Options May Become Perk of Past

Change in Accounting Rule Could Reduce the Appeal Of Offering, Getting Grants

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Watch your pay package.

Proposed new rules for expensing stock options could produce sweeping changes in stock-option plans and other forms of equity-based pay. Among other things, the number of workers who receive stock options is likely to drop, with the cuts falling most heavily on lower-level employees.

Some workers could see their option packages replaced by restricted stock or other forms of stock-based pay. In addition, employee stock purchase plans, which typically allow workers to buy company shares at a 15% discount, could become less attractive.

The long-awaited proposals from the Financial Accounting Standards Board, announced yesterday, would require companies to recognize on their income statements the cost of stock-option grants, which allow workers to buy shares of a company stock at a pre-set price. The proposed rule changes come at a time when lavish stock option grants have also come under fire from shareholders

Derailing Effort Afoot

The final rules wouldn't take effect for public companies until next year, and there are already efforts afoot on Capitol Hill for legislation to block the proposals. But if the proposals—which are still being analyzed— survive to become reality, compensation experts say that the new rules are likely to produce a sharp reduction in the size and number of stock option grants. The roughly $80 billion of stock options doled out by companies in the Standard & Poor's 500 in 2002 "will drop by as much as 50%" by the year 2010, predicts Ira Kay, head of the compensation consulting practice for Watson Wyatt Worldwide. Top-performers are still likely to receive stock-based pay, Mr. Kay says, "but companies are going to be reducing eligibility."

Even before the proposal was released, many companies had begun revamping their stock-based pay programs. Merrill Lynch & Co., which administers roughly 400 corporate stock plans, says about one-third of its clients have already made changes in their programs. "The rest are looking at changes," says Merrill Lynch first vice president Daniel Roccato.

As companies revamp their plans, lower- and mid-level workers are likely to feel the pain far more than the top brass. The number of companies offering broad-based stock option plans could fall by as much as one-third, according to the National Center for Employee Ownership, though many of the companies doing away with these awards didn't provide significant grants to many of their workers. The popularity of broad-based plans, where companies give options to more than half of their employees, peaked three years ago at 22%, according to a proxy analysis of 350 major U.S. corporations for The Wall Street Journal by Mercer Human Resource Consulting, New York. That proportion had dropped to 17.7% by last year's proxy study.

PepsiCo Cuts Back

Among those cutting back is **PepsiCo** Inc. In December, Pepsi revamped its so-called SharePower program begun in 1989 that now dispenses stock options to staffers here and in 54 other countries. It roughly halved the number of options bestowed upon U.S. based staffers in order to fund a new 401(k) plan match of Pepsi stock. In the same announcement, the Purchase, N.Y., snack and beverage giant said it would begin to expense options in the fourth quarter and rely more on restricted stock.

In other cases, companies are likely to replace options with restricted stock or other grants tied to performance, or offer workers a mixture of stock options and stock grants. Last summer, for instance, **Microsoft** Corp. stopped doling out options to all employees in favor of restricted-stock units. **Delphi** Corp., a Troy, Mich., auto-parts maker, recently shelved a broad options plan for all non-executive U.S. salaried employees in favor of performance-based cash awards.

Stock purchase plans could also get hit. Currently, most companies don't recognize the cost of these plans as an expense. But under the proposed rules, companies would be required to recognize the cost of any purchase plan that has a discount, unless the discount is offered to all other shareholders. In response, many companies are likely to cut back on the discount employees receive, consultants say. Some may drop them entirely.

Even if the plans remain, participation is likely to fall. "The discount gives employees a little bit of a built-in gain or a little bit of a cushion for the stock price to go down," says Blair Jones, a senior vice president with Sibson Consulting. The National Center for Employee Ownership estimates that as many as half all employers will revamp their stock purchase plans in ways that make them less attractive.

The rules could also lead some companies to revamp the terms of how stock options vest. Typically, a portion of the option grant vests—or becomes exercisable—each year over a period of three to five years. But with the proposed rules, more companies may elect "cliff vesting," in which all the options become exercisable at once. "Employers might say everything vests at three years" because that way the options would have a more consistent impact on earnings each year, says Matt Ward, a senior vice president with Aon Consulting, a unit of **Aon** Corp.

Some companies may also stop tying performance-based stock grants to changes in their stock price or shareholder returns because they would have to take a charge for those grants even if the company doesn't meet its targets, says Mr. Ward. Instead, these grants might be tied to the completion of specific projects or particular financial goals, he says.

'Stock Appreciation Rights'

More companies may also begin issuing "stock appreciation rights", which give workers the right to receive any future increase in the stock's value after the grant is made. "Under current account rules, stock appreciation rights receive negative treatment," says Arthur Meyers, a partner in the law firm of Palmer & Dodge. "Now, the playing field will be level." One plus for workers: Employees have to come up with cash or shares to cover the cost of exercising options, but don't have to pay to exercise stock appreciation rights.

As companies whittle down the number of employees getting options, it's especially important to put your best foot forward. "If you make this cut, it will be harder to get dropped," says Alan Johnson, managing director of Johnson Associates, a compensation-consulting firm. But if you don't get options now, it's likely to be harder to get them in the future.

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