

Restricted Stock & Trends In Equity Compensation: What Advisors Need To Know About The Fastest-Growing Forms Of Equity Compensation



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Road map for presentation

- Trends in equity compensation
- Restricted stock/RSU grants
- Other types of grants: performance shares and stock appreciation rights
- Related topics in stock compensation financial planning: Rule 10b5-1 trading plans



Equity compensation remains important, with changes

- **From proxy of EMC:** “As of December 31, 2006, approximately 80% of EMC employees held one or more equity awards. In addition, *shares subject to equity awards granted to employees below the level of senior vice president accounted for about 95% of all shares subject to equity awards granted in 2006.*”
- “*Prior to 2003, EMC granted equity solely in the form of stock options. However, since the adoption of the 2003 Stock Plan, which included additional types of equity awards, EMC has also granted restricted stock awards to provide employees with a mixed equity portfolio and to increase employee retention.*”
- “*In December 2005 the EMC Compensation Committee granted multi-year performance shares to certain members of its senior management team (no equity grants to them in 2006). These awards provide executives with the opportunity to vest in a substantial number of shares, but only if EMC achieves superior earnings per share (EPS) performance over fiscal 2006-2008. If the target is not met, then these shares will be forfeited.*”



Trends in equity compensation: PricewaterhouseCoopers 2007 survey

PwC's survey of 152 multinational companies revealed:

- Nearly 50% of the companies have shifted from granting only stock options to granting other types of equity compensation as well.
- 40% of companies still do not expect to make any changes in their stock option plans because of expensing.
- About 8% are exploring alternatives.

Among the companies that have made changes:

- Just under 20% have reduced grant levels.
- Just over 20% have restricted the eligibility for grants.
- About 5% have eliminated some or all of their stock plans.



2009 survey

Buck Consulting Survey ("Taking The Pulse Of Equity Compensation") on what companies have implemented or plan to implement in 2009.

- 31% of companies expect to somewhat increase the number of options or shares in 2009. Very few intend to fully restore last year's value.
- At companies issuing equity compensation based on a number of shares, 60% anticipate no change in awards. At companies making grants on a dollar-value basis, only 30% expect no changes in awards.
- 45% considering a change in equity compensation mix.
- 29% will increase use of shares and decrease use of options
- 16% will increase their use of options and decrease use of shares. Firm notes that this creates the "possibility of delivering more future value from the increased number of options granted."



High-profile examples of changes

- **Microsoft** switched from options to restricted stock units (RSUs), with performance shares at higher levels.
- **General Electric** substituted RSUs for 40% of the estimated value of its annual stock option grants to about 600 company leaders.
- **McDonald's** reduced its stock option award guidelines and shifted equity grants to restricted stock units or cash-based incentives. For employees below the level of senior vice president, equity awards in 2005 consisted of stock options (70%) and RSUs (30%). Senior management received equity compensation of 50% stock options and 50% RSUs.
- **Johnson & Johnson** is giving employees a choice between options and RSUs in various combinations. Best Buy and Office Depot among major companies trying “employee choice” type programs.
- **Intel** started to grant stock options to only its senior staff and instead broadly grants RSUs. Key employees will receive options and RSUs, and the most senior employees driving company growth will get mainly stock options.



Changes in ESPPs

- Accounting rule change has impacted tax-qualified (IRC Section 423) ESPPs. Other than companies making no changes at all, biggest modifications are: reducing the discount; shortening the lookback period; and even ending the plan completely.
- Examples: Dell shortened its purchase period to three months and eliminated the lookback. Kept the purchase price at 85% of the price on the last day of the purchase period.
- Microsoft eliminated its lookback and changed its discount. Uses three-month purchase periods (previously six) with a 10% discount based on the stock price on the last day of each three-month period.



ESPP changes

- Reducing or eliminating the lookback has the greatest impact on the earnings charge.
- Plan design does appear to affect enrollment in ESPPs. Fidelity Stock Plan Services examined participation rates at ESPPs that it administers. Lowering the discount to 5% caused the average participation rate to drop by 50%. However, lowering the discount to 10%, removing the lookback, or shortening the offering period had no substantial impact on plan participation.



Just at beginning of new trends: what lies ahead

Changes in executive and equity pay practices that are "far more wrenching" than those caused by the 2000–2002 market drop:

- More companies are affected.
- Stricter rules on disclosure and shareholder approval, and much more aggressive public and media attention.
- Changes expected in various laws that could expand beyond financial institutions accepting TARP money, such as \$500,000 limit and performance-based exception.
- Economic downturn with high employment challenges the importance of "recruitment, retention, motivation" goals of equity compensation.
- Tax hikes for higher income brackets in 2011 increases interest in compensation with deferral features, such as stock options and RSUs with deferral of share delivery. See articles series on myStockOptions.com: [**How Tax Rate Changes Impact Strategies For Stock Options & Restricted Stock**](#)
- Other tax changes for Social Security shortfall or new type of qualified stock grant.



Summary of equity compensation trends important to advisors

- Rank-and-file employees and executives receiving fewer options and eligibility shrinking, yet grants still meaningful. Remains an important part of the compensation philosophy and approach at public and growing private companies. Important wealth-builder.
- Stock grants continue at higher levels (e.g., management and executives) as important part of long-term incentive compensation. **Look at company's proxy statement; annual report footnotes; and Section 16 Forms 3,4,5 for details on grants to executives.**
- Equity grants at companies have changed from being all stock options to being a mix of other types: restricted stock, restricted stock units, stock appreciation rights (SARs), and performance shares. **Makes financial planning more complex.**
- Substantial number of stock options still outstanding and companies remain committed to them. Companies looking at what to do about underwater stock options.



Underwater stock options

- Companies considering option exchanges for new options, restricted stock, or cash. Cancellation of underwater options followed by immediate new grant. **Formal election procedure and timeline your clients need to follow.**
- Not as easy to do as after the last big market drop (2000-2002). Unpopular with investors; usually needs shareholder approval; SEC filings (Schedule TO, which requires offer to be open at least 20 business days).
- Accounting rules create “incentive” for companies to consider exchanges: Reuse earnings charge and no new expense when “value-for-value” exchange. One-to-one rare (Google exception).
- Conditions for shareholder approval: senior executives excluded and new vesting changed. Only exchange options with exercise price above 52-week high.



Underwater stock options

- As of late March 2009, HR consulting firm Radford found that the most common treatments (115 companies, with 63 in technology) involve exchanging options for:

Grant type	% Used
Options	48%
Restricted stock	34%
Cash	14%
Combo	3%



Examples

- Starbucks plans an exchange for those options granted at least 17 months ago with an exercise price above the 52-week high using a value-for-value exchange that varies according to the exercise price (ranges from 4-to-1 to 15.5-to-1). Excludes executives.
- Marvell Technology allowed employees with an exercise price of \$12 or higher (stock price trading in the \$6–\$7 range) to exchange options for a pro-rated number of RSUs. For example, stock options with exercise prices from \$12 to \$18 resulted in one RSU for every 6.55 exchanged options.
- United Therapeutics (Silver Spring, MD): options with exercise price greater than \$65 exchange one-for-one (price around \$54 per share at time of exchange). Vested options have one-year vesting condition added.



Aspects of restricted stock to know and retain

- Reasons for increased interest and use
- The restriction and vesting
- Taxes
- Accounting
- Differences between restricted stock and restricted stock units (RSUs)
- Financial planning Issues

Term “restricted stock” includes “restricted stock units/RSUs” unless otherwise noted



1. Why increased interest and use

- Often has been part of senior executives' compensation, now more broadly.
- Popularity with institutional investors runs in cycles: "Pay for pulse."
- Historically most useful in employee recruitment/retention when leaving behind valuable options or when stock price flat.
- Top alternative to or in combination with stock options now that accounting treatment similar between types of equity compensation: "level playing field."
- Less dilution than with options because fewer granted. Common ratios: 1-to-3 or 4.
- Value in down and volatile markets: never underwater, gets dividends, but less upside compared with stock options.
- Stock options tarnished by scandals, backdating, and complexities of 409A



Bill Gates on the move from options to restricted stock units at Microsoft

- “When you win [with options], you win the lottery. And when you don't win, you still want it. The fact is that the variation in the value of an option is just too great.”
- “I can imagine an employee going home at night and considering two wildly different possibilities with his compensation program. Either he can buy six summer homes or no summer homes. Either he can send his kids to college 50 times, or no times.”
- “The variation is huge; much greater than most employees have an appetite for. And so as soon as they saw that options could go both ways, we proposed an economic equivalent. So what we do now is give shares, not options.”



2. What's the restriction?

- Confused with restricted securities, performance shares, or outright grants. Another term is “full-value shares.” Better term is “unvested stock grants.”
- Restricted because you cannot sell stock until it has vested or with RSUs when shared delivered. Not fully “owned” in the traditional sense of being able to sell, gift, or pledge.
- Vested: when sale restrictions lapse for restricted stock and when shares delivered for RSUs. **Vesting is when companies need to focus on administrative issues/tasks and participants (with their advisors) make decisions.**
- Lapse: no longer subject to “substantial risk of forfeiture.” Tax code term.
- Private companies: early-exercise pre-IPO options. Receive restricted stock at exercise subject to reverse vesting.



Vesting: key concept

- Public company version: no money paid to company (no exercise). **No concerns about in-the-money options going unexercised!**
- You have unfettered ownership at vesting, like any stock you own.
- Time-based vesting most popular. Cliff vesting seems more common than it is with stock options. Time-based grants are not eligible for performance-based exception under rules that limit deduction for compensation over \$1 million [Section 162(m)].
- Performance targets: can trigger or accelerate vesting, and performance goal must be related to company. Performance shares somewhat similar. Very common now for senior executives.
- Termination: forfeit unvested shares.
- Treatment for death, disability, change in control can vary: acceleration of unvested shares, let vesting continue, or unvested shares forfeited? **Help your client track and follow these events.**

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Share price: ROM: 74.06 As Of Date: 4/26/2007 View: All grants Calculate

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Total Grant View

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Add Grant Outstanding Restricted Stock or RSU Grants -- Sorted by Grant Date

	Grant Stock	Grant Num.	Grant Date	Shares Granted	Shares Sold	Shares Unvested	Next Vest Date	Shares Vested	Total Value Unvested	Total Value Vested
Edit Details	ROM	1001	12-Jan-2004	10,000	1,000	3,750	1-Jul-2007	5,250	\$277,725.00	\$388,815.00
Edit Details	ROM	1002	12-Jan-2005	10,000	1,200	5,002	12-Jul-2007	3,798	\$370,448.12	\$281,279.88
Edit Details	ROM	1003	12-Jan-2006	10,000	300	3,750	1-Jul-2007	5,950	\$277,725.00	\$440,657.00
Totals:				30,000	2,500	12,502		14,998	\$925,898.12	\$1,110,751.88



Performance shares: growth in grants to top executives

- Payout in shares earned by meeting targets. Can be all or nothing or scale. Part of long-term incentive plan (LTIP).
- **Three parts:** The goal, the period for reaching it, the target award size (and any sliding scale with substantial upside).
- Performance shares are not issued up front. The grant is taxed at payout as ordinary income similar to restricted stock at vesting. Some plans give choice to defer payout and thus taxes, when elections properly made.
- **Performance goals:** Other than company specific targets (e.g., product development milestones, levels of customer satisfaction), common performance targets include total shareholder return (TSR), earnings per share (EPS), sales, return on assets, return on equity. Customized and variation among companies.

Example: Instead of granting you 2,000 shares of restricted stock that vest 25% a year on the anniversary of the date when your employment started, your company grants you 2,000 performance shares that will result in 2,000 shares when the earnings per share (EPS) of your company grow by 30% at the end of three years.



Terminology intertwined: restricted stock with performance vesting

“In December of 2005, the Compensation Committee granted **restricted stock** to members of EMC’s senior management, including Messrs. Tucci, Teuber, Goulden, and Donatelli, that vest only if a specified performance goal is achieved. **We refer to these grants as ‘performance shares.’** The number of performance shares that vest depends on the percentage of achievement of a three-year cumulative EPS target. We refer to these as **‘target performance shares.’** An additional number of performance shares (equal to 25% of the target performances shares) will vest if at least 106% of the performance goal is achieved and the Named Executive Officer remains employed by EMC through January 2010. We refer to these as the **‘overachievement performance shares.’**”



Award structures vary; customized for corporate goals.

Performance Share Award At Capital One (from preliminary proxy filed March 3, 2009)

Mr. Fairbank (CEO) opportunity to earn a **target award** of **95,239 shares** of the Company's common stock. **Sliding scale: from 0% to 200%** of the target award based on the Company's performance over the three-year period from January 1, 2009 through December 31, 2011. The Company's performance will be assessed on the basis of **relative total shareholder return ("TSR") against a peer group consisting** of companies in the Standard & Poor's financial index as of January 1, 2009, excluding those companies that are classified as insurance or real estate companies in that index.

- Mr. Fairbank will receive the target number of shares if the Company's TSR is at the 50th percentile relative to the peer group; no shares if the Company's TSR is less than the 20th percentile; and the maximum number of shares if the Company's TSR is at the 100th percentile. In early 2012, the Committee will certify the Company's performance and issue the appropriate number of shares of the Company's common stock, if any, subject to the requirement that Mr. Fairbank retain any shares received on an after-tax basis until the Treasury no longer holds the Company's preferred stock



3. Tax treatment different from options: two alternatives for restricted stock

Standard: pay tax at vesting

- Taxed as ordinary income at vesting when “forfeiture risk” removed/shares delivered with RSUs (with options not taxed at vesting).
- No AMT issues (not like ISOs) like other supplemental income
- Cannot control taxable event, as you can with stock options.
- Taxable income is the value of the stock when each slice vests. Stock price at grant does not matter unless Section 83(b) election is made (discussed next).
- If you sell the stock, you have capital gains or losses as with the sale of any shares.
- Tax basis is the amount you included in income as compensation.
- Capital gains holding period begins at the time of vesting.



Example: let shares vest

4,000 shares of restricted stock that vest at a rate of 25% a year; grant market price at \$18.

- year one: \$20 (1,000 x \$20 = \$20,000 of ordinary income)
 - year two: \$25 (\$25,000)
 - year three: \$30 (\$30,000)
 - year four: \$33 (\$33,000)
 - total: \$108,000 in ordinary income
-
- Each increment is taxable on its vesting date.
 - Sell all the stock two years after the last shares vest, when the price is \$50 (\$200,000 for the 4,000 shares).
 - Capital gain is \$92,000 (\$200,000 minus \$108,000). [Tax Center](#) on myStockOptions.com illustrates the tax and Schedule D reporting rules.



Second tax treatment: 83(b) elections

- Make a Section 83(b) election with the IRS within 30 days of the grant (or exercise with private company early-exercise options). Not available for RSUs.
- No special tax form for a Section 83(b) election.
- You send the local IRS office your election with information that identifies you and the property you include in your income. Still attach a copy of the election when you file your return.
- Pay taxes on the value of all the stock at grant.
- Remember: you cannot sell any shares until they vest.
- Advantage: tax for compensation income will (hopefully) be lower and start capital gains holding period.



Example with 83(b) election

Facts of the previous example for appreciating stock:
you make a timely 83(b) election at grant:

- Compensation income of \$72,000 (4,000 x \$18).
- Capital gain of \$128,000 at sale (\$200,000 minus \$72,000).
- Election allowed you to convert \$36,000 of ordinary income to the lower-taxed capital gains (\$128,000 = \$92,000 of capital gain in the prior example plus \$36,000 that was ordinary income without the 83(b) election).



Risk with election

- Very few employees/executives make the election with public company grants. In a private company, when you exercise options to get restricted stock you make election.
- You leave the company, and restricted stock never vested. Cannot recover taxes paid.
- Almost impossible to rescind election.
- Stock price dropped by vesting: you cannot recover taxes paid with 83(b) election.
- You might be better off with using the tax dollars to buy stock on open market. Need to run the numbers with your client.
- *Low/depressed stock price and higher tax rates ahead could impact analysis.*

Section on restricted stock includes article series on key decisions and their timing.

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Restricted Stock: Section 83(b)
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Decisions At Grant With Restricted Stock (Part 2): The 83(b) Election Risks [mso+](#)
Tom Davison

In Part 1, we examined the basic facts of restricted stock and the decisions you need to make at grant. One of the biggest decisions is the choice to be taxed either at grant or at vesting. You can choose to be taxed at grant with a Section 83(b) election (this choice is unavailable with RSU grants). This article explains the risks of the election.

- Decision Alternatives At Grant**
- You have three alternatives when the grant is made:
1. Make an 83(b) election for all or part of the grant, paying taxes up front.
 2. Take the up-front cash that you would otherwise use to pay the taxes and invest in a diversified portfolio.
 3. Take the up-front cash that you would otherwise use to pay the taxes and invest in more shares of your company stock.

Risks Of The 83(b) Election

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Withholding taxes on restricted stock

- Subject to tax withholding at vesting or 83(b) filing.
- Compensation income similar to NQSO treatment on spread at exercise. 25% supplemental income tax rate, state (if have income tax), Social Security/Medicare: **familiar W-2 reporting**
- Amount is withheld from salary, cash payment made, sell-to-cover, or company may allow (or require) share withholding. Trend towards automatic share surrender.
- Issues with automatic share withholding: how to handle fractional shares; company needs to have the cash to pay IRS for the withholding taxes, as no shares sold to generate the funds.
- With share withholding/surrender, employees may have additional reporting for securities sale on Schedule D of tax return.



Withholding issues for executives

- Senior executives and directors file Form 4 if shares are withheld at vesting even though no shares are “sold” into market. Normally file Form 4 at grant of restricted stock and then with stock sale, not at vesting. When RSUs are reported as derivative securities at grant, then also file at vesting.
- Companies considering Rule 10b5-1 trading plans to cover share withholding.
- **ALERT:** Companies can no longer lend senior executives or directors the necessary funds for tax withholding or for buying restricted stock. SOX “reform” thanks to former Tyco executives who abused loan fund.



Decisions on taxes and restricted stock

Dates when actions and transactions will occur related to taxes, and decisions to make with advisor input:

1. At grant: 83(b) election (not for RSUs); grant acceptance required or not.
2. Withholding methods or mandatory share surrender.
3. Lapse election process when choices given on how to pay taxes at vesting.
4. Elections on what to do with stock and cash, unless always go to account at specific broker or transfer agent.
5. Additional elections if RSUs with deferral feature.
6. Whether to hold the shares or sell them.

Please remember: With immediate sale at vesting of all shares, do not assume because “no gain” and all income reported on W-2, no Schedule D reporting required. Client will receive notice from IRS (CP-2000). Similar issue with cashless stock option exercise when all sales sold at exercise.

Annotated Schedule D illustrations for sales of stock from all types of equity compensation

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Understand withholding, W-2s, and tax returns.

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Dividends on restricted stock

- Dividends on unvested shares are compensation income reported on W-2. They are not “qualified dividends” taxed at lower rates until vested.
- Dividends when timely 83(b) election at grant causes dividends to be “qualified” and reported on 1099-DIV.
- Approximately 10% pay dividends in more shares, although not received until underlying shares vest.



5. Restricted stock units (RSUs)

- Stock itself is not issued or outstanding until the actual release of the shares at vesting.
- Holders of RSUs have no voting rights.
- Dividends (i.e., equivalents) not required as RSU-holders are not shareholders. May be dividend equivalents based on the plan details.
- Microsoft does not pay dividends on RSUs. Made adjustments with large dividend payment. General Electric does pay dividends.



Restricted stock units

- Share delivery occurs at vesting in broad-based plans, with share withholding for the taxes.
- Specialized RSU plans have a deferral feature that lets you select a date for share delivery, or one is specified by the company (e.g., retirement). Need to follow all the guidance and rules for deferred compensation elections under 409A of American Jobs Creation Act.
- Social Security and Medicare at vesting with deferrals, with ordinary income when shares later delivered.



Why companies use RSUs instead of restricted stock for grants?

- No 83(b) election. No administrative burdens for company or employee risks.
- Can avoid paying cash dividends during the vesting period.
- No tax at grant in countries where tax not delayed until vesting.
- RSUs do not avoid the administrative issues for withholding taxes at vesting.
- No shares issued at grant, so record-keeping can be simpler at grant and when employees are terminated.
- Specialized RSU plans defer delivery of the shares (not at vesting) until date specified by executives or termination of employment. Need to follow AJCA guidance from IRS/Treasury.



If My Restricted Stock Value Changes, How Many Shares Would I Have? What will my restricted stock value be if the price changes? See your calculator.

RSA/RSU calculator on myStockOptions.com for the after-tax value of grants. Can do "what if" modeling & comparisons

Quick-Take Calculator for Restricted Stock and Units

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What if Company Stock Price:
 Increases by %?
Recalculate

Tax Rates

Fed:	25%
Soc:	6.20%
Med:	1.45%
MA:	5.30%

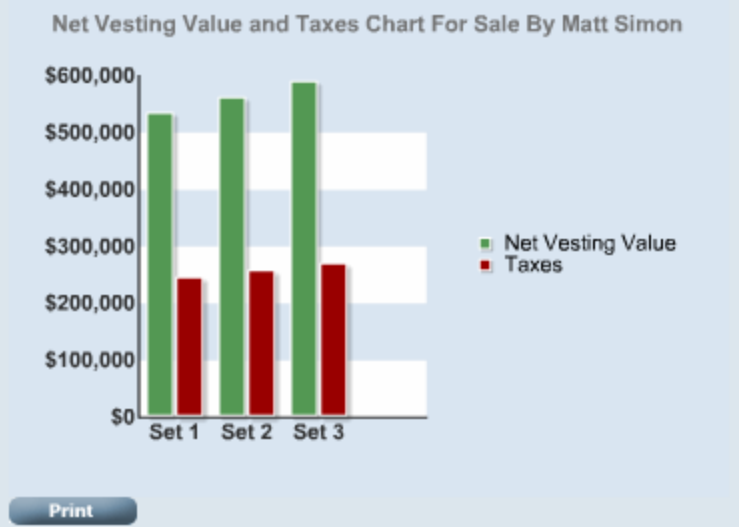
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Results

Proceeds

	All shares or	Shares to cover taxes
You sell on vest date:		
Pre-Tax Gain	\$873,180.00	\$873,180.00
(Less Total Tax)	(\$283,075.05)	(6,484 shares)
See Tax Breakdown		
Net in Cash or Stock	\$590,104.95	13,516 shares

Net Proceeds does not consider commissions or fees specific to your plan. Calculator assumes stock sold on the vesting date and no taxes previously paid. For more details, see the [instructions](#).





Restricted stock accounting

- Much simpler than accounting for stock options and SARs: earnings charge fixed according to the grant date value, spread out over vesting/restriction lapse dates, unless 83(b) election made.
- Timing for tax deduction and earnings charge matches that for taxable compensation to employee when yearly vesting.
- No use of option valuation models: Black-Scholes or lattice.
- More complex issues: forfeiture estimates; retirement-eligible employees with grants; deferred tax accounting.
- Performance-vesting provisions more complicated: fixed accounting with adjustments.



Accounting example

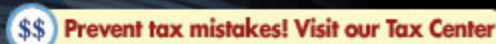
4,000 shares of restricted stock vest at 25% a year (1,000 shares yearly); grant market price at \$18 and no 83(b) election.

- year one: stock price \$20 (1,000 x \$18 = \$18,000 earning charge and \$20,000 tax deduction)
- year two: \$25 (\$18,000 charge, \$25,000 deduction)
- year three: \$30 (\$18,000 charge, \$30,000 deduction)
- year four: \$33 (\$18,000 charge, \$33,000 deduction)
- 83(b) election to be taxed at grant: \$72,000 earnings charge and tax deduction



Equity comp wrap up: financial planning specific to restricted stock

- What to do at grant depends on whether client has restricted stock or RSUs. What other equity grants expected?
- What to do at vesting (hold/sell) depends on same factors for holding any stock. **Would client buy the stock today with cash?**
- Consider client's financial goals and cash needs, along with concentration in company stock; dividends; GRATs and hedging for high net worth.
- Special rules for executives and others with substantial stock holdings: stock ownership guidelines; holding requirements after vesting; hedging restrictions; Rule 10b5-1 plans.
- Diversification decisions with a portfolio of company grants: exercise stock options/sell stock, or sell other stock owned. Pie grant approach with rebalancing harder to apply, but possible.
- Stock option strategies more varied, particularly with down market and excessive volatility . Should time "time value" matter?



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▶ **Stock Option Financial Planning After Your Tax Return Is Filed And At Year-End (Part 1)** [mso+](#)
Tom Davison and Liam Hurley

Right after you have completed your taxes is a great time to do your big-picture financial planning. At the end of the year, review your analysis and strategy again.

▶ **When To Wait, Hold, Or Sell: A Wealth Manager Reveals His Exercise Strategy Wisdom (Part 1)** [mso+](#)
Tim Kochis

Once your stock options vest, you need a strategy to maximize their wealth-building value. But no single strategy fits everyone. This article discusses various approaches to planning your option exercises.

▶ **When To Wait, Hold, Or Sell: A Wealth Manager Reveals His Wisdom On Stock Option Exercise Strategy (Part 2)** [mso+](#)
Tim Kochis

Part 1 looked at the basic exercise strategy for optionholders but underlined several exceptions to the rule. This article considers reasons and strategies for diversifying away from a concentrated position in your company's stock.



Develop a financial plan to build wealth from stock options.

Financial-planning sections on advanced topics

▶ FEATURED FAQs

NEW! [When I hold ISO stock, how far must the stock price drop from the market price at exercise for AMT to exceed what my ordinary income tax would be if I sold the shares this year?](#) [mso+](#)

Assume that the ISO exercise/hold or other parts of the AMT calculation will trigger AMT. A rule of thumb is...

NEW! [Why would I transfer stock options to a living trust? What is the tax impact?](#) [mso+](#)

Assuming your stock plan allows this and it did not allow you to name a beneficiary, transferring unexercised vested options to a living trust would...

NEW! [For NQSOs or SARs exercised on the last business day of 2006, or for restricted stock that vests on that day, is the income taxable in 2006 or 2007?](#)

All exercises with an exercise date in 2006, and all restricted stock with a vesting date in 2006, will be included



Stock appreciation rights

- Rights company grants that entitle you to receive the appreciation in value of shares of its stock from the grant date.
- Instead of exercising a stock option, you exercise the SAR.
- Depending on the plan's design, you receive in either cash or stock the spread between the exercise price and the fair market value on the date of exercise. Stock-settled SARs more popular.
- All the other rules and financial-planning considerations are similar to those of stock options. Less dilution for companies and shareholders. Private companies also use them instead of having to issue stock when appreciation paid in cash.
- This spread at exercise is ordinary income, taxed similarly to that of NQSOs. Withholding at exercise, though company may automatically "withhold" shares to cover the taxes.



Stock appreciation rights

Example: Granted 1,000 SARs at a price of \$10. After the vesting date, exercised when the market price is \$25.

Outcome: The company issues 600 shares for the \$15,000 spread (\$25,000 value at exercise minus \$10,000 value at grant) divided by \$25 current share price.

Taxes: Federal income tax (and any state or local), Social Security, and Medicare tax on the spread. Alternatively, company may hold back 150 shares (25% supplemental income rate) for taxes, forwarding the appropriate amount of money to the IRS, and issue 450 shares to employee.



Companies moving from options to SARs

From proxy of **American Airlines**: “As part of its 2006 compensation review, the Compensation Committee decided to replace stock option grants to our officers (including our current named executive officers) with grants of stock settled stock appreciation rights (SSARs) because *SSARs require the use of fewer shares from the LTIP upon their exercise*, while delivering the same economic value to the recipients as stock options. Similar to stock options, SSARs provide value when the price of our stock exceeds the exercise price of the SSAR. We pay the value of the appreciation in an equivalent number of shares of our stock.”

“SSARs are exercisable for ten years from the date of grant, have a grant price equal to the fair market value of our common stock on the date of grant, and vest in 20% increments over five years (unless the recipient dies, in which case vesting is accelerated).”



Example of ownership guidelines and retention requirements

- Want to show that executives own stock and hold it. More common to see guidelines based on owning shares equal to multiple of salary. What happens when stock price drops?
- Example: All executive officers must own shares of **Capital One** stock with a fair market value of at least the following annual salary multiple:
 - CEO: 5X
 - Other NEOs and executive officers: 3X
- What shares count: shares owned without restriction; unvested restricted stock; shares acquired through the Associate Stock Purchase Plan (“ASPP”); and shares owned through Capital One’s 401(k) plan. Vested stock options not in list.



Example of ownership guidelines and retention requirements

- Some companies have retention ratios requiring continued ownership of after tax shares for specified time period or retirement.
- Look for much more of this in future to show commitment to long-term performance. Prevents short-term profits from stock grants and any perception that insiders manipulated stock price.

ExxonMobil: 50% of stock awards restricted from 10 years or until retirement, whichever is later.



Rule 10b5-1 trading plans

What are Rule 10b5-1 trading plans?

Executive adopts a written plan for periodically trading a specific amount of securities at set prices and/or times. Available for anyone (directors, investors), not just insiders. *Must be unaware of inside information when enter into plan!*

Example: A written one-year contract between executive and broker that instructs the broker to sell 10,000 shares on the first trading day of each month and twice as many shares (20,000) if the price has increased by 5% since the prior sale date.

These plans can provide an affirmative defense (not a shield) for anyone with stock (e.g., insiders, founders, large shareholders) against insider trading claims.



Rule 10b5-1 trading plans: advantages

How do 10b5-1 plans help?

- Sales can take place even when insiders are aware of material nonpublic information and during blackouts.
- You can set plans up to use the stock proceeds for specific known financial needs, such as college tuition. Allows implementation of diversification plan set up by financial advisor.
- Can head off media criticism and analysts' questions about trades, particularly when sales occur before bad news.
- Can be used for prearranged sales of shares for taxes with restricted stock/RSU vesting.
- 35.2% of S&P 500 companies had at least one executive who sold shares under a 10b5-1 trading plan. 44% of these had 2-5 (data from Equilar).



Rule 10b5-1 plans: what's the risk?

- Best practices evolving, but law uncertain on some aspects. Rules not clear on ending plans before fully executed, modifications of plans, setting up multiple short-term plans, and selling immediately after adoption.
- Insider trading charges and guilty verdict against for CEO of Qwest Communications. He ended plan early and then sold more shares. Now serving 6 year term for insider trading
- SEC is looking at abuses in these plans. Examples of sales under plans set up soon before stock drops.
- A special content section on myStockOptions.com covers insider trading and Rule 10b5-1 plans.



Test Your Knowledge: Restricted Stock & Restricted Stock Units Quiz

Test your knowledge of restricted stock and restricted stock units. Please answer the following 10 questions. This quiz is also a course of study. The answer key links to content on the topic for follow-up reading.

[Skip the quiz and view the answers](#)

1. **What is restricted stock?**

- A type of stock option
- The collective term for a grant of stock units
- A grant of company stock you must register with the SEC
- A grant of company stock that you cannot sell until vesting

2. **How long after grant does restricted stock usually expire?**

- It never expires, unless your employment ends before vesting
- 10 years, unless your employment ends before vesting
- 10 years, regardless of whether your employment ends before vesting
- When you retire

3. **What happens to vested restricted stock?**

- 50% of the stock is rolled into another company benefit, usually a 401(k)
- The stock becomes yours to hold or sell after a lockup period of 180 days

Free quiz on restricted stock/RSUs on myStockOptions.com home page. Additional CFP quiz for CE credits.

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Client Grant Alerts
 Welcome to Client Grant Alerts. This area gives you the flexibility to schedule helpful email notices for you and/or your clients (sent around 11:00 pm, ET each day). These include timely alerts about your vesting and expiration dates and informative summaries about your holdings in stock options, restricted stock/RSUs, and SARs. Alerts will be sent to: 1) the email address contained in [your account profile](#) (currently [ben@cpawealth.com](#)); 2) to your client, if you choose to send them alerts, based on their email address in their [client profile](#) (currently [ben@cpawealth.com](#)).

Client: Jane Sample
 Advisor: Pat Standish

Please select one of the alerts from the list below.

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- Expiration date alerts**
Get alerts when the client's stock options or SARs are about to expire.
- Grant value alerts**
Get alerts when the client's stock options, restricted stock, or SARs are about to be exercised or sold.

myRecords
 Share price: \$27.43 | \$27.43 | \$27.43
 All of Date: 1/23/2017 View: All grants
 Have comments or questions? Contact [support](#)

Outstanding Stock	Appreciation Rights	Total Gain	Total Gain
Stock	Granted	Unvested	Unvested
MS	10,000	10,000	\$237,300.00
RSUs	10,000	10,000	\$237,300.00
Total Value Unvested		\$474,600.00	

Outstanding Restricted Stock
 Total Value Unvested: \$444,053.75

"Whether the client is an executive with options or restricted stock, your tools help complete an analysis with action steps."
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"We are a boutique financial-planning firm and use your services to help analyze and anticipate our clients' stock options. I love your website."
Jared Roskelley
 CFP, Jackson Financial Advisors

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FEATURED FAQs

Q: **UPDATED!** How long do I have to exercise my vested stock options after my employment ends?

A: The period for exercise depends on both your employer's plan design and the reason for your termination...

Q: **UPDATED!** With restricted stock units, can I defer delivery of the shares at vesting?

A: RSUs that let you delay the delivery of shares at vesting depend...

RECENT QUESTIONS

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Become smarter about employee stock options, ESPPs, restricted stock/RSUs, and SARs. Our Knowledge Center provided by the experts at myStockOptions.com will help you make educated decisions.



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