



Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

Episode 59

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Taryn Cannataro: Welcome to *Just Compensation*. I'm Taryn Cannataro, counsel in the firm's Executive Compensation, Employment, and Employee Benefits Group. And I'll turn it over to my colleagues who are joining me today.

Andrew Graw: Hi, my name's Andrew Graw. I chair the Executive Compensation and Benefits Practice Group.

Kate Basmagian: And I'm Kate Basmagian. I'm a partner in our Capital Markets and Securities Group.

Taryn Cannataro: In today's episode, we will discuss inducement equity grants, which is a compensation mechanism frequently used by publicly traded companies in connection with the recruitment of key personnel. Although inducement grants are commonplace in competitive hiring markets, they're often misunderstood. Because these awards are granted outside of shareholder approved equity plans, they're subject to specific exchange requirements and governance considerations. When structured properly, inducement grants can provide necessary flexibility in recruiting while remaining compliant with applicable listing standards and disclosure obligations. As always, this is not intended to be an exhaustive discussion, and we encourage you to consult with your legal counsel if you're interested in making inducement grants.

Andy, what exactly is an inducement grant, and how are they typically structured?

Andrew Graw: An inducement grant is an equity award, such as an option, offered to a potential new hire as a material inducement to accept employment with the company. Inducement grants allow public companies to make equity awards without reducing the shares reserved under a shareholder-approved equity plan. That allows the shares under the shareholder-approved plan to be preserved for grants to employees, directors, and consultants in the future.

There are two primary approaches to structuring inducement grants. One is the individual standalone grant, and the other is for a company to create an inducement plan. An individual standalone grant process allows the company to simply make grants of inducement awards on a case-by-case basis, whereas

creating an inducement plan enables the company to have a dedicated plan with a reserved number of shares available for the grant of inducement awards.

Whether made as standalone grants or under an inducement award plan, a share subject to inducement grants can still be registered on an S-8, like shares subject to grants under a shareholder-approved plan. If inducement grants are made on a standalone basis, an S-8 needs to be filed for each grant, whereas if an inducement plan is created with a reserved number of shares, then an S-8 can be filed for the shares reserved under the inducement plan for availability in the future. In either case, though, shareholder approval is still not required.

And although inducement awards are granted outside of a shareholder-approved plan, typically, the terms and conditions and documentation of inducement awards are substantially the same as the terms of awards under the shareholder-approved plan.

Taryn Cannataro: And who can a company make inducement grants to?

Andrew Graw: It's limited to new employees as an inducement for them to accept employment with the company. It's not available for directors or consultants. There is a special exception under which an individual who rejoins the company as an employee following a bona fide period of non-employment can also qualify for an inducement grant.

Taryn Cannataro: Since these are not granted under a shareholder-approved plan, are there any other requirements that we should be aware of?

Kate Basmagian: Yes, for sure. Inducement grants must be approved by the company's independent compensation committee or by a majority of the company's independent directors. And as Andy has noted, and I'll reiterate just for emphasis, these awards must be a material inducement to the individual actually accepting the job, so these need to be discussed during the hiring process. The individual's offer letter should actually include the specific terms of the inducement award, including the number of shares being granted, and the letter should explicitly state that the award is a material inducement to the individual's employment.

As Andy also mentioned, the shares underlying the inducement award may be registered on a Form S-8. In that case, you would also provide the individual with a prospectus describing the material terms of the plan or the award, and all of that information would need to be provided to the recipient as well.

In terms of timing, if a company is adopting a formal inducement plan, then they would file the S-8 after the board approves the plan to register the shares available under that plan. If they're not doing an inducement plan, but rather they're doing individual grants for stock options, you would need to get the S-8 on file after the grants, but prior to any exercise of the stock options. And if we're talking about RSUs, the S-8 would need to be filed on or before the date the RSU grant is made.

Taryn Cannataro: What disclosure requirements does the company have if they're issuing inducement grants?

Kate Basmagian: Yes. So, there are some unique disclosure requirements. Whether we're talking about grants made pursuant to an inducement plan or individual grants, you must promptly issue a press release, and an 8-K will not satisfy these requirements, disclosing the material terms of the award, including the recipient and the number of shares involved. When we're talking about inducement awards made to executive officers or individually negotiated inducement awards, those must be disclosed separately, and the identity of the recipient also has to be stated in the press release.

Now, if you're a NASDAQ-listed company, you may be able to aggregate disclosure of multiple awards in a press release if the grants are done over a two-week period for a company that typically does make inducement grants to new employees, but you would not be able to aggregate the disclosure for individually negotiated awards or awards to executives. If you're establishing an inducement plan or issuing an inducement award to a named executive officer, then you would also have an 8-K that is required to be filed within four business days of the grant. And again, this would be in addition to the press release, not in lieu of the press release. In that 8-K, you would, again, state the material terms of the award, the number of employees receiving the awards, and the number of shares involved.

You'll also have additional disclosure requirements in your 10-K and your proxy statement. Any inducement grants that you issue must be included in your 10-K or proxy statement under the Equity Compensation Plan Information table. And in that table, you would disclose the number of shares subject to the outstanding inducement awards, the weighted average exercise price of outstanding inducement awards, and the number of shares remaining available for issuance under the inducement plan, if you have an inducement plan. You would also need to provide some additional narrative disclosure explaining the material terms of the inducement award or the plan. And if inducement awards are given to a named executive officer, the material terms of those grants would also be disclosed in the CD&A and your proxy statement.

Taryn Cannataro: Andy, are there any ongoing disclosures required in annual filings after the initial disclosure requirements?

Andrew Graw: Yes, in a word. Inducement grants must continue to be disclosed in the company's 10-K or proxy statement under the Equity Compensation Plan Information table. Required disclosures include number of shares that are subject to outstanding inducement awards, the weighted average exercise price of outstanding inducement awards, and the number of shares remaining available for issuance under an inducement plan if the company had adopted an inducement plan. In addition, there's additional narrative disclosure explaining material terms of the awards or of the inducement plan as well.

Taryn Cannataro: There are also considerations to keep in mind with respect to the stock exchange listing requirements. Can you talk a little bit about those for us, Kate?

Kate Basmagian: Yes. Each stock exchange does have their own individual rules, but overall, they are similar, and most of what we've discussed already applies to both NYSE companies and NASDAQ companies. Both the New York Stock Exchange and

NASDAQ do require companies to issue press releases disclosing that they have made inducement awards. Each exchange also has certain listing application requirements related to inducement plans and inducement grants.

For example, if you're listed on NASDAQ, to establish an inducement plan, you must submit a Listing of Additional Shares application at least 15 calendar days prior to the adoption of the plan. Also under NASDAQ, for grants under an existing inducement plan, you would submit the listing application on the earlier of five calendar days after entering into the award or the date the company discloses the material terms of the award in a press release.

The requirements are slightly different for inducement grants that are made outside of an inducement plan. For individual inducement grants outside of a plan, you would submit the listing application to NASDAQ no later than the earlier of five calendar days after an offer of employment is accepted or the date the company discloses the material terms of the inducement award in a press release.

The NYSE also has its own application requirements. Under the NYSE rules, you would submit a Supplemental Listing Application at least two weeks before the issuance of the securities under the inducement award. The NYSE does not distinguish between the establishment of a new inducement plan or grants under an existing plan or individual grants outside of an inducement plan, like NASDAQ does.

Taryn Cannataro: Are there any other considerations or pitfalls of inducement grants that we should be aware of?

Andrew Graw: Yes. Inducement grants that are structured as stock options cannot qualify as ISOs, incentive stock options, under Section 422 of the Internal Revenue Code, because plan or grant that they were made under was not approved by shareholders. Additionally, it's important to be mindful of any changes to an inducement award after they've been granted. While it is possible to amend an inducement award, shareholder approval may be needed if the amendment is material enough to result in an increase in benefits to the holder.

Taryn Cannataro: As we heard today, an inducement grant is a well-established tool many employers use to attract top talent in competitive markets. However, because these awards are issued outside shareholder-approved equity plans, you must give careful consideration to approval procedures, compliance with applicable listing rules, and timely and accurate disclosure. When thoughtfully structured, inducement grants can serve as an effective tool to attract high-caliber talent, while aligning long-term incentives with shareholder value. As always, companies should consult with their legal counsel to ensure that any proposed inducement awards are structured correctly.

Thank you for joining us today. If you enjoyed today's discussion, please subscribe, leave us a review, and share this episode with your colleagues. You can also reach out to us via email if you have questions or ideas for future topics. We look forward to having you all back on the next episode of *Just Compensation*.

Megan Monson:

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