

# Equity Compensation Trends in a Challenging Economic Landscape

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During the first quarter of each year, employers begin the annual process of establishing incentive compensation for their management teams, both in the form of cash and equity awards. Typically, the equity awards will contain a mix of time and performance-based vesting conditions. While trends vary by industry, this year one pattern has remained true among all industries as employers are trying to balance the challenge of satisfying shareholders in a volatile stock market while retaining key employees in a tightening labor market. Some ways employers are attempting to meet this challenge include:

- Continuing to favor RSUs over stock options. Since options typically use an exercise price equal to the fair market value of the company's stock on the date of grant, options can be less incentivizing in a volatile market (where they can easily become out of the money). RSUs provide the employee with the full value of the stock, retaining some level of value even when the stock price swings wildly. Where an employer does choose to grant stock option awards, consideration should be given to the effect of volatile stock prices and how decreases in an employer's stock price could negatively affect the compensatory and retention goals of such awards. Limits on stock option repricing, whether under the terms of an equity plan or the rules of the applicable stock exchange, could make any adjustments to these awards difficult, if not impossible.
- Adjusting how awards will vest. Where previous awards may have vested on an annual basis over a three or four-year period, some employers are changing vesting schedules so awards vest on a quarterly or even a monthly basis over the same time period (though public companies still generally provide for no vesting until the first anniversary of the date of grant).
- Modifying how leaves of absence impact vesting of time-based awards. Where vesting of prior awards may have paused while an employee was on any approved leave of absence (except to the extent required by law), some employers are permitting awards to continue to vest while an employee is out on certain types of leaves, such as extended parental leave.
- Revisiting performance metrics for new awards. Many employers reduced certain performance metrics in response to the COVID-19 pandemic, but recent guidance from ISS indicates that, as of February 1, 2022, it is restoring its pre-pandemic expectations of compensation practices and disclosures and will again view, with increased scrutiny, mid-year changes to performance metrics, lower year-over-year performance targets, and the granting of special one-time awards to replace previously forfeited awards.
- Making off-cycle awards. Many employers are making off-cycle awards (*i.e.*, awards granted outside of the typical annual award cycle) at the time an employee is promoted to align the employee's equity compensation with the new position, rather than waiting until the next annual award cycle to make such an adjustment.

Regardless of whether and how employers choose to modify their equity compensation practices in response to the current economic landscape, they should (i) ensure there are sufficient shares reserved for issuance under their equity compensation plan to support such awards (as well as for any anticipated future awards), (ii) consider how any changes in vesting terms or performance metrics may be perceived by proxy advisory services such as ISS and Glass Lewis, and (iii) consult with their benefits counsel regarding the legal and tax consequences of making such awards,

including, without limitation, under Code Sections 162(m) (taxation of compensation in excess of \$1,000,000 to certain executives and highly compensated employees of publicly held corporations), 280G (golden parachute payments), and 409A (deferred compensation).