

The CARES Act Offers U.S. Companies Relief, but Not Without New Limits on Executive Pay

The new CARES Act, signed into law on March 27, will affect executive compensation in a variety of ways. In this article, we describe potential impacts and what companies need to consider before accepting economic relief.

The \$2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES Act), signed into law on March 27, is the largest emergency stimulus plan in United States (U.S.) history. The law is intended to soften the blow of the COVID-19 pandemic on the economy and includes assistance for businesses and individuals. The Act also puts limitations on executive compensation paid by any type of organization that uses government loans and loan guarantees under the legislation. Employers should carefully assess what these restrictions are before determining whether they want to accept economic relief.

In this article, we'll summarize the implications of the CARES Act on executive compensation as well as retirement plan provisions and what companies should consider before accepting federal loans.

Limitations on Employee Compensation

The CARES Act places three specific limits on employee compensation for companies receiving federal loans or loan guarantees under the Act. From the date a loan is executed to the date that is one year after the loan is no longer outstanding (i.e. the restriction period), the following restrictions apply (with the exception of air carriers and certain other borrowers that have a restriction period of March 24, 2020, to March 24, 2022):

- No officer or employee who received total compensation in 2019 that was more than \$425,000 and not greater than \$3,000,000 may receive, during any 12-consecutive month period, total compensation in excess of the 2019 compensation;
- No officer or employee who received total compensation in 2019 that exceeded \$3,000,000 in 2019 may receive, during any 12-consecutive month period, total compensation in excess of \$3,000,000 plus 50% of the excess of 2019 total compensation over \$3,000,000; and
- No officer or employee who received total compensation in 2019 that exceeded \$425,000 may receive severance pay or other benefits upon termination which is more than twice the maximum total compensation received by the employee in 2019.

The term “total compensation” includes salary, bonuses, awards of stock and other financial benefits provided by an eligible business to an officer or employee of the eligible business.

Furthermore, companies accepting loans or loan guarantees are barred from initiating stock buybacks (unless contractually obligated to do so) or paying stockholders dividends during the restriction period. As such, dividend equivalents as typically defined in equity award agreements would not be accrued during the restriction period.

Questions to Consider Relating to Compensation Limitations

The CARES Act raises several questions related to executive compensation limits, including:

- How do companies measure the value of awards of stock and “other financial benefits” that are included in the definition of total compensation?
- How do companies determine the timing of compensation during a 12-month period? Should they use the traditional Internal Revenue Code timing rules or other timing rules (e.g. GAAP)?
- How do companies resolve conflicts between the compensation and severance payment restrictions and pre-established legally binding arrangements between the company and affected individuals (e.g., employment agreements, award agreements, incentive plan documents, severance plans, etc.)?
- Will companies need to obtain waivers from individuals whose contractual rights would conflict with these rules?
- Will companies that may have provided pay increases or entered into severance agreements immediately prior to initiating a loan have any special pay restrictions or other conditions imposed on them?

As with any new law of this nature, precedents and best practices will emerge in due time; however, we encourage clients to consider each of the questions above carefully before taking action. Ultimately, companies will need to feel comfortable their approach to these issues is defensible to regulators, shareholders, employees and the general public.

Nonqualified Retirement Plan Concerns

Companies that receive financial assistance under the CARES Act could consider deferring compensation otherwise payable to certain individuals during the restriction period. However, existing Code Section 409A rules may present obstacles to doing this and can limit flexibility on when these deferred amounts could eventually be paid.

Companies with existing nonqualified deferred compensation plan obligations will need to monitor the plan for payments that are due during the restriction period as those payments could result in a violation of a CARES Act pay limit.

Code Section 409A does not generally allow an extension of a stock option beyond the original term of the option. If stock option exercises are counted towards “total compensation” this could present an issue for individuals who are subject to a CARES Act pay limit if they hold options that are due to expire during the restriction period.

Companies that might be interested in terminating and liquidating nonqualified plans that are subject to Code Section 409A need to be mindful that the Code prevents doing so if it occurs during a downturn in the financial health of the employer.

Individuals who need financial assistance during the loan restriction period may still be able to make hardship withdrawals from a nonqualified plan; however, in accordance with the rules under Code Section 409A they would be required to exhaust other assets first (to the extent the liquidation of such assets would not cause severe financial hardship).

Qualified Retirement Plan Provisions

The CARES Act also provides economic relief to individuals and employers through their retirement plans.

An individual can access up to \$100,000 from his/her 401(k) account(s) for “coronavirus-related distribution(s).” There is no mandatory income tax withholding on these distributions and there is no additional 10% early withdrawal tax. The income tax due on the distributions do not need to be incurred at once; it can be spread over three years. Additionally, the individual will have three years to repay the distribution(s) from an eligible retirement program if they choose to do.

A “coronavirus-related distribution” is a distribution made during 2020 from the account of an individual who is diagnosed with COVID-19; whose spouse or eligible dependent is diagnosed; or, who experiences specified “adverse financial consequences” due to the virus. “Adverse financial consequences” due to the virus include being quarantined, being furloughed or laid off, and being unable to work due to lack of child care. (The IRS has the authority to include other factors.) Importantly, individuals will not be required to exhaust other means before taking a coronavirus-related distribution.

The CARES Act also increases the limits on plan loans to the lesser of \$100,000 (from \$50,000) or 100% of the account balance (from 50%). If an individual remains employed and has the means to make loan repayments, then a plan loan may be a better option to address virus-related adverse financial consequences.

On the employer side, the retirement plan provisions provide companies who sponsor a single employer pension plan more time to meet their funding obligations by delaying the due date for any contribution otherwise due during 2020 until January 1, 2021. At that time, contributions due earlier would be due with interest.

Next Steps

Ultimately, the decision by a company to accept, or pass on, aid from the CARES Act will likely be driven by factors well-beyond any of the executive compensation and retirement plan considerations listed above. However, once a company feels compelled to seek out federal assistance, a careful analysis of the short- and long-term impacts on executive compensation must be carried out. Conducting such an analysis is not really a question of how much executives may or may not be paid, but rather an important step in ensuring additional legal or regulatory pitfalls are not created in the process. Additionally, companies must carefully consider how they will communicate changes and limitations to executives, shareholders, employees and the public.

Additional Resources from Aon

For more information about how businesses are responding to the current pandemic, including stakeholder communication, health and benefits impacts and business continuity planning, please see Aon's COVID-19 Response Site [here](#).

To download complimentary results of our pulse survey on Navigating the Impact of COVID-19 on Workplace and Rewards Practices in North America and Europe, please [click here](#).

For more information about how total rewards are being impacted by COVID-19 across all industries, see our recent article [Considerations for Your Total Rewards Strategy in Response to COVID-19](#).

Finally, to learn more about the CARES Act and executive compensation, please reach out to one of the authors or write to rewards-solutions@aon.com.

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