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Client Alert | US Public Company Advisory Group

Equity Grant Procedures and Guidelines for the Granting of Equity Awards

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As we enter 2024 and companies plan for annual equity awards to compensate employees and executives, one important consideration is whether the appropriate equity grant procedures are in place, considering new Item 402(x) of Regulation S-K and (relatively) new Staff Accounting Bulletin ("**SAB**") 120 of the Securities and Exchange Commission (the "**SEC**").[1] Both of these requirements illustrate the SEC's focus on the timing of grants of equity awards to executives that might be considered problematic in light of a company's possession and subsequent release of material non-public information ("**MNPI**").

SAB 120 provides guidance for companies on how they should recognize and disclose the cost under Accounting Standards Codification (ASC) 718 ("**ASC 718**")[2] of providing "spring-loaded" awards, which SAB 120 defines as a "share-based payment award granted when a company is in possession of [MNPI] to which the market is likely to react positively when the information is announced." SAB 120 notes that "non-routine spring-loaded grants merit particular scrutiny by those charged with compensation and financial reporting governance."

New Item 402(x), which was added by the SEC in connection with the amendments to the 10b5-1 rules and applies to Form 10-K filers, requires both narrative disclosure[3] and tabular disclosure[4] of option grants awarded close in time to the

[1] *See* SEC.gov | Staff Accounting Bulletin No. 120.

[2] SAB 120 only explicitly applies to ASC 718 under US GAAP. Still, for foreign private issuers reporting under International Financial Reporting Standards or local GAAP, thoughtful grant timing is a good governance practice, and thus implementing these procedures is generally recommended. Such issuers may also find it helpful to discuss with their auditors the specific circumstances where principles similar to those in SAB 120 apply under IFRS or local GAAP.

[3] Narrative disclosure discussing: (i) the issuer's policies and practices on the timing of awards of stock options, stock appreciation rights ("**SARs**") and/or similar option-like instruments in relation to the disclosure of MNPI by the issuer, including how the board determines when to grant such awards (*e.g.*, whether such awards are granted on a predetermined schedule); (ii) whether, and if so, how, the board or compensation committee takes MNPI into account when determining the timing and terms of an award; and (iii) whether the issuer has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.

[4] The tabular disclosure must include, among other things, for each reportable option, the percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and the trading day immediately following the disclosure of MNPI.

release of MNPI.[5] The tabular disclosures are **only** required if, during the last fiscal year, stock options, SARs and/or similar option-like instruments were awarded to a named executive officer (as defined in Item 402 of Regulation S-K) ("**NEO**") within the window starting four business days before the filing of a periodic report on Form 10-K or 10-Q or the filing or furnishing of a Form 8-K that discloses MNPI (including earnings information) and ending one business day after the filing or furnishing of such a report. For calendar year end companies, this disclosure applies to grants made in the current (2024) fiscal year and will be required in proxy statements filed in 2025.

Both new Item 402(x) and the guidance in SAB 120 make the timing of equity grants crucial this year. To this end, we have put together the below procedures, which companies can consider as practical guidelines, even if they are not adopting a formal equity grant policy.

Purpose

The purpose of these Equity Grant Procedures and Guidelines for the Granting of Equity Awards (the "**Procedures**") is to create a consistent framework for the process of granting equity awards to executive officers, employees, directors and consultants under the equity plan of an issuer reporting with the SEC on Form 10-K or 20-F (the "**Company**"). These Procedures cover the grant by the Company to any executive officer, employee, director or consultant of compensatory awards in the form of the Company's equity ("**Equity Awards**"), including, but not limited to, full value awards (*i.e.*, restricted shares, restricted stock units, performance shares, performance stock units and other similar awards, and collectively, "**Full Value Awards**"), and option-like awards (*i.e.*, stock options, SARs and other option-like instruments, and collectively, "**Option Awards**").

Timing of Grants of Equity Awards

Grants Should Occur in Open Quarterly Windows and When There Is Otherwise No MNPI

Generally, Equity Awards should be granted only (i) during open quarterly windows under the Company's insider trading policy *and* (ii) when the Company otherwise has no MNPI, whether qualitative or quantitative.

Granting an Equity Award when the Company has MNPI creates the risk that the Company may be perceived in hindsight by its external auditors as engaging in problematic "spring-loading" and under SAB 120 could require special accounting treatment to the Equity Award. This risk of special accounting treatment under SAB 120 is heightened in situations where, following the release of the MNPI in question, the Company's stock price is likely to materially increase or is in fact observed to materially increase,[6] and even more so when the Equity Award is of a size likely to materially impact or does in fact materially impact the financial statements or other SEC disclosures.[7]

Before making an Equity Grant, the Company should verify across the organization whether there is MNPI and assess the likelihood of it materially increasing the stock price once released. To assess whether non-public information is likely to result in a material increase in its stock price, the Company should consider various factors, including, but not limited to, the following:

- Whether the information will constitute a positive surprise to the market (*e.g.*, advancement in the development of a product or service, attainment of a critical milestone in the Company's business, including before commercialization, launch of a new product or service, entry into an important agreement or partnership, or the resolution of important litigation);
- In the case of financial results, whether the information will reveal the Company materially exceeding

5 For more information, *see* our alert, "SEC Adopts Amendments to Rule 10b5-1."

6 SAB 120 can be applied by external auditors with the benefit of hindsight, such that a jump in stock price, even if not initially expected, could force a valuation adjustment on a post-grant basis. *See* SAB 120 Section D. Certain Assumptions Used in Valuation Methods—3. Current Price of the Underlying Share (Including Considerations for Spring-Loaded Grants) ("[t]he [SEC] staff believes a material increase in the market price of the company's shares upon release of such information indicates marketplace participants would have considered an adjustment to the observable market price").

7 *See* SAB 120 Section D. Certain Assumptions Used in Valuation Methods—3. Current Price of the Underlying Share (Including Considerations for Spring-Loaded Grants).

consensus estimates and/or Company guidance; and

- Whether past results of a similar nature have resulted in material stock price movement.

A best practice would be to record the Company's final assessment in a memo-to-file or other internal document.[8] The Company may also wish to engage with the appropriate specialists on the external audit team to discuss such determination prior to granting the Equity Award.

Closed Window Grants Are Discouraged, but May Be Feasible Under Limited Circumstances

Grants made during closed quarterly windows or when the Company otherwise has MNPI ("**Closed Window Grants**") are generally discouraged for the reasons discussed above. However, if the Company wants or, due to extenuating circumstances, needs to make a Closed Window Grant, it should receive prior approval from the Company's [General Counsel] and [Chief Accounting Officer], and the grant should meet *both* of the following criteria:[9]

1. The grant is *not* made shortly before the planned release of MNPI that is likely to materially increase the Company's stock price. This generally means not within two weeks before the release of the MNPI.

2. The size of the Equity Award is not likely to materially impact the financial statements or other SEC disclosures.

In addition, the risk of a SAB 120 revaluation will be lower if the grant is "routine," meaning that it occurs on a regular schedule of board or committee meetings consistent with the Company's prior practice and has not been scheduled opportunistically in anticipation of the release of MNPI.[10]

Special Considerations for Option Awards

If the Company is a Form 10-K filer, grants of Option Awards to NEOs of the Company should also not occur in the period starting four business days before or ending one business day after the filing of a Form 10-K/10-Q or the filing or furnishing of a Form 8-K containing MNPI. Making a grant during this window will require affirmative disclosure of the grant, along with other information, in the annual proxy statement under Item 402(x) of Regulation S-K.

Meaning of the Term "Grant"

For purposes of these Procedures, the term "grant" refers to the accounting grant date of the award under ASC 718, as both Item 402(x) and SAB 120 link to this accounting grant date. Generally, the accounting grant date is the date when the Equity Award is approved by the board or committee. However, there are situations where the grant becomes effective on a later date, which then is considered the grant date under ASC 718.[11] In cases where the Company might take such position, it should confirm the analysis with the Chief Accounting Officer under the principles governing ASC 718.

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8 Contemporaneous discussion and documentation are key given the ability of external auditors to evaluate valuations in hindsight.

9 Examples of acceptable Closed Window Grants include the following:

- Grants made every year on the same date, during a closed quarterly window but well in advance of the release of MNPI (*e.g.*, one to one and a half months before), and not made in anticipation of MNPI.
- Reasonably sized grants to directors made each year immediately following the annual general meeting, not scheduled in anticipation of MNPI.

10 *See* SAB 120 Section D. Certain Assumptions Used in Valuation Methods—3. Current Price of the Underlying Share (Including Considerations for Spring-Loaded Grants).

11 For example, under ASC 718, the grant date may be deemed made on a specified date after the approval date where, as of the approval date, the Company has made all required approvals and fixed all terms of the award, except for:

- in the case of an Option Award, the strike price, which the Company has fixed as the market price of its stock on such specified future date; or
- in the case of a Full-Value Award, the number of shares of stock underlying the award, which the Company has fixed as a dollar amount (already set as of the approval date), divided by the market price of its stock on such specified future date.

Illustrative Timeline for Equity Awards

For calendar-year end companies, the below is a sample calendar of grants, assuming that on the dates of such grants, the Company has no MNPI that would elevate the risk of special accounting treatment under SAB 120.

		10-K Filer			20-F Filer
		Large Accelerated Filer	**Accelerated Filer**	**Non-Accelerated Filer**	
During Annual Reporting Season	Assumed reporting calendar	**Mid-Feb.**: Audit Committee Meeting **Mid-Feb.**: Q4/FYE Earnings Release **Late Feb.**: Form 10-K Filing	**Mid- to Late Feb.**: Audit Committee Meeting **Mid- to Late Feb.**: Q4/FYE Earnings Release **Mid-March.**: Form 10-K Filing	**Mid-March**: Audit Committee Meeting **Mid-March**: Q4/FYE Earnings Release **Late March**: Form 10-K Filing	**Mid-Feb.**: Audit Committee Meeting: **Mid-Feb.**: Q4/FYE Earnings Release **March or April**: Form 20-F Filing
	Best time to make the grant	At least two business days *after* issuing Q4/FYE earnings release, and if granting Option Awards to NEOs, at least five business days before filing Form 10-K. However, if Form 10-K contains MNPI, grant should instead be made at least two business days after Form 10-K is filed and before window closes on March 15.	At least two business days *after* issuing Q4/FYE earnings release, and if granting Option Awards to NEOs, at least five business days before filing Form 10-K. However, if Form 10-K contains MNPI, grant should instead be made at least two business days after Form 10-K is filed and before window closes on March 15 (or, if not feasible, as early as possible in March).	At least two business days *after* issuing Q4/FYE earnings release, and if granting Option Awards to NEOs, at least five business days before filing Form 10-K. However, if Form 10-K contains MNPI, grant should be made in the next open window, at least two business days *after* Q1 earnings are released.	At least two business days *after* Q4/FYE issuing earnings release. However, if Form 20-F contains MNPI known at time of earnings release, the grant should instead be made in the next open window (if Form 20-F is filed before March 15, two business days after Form 20-F is filed; if Form 20-F is filed after March 15, then at least two business days after Q1 earnings are released).
After Annual Reporting Season	Assumed reporting calendar	**Early May/Aug./Nov.**: Audit Committee Meeting **Early May/Aug./Nov.**: Earnings Release and Form 10-Q Filing on same day or one day apart	**Early May/Aug./Nov.**: Audit Committee Meeting **Early May/Aug./Nov.**: Earnings Release and Form 10-Q Filing on same day or one day apart	Early to Mid-May/Aug./Nov.: Audit Committee Meeting **Mid-May/Aug./Nov.**: Earnings Release and Form 10-Q Filing on same day or one day apart	**Early May/Aug./Nov.**: Audit Committee Meeting Early May/Aug./Nov.: Earnings Release
	Best time to make	At least two business days *after* issuing earnings release and	At least two business days *after* issuing earnings release and	At least two business days *after* issuing earnings release	At least two business days after issuing

		10-K Filer			
		Large Accelerated Filer	Accelerated Filer	Non-Accelerated Filer	20-F Filer
	the grant	at least two business days after filing Form 10-Q.	at least two business days after filing Form 10-Q.	and at least two business days after filing Form 10-Q.	earnings release.

If a Company has MNPI during an open quarterly window where it wishes to grant an Equity Award (whether an anticipated annual grant or a special grant; *e.g.*, for a new hire), or the Company otherwise maintains a practice of routinely granting Equity Awards during closed quarterly windows, it should endeavor to grant the awards at least two weeks before the pending release of the MNPI and confirm that the size of the Equity Award is not likely to materially impact the financial statements or other SEC disclosures.[12] Alternatively, the company should wait to grant the Equity Award until at least two business days after the release of the MNPI.

Vesting Schedules for Full Value Awards

For the vesting of Full Value Awards, if the Company plans to facilitate sales of equity by award recipients with access to MNPI to cover withholding taxes, the vesting date should be scheduled to occur in an open quarterly window under the Company's insider trading policy and when the Company otherwise is not expected to have MNPI.

If this is not feasible, the Company may provide for language in the award agreement that "locks in" and makes automatic the sales without any discretion by the award recipient. This may be, but is not required to be, in the form of a formal 10b5-1 plan (which includes the applicable cooling-off period and certification of no MNPI by the insider at the time of grant).

Prohibited Manipulative Practices

The Company should never back-date Option Awards. "Back-dating" is the practice of setting grant dates in the past, typically with the goal of decreasing the fair value and/or option strike price. Furthermore, the Company should not manipulate the timing of (*i.e.*, by accelerating or delaying) the public release of MNPI in consideration of a pending award to allow an award recipient to benefit from a more favorable stock price, nor manipulate the timing of grants for the same purpose.[13]

Other Procedures

Every Equity Award granted by the Company should be reflected in the minutes of the meeting of the Committee, board of directors ("**Board**") or management, the unanimous written consent of the Committee or Board or the written record of management in which such award was approved. The minutes, consent or written record, as appropriate, should include the names of the award recipients, the number and type of awards granted to each recipient and vesting terms, and any delegation of authority to a Company officer to grant Equity Awards should be done in a manner that is compliant with applicable corporate law and the plan documents.

Recipients should be notified promptly after an Equity Award is made. All awards should be evidenced by a written award agreement, the form of which must be approved by the Committee or Board, as appropriate (management may not approve such form). Award packages should be distributed to all grantees as promptly as practicable after the award is made.

12 SAB 120 is an accounting standard and, unlike Item 402(x), does not establish a bright line in terms of timing of Equity Awards relative to the release of MNPI (*e.g.*, not the "four business days before, one business day after" standard in Item 402(x)). As such, the timing determination should be made based on the particular facts and circumstances facing the Company. More concrete best practices may evolve over time as the rule is applied in practice.

13 In addition to considerations under applicable securities laws, backdating Option Awards so that they have an exercise that is lower than grant date fair market value will result in adverse tax consequences under Section 409A of the Internal Revenue Code.

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