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Fewer companies are issuing underwater stock option exchange and repricing plans this fall, contrary to what some consultants expected to be a flood of such actions.

The overall recovery in the stock market is a major factor for the halt of exchange plans, according to several compensation consultants and lawyers. Now that the market is rebounding, companies are unsure of how high the market will go and are taking a wait-and-see approach.

However, at least one consultant says changing guidance from **RiskMetrics Group** has eliminated some of the rationale for exchange plans and has caused some companies to cancel or revise their plans.

During the first half of the year, RiskMetrics' corporate advisory division told companies considering an exchange that it didn't want to see a plan with an exercise price below the company's 52-week trading high. "It was as hard and fast as a rule gets when it was in place," says **Brett Harsen**, a vice president of **Radford**, an **Aon** consulting company.

Due to the 52-week rule, Harsen expected many companies to hold special meetings to approve exchange plans this fall. If companies waited until this fall, the logic went, the 52-week high in the stock price would come after the market's precipitous decline in the fall of 2008. Within RiskMetrics' guidelines, this would allow for a lower exercise price on the options and therefore make the goal of bringing the stock price above that point seemingly more attainable for executives.

But the rules of the game as defined by RiskMetrics have changed, according to Harsen. Now that many companies' stock prices are starting to recover, the proxy advisory firm is no longer looking at the 52-week high as a bright line test. The firm, based upon feedback Harsen has heard, is looking for the exercise price to be at least 25% above the company's current stock price, a hurdle that could be much higher than the stock's 52-week high.

Option Exchanges: What RiskMetrics Doesn't Want to See

- Volatile Stock Price
- A non value-for-value exchange
- Options that are immediately vesting
- Terms of new options that are different than the ones being replaced
- An exercise price not set at fair market or a premium to the market
- Plans that include executive officers and/or directors

Source: RiskMetrics Group's 2009 policy guidelines

Harsen says the new informal guideline makes more sense than the 52-week rule because it takes into account current market conditions. But he wishes the proxy firm would have been more transparent about the change. "I absolutely understand their logic… I just don't like changing the rules in the middle of the game for companies doing their best to comply," he says.

RiskMetrics, for its part, says it hasn't changed any rules. Rather, it has always evaluated exchange and repricing plans on a case-by-case basis. Its 2009 policy guidelines[1] state that point clearly and then provide some of the factors the firm takes into consideration (see graphic). But the guidelines make another clear statement: "The exercise price of surrendered options should be above the 52-week high for the stock price."

A RiskMetrics spokeswoman says the firm will be issuing further guidance on exchange plans "because some companies have viewed the 52-week high as a bright line test even though an option program may not be appropriate at this time, especially in light of a market rebound."

Seagate Technology withdrew its option exchange plans right before its Oct. 28 annual meeting, where shareholders were scheduled to vote on the proposal. The company did not confirm or deny whether RiskMetrics changed its guidance on Seagate's exchange plan and, if so, whether that had an impact on the board's decision to cancel the exchange. A spokesman says part of the reason the exchange was canceled was due to a rise in the stock price. Shares of Seagate were trading around $12 in mid-August when the exchange proposal was announced[2] and rose to about $14 at the time of the annual meeting. The exchange plan did fit the parameters of the 52-week rule, but did not include details on what the new option price would be relative to the current stock price.

While RiskMetrics claims it doesn't have bright line tests on exchange and repricing plans, some consultants disagree. "The reality is they are very mechanical in the way they kind of perform their calculations," says **Andrew Mandel**, a principal in the New York office at **Buck Consultants**.

Mandel says he doesn't think the recent halt in option exchanges this fall is driven by RiskMetrics. However, he notes that some of his clients have held off on an option exchange if complying with RiskMetrics' advice didn't make the plan worth initiating. Aside from the fact that RiskMetrics' guidelines preclude participation by the senior executive officers, there could be other issues that reduce the value of an exchange.

For example, RiskMetrics looks at the value of all shares, including shares that have gone back into the share pool, in assessing future requests for shares.

"Some companies found out that in the exchange process, the value of shares coming back were higher than anticipated and would have affected [their] ability to get additional share authorizations upon a request from shareholders," Mandel says.

Meanwhile, Harsen says there could be renewed interest in exchange plans this spring if companies' stock prices fail to ignite.

Links

1. http://www.riskmetrics.com/sites/default/files/2009RMGUSPolicyConciseSummaryGuidelines.pdf
2. http://investor.shareholder.com/seagate/en/secfiling.cfm?filingID=1047469-09-7942