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EXEQUITY

Independent Board and
Management Advisors

Client Alert

2020 Director Equity Grant Practices

The significant stock price declines of many companies over the past few months have raised the question of whether a company's traditional approach to impending equity awards should be revised. In particular, making equity awards that are based on a given grant-date value will require consideration of whether the number of shares underlying the grant should be based on today's reduced share price (requiring the number of shares underlying a near-term award to be raised to deliver the targeted grant value), or whether an alternative approach should be considered.

The first widescale evidence of companies' responses to this dynamic is unfolding in the context of 2020 director equity awards. These awards provide a good test case for companies' early approaches to equity award valuation, as the great majority of director equity grants are established as a targeted grant value, and a significant number of companies are facing this issue right now as the second quarter of the year is prime time for director equity grants.

Across the S&P 500, more than 80% hold their annual shareholders meetings in the second quarter of the calendar year. For most boards, equity awards are made concurrent with the annual meeting. Some companies have contemplated changes to their equity grant policies for 2020, such as using an averaging period to denominate director equity, in response to the market volatility. This *Client Alert* analyzes the equity grant practices of 109 S&P 500 companies holding their annual meetings between April 1, 2020 and May 1, 2020 to identify trends in director equity grant policies resulting from the market impact of COVID-19.

Summary of Results

Exequity's review finds that just 3% of companies reviewed appear to have adjusted their grant policies. In these few instances, companies appear to have used an averaging period to denominate the number of shares awarded, resulting in a reduced number of shares awarded. Ninety-one percent of companies reviewed have made no discernable changes to their grant policies, i.e., they continued to denominate awards based on the same methodology used in 2019. The remaining 6% have yet to disclose equity grants.

Implications

The data suggests that directors may be hesitant to change their policies for granting equity awards. In Exequity's view, directors are in a Catch-22: No matter the decisions they make with respect to equity grants, they are at risk of criticism. Directors have two options for their equity grant policies:

- **Maintain Policy**: Some constituencies may criticize directors for *not* making a change and being insensitive to the economic circumstances—even if they have already temporarily reduced or eliminated their cash retainers.

- **Change Policy**: Boards adjusting their grant policies may open the door to "what if" criticisms and questions about their decision-making processes. For boards already reducing or eliminating cash retainers on a temporary basis, a change in the equity grant policy could further open the door to scrutiny into their grant practices.

The path of least resistance appears to be maintaining existing policies. For companies considering adjustments, Exequity advises companies to consider the potential future implications of policy changes because most director pay programs are designed to be neutral to market swings. Does changing the policy to respond to current market volatility create a precedent to make director equity awards *more* reactive in the future?

Companies considering changing their grant policies for 2020 are advised to consider the pros and cons of doing so, as well as whether the change in policy would be applied to grants in future years. For example, if a company decides in May to use an averaging period for a grant taking place in June, what should the company do if the stock price increases right before or on the grant date? It could appear as though directors were taking advantage of a depressed stock price for denominating awards. Alternatively, if the stock price falls and the company decides not to use an averaging period, there is a possibility that directors would be viewed as taking advantage of a depressed price.

Given the magnitude of director equity awards (relative to executive awards) and the potential for poor optics no matter what decision directors make, it is not surprising that most companies to date are choosing to stick with their existing director policies. As companies consider their 2021 proxy disclosures, what feels most defensible to most is staying the course.

Other Findings

Of the companies reviewed, 90% grant equity annually, 6% quarterly, and 4% grant no equity. Of the 96% of companies granting equity, all but one company disclose a targeted equity value. Of those 90% of companies granting equity on an annual basis, 57% do so within one week of the annual meeting, 27% grant during the first quarter, and 9% grant more than one week after the annual meeting. As of this publication, the remaining companies had not disclosed 2020 director equity grants with the SEC, but in 2019, most of these companies granted more than one week after the annual meeting.

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