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HealthCare Appraisers' Industry Insight

HOW THE COVID-19 STIMULUS BILL IS AFFECTING EXECUTIVE PAY

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The \$2.2 trillion Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), H.R. 748 (2020), is intended to provide financial relief to both individuals and businesses affected by COVID-19. The Coronavirus Economic Stabilization Act of 2020 is Title IV under the CARES Act.¹ This portion of the CARES Act creates a \$500 billion pool of money for loans, loan guarantees, and other investments for distressed businesses that do not qualify for the small business relief. Up to \$46 billion is earmarked for airlines, air cargo and critical national security businesses, with the remainder for all types of organizations including large nonprofit companies, states, and municipalities.² This would include 40% of hospitals and 53% of self-identified, non-profit health systems which have 500 or more full time employees.³

Qualifying organizations should note that the acceptance of federal loans under Title IV of the CARES Act will be subject to Section 4004 of H.R. 748, which discusses imposing a "limitation on certain employee compensation."⁴ These limitations will affect executive compensation for a significant time period: the caps are in effect for the period the loan remains outstanding (up to a maximum of 5 years) and for one year after the loan is paid off.

EXECUTIVE COMPENSATION LIMITS

For any officer or employee of an eligible business whose "total compensation" exceeded one of the following thresholds in calendar year 2019, total compensation during any 12 consecutive months of the loan period is capped for the period of the loan plus one year after loan repayment ("Loan +1"). The bill defines "total compensation" as salary, bonuses, awards of stock, and other financial benefits provided by a business to an officer or employee.⁵ The compensation limitations, expressed per 12 consecutive month period, are as follows:

- If compensation exceeded \$425,000, but is less than \$3 million, total compensation is capped at the amount received in calendar year 2019
- If compensation exceeded \$3 million, total compensation is capped at \$3 million plus 50% of the excess over \$3 million of compensation received in calendar year 2019
 - For example: an executive "received" \$7 million in 2019. This executive may only receive a maximum of \$5 million (i.e., \$3 million plus 50% of \$4 million "overage") during any 12 month period of Loan +1

¹ H.R. 748, 116th Cong. (2020): Title IV. Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy; last accessed March 30, 2020 from: <https://www.congress.gov/116/bills/hr748/BILLS-116hr748eas.pdf>

² Ibid., Sec. 4003 (b)(4) Loans, Loan Guarantees, and Other Investments

³ FY2018 Medicare hospital cost reports, FY2018 IRS form 990 filings

⁴ H.R. 748, 116th Cong. (2020): Sec. 4004. Limitation on Certain Employee Compensation; last accessed March 30, 2020 from: <https://www.congress.gov/116/bills/hr748/BILLS-116hr748eas.pdf>

⁵ Ibid., Sec. 4004 (b) Total Compensation Defined.



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HOW TO DEFINE “COMPENSATION RECEIVED”?

The bill does not provide a definition for what “received” means in this context, which raises the question of how received compensation will be determined. In addition, it is unclear if related organizations are subject to the restrictions or if they are considered separate businesses for the purpose of the loan terms. Note that these limits will not apply to any officer or employee whose compensation is determined through an existing collective bargaining agreement.

Due to lack of guidance, organizations should document how they choose to define compensation “received” and any atypical compensation should be identified and tracked.

SEVERANCE

The CARES Act further establishes that no officer or employee may receive severance pay or other benefits upon termination of employment which exceeds twice the maximum total compensation received by the individual in calendar year 2019. The Act does not explicitly state if it applies to terminations or severance pay during the final twelve months of the Loan +1 period.

CONSIDERATIONS FOR EXECUTIVES AND ORGANIZATIONS

If an organization is considering applying for a loan under the CARES Act, its board, officers, and management should consider doing the following:

- Evaluate the eligible businesses, and whether all related organizations should be included when determining executive compensation.
- Identify the affected employees – those with compensation above \$425,000 and compensation of \$3 million or more – and define “received” compensation. Until further guidance is provided, the most straightforward definition could be based on 2019 IRS form W-2.
- Discuss the compensation implications with any employee that is affected if a loan is taken.
- Proactively identify all severance arrangements for affected employees to determine if any would exceed two times their 2019 compensation if severance were to be paid during the Loan +1.
- Identify any one-off or atypical compensation that is to be paid during the Loan +1 for each affected employee. For tax-exempt organizations, this would include deferred compensation arrangements for executives that may vest and become payable.

CHALLENGES FOR FUTURE COMPENSATION ARRANGEMENTS

The uncertain economic environment creates additional issues when addressing executive compensation. Measuring success in a crisis is difficult due to the inability to project organizational performance and financial health on an ongoing basis. Organizations should consider the following:

- Establish a framework for applying discretion in performance assessments
 - How discretion will – and won’t – be applied in order to ensure decisions are consistent with expectations
- Track the impact on all annual goals
 - The impact on quantitative and qualitative results will help organizations exercise discretion thoughtfully

