The ALIGN Act of 2023 Summary

To build a more resilient economy in the 21st century, Senators Warner, Warren, and Baldwin are proposing legislation to ensure those entrusted with leading United States' public companies are focused on long-term growth rather than short-term profits. Similar to proposals in President Biden's Fiscal Year 2023 and Fiscal Year 2024 Budget, the bill would require executives to hold stock-based compensation for at least 3 years and to hold their stock 12 months following the announcement of a stock buyback.[1] The bill would also direct the U.S. Securities and Exchange Commission to establish public disclosure policy for a share repurchase authorization. These targeted reforms would align top corporate executives' incentives with their company's long-term success and discourage certain buybacks that would damage the company in the long-run. Together, these provisions work to relieve some of the pressures executives face to prioritize quarterly results at the expense of investments in workers, research and development, and long-term, sustainable growth.

3-Year Holding Period for Stock-Based Compensation

Market standards for executive pay packages already recognize the value of aligning executives' interests with the long-term performance of the company. For example, a leading analysis of S&P 500 CEO pay strategies found that for most executives, a majority of their stock and option awards vest after three to four years, which is deemed to be the appropriate amount of time to reflect long-term performance.[2] Under a typical executive pay plan, a percentage of equity compensation vests each year. Usually, there is no restriction on executives' ability to offload their equity incentives once they have vested. This continues to drive a misalignment with long-term performance sought by the three-year plus vesting period.

For example, if an executive vests a third of their stock awards and then immediately sells after one year, there still is an incentive to focus on short-term growth. This misalignment has been well documented by corporate governance and executive compensation experts.[3] In addition, a recent Wall Street Journal analysis also pointed out that the lack of time restrictions on "corporate insiders" selling their stock may allow individuals to take advantage of nonpublic information, citing a 2021 study which found insiders who trade soon after adopting trading plans "systematically avoid losses and foreshadow considerable stock price declines."[4]

The legislation would not change or amend executive compensation directly or apply retroactivity. Equity that vests would still become the property of the executive. The bill merely requires some separation between grant of options and sale, consistent with the long-term view that has already been embraced by private sector compensation packages.

Example #1: A corporate executive has stock-based compensation of $9M that vests over three years. The executive receives the stock in thirds every year, $3M in year one, $3M in year two, and $3M in year three. Under the legislation, the executive would not be able to sell that awarded stock until 3 years has passed. Therefore, they would need to wait 2 years to sell the first $3M of vested stock; 1 year to sell the second $3M of vested stock; and no years upon receipt of the third $3M.

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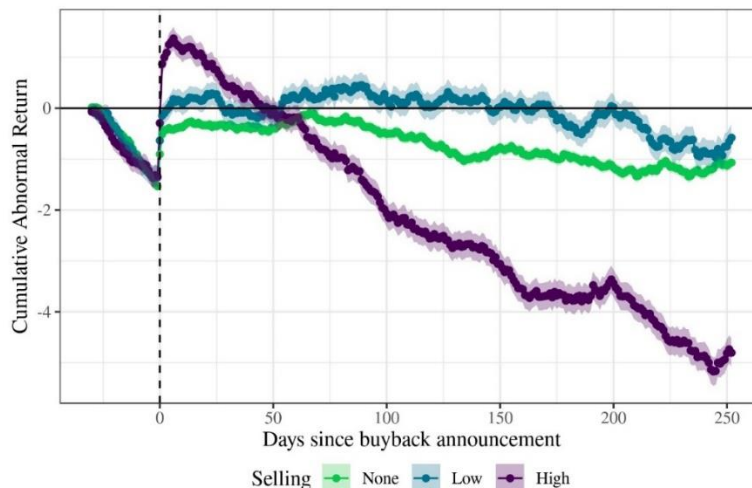
[1] https://www.whitehouse.gov/wp-content/uploads/2022/03/budget_fy2023.pdf
[2] https://www.equilar.com/reports/3-equity-vesting-schedules.html#:~:text=Across%20sectors%2C%20vesting%20periods%20are,the%20most%20common%20vesting%20period.
[3] http://www.law.harvard.edu/faculty/jfried/How%20To%20Tie%20Equity%20Compensation%20to%20Long%20Term%20Results.pdf
[4] https://www.wsj.com/articles/executive-stock-sales-questions-insider-trading-11656514551

Example #2: A corporate executive has a stock-based compensation of $10 million that vests after 4 years of service. In this case, the executive would be untouched by the bill.

12-Month Holding Period following a Stock Buyback

Share repurchases or "stock buybacks," have increased in use since the 1980s.[5] The problem the bill seeks to address is corporate executives' personal incentive to use repurchases to cash out on their shares in a way that might be misaligned with the best interests of the company and shareholders. By mandating a "cooling period" following an announcement of a buyback, this legislation would eliminate the personal incentive for executives to conduct buybacks based on their own self-interest. In all cases, executives claim that buybacks are positive for the long-term growth of the company. They might be right or wrong; the bill is neutral. If the repurchase is in the long-term interest of the company and shareholders, the bill does not change that equation and those executives should want to hold their stock.

Data suggests the legislation is also in shareholders' best interests. Based on an analysis of firms who conducted buybacks by former Commissioner of the U.S. Securities and Exchange Commission (SEC) Rob Jackson, companies that had higher amounts of executives selling stock following an announcement saw worse returns than firms whose executives sold little to no stock. The 12-month holding period is reflective of these findings that companies underperform for a full calendar year (252 trading days) as the market incorporates the combined signal of the buyback and the executive's selling activity into the price of a stock.



Executives Impacted by the Bill

This legislation applies to corporate executives based on the definitions in the SEC's Rule 3b-7. The legislation is intended to be narrowly focused on the leadership of corporations, not low- or mid-level employees or managers. The bill also includes emergency distributions for executives who would be required to hold their stock consistent with 401(k) rules that govern employees' ability to take early or emergency withdrawals such as for extreme medical expenses and permanent disability.

[5] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3474175