The CARES Act restricts how much executive compensation can be paid by employers that avail themselves of loans and loan guarantees from the US Treasury's Exchange Stabilization Fund under Title IV of the CARES Act. Employers seeking this relief need to carefully assess the impact of these restrictions before applying for loans or loan guarantees. Participation in the Exchange Stabilization Fund is conditioned on complying with the executive compensation restrictions. Identifying whose pay will be restricted and limiting payments under existing contracts is likely to be challenging.

**Do the restrictions on executive compensation under the CARES Act apply to all employers?**

No. Only employers that receive loans or loan guarantees under Title IV of the CARES Act are subject to the restrictions under the CARES Act. Employers that do not receive loans or loan guarantees from the Exchange Stabilization Act are not be subject to these restrictions. For example, employers that receive financial assistance pursuant to the Paycheck Protection Program established under the
Can any type of employer participate in the Exchange Stabilization Fund and become subject to the restrictions on executive compensation?

Yes. Any organization, whether taxable or tax-exempt, whether a publicly traded company or privately held company, can participate in the Exchange Stabilization Fund (and would become subject to the restrictions on executive compensation by so participating).

How long do the restrictions on executive compensation under the CARES Act last?

The executive compensation restrictions under Section 4004 of the CARES Act begin on the date the loan or guarantee agreement is entered into, and end one year after the loan or guarantee is no longer outstanding. The period during which the executive compensation limits apply is referred to below as the “restricted period.”

Which employees are subject to restrictions on executive compensation?

Any employee or officer whose total compensation exceeded $425,000 during the 2019 calendar year (other than an employee whose compensation is paid under a collective bargaining agreement entered into before March 1, 2020) is subject to the restrictions on executive compensation. An employee subject to the executive compensation restrictions under the CARES Act is referred to as a “covered employee” below.

There are important unanswered questions as to who is a covered employee, including the following:

- Will an individual providing services (to an entity receiving loans or loan guarantees under Title IV) as a non-employee director, partner or independent contractor be deemed an “employee”?
- Do the rules apply to an individual hired after 2019? Read literally, these individuals would not be covered employees due to not having any 2019 total compensation from the covered employer.
- What if an individual is employed for only part of the 2019 calendar year – will the government require certain compensation to be annualized when determining if there is more than $425,000 of total compensation for 2019?

What is “total compensation” for purposes of these rules?

“Total compensation” includes salary, bonuses, awards of stock and “other financial benefits.” The scope of what is considered a financial benefit is unclear. There is no express exclusion from total compensation in the CARES Act for non-taxable benefits.
(e.g., accruals under a tax-qualified plan or deferred compensation plan, medical care coverage or excludible fringe benefits).

**What are the limits that apply to annual compensation for covered employees during the restricted period?**

No increases to total compensation are allowed for covered employees during the restricted period. Specifically, covered employees may not receive total compensation from a covered employer that exceeds their 2019 total compensation during any 12 consecutive months within the restricted period.

A special lower limit applies to covered employees whose 2019 total compensation was more than $3 million. The compensation limit for these covered employees, during any 12 consecutive months within the restricted period, is equal to $3 million plus 50% of 2019 total compensation in excess of $3 million. So, if a covered employee’s 2019 total compensation is $4 million, compensation limit is $3.5 million ($3 million + (50% * ($4 million – $3 million)).

**What happens if total compensation during 12 consecutive months within a restricted period exceeds the applicable limit on total annual compensation?**

The CARES Act does not address what happens to total compensation to which a covered employee has a contractual right that cannot be paid currently due to exceeding an applicable limit. Presumably such compensation would be deferred (without violating Section 409A of the Internal Revenue Code) until a later period of 12 consecutive months, or perhaps after the end of the restricted period. This interpretation avoids having the annual limits apply in a manner that penalizes the bunching of compensation at certain points during the restricted period. It remains to be seen whether the government will interpret these limits to require forfeitures of total compensation exceeding the applicable annual limit given the current political climate.

**Are there any limits under the CARES Act on severance pay or other benefits resulting from a covered employee’s termination of employment?**

Yes. Severance pay and “other benefits” resulting from a covered employee’s termination of employment cannot exceed more than two times the covered employee’s “maximum total compensation” for calendar year 2019 compensation. So, if a covered employee’s 2019 total compensation was $900,000, not more than $1,800,000 could be provided as severance pay or other benefits.

It is unclear what falls within the scope of “other benefits” for purposes of this restriction. Presumably it was intended to cover items such as continued health coverage, pro rata bonuses and other items of remuneration triggered by an involuntary termination of employment, and not accrued amounts that are payable upon voluntary resignation, such as benefits under either a nonqualified deferred compensation plan or a tax-qualified retirement plan.
When is compensation considered to be received by a covered employee under the CARES Act?

The CARES Act does not address when and how to take into account an item of compensation when determining “total compensation.” It is unclear whether to measure compensation on the cash basis, accrual basis or some other method. The resulting ambiguity significantly complicates how to apply the limits under the CARES Act when determining who is a covered employee and when “total compensation” exceeds an applicable limit.

Note that this is an important issue in determining the baseline (2019 total compensation) for the limit and in determining the compensation being received during the restricted period. Section 4004 of the CARES Act focuses on the amount that a covered employee “received” in 2019, and what the covered employee “will receive” during any 12 consecutive months during the restricted period. The issues of accrual, deferral and vesting will be particularly troublesome for both periods of measuring what is “received,” and that will be true whether the employer is taxable or tax-exempt.

When might an equity award be considered to be received under the CARES Act?

The answer depends upon whether compensation is considered to be “received” in the year of grant, the year of vesting or the year of payment. For example, consider a covered employee of a publicly held covered employer that receives a grant of restricted stock units (RSUs) in March 2018 with a $250,000 grant date value. One-third of the RSUs vest in 2019 and have a $100,000 value at that time. These vested RSUs are later paid in stock during March 2020, when the value has declined to $50,000. Are these RSUs counted as total compensation in the year of grant in 2018, and therefore disregarded in determining who is a covered employee? Alternatively, is the vested value of one-third of the RSUs, or $100,000, to be taken into account as total compensation for the purpose of applying the annual pay limit for 2020? Or are the RSUs to be taken into account as total compensation only when there is an actual payment (i.e., when the stock that’s paid under the vested RSUs is only worth $50,000)?

When might deferred compensation be considered to be received under the CARES Act?

The answer depends upon whether compensation is considered to be “received” in the year that it is deferred, in the year of vesting or in the year of payment. For example, consider a covered employee of a tax-exempt organization who was credited in 2019 with $100,000 in nonqualified deferred compensation, which is scheduled to become vested (and taxable) in what will be the restricted period under the CARES Act. Will this deferred compensation be included in total compensation in 2019 when accrued (but not taxable) or in the restricted period when vested and taxable? A variation of this example could involve an employee (again, of a tax-exempt organization) who during the restricted period would receive compensation, but acts to defer it until a year that is calculated to be well beyond the restricted
period. Would that deferred amount be treated as not having been “received” during the restricted period, due to the deferral election?

What items of compensation are payable if total compensation exceeds the executive compensation restrictions under the CARES Act?

It is unclear (1) what compensation is cut back to comply with the restrictions on executive compensation under the CARES Act, (2) whether a covered employee has any choice in the matter, and (3) how such compensation items are to be valued for this purpose. Note that some of these potential actions (to comply with the executive compensation restrictions) could violate plan documents, employment agreements or other agreements between the employer and covered employee. As discussed below, all such conflicts need to be anticipated and should be addressed before an employer participates in the Exchange Stabilization Fund.

What actions must an employer subject to the executive compensation restrictions under the CARES Act take in connection with securing a loan or loan guarantee under the Exchange Stabilization Fund?

An employer seeking a loan or loan guarantee is required to sign a binding agreement that it will comply with the executive compensation restrictions under the CARES Act. As a practical matter, an employer first will need to identify the individuals who are likely to be its covered employees, which is complicated by the ambiguity in the CARES Act regarding how to measure total compensation. Presumably the board of governors of the Federal Reserve Board and the Secretary of the US Treasury will quickly resolve the ambiguities in the CARES Act before binding agreements are entered into with covered employers.

Immediate attention should be given to identifying covered employees who may already have contractual rights to receive amounts that exceed the applicable limits under the CARES Act. Loans and loan guarantees are conditioned on compliance with the executive compensation restrictions. A covered employer will need to address with covered employees the restrictions in a manner that provides a reasonable basis for making the required certifications. This could be a particularly difficult issue in the case of a covered employee who terminated employment in 2020 prior to the enactment of the CARES Act and has already signed a separation agreement.

Are there any special rules for particular industries?

Yes. Section 4116 of the CARES Act sets forth a special rule for air carriers or contractors receiving financial relief under the “air carrier worker support” provisions of the CARES Act. Section 4116 provides that the executive compensation limitations described above apply for the two-year period ending on March 24, 2022, but it is not entirely clear whether this period applies in lieu of the restricted period applicable to all other covered employers.

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