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How Longer Vesting Periods Could Reshape Equity Pay

By David Bixby and Eddie Capistran

LONG-TERM EQUITY-BASED INCENTIVE OPPORTUNITIES are generally viewed as the most effective way to retain executives and align them with shareholder interests. Most US public companies vest long-term incentives over a three-year period, with an emphasis on performance-based equity that is driven by prevailing investor and advisory firm preferences. However, recent developments indicate that some investors may have a new perspective.

In August 2024, Norges Bank Investment Management (NBIM) published an open letter encouraging Institutional Shareholder Services (ISS) to think differently about the merits of time-vested restricted stock. NBIM expressed concerns about a lack of transparency in performance share unit awards, questioned whether they align pay and performance better than time-vested restricted stock, and called on ISS to place a higher value on equity grants with longer vesting periods.

Both ISS and Glass, Lewis & Co. addressed the topic in their respective 2024 policy surveys. ISS Global Benchmark Policy Survey results indicate some appetite for change: nearly one-third of investors (31%) surveyed felt that longer vesting periods should be a mitigating factor for evaluating time-vested restricted stock, and most of these investors (66%) felt that "long vesting" should last at least five years, while 25 percent thought it should last at least seven.

In response, ISS indicated openness to a potential policy shift on time-based awards in 2026 or beyond. For 2025, ISS modified its guidelines for performance-based awards to include closer scrutiny of potentially problematic design features.

Is Longer-Vesting Restricted Stock Right for You?

Setting credible, multiyear targets for performance-based awards can be tricky, and design complexity can hamper transparency and obscure the link between pay and performance. Time-vested stock with longer vesting focuses on the simplest, most transparent metric—stock price—over a horizon that discourages myopathy. Potential advantages of long-vested restricted stock include:

- focusing on the sustained health of the company for an extended period after the grant date,
- avoiding complexity that can misfire in volatile markets,
- maintaining retention value through short-term ups and downs, and
- broadcasting the company's commitment to sustainable, long-term profitable growth.

However, increasing emphasis on these types of awards presents potential challenges, such as:

- the potential to miss out on candidates who prefer shorter vesting periods offered by other employers,
- a demand for higher cash compensation or grant values to offset delayed equity realization,
- investor concerns that time-vested awards of any kind are not sufficiently based on performance,
- an inability to highlight specific near-term or long-term priorities through incentive payouts, and
- increased stock plan overhang from awards being outstanding for longer periods of time.

You're Ready—What's Next?

The following items should be on the board's list of considerations when shifting to longer vesting periods:

1. **The transition.** A change in vesting period can temporarily disrupt executive vesting pipelines. Are there appropriate remedies, such as slowly increasing the vesting period over several annual grants?
2. **Vesting terms upon termination or change in control.** With more value at risk over longer vesting periods, clarity regarding vesting in special situations helps executives and shareholders feel they are being treated fairly.
3. **Shareholder communication.** Directors should engage proactively with investors to explain the value proposition and how the new approach aligns with business strategy.
4. **Executive buy-in.** A successful transition requires open dialogue with leadership. Ensure management appreciates the benefits of the trade-off between longer vesting periods and performance-based risk.

The Bottom Line

Long vesting periods for time-based stock are not a one-size-fits-all solution or a gimmick to justify one-off special awards. When used appropriately, they can be a compelling tool for promoting endurance through market volatility, simplifying design, and aligning with investors clamoring for long-term focus. The trade-offs require careful navigation, and whether they make sense for your organization is dependent on your company's specific business and talent strategy. As with any program change, quality planning and robust communication can help ensure that the benefits are realized. D


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