2016 Stock Ownership Guidelines
EXECUTIVE

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Executive Stock Ownership Guidelines

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Public companies are beholden to align long-term interests of executive officers with those of their shareholders, and this balance often manifests in how executives are paid in relation to company performance. Many companies address this through use of equity packages, but because executives can still sell or hedge these shares, their incentives to make long-term decisions for the company are not always clear. To avoid this, many companies implement stock ownership guidelines, requiring executives to own a certain amount of equity in the company.

Ownership guidelines require executives to obtain a certain amount of shares within a set timeframe, and holding requirements mandate that they retain a certain amount of shares received through vesting of stock or exercising of options. Aside from incentivizing executives, implementing one or both of these policies is important for shareholder support and for proxy advisors when justifying of pay packages.

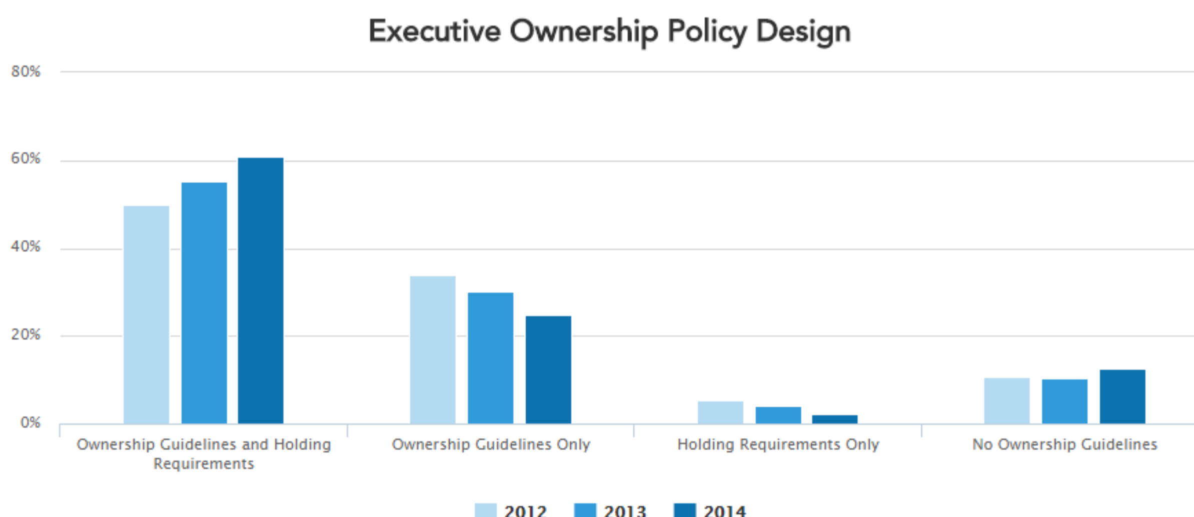
In this report, Equilar examined various trends and components of executive stock ownership over the 2012, 2013 and 2014 fiscal years for Fortune 100 companies, and found that a combination of ownership guidelines and holding requirements has increased considerably in that time frame. In addition, there has been a steady increase in the value of required stock ownership over the past three years. Overall, Fortune 100 companies are implementing more restrictive stock ownership requirements with a higher median target value of required equity.

Methodology

Equilar's Executive Stock Ownership Guidelines report details the prevalence and features of stock ownership guidelines and holding requirements applied to executives by Fortune 100 companies, as disclosed in their annual proxy statements. The prevalence of features is the percentage of Fortune 100 companies disclosing them for fiscal years 2014, 2013 and 2012. The study samples include 97 companies in fiscal 2014, 96 companies in fiscal 2013 and 94 in companies in fiscal 2012. Years are defined as fiscal year ends between August 1st and July 31st.

Ownership Guidelines

While the percentage of Fortune 100 companies that disclose ownership guidelines or holding requirements in any form decreased from 89.6% to 87.6% over the past three years, the number of companies who implement both ownership guidelines and holding requirements has increased. In 2012, 50% of Fortune 100 companies detailed both types, and that figure grew to 60.8% in 2014. Accordingly, the number of companies that only implement holding requirements or ownership guidelines exclusive of the other decreased over the last few years.

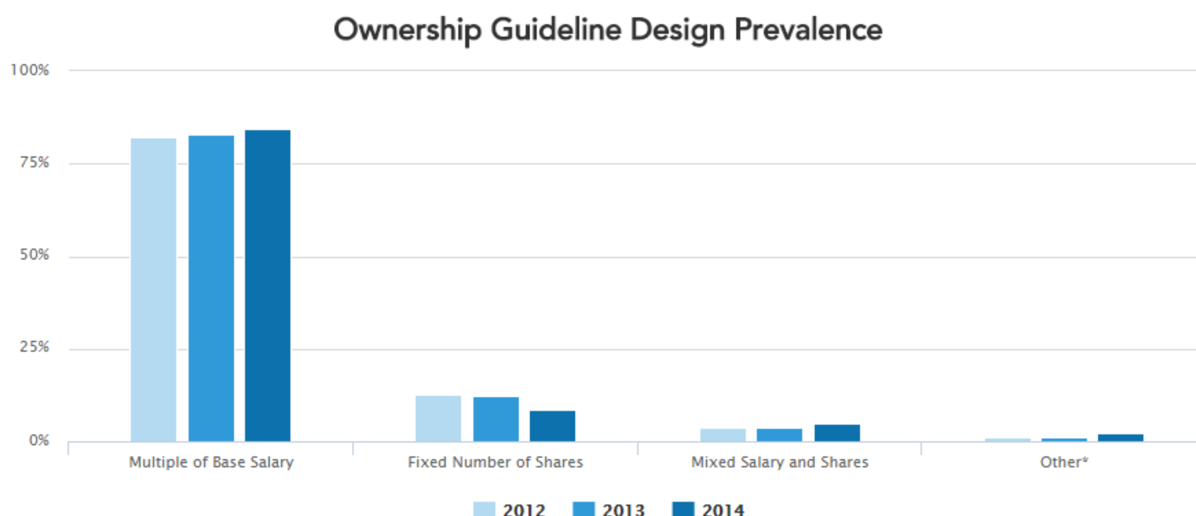


“When used effectively, ownership policies—including ownership guidelines and holding requirements—can help mitigate risk, signal to shareholders a commitment to the stock, and enhance alignment with shareholders,” said Seamus O’Toole, Managing Director, Semler Brossy Consulting Group.

Companies generally establish an accumulation period within which executives have to meet stock ownership guidelines. While accumulation periods can vary from company to company, generally between one and eight years, most are set at five years. In 2014, 67.5% of Fortune 100 companies with ownership guidelines set accumulation periods, and of these companies, 87.5% required executives to meet guidelines within five years.

"Overall, companies with high levels of executive pay, large one-time equity awards or low Say on Pay votes have an even greater expectation from shareholders that the ownership policies will be aggressive," added O'Toole. "If a company's primary goals are to simply meet minimum investor voting guidelines and/or align with 'typical' competitive practice, this 'check the box' approach potentially misses an opportunity to use the guidelines in a more effective and powerful way—as a tool to actually influence behavior and drive a culture of ownership and focus on long-term, sustained performance."

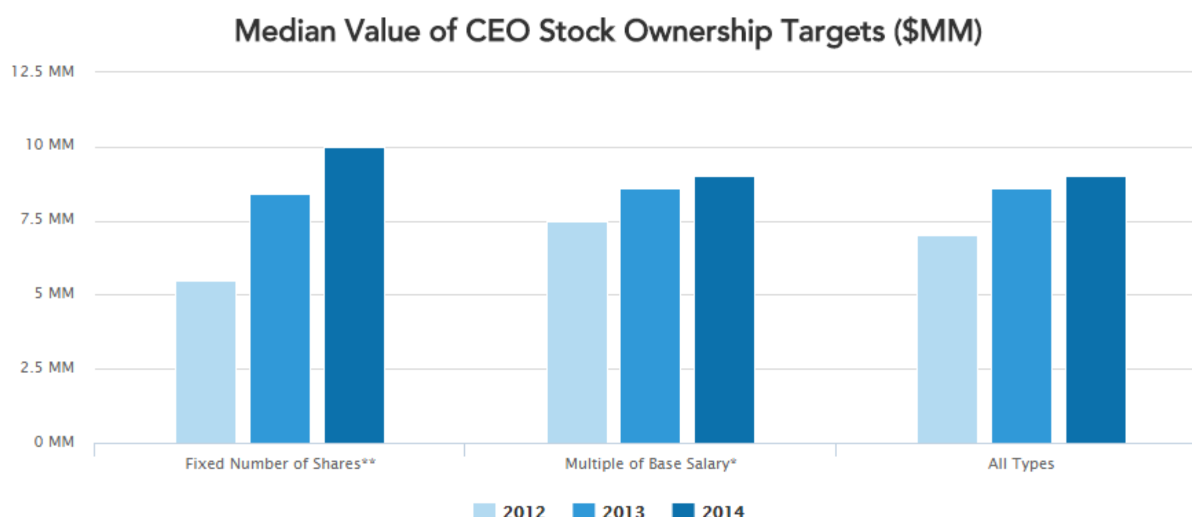
The amount of equity an executive is required to own or hold is defined in a number of ways. Though ownership guidelines designs vary, multiple of base salary is by far the most common, with more than 84% of Fortune 100 companies utilizing this design, followed by fixed number of shares at 8.4%—which notably has fallen from 12.7% in the past three years. Other combinations are rarely utilized amongst the Fortune 100 though they have ticked up slightly.



* The "Other" category in 2012, 2013 and 2014 includes ownership guidelines that define target levels as a fixed dollar value of shares, or as a multiple of the sum of base salary and target annual bonus.

Median values of CEO stock ownership targets have steadily risen over the last few years, increasing from $7.0 million to $9.0 million. During that time frame, fixed

numbers of shares have seen the most drastic increase from $5.5 million to $10 million, which could be due in part to increasing stock prices.



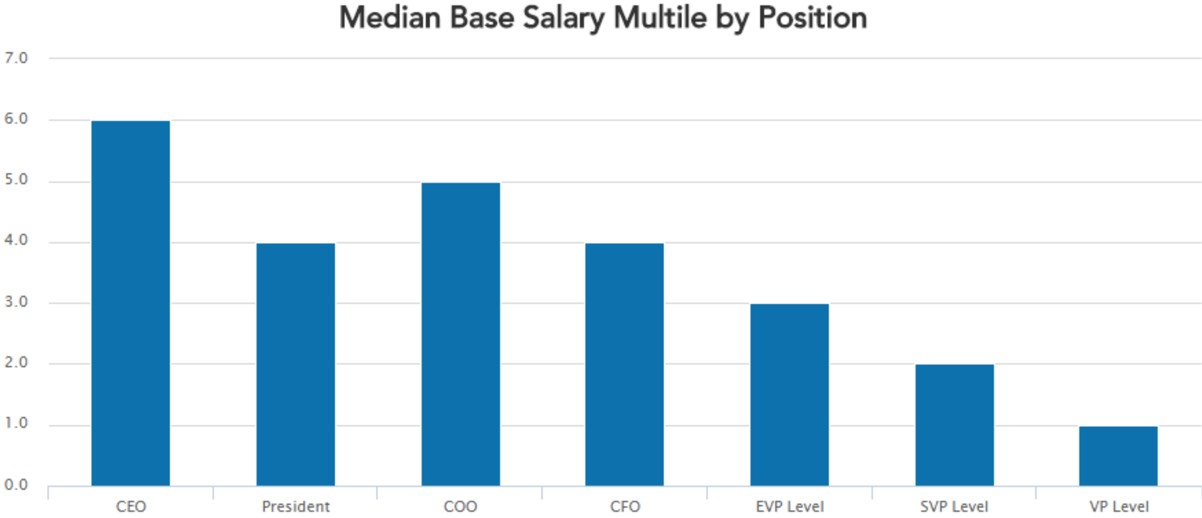
* Assumes base salary from fiscal year represented in chart.

** Assumes year-end stock price for fiscal year per section.

"The size of grants and portion of overall pay delivered in equity has increased materially over the past five to 10 years for many companies," said O'Toole. "The increases in values have also been accompanied by a move away from stock options, which have a longer-term orientation, towards full value shares, which tend to payout over a shorter time frame. Many boards have responded to these shifts in grant practices by requiring executives to keep some portion of this additional equity for an extended period through enhanced ownership policies."
"The increase in the value of fixed share requirements is particularly interesting," added David Outlaw at Equity Methods. "While the use of fixed share guidelines is in the minority, some companies may prefer the structure given its fixed, objective nature. But because it is not the industry norm, there is pressure on these companies to raise the fixed-share bar to signal good governance."

For companies using multiple of base salary for ownership guidelines, the multiple used generally varies by position. The most influential members of the company have

the highest median base salary multiples, while those lower on the executive ladder have a lower multiple value. For example, the median base salary multiple for Fortune 100 CEOs was six times, vs. just one time for vice presidents.



Among CEOs in the study for whom ownership guidelines were defined by a multiple of salary, multiples of five and six were most common, with nearly two-thirds of companies disclosing one of these two multiples. Notably, however, nearly all other companies disclosed multiples higher than this, and 12.2% of companies mandate multiples of 10 or higher.

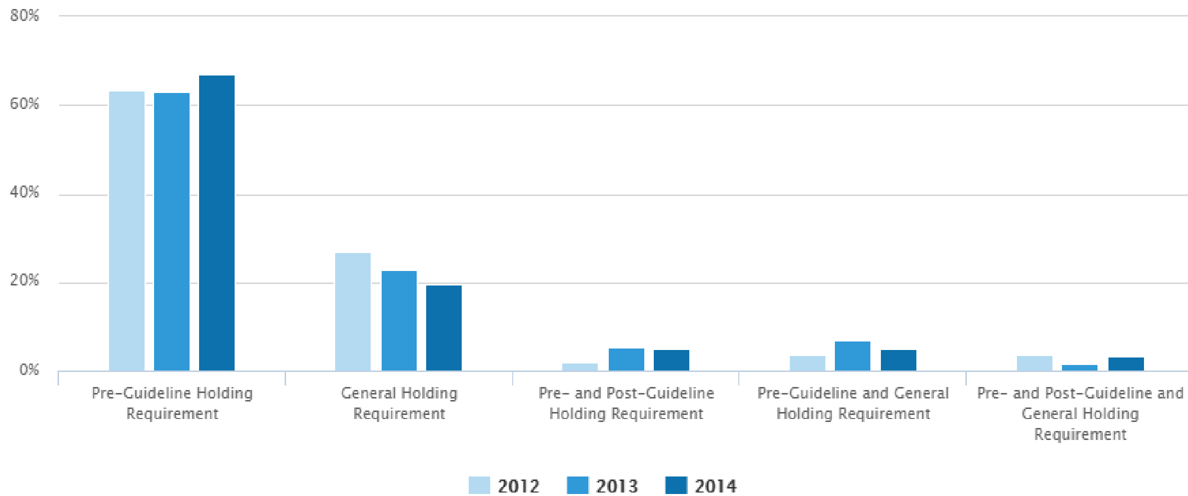
“The problem with a salary multiple approach is that it creates a moving target: if pay is adjusted upward, does this mean the bar is automatically raised for ownership requirements?” said Outlaw. “Even worse, stock price declines mean that the shares held may no longer exceed the target value. One elegant feature of a fixed share threshold is that it’s unaffected by share price volatility. A ‘once met, always met’ rule can mitigate this risk, by essentially causing the salary multiple watermark to transition into a fixed share goal after the multiple is initially hit.”

Holding Requirements

Typically, executives are able to sell shares upon meeting vesting requirements, eliminating their financial stake in a company. To prevent this, companies are increasingly implementing holding requirements, in which executives are unable to transfer shares until either a specified period of time or their ownership guidelines are met.

Holding requirements are a share retention tool that can be implemented with or without stock ownership requirements. There are different types of holding requirements, the most common being pre-ownership or post-ownership, in which executives must retain a certain amount of company stock they acquire through exercised stock-based awards before or after they reach their ownership guidelines.

Among the Fortune 100 companies that included holding requirements, a majority had only pre-ownership guidelines requirements. More than two-thirds of companies included these requirements, which increased from 63.5% in 2012.



“There are a handful of factors behind the increase in the use of holding periods, depending on the problems each company is trying to solve,” said Outlaw. “First, pre-threshold holding requirements are an elegant, automatic mechanism for nudging ownership to the required level. Second, ISS’ scorecard gives points for having them (and more points for longer requirements), so satisfying governance groups is a concern. The third factor is increased recent attention in the industry about post-vest holding periods and the potential ability to take a valuation discount, thereby lowering the accounting value so that more shares can be issued for the same aggregate dollar value. While a clear consensus has yet to emerge among regulators and auditors regarding the suitability of discounts, there sheer buzz alone has contributed to an uptick in use.

“Avoid the temptation to just follow the pack. The right design for a long-tenured management team at an industrial company might differ materially from what works best for a high-growth Silicon Valley company,” said O’Toole. “Additionally, many shareholders not only scrutinize the ownership guidelines themselves, but also the actual ownership levels and the amount and timing of stock sales by executives. This has been a common area of focus and criticism for many activist investors in particular, and companies are spending more and more time reviewing both their ownership policies and actual executive stock sale activity.”

Seamus O'Toole
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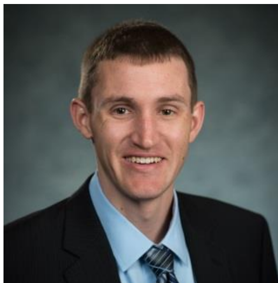
Seamus O'Toole has served as a trusted advisor on compensation and incentive design issues for both public and private companies for over 12 years. Working with companies of all sizes and across all industries, he helps companies execute their strategy through appropriate performance measurement and incentive design, including annual and long-term programs. He can be contacted at SOToole@semlerbrossy.com.



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David is a Manager at Equity Methods, specializing in compensation design and modeling, as well as fair value measurement and accounting under ASC 718. In addition to managing many of the practice's most complex projects, David plays a leadership role in internal training and mentoring programs and is one of Equity Methods' most prolific authors and presenters. He can be contacted at david.outlaw@equitymethods.com.

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