

SEC Issues Guidance On “Spring-Loaded” Executive Compensation

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On November 24, 2021, the Securities and Exchange Commission (the “SEC”) released Staff Accounting Bulletin No. 120 (“SAB 120”) pertaining to the accounting treatment and valuation of “spring-loaded” incentive awards. As defined in SAB 120, a spring-loaded award refers to a “share-based payment award granted when a company is in possession of material nonpublic information to which the market is likely to react positively when the information is announced.” Such awards include all instruments, including stock options and restricted stock units.

Accounting Standards Codification Topic 718 (“ASC 718”) provides that equity incentive awards are to be valued for accounting purposes based on their fair value on the date those awards are granted, using certain assumptions regarding share price, volatility and other factors as of that same date. Spring-loaded awards granted before the public announcement of positive market-moving information can be expected to quickly increase in value as the market learns of information that was privately known to the company at the time of the grant but not reflected in the share price and expected volatility used for initial valuation of those awards. Spring-loading is a disfavored practice, and many public companies plan their equity incentive awards to be made after the public release of financial and other material information to avoid the appearance of spring-loading.

The SEC has made clear with SAB 120 that compensation cost resulting from share-based payment transactions must be recognized in financial statements at fair value, which may involve considering any material positive nonpublic information in arriving at a valuation for spring-loaded awards. SAB 120 also states that if an issuer is required to adjust the share price used to estimate the grant date fair value of spring-loaded incentive awards, the issuer must disclose in its financial statements how it determined the amount of the adjustment, the characteristics of the awards granted and how the awards differ from other share-based awards granted by the issuer. For equity awards that are not spring-loaded, the SEC has confirmed that the observable market price of the underlying share on the date of grant is a “reasonable and supportable estimate.”

SAB 120 indicates that incentive award grant timing will be a point of focus for the SEC in the future and may lead to comment letters or enforcement activity in this area. Accordingly, revision of internal disclosure controls and procedures may be necessary to ensure that positive material nonpublic information is identified and publicly released in a way that avoids the creation of spring-loaded incentive awards.

For further information, please contact a member of the Haynes Boone [Capital Markets and Securities Practice Group](#).