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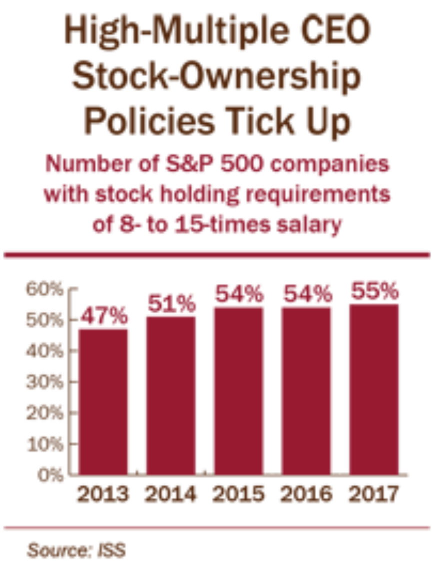
High-Multiple CEO Stock Requirements Rise

By Melissa J. Anderson December 4, 2017

Microsoft announced in its recent proxy that it plans to raise its CEO stock-ownership requirement from 10 times annual salary to 15 times annual salary starting in June 2018. It isn't the only company touting high-multiple stock-ownership requirements: According to data from **ISS**, the number of S&P 500 companies with high-multiple requirements — between eight and 15 times base salary — is now 55, compared to 47 in 2013. Some of these companies include **Altria Group** and **General Dynamics**.



The median stock-ownership requirement for the S&P 500 has also risen, from five times annual salary in 2013 to six times annual salary today, according to ISS. Experts say that CEO stock-ownership policies help align CEOs with investors and reduce excessive short-term risk taking. They also say that tightening these policies can help boards signal to investors that they care about good governance.

Indeed, most executives are able to build up their stock holdings while still in the standard grace period of three to five years before the requirement kicks in, says **Peter Kimball**, executive director and head of advisory and client services at ISS Corporate Solutions.

"So, companies often find that it's not an imposition on the executives and not a bitter pill for the board to swallow to increase guidelines again to make that signal of good governance even stronger."

There's no legal requirement that companies implement a CEO stock-ownership requirement; however, if they do have one, companies must describe it in their CD&A. According to **Shearman & Sterling**'s annual corporate governance and compensation report for 2017, 97% of the 100 largest U.S. public companies disclosed that they maintained stock-ownership policies.

Microsoft raised its stock-ownership requirement for other executives this year as well, increasing the salary multiple from three times to eight times for three NEOs and from three times to five times for one other NEO. **John Seethoff**, vice president, deputy general counsel and corporate secretary at Microsoft, writes in an e-mail that the board instituted the changes "so that our most senior executives maintain a significant personal financial stake in the company." As a result of those changes, it made sense to raise the requirement for its CEO **Satya Nadella** commensurately, he says. Previous stock-holding requirements for the CEO and NEOs have been in place for a decade.

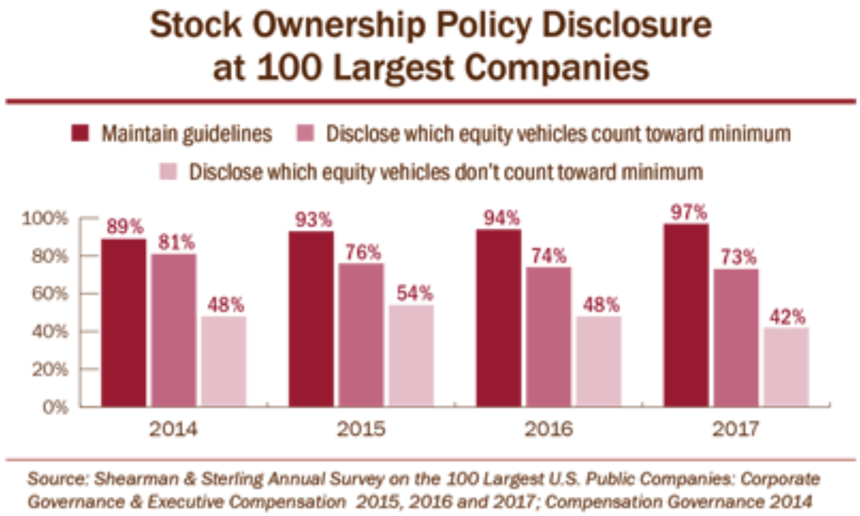
"The policy complements our overall executive compensation design that delivers the majority of executives' target pay through equity awards," Seethoff writes.

Nadella's base salary for 2017 was $1,450,000, which accounts for less than 10% of his total compensation. According to the proxy, which was filed Oct. 16, Nadella holds 656,241 shares of common stock and 2,279,798 additional underlying shares or stock units. As of press time, his holdings were worth $247.8 million, well above the stock-ownership requirement.

Policy Requirements

However, that doesn't quite account for where Nadella is with respect to the threshold. Stock-holding policies include a variety of modifiers and other requirements to determine whether the CEO is actually meeting the threshold, only some of which may be disclosed publicly.

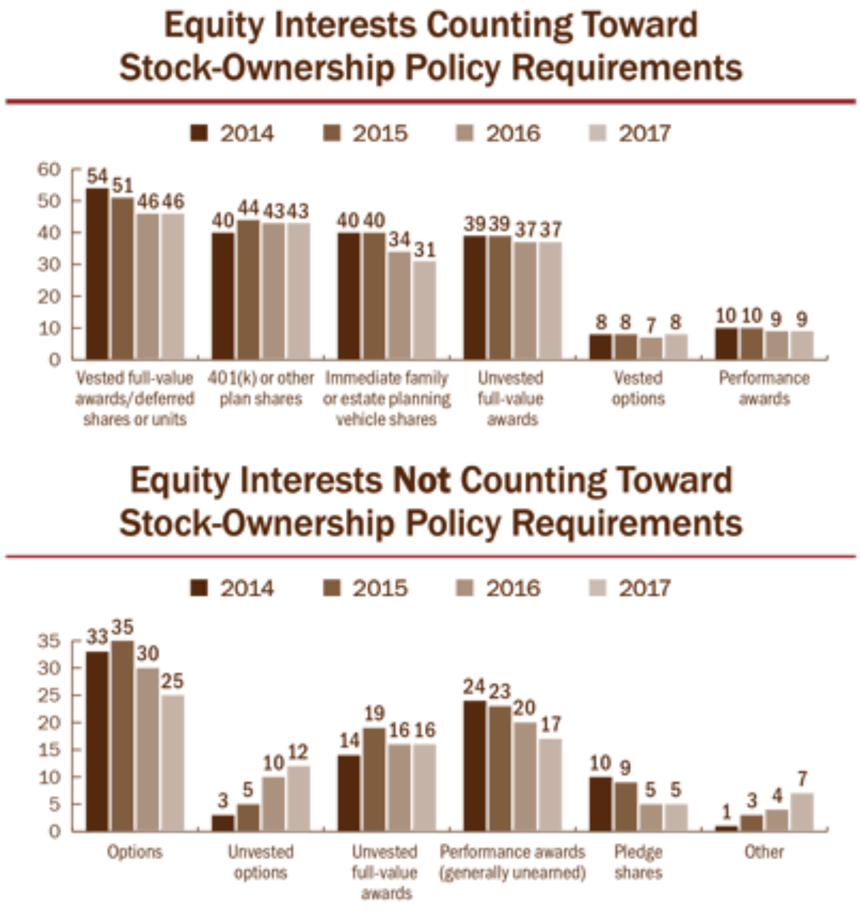
For example, at Microsoft, the proxy states that executives subject to the policy must "retain 50% of all net shares (post-tax) that vest until achieving his or her minimum share ownership requirement." Additionally, according to its stock-ownership policy, the company counts shares held by the CEO or NEO "acquired through open market purchase, vesting of stock awards, stock option exercise, or purchase through the Employee Stock Purchase Plan." It also covers shares held by the executive's spouse or dependent children, shares held in trust for the benefit of the executive or their spouse or dependent children, and shares held in a 401(k) plan.



A review of Shearman & Sterling's annual governance reports for the past four years shows how companies' policy on these modifiers is evolving. The annual report studies compensation practices at 100 of the largest U.S. public companies listed on the NYSE or Nasdaq.

While the percentage of companies Shearman studied that disclosed they maintain a stock ownership policy has increased since 2014, the number of companies disclosing which specific equity vehicles count toward the minimum threshold has hovered around 71 for the past four years.

The number of companies in the study saying they count vested full value awards or deferred shares or units has declined from 54 in 2014 to 46 in 2017. The number of companies saying they count immediate family or estate planning vehicle shares has also declined, from 40 in 2014 to 31 in 2017.



Source: Shearman & Sterling Annual Survey on the 100 Largest U.S. Public Companies: Corporate Governance & Executive Compensation 2015, 2016 and 2017; Compensation Governance 2014

Meanwhile, some companies also specifically disclose which equity vehicles are not counted toward the minimum. The number of companies that say they do not count options has declined from 33 in 2014 to 25 in 2017, while the number saying they do not count unvested options has risen from three to 12.

These changes could be due to investor pressure. **David Teigman**, partner in the executive compensation, benefits and Erisa practice at **Cadwalader, Wickersham & Taft**, says shareholder activists are subjecting these policies to increasing scrutiny.

"One result of this is that investors are increasingly moving towards detailed examination of the actual ownership levels of company insiders and their trading history, instead of just looking at the parameters of the stock ownership guidelines promulgated by the company," he writes in an e-mail.

He says that some companies implement high-multiple plans because the CEO's salary accounts for little of their total comp, with the bulk being constituted by equity awards.

"Any trend towards increasing the multiples or other requirements could be intended to make these programs more effective, with boards looking to incentivize increased company performance and create stronger alignment between the company, its executives and shareholders," he writes. Conversely, Teigman writes, at some companies, "even a multiple of base salary may not represent a significant economic stake."

Criticism

Indeed, recent academic research has also called these policies into question. **Nitzan Shilon**, professor at **Peking University** School of Transnational Law, authored a 2015 paper in the *Indiana Law Journal* that discussed several concerns.

One of the big ones is accountability, he says. Practically none of the policies describe the consequences of a CEO's dipping below the stock-ownership threshold. Many of the plans allow CEOs to count unvested stock toward stock-ownership minimums, and very few adopt meaningful stock-retention policies, he says. And most of the grace periods — the years during which CEOs are able to amass stock to meet the threshold after being hired for the job — are not much shorter than the average tenure for a CEO. A five-year grace period does not mean much for a CEO whose tenure will most likely not last more than nine years, the average tenure for a departing S&P 500 CEO in 2016, according to **The Conference Board**.

According to Shilon's research, two thirds of Fortune 250 policies would allow CEOs to unload all of their stock without facing consequences. The other problem, he says, is that this ineffectiveness is camouflaged.

"With stock-ownership policies, the firm explicitly states that those polices help to achieve certain goals, such as alignment with shareholders, curb of excessive risk taking, that they should work against short-term policies. They hold the policies to have very important goals, but at the same time, most of them basically hold policies that do not have any bite," Shilon says, in an interview with *Agenda* .

"They're paper tigers in reality, but they're held to attain very important goals."