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A VARIETY OF TOPICS DISCUSSING EXECUTIVE COMPENSATION

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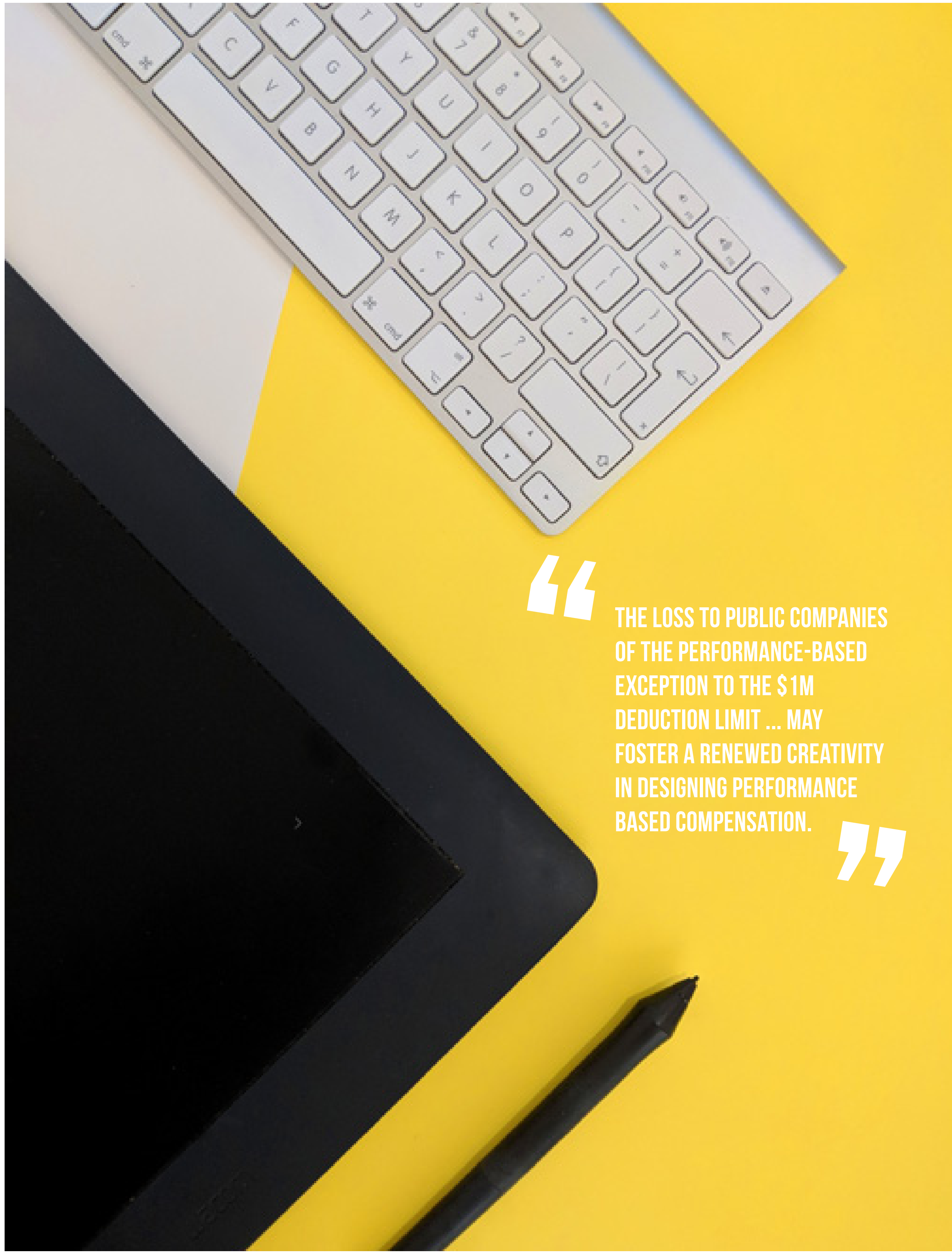
COMPENSATING EXECUTIVES IN THE DIGITAL AGE

By Michelle Capezza

One of the key drivers of any organization's success is attracting and retaining the desired employees to execute the business objectives, support the mission, and build a productive workplace. To attract and retain employees at the executive level, organizations must navigate additional layers of marketplace competition for the best talent and determine appropriate compensation incentives while managing scrutiny of such programs from regulators, the public and shareholders, just to name a few.

There are many requirements impacting the design of executive compensation programs which have evolved in recent years, from changes ushered in by the Dodd Frank Act, to tax code rules for the deferral of compensation under Section 409A of the Internal Revenue Code (the "Code"), as well as other governance and entity-specific rules and regulations. Most recently, The Tax Cuts and Jobs Act of 2017 (the "TCJA") impacts compensation practices as it prohibits public companies from taking a tax deduction for executive compensation of covered executives in excess of $1 million and removes the performance-based compensation exception to the deduction limit that existed under Section 162(m) of the Code. The TCJA also creates an excise tax regime for tax-exempt organizations with regard to excessive compensation of covered executives, among its other changes. While the tax implications of compensation practices will continue to be a factor in compensation design, and many organizations are revisiting their programs in light of the TCJA, the overarching issue for organizations to consider is how to design compensation programs to attract and retain the necessary talent to manage their business and attain their organizational goals in the Digital Age while also staying in compliance of applicable regulatory requirements.



With generational shifts in workplace demographics, advances in technology and mobility, and rise in entrepreneurship, organizations must weigh a myriad of factors into their compensation design decisions in order to attract and retain its future leaders, such as:

- **Determining the desired compensation package beyond base salary and company-wide benefits.** Consideration should be given to the types of arrangements to offer (a) incentives whether short and/or long term, (b) equity-type arrangements (options, restricted stock, units, other), (c) deferred compensation arrangements, (d) a reasonable level of perquisites, and (e) any severance or change in control benefits. Undertaking an appropriate benchmarking analysis can assist organizations assess the most competitive package by industry for the types of executives they desire.
- **Establishing clearly defined performance-based compensation objectives that align pay with performance.** In the Digital Age, information is readily available and transparency is increasingly required (including public company requirements to pass muster of increasing scrutiny on pay disclosures). For performance-based compensation to serve as a desired incentive tool, organizations should set clear goals in a realistic and understandable manner with motivational targets that are attainable which will incentivize behaviors to drive performance (e.g., business terms/formulas, performance period, thresholds, targets and maximums).
- **Undertaking a compliance review of the compensation design.** Once the design philosophy is established, the terms of the compensation arrangement must be reviewed against all applicable compliance requirements, including any risk assessments and clawback policies, legal requirements (securities, tax, other laws), accounting, governance and approval procedures. Then, the program can be memorialized in documentation and communicated.

In some ways, the loss to public companies of the performance-based exception to the $1m deduction limit for a covered executive's compensation under Section 162(m) of the Code may foster a renewed creativity in designing performance-based compensation in general, which could permeate to other types of organizations. Instead of designing such compensation under an approach which fits within the parameters of the prior tax rules in order to preserve a tax deduction, companies can start with their organizational objectives when designing performance-based compensation. Some organizations may also be able to take advantage of the TCJA's grandfathering rules for performance-based compensation paid under a written binding contract in effect on November 2, 2017 which has not been materially modified, and thus preserve their exception to the $1 million deduction limit for a time, or they may determine that it may be more beneficial to the employer to amend or terminate the contract rather than maintain an arrangement that does not serve the organization well.. That being said, if the organization permits deferrals of performance-based compensation under programs that were designed to comply with Section 409A of the Code, then the design of such compensation would still need to meet those rules and it might not be possible to deviate from prior compensation design so easily.

Undoubtedly, the TCJA will cause organization's to re-evaluate their executive compensation program designs. Yet, in today's fast-paced, mobile work environment, replete with generational shifts, the primary question for any organization undertaking compensation design should be how to attract and retain the desired talent. Utilization of a well-considered, compliant and appropriately approved compensation program should remain an important driver of organizational success and serve to attract and retain the leaders needed to make it happen.

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