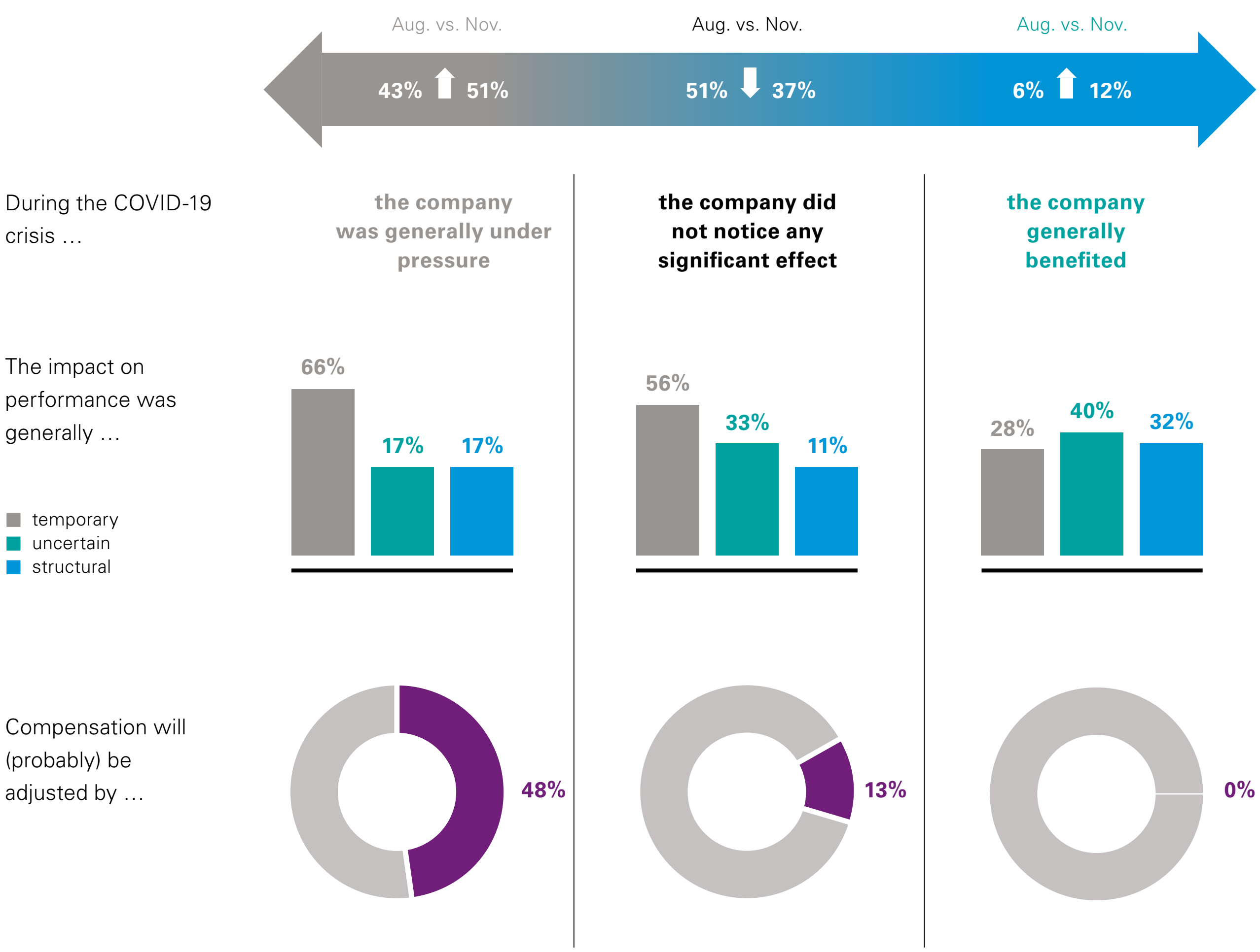
1 Approach to Executive Compensation in the Context of the COVID-19 Pandemic, Glass Lewis, published in April 2020
2 Impacts of the COVID-19 Pandemic, ISS Policy Guidance

As a result, some companies did adjust their dividend payments. Bossard Group, Zehnder Group and SFS Group, for example, reduced their dividends, while Feintool, Starrag and APG/SGA canceled them altogether. At the request of FINMA, banks like UBS, Credit Suisse or Julius Bär split their dividend payments.

COVID-19 "losers" and "winners" react differently
HCM International Ltd. surveyed approximately 110 listed and unlisted companies in August and November 2020. In August 2020, 43 percent of those polled reported being negatively affected by the pandemic. That number increased to more than half in November, at 51 percent. At the same time, the number of COVID-19 "winners" increased. Whereas just 6 percent of firms reported strong business in August, that number had doubled to 12 percent in November.

The surveys also reveal that 48 percent of those firms affected by the squeeze of the pandemic intended to adjust their compensation systems. In contrast, among companies that had noticed no significant effects, just 13 percent said they would do the same. Companies that enjoyed a strong performance during the crisis reported that they were unlikely to amend their existing compensation systems.

Adjustments to fixed salaries and short-term bonuses
Survey by HCM International Ltd. on compensation and coronavirus (2020):



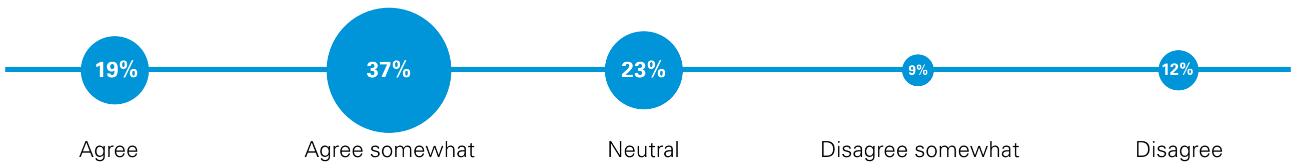
Eleven percent of the companies surveyed also planned to reduce the base salary component of the board of directors. ABB and SFS, for example, have already reduced board members' fees. On average, companies were planning a reduction of around 30 percent. Likewise, 11 percent of those surveyed – but not necessarily the same companies as just mentioned – reported an intention to reduce the base salary of the executive committee members. Average cuts were in the region of 17.5 percent. Respondents cited internal signaling as the main reason, with 86 percent also mentioning external signaling. For 43 percent, cost and liquidity were also key factors. Some companies have already published their 2020 remuneration reports. These show that certain companies have voluntarily reduced the base salary of management by between 5 and 25 percent. Examples include ABB, Autoneum, Bossard Group, Dormakaba, Schaffner Holding, Schindler and SFS Group.

The survey also collected details of possible changes in short-term variable compensation. Ten percent of respondents indicated that they intend to adjust their short-term bonuses. The CEO of Lindt has already voluntarily waived his short-term bonus, as announced recently. For some companies, however, bonuses were not revised despite the negative impact of coronavirus. In terms of long-term variable compensation, companies were planning fewer or even no adjustments, and this trend is also reflected in remuneration reports published to date. Voting advisor ISS takes the view that adjustments to short-term bonuses are possible as long as appropriate rationale is provided. Adjusting long-term bonuses in current plans is viewed negatively.

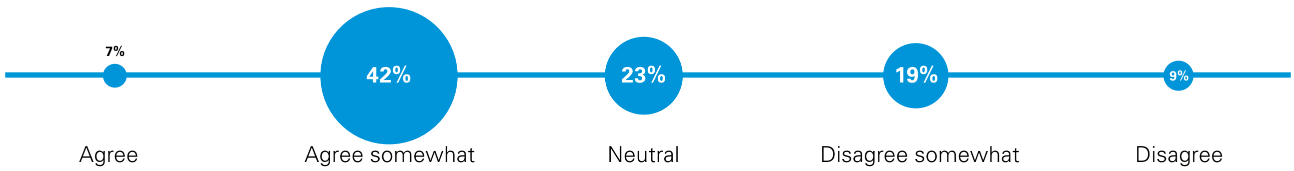
Lessons for the future

It will be some time before all Swiss companies have published their remuneration reports and we can draw far-reaching conclusions. However, certain consequences of the coronavirus crisis are already emerging as lessons for the future. These include ensuring more robust and less risk-oriented targets for variable compensation components, especially for share-based compensation plans. In addition, the results of the HCM surveys show that 56 percent of respondents expect sustainability issues to be more strongly embedded in variable compensation plans. We are likely to see a return to discretionary leeway for bonus assessments, where there is good reason, enabling bonuses to reflect extraordinary situations while remaining within the defined compensation system. At the same time, no increase in the weighting of variable compensation is expected.

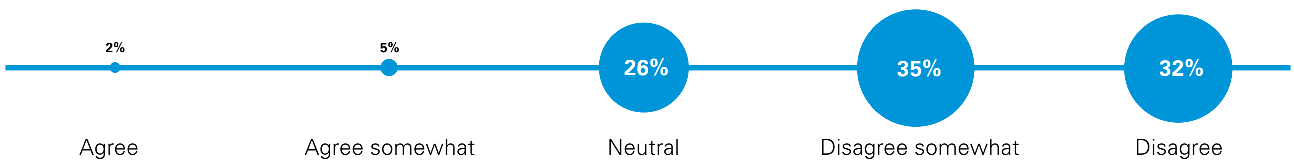
COVID-19 will cause ESG topics to be embedded in compensation systems permanently



A lasting consequence of the coronavirus pandemic will be the increased use of discretion in assessing bonuses



COVID-19 will trigger a shift in the balance of the compensation structure, i.e. from fixed to variable



Conclusion

Overall, most companies have not changed their existing compensation systems so far. At the same time, many are currently examining their rewards strategies and exploring ways to prepare better for the future - and for the unexpected.

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