

Corporate boards grant equity to executives in order to align their incentives with those of shareholders, but also provide executives broad freedom to sell this equity. Most top executives at S&P 1500 firms sell equity at least once, with the median sale equal to 15 percent of the executive's total holdings in the firm. Agency theory predicts that boards should respond to such sales by replenishing executives' equity holdings, in order to prevent incentives from diminishing over time. I test this prediction empirically, and find that boards do not grant substantially higher proportions of equity pay to executives who recently sold firm equity.

Unobservable firm-level variables which cause executives to sell equity and also decrease optimal incentives could explain the lack of replenishment. I therefore compare executives who sell equity to other top executives at the same firm who do not sell. Unobservable changes to the firm should have a similar effect on the pay of each of these executives. My empirical results show that for \$1 of equity sold, executives receive at most \$0.1 dollars in new equity relative to non-selling executives at the same firm. This implies that boards are not responding to equity sales in a manner consistent with economic theory.