Executive Compensation Restrictions and the CARES Act

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The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), signed into law by President Trump on March 27, 2020, provides various forms of relief for the economic impact of the Coronavirus crisis. The relief measures include, but are not limited to, loans, loan guarantees, and payroll assistance; however, companies that receive loans or loan guarantees under Title IV of the CARES Act subject themselves to certain constraints including executive compensation restrictions or limitations.

The CARES Act was drafted expeditiously in response to a national crisis, but as a result, lacks specificity in a number of important areas and definitions as it pertains to executive compensation issues. The purpose of this paper is to offer some initial insight into executive compensation restrictions and provide some potential suggestions on how an employer could react to these restrictions.

Executive Compensation Restrictions and Thresholds

Companies that accept loans or loan guarantees must first identify officers and employees with total compensation in excess of $425,000 for the calendar year 2019. During the restricted period of the loan or loan guarantee, employees in these companies cannot receive in a consecutive 12-month period, total compensation that is in excess of their calendar year 2019 compensation.

Special restrictions also apply to employees with total compensation in excess of $3 million in calendar year 2019.

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These employees cannot receive compensation in excess of $3 million plus 50 percent of the excess over $3 million in calendar year 2019.

Total compensation is defined as including all sources of cash compensation, stock awards, and "other financial benefits" which presumably could include non-cash perquisites or benefits. The CARES Act does not define calculation of annualized compensation for employees hired mid-year, non-officer Directors, or independent contractors.

Recruiting and Retaining Executive Talent

A continuing challenge for large employers, in both good times and bad, comes in the employer's ability to retain and recruit executive talent that meet specific needs. The current COVID-19 pandemic crisis requires an executive team with unique talents to quickly respond to a rapidly changing business environment. For a company to retain this talent could present challenges if the employer is receiving loans or loan guarantees under the CARES Act and the executive is being recruited by an employer that is not under the CARES Act restrictions.

Although we have not been given specific guidance, it may be possible that a properly designed nonqualified deferred compensation plan could offer a solution to this and other types of talent retention. The restricted period during which compensation cannot be increased over the baseline year of 2019 starts on the date of the loan or guarantee agreement and extends to one year after the loan or guarantee is no longer outstanding. Using the current language of the CARES Act, compensation in excess of the compensation offered in the 2019 baseline year could be offered to a covered executive if that compensation was deferred and unvested for the length of the restricted period. This will depend on whether deferred income awards will count toward the caps, and whether or not there would be a difference between vested and unvested awards for cap recognition.

A significant challenge exists when establishing both the vesting period for deferred compensation during the CARES Act restricted period and the distribution event for the payout of the deferred compensation. The vesting period could be defined as the loan payoff date plus one year or the termination date of the guarantee agreement plus one year. Generally, the allowed distribution events under IRC 409A are limited to separation of service, fixed date, disability, death, change in

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control, and unforeseen financial emergencies. However, distributions may also be triggered by the attainment of certain objective criteria, such as the end of the cap restrictions described above.

If the deferrals are allowed in excess of the caps (due, likely, to their unvested nature) questions remain about any other triggers for distribution. For example, would vesting occur at death, disability, involuntary separation, or retirement? While such vesting is usually the case in most plans, would it be allowed under the CARES Act rules while the employee is still a covered employee?

Actions to Take Now

At the time of drafting this document, neither the U.S. Department of the Treasury nor the Department of Labor has published any communications about implementing regulations or other guidance on executive compensation restrictions under the CARES Act. Until additional guidance is received, the use of deferred compensation to retain or recruit executive talent under the restrictions of the CARES Act is a topic that should be carefully pursued. Fulcrum Partners will continue to provide updates on this topic if regulatory guidance is issued or we learn more about the legislative intent of these compensation restrictions.

During these unprecedented times, employers need trustworthy consultants that can provide accurate and timely advice on issues and events companies have never previously experienced. The consultants at Fulcrum Partners have been trusted partners with compensation committees and executives in corporations of all sizes in both good times and challenging times. In many cases, these relationships have spanned decades. With financial industry executives who average more than 31 years in executive compensation and benefits consulting, the Fulcrum Partners team is independent, agile, and responsive.

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