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Dollar Cost Averaging of Long-Term Incentive Grants: Worthy of Consideration in Volatile Market Environment

February 2, 2022

"Dollar cost averaging" is an investment strategy whereby investors spread a desired investment amount into periodic investments over a period of time, which mitigates the price risk inherent in investing the entire amount at an inopportune moment. Virtually all public companies grant equity-based compensation as the most significant portion of their executive compensation program. These awards provide an important link between executive and shareholder interests. Market practice is generally to grant these awards in "one shot" toward the beginning of the fiscal year, and the grants are, therefore, dependent on the share price at that moment in time. From time to time it has been suggested that issuers spread grants throughout the year, and some issuers take this approach, although it remains a minority practice.[1] The reliance on the spot price (or price over relatively short averaging periods) leaves the value of the awards subject to the momentary whims of the market. We need to look no further than the dramatic COVID-19 induced drops in the equity markets in early 2020 as evidence that the timing of "one shot" grants can have a significant impact on the value of awards and, therefore, employee incentives. For example, if awards are "out of the money" shortly following a grant, employees may not view the awards as providing much potential value. With equity markets experiencing renewed volatility at the beginning of 2022 due to a variety of factors, including expected interest rate increases and continuing COVID-19 and geopolitical uncertainty, companies may wish to reconsider their historical practices with respect to equity award grant timing as the time for 2022 equity grants quickly approaches.

Implementing dollar cost averaging in incentive compensation would be relatively straightforward. For example, an executive who receives $1 million of equity awards on an annual basis could receive one-quarter of that value on a quarterly basis throughout the year. This type of structure may have the following benefits:

- **Mitigates the Risks of "Buying High"**. As noted above, spreading equity grants throughout the year mitigates the risk of granting at a "high" price at that moment in time. The opposite is also true, and "one shot" grants could also be granted at a "low" point. Unfortunately, there is no crystal ball for equity prices, and, on balance, spreading out the grants would mitigate the risks associated with temporary market swings.

- **Retention Considerations**. It may also be the case that periodic grants of equity awards would serve as an important retention tool, as employees would be routinely close to the receipt of equity compensation. In fact, for this reason it is relatively common among technology-focused companies for vesting to be staggered such that employees vest in awards on a monthly or quarterly basis. Staggering the grant dates could achieve a similar result.

- **Optics Considerations**. Because "one shot" awards concentrate grants at a single stock price (which may move in unpredictable ways either in the run up to or after the award), companies are exposed to the risk that even innocently timed awards are perceived as manipulative. Awards that are granted prior to a positive piece of news may be perceived as "spring-loading" and, conversely, awards granted following bad news may be perceived as "bullet-dodging", even if the events leading to the stock price movements are truly exogenous to the company and unrelated to the timing of the company's equity awards. This may expose the company to unwarranted negative press or unnecessary inquiries into its accounting and governance practices. Timing-related considerations have recently received regulatory attention with the SEC's release of Staff Accounting Bulletin No. 120. Dollar cost averaging reduces this risk by lessening the concentration of awards and, by establishing a more frequent cadence of grants, gives the company a longer track record of consistently timed grants to point to even if any given award is questioned as suspiciously timed.

If a change in grant practices is seriously considered, Compensation Committees and Boards of Directors should evaluate the legal terms of the equity compensation plans to ensure that staggering grants complies with relevant plan provisions (such as minimum vesting period requirements) and complies with relevant tax requirements. Additionally, companies should consult with relevant finance and accounting teams when considering such a change, as modifications to grant timing practices and/or vesting schedules may result in changes to the way in which such awards are expensed for financial accounting purposes. Finally, companies should consider whether they are in possession of any material non-public information which could lead to the allegation that a change in grant and vesting timing was itself done in bad faith and for inappropriate reasons.

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[1] *See*, *e.g.*, 2021 Proxy Statement of Netflix, Inc. and "Smoothing Equity Award Delivery in Volatile Times", April 23, 2020, https://www.paygovernance.com/viewpoints/smoothing-equity-awards-delivery-in-volatile-times.