

# Stock Ownership Guidelines

## The Basics

### What are stock ownership guidelines?

A stock ownership guideline is a policy created by the compensation or governance committee establishing the level of stock ownership that is expected for the executives or outside directors of a company. A majority of public companies in the US and Canada now have ownership guideline for their senior executives and outside directors. The key reasons for establishing stock ownership guidelines include:

- Creating alignment between individual executive wealth and the long-term performance of the company.
- Minimizing excessive risk taking that might lead to short-term returns at the expense of long-term value creation.
- Building an ownership mentality among executives.
- Alignment with good governance principles supporting many shareholder groups.

The primary design parameters to consider when developing ownership guidelines are:

- **Participation**—which executives will the guidelines cover?
- **Ownership requirement**—how much stock is required to be held?
- **Ownership definition**—what kinds of equity vehicles will constitute ownership under the guideline?
- **Compliance window**—how long does an executive or director have to meet the requirement?
- **Noncompliance**—what actions will be taken if a guideline is not met?

## The Details

### Participation

Participation is generally limited to the senior executives of a company and the outside directors. Nearly all companies with ownership guidelines include the CEO and the direct reports (generally EVPs and SVPs). Some companies will extend guidelines to one additional level (typically the VP level). Very few companies will establish an ownership guideline below this level. The ownership requirement is typically scaled based on the level of the executive.

### Ownership Requirement

The ownership requirement is typically defined as either a multiple of salary/retainer or a fixed number of shares. The majority of companies will require that a specified value of stock expressed as a multiple of salary (or retainer for directors) be held by each participating executive. Given that share price can fluctuate over time, changing the value of the shares held, many companies will use an average share price (i.e. 90 days or 180 days) to calculate the value of shares held. A common executive ownership requirement framework would be as follows:

Level	Requirement
CEO	5 times salary
EVP/SVP	3 times salary
VP	1 times salary

(Typical outside director requirements range between 2 to 3 times retainer.)

Institutional Shareholder Services considers a 5 times requirement to be “adequate” for a CEO, however, a 6 times or greater multiple is “preferred” and will generate a higher GRId score under their methodology.

While a majority of companies use a multiple of salary to define the ownership requirement, some companies will use a fixed number of shares to define the ownership requirement. Using a fixed number of shares eliminates the impact of share price volatility; however, an extended decline in the share price of the company could leave executives holding a much smaller stake in the company than desired.

### Ownership Definition

Outright ownership of company stock is universally deemed to be ownership under stock ownership guidelines. A majority of companies expand the ownership definition to also include shares held in retirement accounts and unvested restricted shares, RSUs and DSUs. A small minority of companies will allow for other forms of equity to be counted toward ownership such as vested stock options or unpaid performance shares.

### Compliance Window

Most companies will allow executives and directors a period of time to reach ownership requirements. By far the most common window period is 5 years. This window period would begin when a new ownership guideline is established or amended or when a new participant is added to a guideline.

## **Noncompliance**

If the window period is complete and an executive or director is not in compliance, a company must determine what, if any, action it will take. Many companies will leave this open to the Committee's discretion, while some companies will outline possible actions when establishing the guideline. Possible actions include written reprimand from the Board, restriction on the sale of shares and delivery of salary/retainer or bonus in stock rather than cash.

## **What are retention requirements?**

Some companies will also establish a share retention requirement as part of their ownership guideline. Typically a retention requirement will require that executives or directors retain a certain percent (typically 50%-100%) of any equity they receive from the company until they reach the ownership guidelines. Once they have reached the guideline, they are free to sell shares.