American Benefits Council:
Executive Compensation Webinar #2:
Stock Plans and Awards

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Lynn Dudley, Mark Poerio, Brigen Winters,
Erik Lundgren, and Elizabeth Drigotas
About our Panel

- Lynn Dudley, American Benefits Council
- Mark Poerio, Paul Hastings
- Brigen Winters, Groom Law Group
- Erik Lundgren, Winston & Strawn
- Elizabeth Drigotas, Deloitte Tax LLP
Life Cycle of Stock Plans

- Adoption by board of directors
- Shareholder approval
- SEC registration of plan shares
- Administration of Plan
  - Granting of awards
  - Grant-making procedures
  - Interpreting Plan
- Modification of Awards
- Plan amendment and termination
Stock Awards Overview

- **Types of Awards**
  - Appreciation (*Options/SARS*) vs. Full Value (*RS/RSUs/PSUs*)
    - Promise vs. Property
    - Time Vesting vs. Performance Vesting
  - Many Important Considerations – requires Team Effort
    - Governance – Board and compensation committee
    - Tax – individual and company (Sections 83, 162(m), 409A, etc.)
    - Finance and accounting
    - SEC – registration, disclosure and reporting
    - HR and Payroll – design, implementation and administration
    - Shareholder/investor relations
Stock Option Basics

Key Terms
- Incentive stock options
- Non-statutory (nonqualified) stock options
- Grant Date
- Exercise Price and Fair Market Value
- Vesting and Exercise
- In-the-money Value … and Synonyms
- Term and Expiration Date
- Termination of Employment
Stock Options – Tax vs. Financial

Example:
- Grant Date – 100 shares at FMV = $10/share
- Vesting – 50% year 1; 50% year 2
- Exercise Yr 3 – 100 shares at FMV = $15/share
- Sale Yr 5 – 100 shares at FMV = $18/share

Tax Result: Non-ISO vs ISO?

409A: Exception for non-discounted awards

Accounting -- Black-Scholes at Grant Date - $3/share
Stock Options – Financial Picture

<table>
<thead>
<tr>
<th>Year</th>
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Stock Appreciation Rights

Key Terms
- Net Settlement
- Cash vs. Shares

Differences from Stock Options
- Tax
- Accounting

Historical Perspective RE: Little Use
409A: Exception for certain awards
Post-Grant Issues

Underwater ... Out-of-the-Money

Sample Facts:
- Grant Date FMV – 100sh @ $10
- FMV at end Year 1 -- $4/share

Business Challenge???
- Repricing?
- History – Acctg Changes
- Exchange Offer
Restricted Stock - Basics

Key Terms

- Nature of Award
- General Tax and Accounting Rules
- Code Section 83(b)
  - Basic Rule
  - Circumstances when utilized
- Administration – stock issuance; legend
- 409A exemption
Restricted Stock – Financial

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<td>Vest</td>
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Tax and Accounting

$15
$8
$5
$2
Restricted Stock – Tax and Fin’l

Example:
- Grant Date – 100 shares at FMV = $2/share
- Vesting – 50% year 1 @ $5/share
  50% year 2 @ $8/share

Accounting Result? $___ expense per year

Tax Result:
- With 83(b) Election: income = $___ at ___ (when?)
- Normal Rule: income = $____ at ____ (when?)
Restricted Stock – Net Tax Settlement

Assume Net Settlement for 50 shares vesting at FMV $5 per share at end of year one.

- Assume 25% withholding rate on supp income.
- How many shares withheld for taxes? __
- What happens to those shares? Their $ value?
- How many shares issued to employee? ___
Restricted Stock Units (RSUs)

- Nature of Award
  - Administration
- Tax Timing Alternatives
  - Tax on Vesting
  - Deferral permitted?
  - Code Section 83(b)?
  - Code section 409A
- Financial Accounting
### Restricted Stock vs RSUs

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<tr>
<th>Restricted Stock</th>
<th>RSUs</th>
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<tr>
<td>Unvested shares issued, and then replaced with vested</td>
<td>Only vested shares issued</td>
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<td>&gt;&gt;&gt;&gt; easier administration</td>
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<td>Voting of unvested shares</td>
<td>No voting until vesting</td>
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<tr>
<td>U.S. Section 83(b) election allowed</td>
<td>Ineligible for Section 83(b) election</td>
</tr>
<tr>
<td>Tax deferral not allowed post-vesting</td>
<td>Tax deferral possible</td>
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<tr>
<td>Dividends paid or reinvested</td>
<td>Same as restricted stock</td>
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</table>
Performance-based awards

A. Performance shares
B. Performance units
C. Performance-based Amount
D. Performance-based Vesting
   • Service-based Vesting
Other Types of Awards - Terms

- DSUs -- how different from RSUs?
- Phantom Stock
- Phantom SARs
- ESPPs and Section 423 plans
- DRIPs
Conclusion

- Questions?