The Impact of COVID-19 on Chemical Companies and Their Annual Incentive Programs

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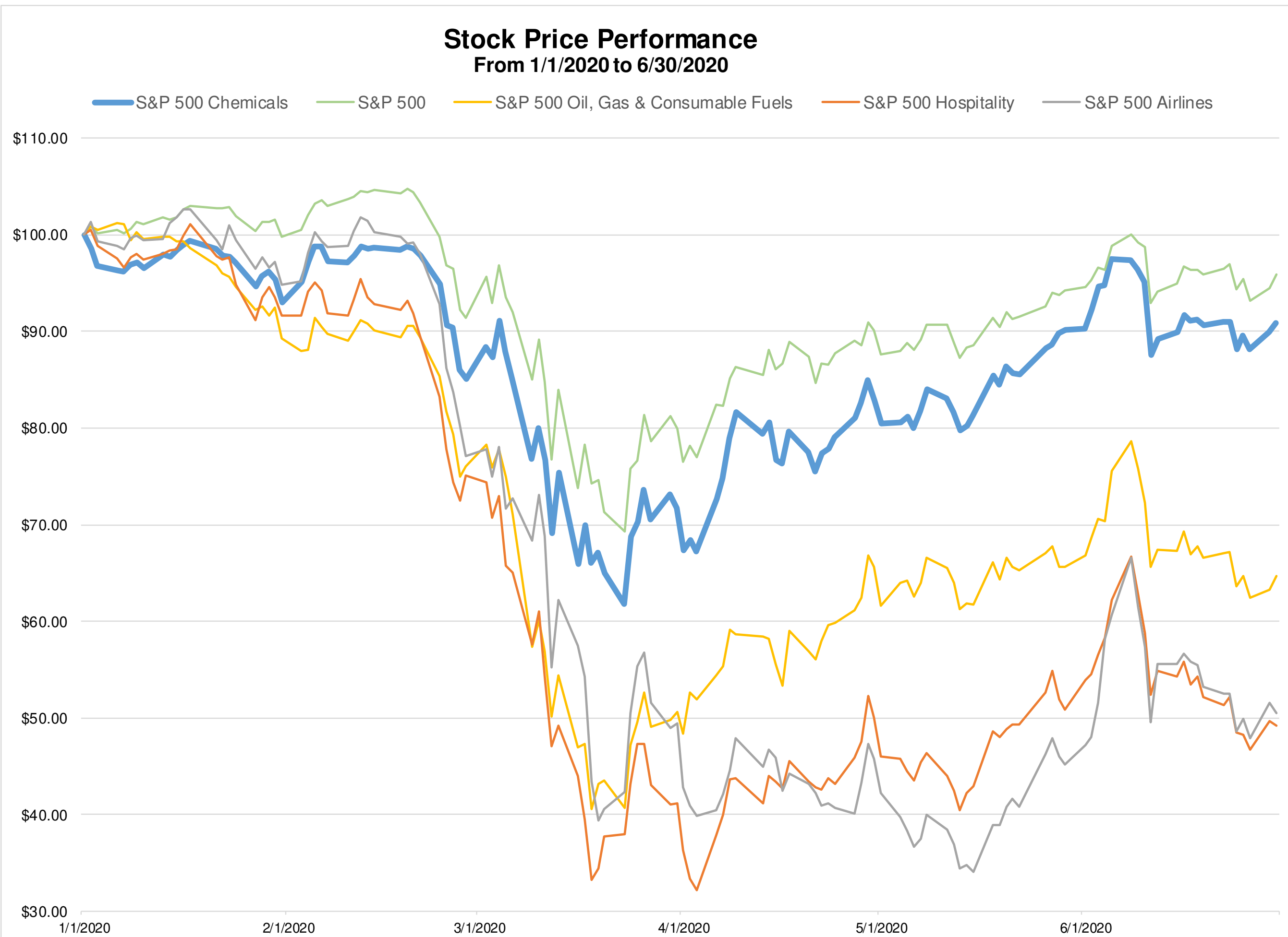
The impact of the COVID-19 on the U.S. and global economy has been dramatic. Despite a recent recovery in the financial markets, the pandemic is affecting the financial and operating results of companies across all industries. Certain industries (e.g., oil and gas, hospitality, airlines) have been hit especially hard, bringing into question the viability of many companies. In response to the situation, many organizations took strategic actions to enhance financial stability and liquidity, including decreased operations, reductions in costs and capital expenditures, drawing down lines of credit and reducing dividends. Interestingly, the chemical industry has not been impacted by COVID-19 as severely as some other industries.



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Initial Response: Workforce and Pay Reductions

The compensation actions taken by companies hardest hit by the pandemic have included layoffs, furloughs and temporary reductions in pay and benefits. In some instances, pay reductions have been extended to outside directors. Across general industry, 463 of public companies with revenues >$400 million, or 20% of companies, have announced executive pay cuts, generally to salary. Median CEO salary reduction is 32% and median reduction for CEO and other executives is 20%, as shown below.

Pay Reduction % of Base Salary by Position – All Industries (Rev. >=$400 Mn)

	CEO	CFO	Other Executives
25th %ile	20%	15%	15%
50th %ile	**31%**	**20%**	**20%**
75th %ile	60%	30%	30%

In contrast, only a handful of chemical companies have disclosed taking such actions. Six chemical companies, or approximately 10% of U.S. chemical companies (with revenues of at least $400 million), have disclosed a pay reduction, as detailed below.

Company	Date Announced	Base Salary Reduction	Duration
Albemarle Corporation	5/6/2020	**Executives**: Undisclosed	Not disclosed
Axalta Coating Systems Ltd.	4/27/2020	**CEO, CFO, other NEOs, and Senior Management**: 20%	Through 8/30/2020
PPG Industries, Inc.	4/2/2020	**CEO**: 30% **CFO**: 20% **Other NEOs**: 20%-25%	Through 9/30/2020
Quaker Chemical Corporation	5/11/2020	**Executives**: Undisclosed	Not disclosed
The Chemours Company	5/6/2020	**CEO:** 40% **Executives**: 30%	Not disclosed
Trinseo S.A.	3/27/2020	**CEO**: 50% **CFO**: 25% **CLO**: 25% **SVP**: 10%	Through June 2020

To supplement public disclosures (which may not be required, depending on the actions taken), Meridian recently conducted a flash survey of more than 50 companies across the chemical industry. The survey questions asked about the status of workforce cuts, pay reductions and incentive plan design changes as a result of COVID. Results of the survey confirmed that only a small number of chemical companies were considering COVID-19 related workforce cuts, executive pay reductions and near-term incentive plan design changes.

Current Focus: 2020 Annual Incentive Plans (AIPs)

Uncertainty remains as to the depth and duration of the impact of COVID-19. Fears of a second wave of infections and resulting negative consequences as well as potentially disappointing Q2 and Q3 financial results remain top of mind for many. To date, relatively few chemical companies have made or announced changes to their annual incentive plans. Our advice to clients has generally been to take a “wait and see” approach, and not make changes to either the performance metrics and/or the goals in their AIPs since significant uncertainty remains. However, as companies begin to better understand the impact of COVID-19 on their financial results, we are increasingly having discussions with companies and their compensation committees about how to address the 2020 AIP, as well as early discussions on 2021 designs.

As we progress deeper into 2020, it has become clear for most companies that AIP goals set just a few months ago are, in many cases, obsolete. Among chemical companies, which typically feature a heavy weighting on earnings-based goals, participants may already perceive 2020 earnings and other financial goals as unachievable, and have an expectation of a low or no bonus payout. We have observed this circumstance at various chemical companies with which we consult, as well as in the broader marketplace. Committees are asking: what alternatives might we consider? Situations vary significantly by company, but we recommend beginning the process by asking specific questions:

- Does the original business plan and its performance targets remain credible?
- Might a bonus (in any amount) be affordable at year end? If that determination is not clear today, when will more information be available?
- What bonus compensation action(s) will best align with investor expectations?
- What are the perspectives of other company stakeholders?
- What company statement best sets employee expectations about how their performance might contribute to a bonus payment, or lack thereof, at year end?
- Are some components of the plan (e.g. safely and/or individual performance/other non-financial metrics) a way to provide some payout, if that is deemed appropriate?
- What discussions with outside auditors are required related to the current bonus accrual?

No doubt shareholders may expect a lower bonus pool at most companies this year, particularly those in the most impacted industries. Concerns about employee retention and engagement arguably hold less weight than in the past, given the situation. When considering potential alternatives, it might be helpful to draft the potential CD&A disclosure early in the process to refine the rationale for whatever approach a company takes for the remainder of the year. Considerations will vary based on the unique facts and circumstances specific to any individual company, and we may see the bonus approach play out differently across different segments of the chemical industry, based on the duration of the economic downturn caused by the pandemic.

Below are some potential approaches for consideration:

Approach	Description	Considerations
"Wait and See"	▪ Since uncertainty remains high, this approach involves allowing formulas to play out before making any determination ▪ If no/low payout, Committee can apply discretion, if appropriate to adjust payouts ▪ Bonus accrual issue needs to be addressed	▪ Likely results in low/no payout, unless discretion is applied ▪ If discretion is applied, important to consider affordability and shareholder experience – what would results have been without COVID? ▪ May result in criticism from external parties if payouts are funded higher than formula
Revise goals	▪ Formally re-determine full year goals based on latest financial information and projections ▪ Could focus on reducing threshold to "flatten the curve" and allow for payouts sooner, or increase likelihood of some/lower payout	▪ Likely greatest external criticism ▪ Complex; requires action sooner rather than later ▪ Could result in goals that are obsolete again in the fall if we see second wave of infections ▪ Limited market precedent
Establish 2nd half of year goals	▪ Develop separate goals for the remainder of the year to maintain incentive and motivation to achieve key priorities ▪ Could only develop threshold and target, not providing any above-target payout	▪ Complex; requires action sooner rather than later; Q3 may be challenging as well ▪ May not have full visibility into 2nd half of the year ▪ Requires determination of how to address 1st half of year ▪ Some precedent, but far less common than "wait and see"
Rely on individual/safety component to maintain incentive	▪ Chemical company programs often rely on safety/non-financial/individual elements for a portion of the AIP ▪ Could focus on that component to maintain incentive and reward effect by fully funding that element	▪ Non-financial goals set at the beginning of the year may not align with key priorities in light of COVID-19 ▪ In some cases funding of non-financial component is linked to achieving financial component, which would require modification ▪ Could still deliver meaningful payouts if non-financial component is 20%-30% of the program, and especially if it includes upside.

The above approaches are not intended to be mutually exclusive. Companies may choose to implement multiple approaches we've outlined. However, in most cases, we would expect chemical company 2020 AIP plan payouts to be less than target. Even if none of the above approaches are formally implemented, and a formulaic plan results in no payout, we expect a significant number of companies will provide a discretionary bonus pool at the end of the year for high performing individuals or those who took on significant additional responsibilities, likely excluding officers. Because a global pandemic could not have been planned for as part of the realm of possible outcomes in 2020, we're expecting many companies to at least be open to considering discretionary bonus payouts. We expect this topic to be a major discussion among committees for the remainder of the year. We've already seen examples of companies communicating (internally and externally) their expectations regarding AIP, and will regularly report on what disclosures are made over the coming months.

Ultimately, the Committee's discretion will play an important role in all of the above specified approaches. We think that any actions will likely be evaluated from a stakeholder perspective – were the 2020 bonus outcomes aligned with the experiences of shareholders, employees, customers, and suppliers, and reasonable in light of a comprehensive consideration of all circumstances?

ISS has acknowledged that many companies will materially change performance metrics, goals or targets used in STI plans, or consider the possibility of discretionary overrides. They have encouraged any company taking such actions to provide contemporaneous disclosure to shareholders of changes and associated rationale. Regarding how these changes will be viewed in next year's analysis, ISS has not established a formal stance. The level of concern will be determined by disclosure and perceived goal rigor.

All of the above factors will be important considerations in the Board's assessment at the end of the year and the selection of an approach to deal with the AIP. We expect many companies will pay no bonuses, but many will also reward for effectively navigating through the pandemic and optimizing outcomes with the cards dealt to them. One thing is for sure: 2020 will be a year of highly customized approaches to AIP payouts based on each company's individual situation and widely varying practices.

Discussions regarding how to address prior long-term incentive performance plans that may have unachievable goals are also taking place among Committees. Although accounting and disclosure considerations will likely make potential adjustments to prior awards challenging, we expect companies to closely review their long-term incentive designs (vehicle mix, metrics and performance goals) for new grants in light of potentially continued uncertainty. Please keep an eye out for a subsequent Meridian blog/article on expectations for changes in equity awards for 2021.