

A large, modern conference room with a curved wooden table and tiered seating. The room features a curved wooden table in the foreground, with several white chairs. The seating area is tiered and filled with white chairs. The walls are made of wood, and the ceiling has recessed lighting. A white geometric shape is overlaid on the right side of the image.

Executive Compensation Planning Strategies: Attracting the C-Suite

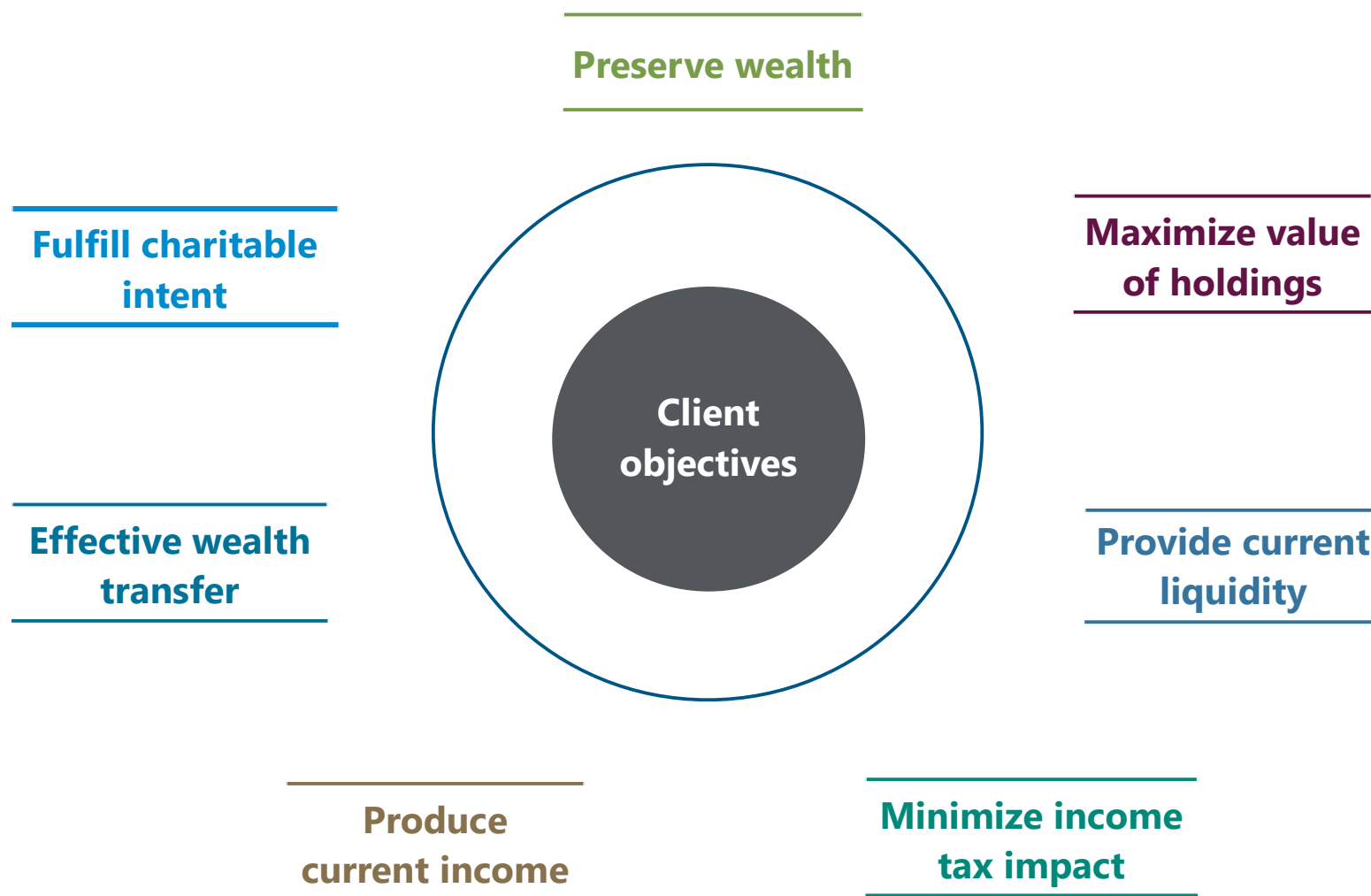
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A company of **Allianz** 

Agenda

- Introduction
 - The need for advice
 - Concentration risk
 - Trends in executive compensation
- Employee stock options (ESO)
- Restricted stock and restricted stock unit (RSU) grants
- Other compensation plans
 - Non-qualified deferred compensation (NQDC) plan
 - Employee stock purchase plans (ESPP)
- Additional considerations and resources

The need for advice



The need for advice

Company constraints

- Imposed lock-ups
- Limited trading windows
- Company mandates

Information processing

- Infrequent reporting
- Confusing plan documents
- Tax ramifications

Investor challenges

- Lack of coordination
- Concentration risk
- Procrastination
- Access to qualified advice

The need for advice

Behavioral biases

Bias	Definition	Potential effect on executive
Overconfidence	The tendency to overestimate or exaggerate one's ability to successfully perform a given task	Because executives generally have access to greater inside knowledge of an individual firm, they tend to overrate their abilities and overvalue company holdings
Status quo	Increased choices and information generally lead to greater indecision	The scientific principle of inertia ; Corporate executives often avoid making changes, instead selecting the option that keeps conditions the same
Home country	The tendency to favor companies in one's own country over those from other regions and countries	With wealth heavily concentrated in company stock , executives may not realize their allocation could be negatively impacting portfolio diversification
Endowment	Tendency to give holdings that are owned a disproportionate value because they are already owned vs. purchasing outright	Executives may hold onto inappropriate assets that they otherwise would not buy (or own) if they didn't already hold them

The need for advice

Discovery questions

- What is your primary objective for these assets (tax minimization, appreciation, risk reduction)?
- What will these assets be used for in your financial plan (retirement, business, charitable)?
- What is your view of your company stock – why?
- How do you see your role in your company changing?
- What is your view on the direction of tax rates?
- Describe your exit strategy for these positions?
- If you didn't work at your current company, how much of the stock would you own in your portfolio?
- What would be more disturbing: selling a security that continues to rise, or holding one that continues to fall?
- If you were presented with cash equal to the value of your current position, how much would you allocate to your company stock?

Concentration risk

Managing concentrated stock positions in a portfolio

Sears Holdings Corp.



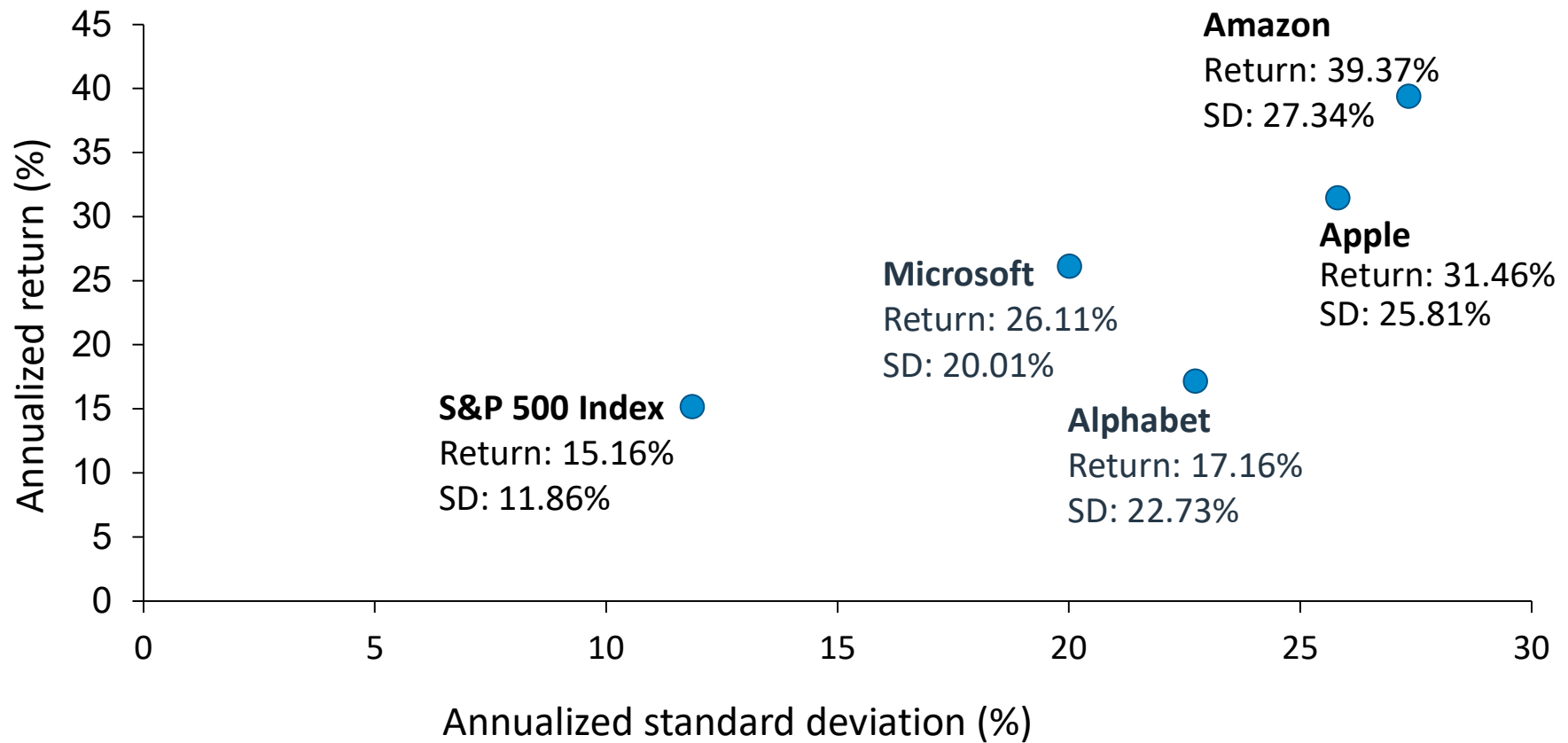
General Electric Co.



Sample for illustrative purposes only
Source: MarketWatch 9/1/2015 – 9/1/2020

Concentration risk

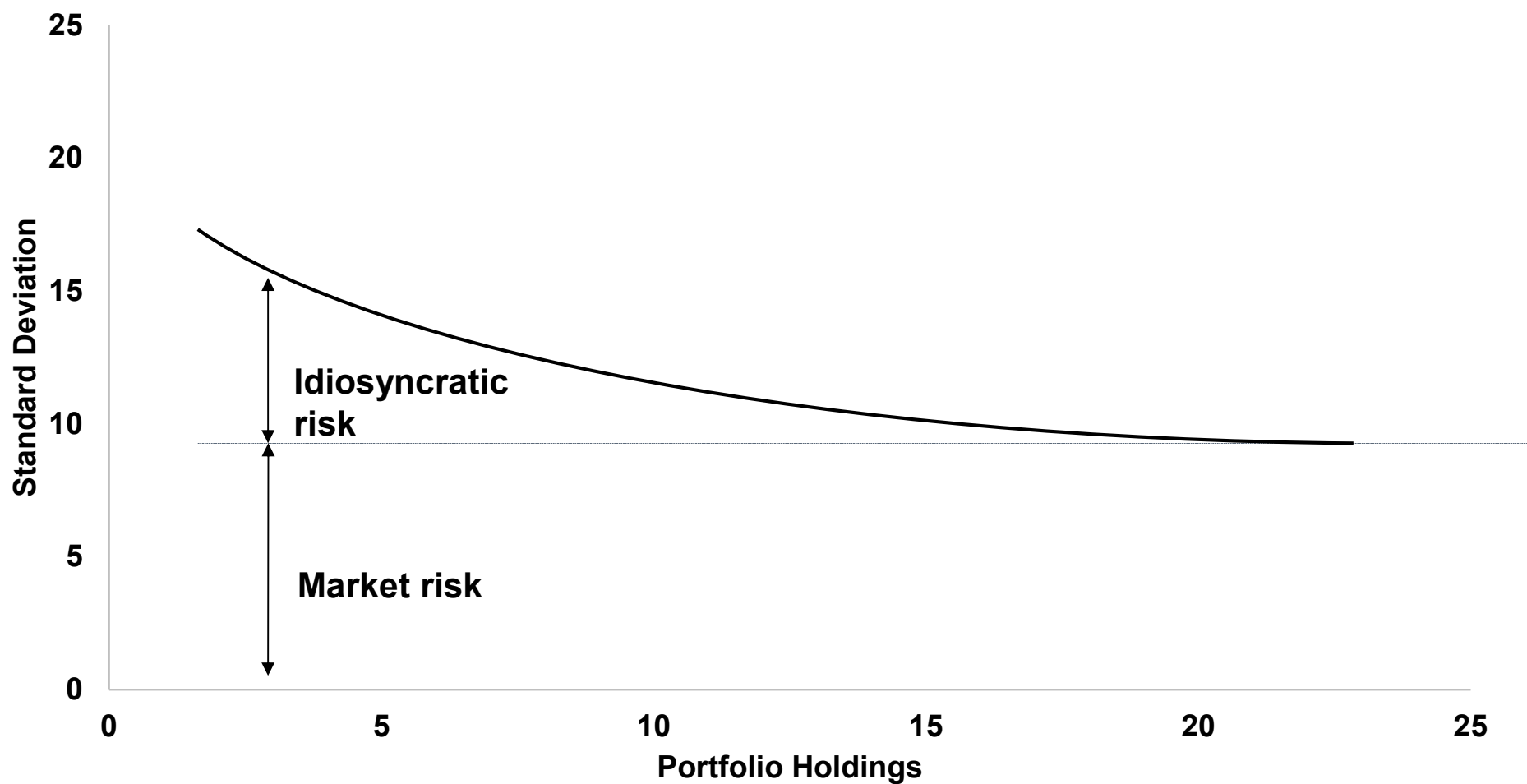
Standard deviation S&P 500 Index vs. Individual stock



Sample for illustrative purposes only
Source: Morningstar, Period: 1/1/2010-12/31/2019.

Measuring risk

Components of risk diversification



Sample for illustrative purposes only

Trends in executive compensation

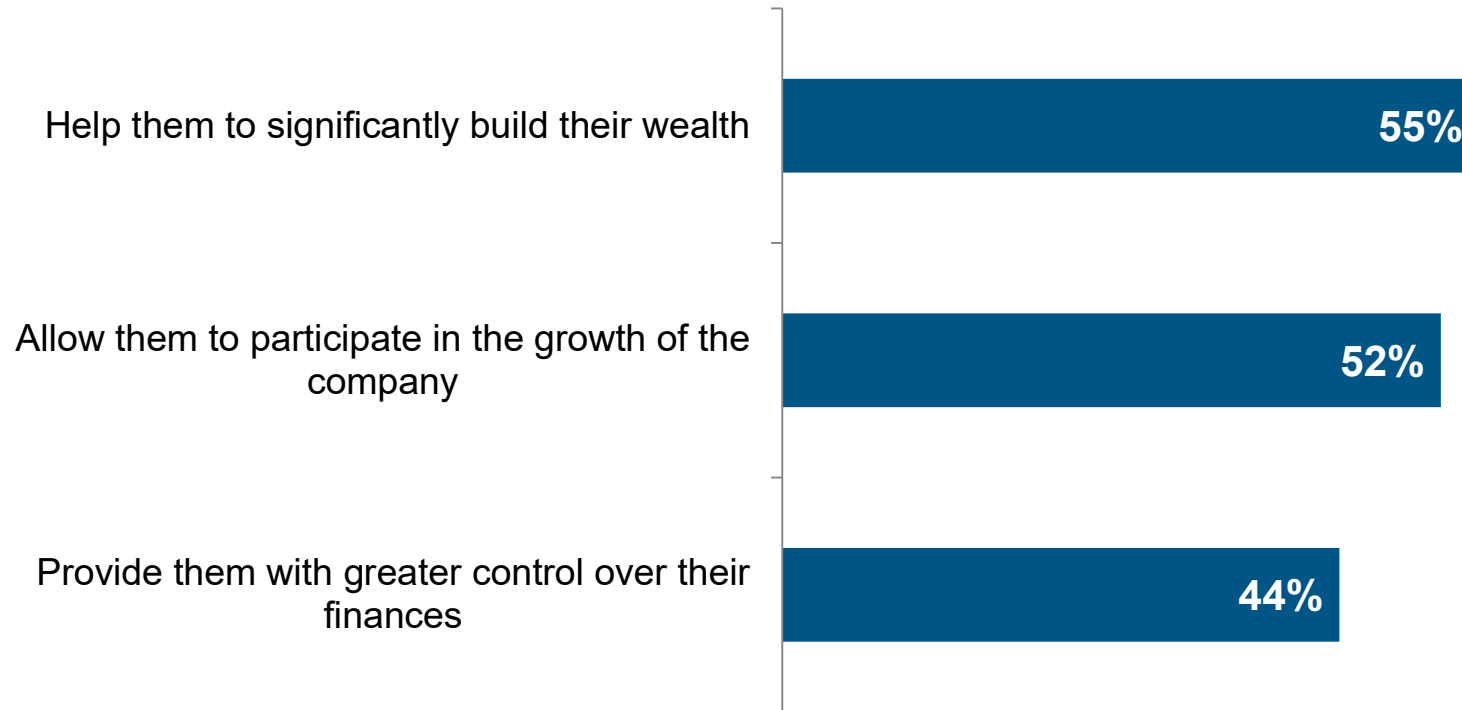
Why companies issue equity compensation awards

- Attract, retain, motivate high-value employees
- Reduce out-of-pocket compensation costs
- Link company performance to employee compensation
- Provide pride of ownership to employees

Trends in executive compensation

Equity compensation is highly valued

Top reasons why plan participants view equity compensation as an essential or very important benefit:

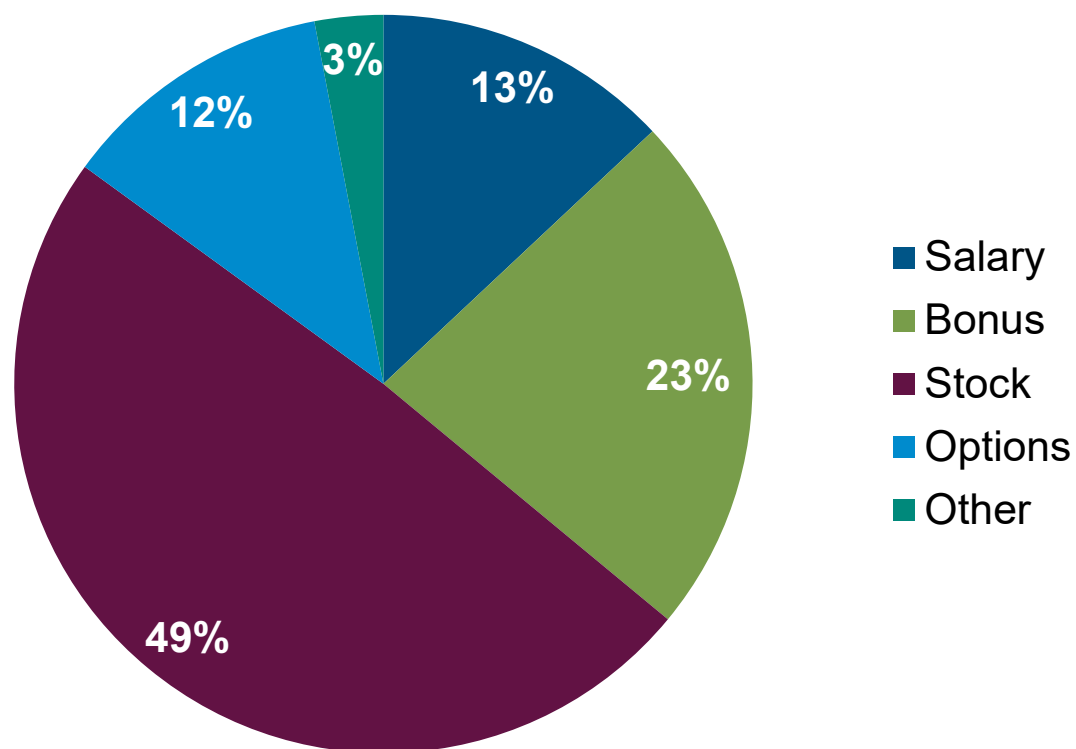


Source: Charles Schwab Equity Compensation Plan Participant Survey 2017

Trends in executive compensation

CEO compensation packages

Dominated by incentive-based pay (bonus, stock and options) whose ultimate value depends on performance



Source: Equilar, CEO Pay Trends (2018)

Sample includes CEO compensation of companies listed in the S&P 500 Index.

Trends in executive compensation

Restricted stock vs. options

In recent years, stock-based performance awards have replaced stock options in long-term incentive pay.

Weight of long-term vehicles as component of incentive pay

Year	Performance award*	Restricted stock	Stock options
2020	54%	35%	11%
2018	56%	30%	14%
2016	55%	29%	16%
2014	53%	29%	18%
2012	50%	24%	26%

*Performance awards include performance shares, performance units and long-term cash awards

Source: Meridian Compensation Partners 2020

Sample includes CEO compensation of companies listed in the S&P 500 Index.

Trends in executive compensation

Restricted stock		ESOs
Time	Vesting	Time
Performance goals		
No	Leverage	Yes
Yes	Intrinsic value	No
Yes, when paid to shareholders	Dividends	No
Yes	Voting rights	No
Vesting	Triggering event	NSO: Exercise ISO: Sale of stock
Ordinary income	Tax treatment	NSO: Ordinary income ISO: LTCG potential
83(b) election option	Early exercise	83(b) election option
At vesting	Issuer expense	At exercise

NSO=Non-qualified stock option; ISO=Incentive stock option

Source: PIMCO

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Employee stock options

Comparing types of options

Terms and concepts

- Stock options
 - non-qualified stock options (NSOs)
 - incentive stock options (ISOs)
- Grant date---vesting date---exercise date---sale date---expiration date
- Strike price/exercise price
- Bargain element
- In-the-money / out-of-the-money
- Cashless exercise
- Qualifying disposition

Comparing types of options

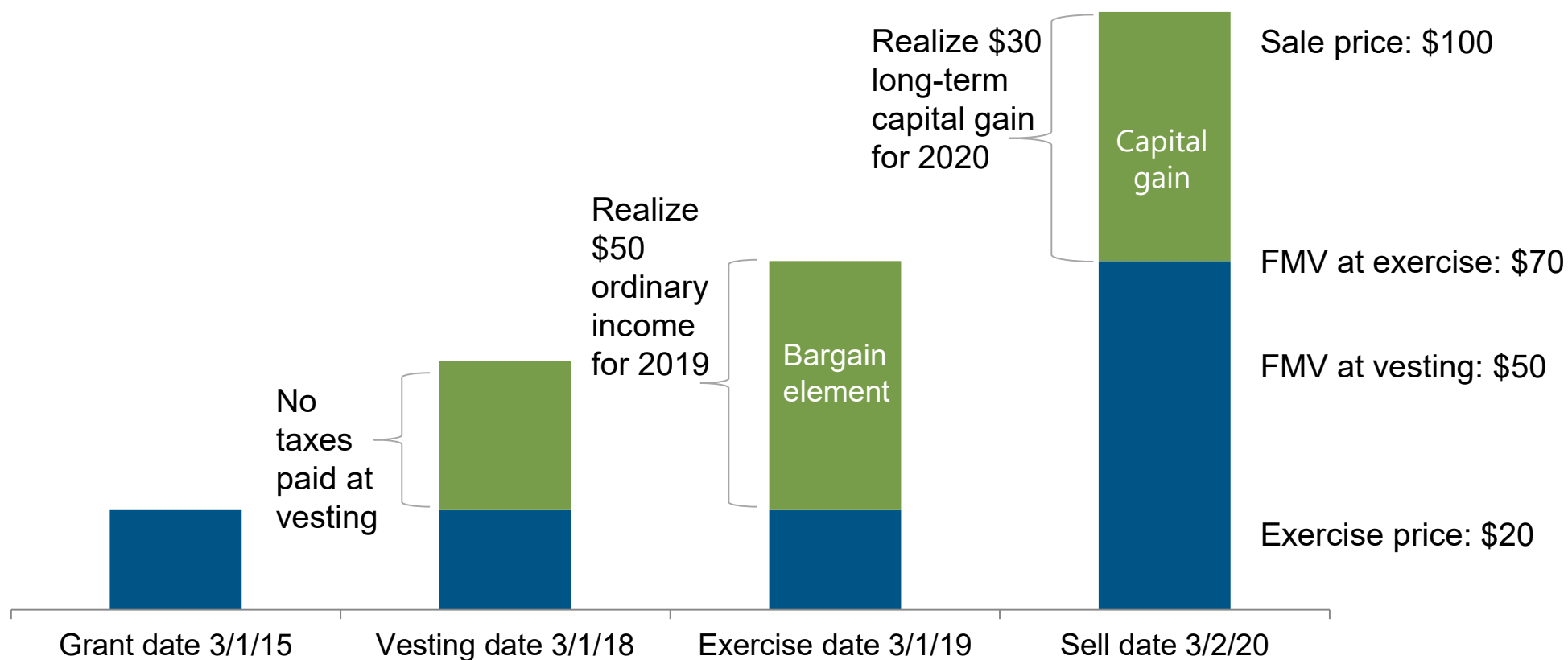
NSOs		ISOs
Employees, Directors, Consultants	Grant	Employees only
Transferable	Transferability	Non-transferable except at death
None	Grant limit	\$100,000 rule
Exercise	Triggering event	Sale of stock
Ordinary	Taxable income	LTCG potential
None	AMT impact	Preference item at exercise

Source: PIMCO

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Comparing types of options

Non-qualified stock options (NSOs)



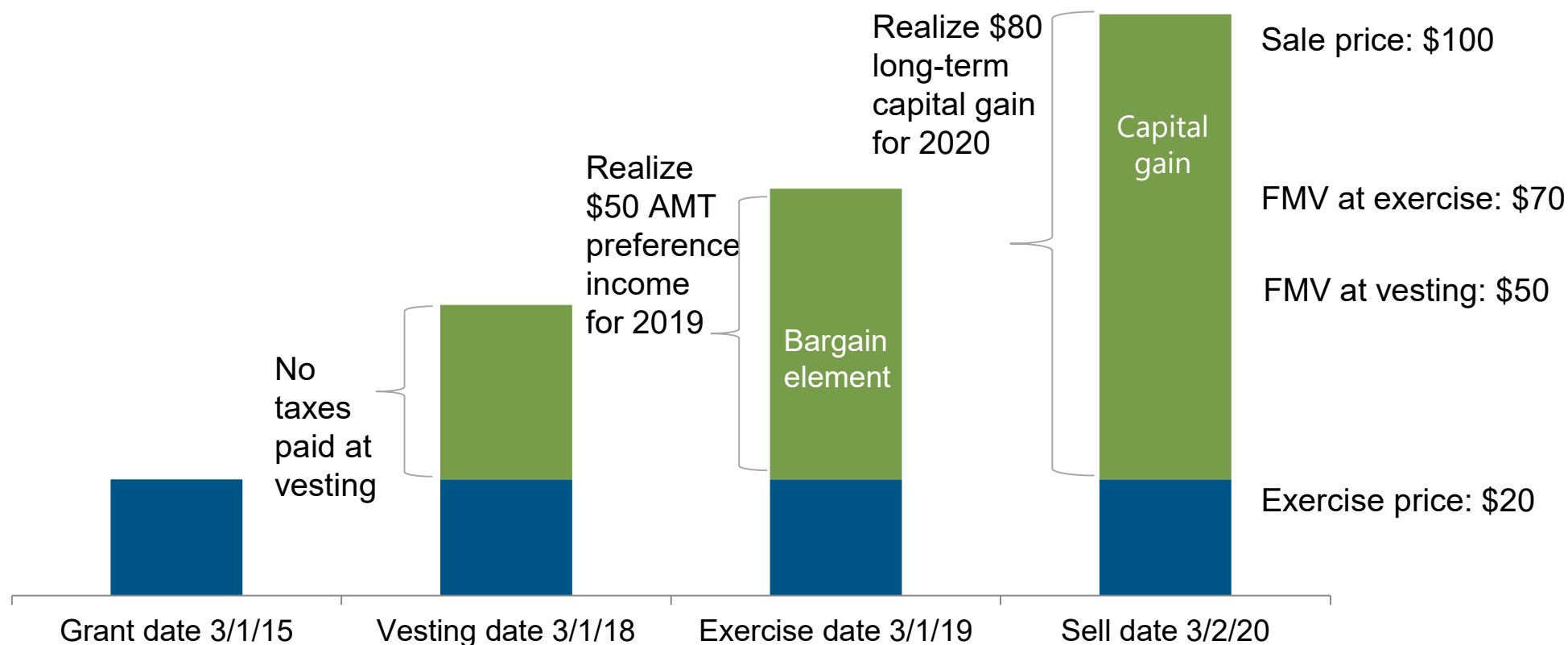
Hypothetical example for illustrative purposes only

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Comparing types of options

Incentive stock options (ISOs)



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Comparing types of options

\$100,000 rule example, 4-year vesting schedule

Year	2016 Grant \$120,000	2017 Grant \$160,000	2018 Grant \$200,000	Total
2017	\$30,000	-	-	\$30,000
2018	\$30,000	\$40,000	-	\$70,000
2019	\$30,000	\$40,000	\$50,000	\$120,000
2020	\$30,000	\$40,000	\$50,000	\$120,000
2021	-	\$40,000	\$50,000	\$90,000
2022	-	-	\$50,000	\$50,000

Hypothetical example for illustrative purposes only

Strategies to help clients achieve objectives

Consider strategies based on primary objectives

Risk reduction

- Exercise and sell to cover
- Stock swap

Liquidity

- Exercise and sell
- Tandem exercise

Tax minimization

- Exercise and hold
- Stock swap
- Section 83(b) election
- ISO qualifying disposition
- ISO tandem exercise
- Gifting
- Charitable lead trust

Wealth accumulation

- Delay – continue to hold
- Stock swap
- Gifting to family

Sample for illustrative purposes only

There is no guarantee that the objectives or the desired results of any strategy, account or portfolio will be achieved.



Restricted stock and RSU grants

Restricted stock

Advantages

- Allows companies to attract, retain and motivate key employees
- Connects company success with personal compensation
- Can carry dividend or voting rights
- Retains some value for employees even if price declines
- Capital gains treatment available on gain with 83(b) election
- Requires fewer shares to provide a similar level of benefit

Disadvantages

- Vesting restrictions can make benefit appear abstract to employees
- Company unable to take tax deduction for the value of the gain employees realize with 83(b) election
- Subject to variable accounting rules, requiring changes in value be charged as compensation expense
- New compensation deduction limit of \$1 million for top 5 earners including CEO and CFO

Source: PIMCO

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Restricted stock

Comparing restricted stock vs. RSU grants

Restricted stock		RSUs
Employees, Directors, Consultants	Grant	Employees, Directors, Consultants
None	Grant limit	None
Non-transferable	Transferability	Non-transferable
No limit after vesting	Term	No limit after shares received at vesting
Yes, taxed at ordinary rates until vested	Dividends	Optional, taxed at ordinary rates until vested
Yes	Voting rights	No
At vesting	Triggering event	At vesting
Ordinary	Taxable income	Ordinary
83(b) election option	Early exercise	Not eligible

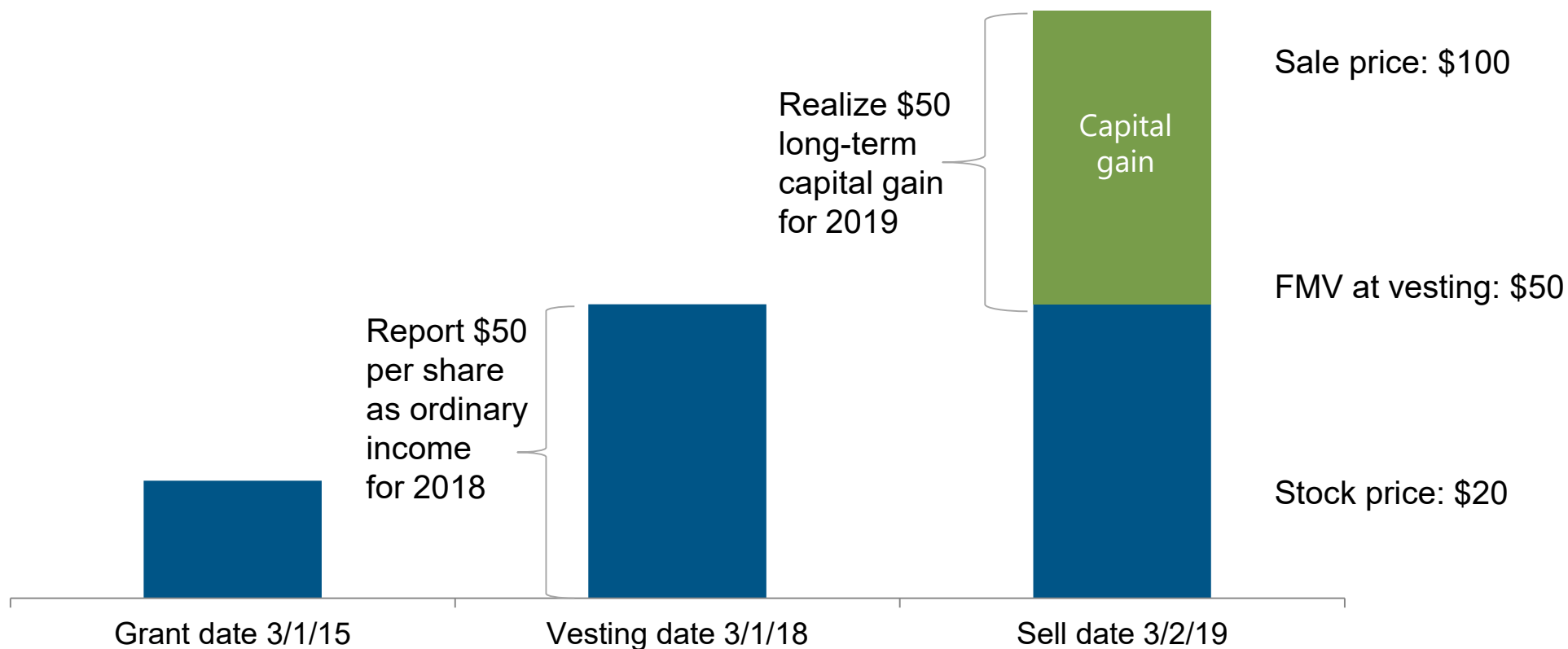
Source: PIMCO

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Restricted Stock

Restricted stock and RSUs



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Restricted stock

Matrix of potential solutions

Liquidity	Hedging	Diversification	Wealth transfer	Tax minimization
<ul style="list-style-type: none">• Restricted stock sale• Writing OTC covered call• Variable prepaid forward• Loan	<ul style="list-style-type: none">• Purchase OTC put option• Zero premium collar	<ul style="list-style-type: none">• Exchange fund• Variable prepaid forward• Purpose loan	<ul style="list-style-type: none">• Gifting to family• Donor advised fund (DAF)• Charitable remainder/lead trusts• Family foundation	<ul style="list-style-type: none">• 83(b) plan

Sample for illustrative purposes only

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Restricted stock

Concentrated strategy comparison

	Restricted stock sale	Zero premium collar	Variable prepaid forward	Exchange fund	Charitable remainder trust
Control assets	Y	Y	Y	N	N
Preserve value	Y	Y	Y	N	N
Gain liquidity	Y	N	Y	N	Y
Participate in growth	N	Y	Y	Some	N
Charitable tax deduction	N	N	N	N	Y
Financing cost	N	Y	Y	If leveraged	N
Flexible	N	Y	Y	N	N

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Other executive compensation plans

Other executive compensation plans

Non-qualified deferred compensation (NQDC) – 409A Plans

- Qualified DC plans allow the employee to defer compensation and taxes currently to be withdrawn and taxed at a later date, subject to IRS limits
- NQDC arrangements provide highly compensated employees to defer additional amounts above the IRS limits
- Irrevocable elections for deferral amount and distribution must be made in year prior to compensation earned
- Benefits: deferred compounding on a larger (pre-tax) amount; tax rate arbitrage
- Plans are not subject to qualified DC requirements: fiduciary, IRS filing, nondiscrimination, funding, vesting, reporting, etc.
- Plans do not receive ERISA protection - unsecured loan subject to bankruptcy
- Investment options often similar to 401(k) menu
- Rollover option not available, but distributions not subject to RMD at age 72
- Triggering events: fixed date, retirement, change in control, disability, death

Other executive compensation plans

Employee stock purchase plans – ESPPs

- Opportunity for employees to purchase company shares at discounted price through payroll ongoing deductions
- Many plans offer discount of 15% using “look back” provision: the lesser of the offering date or the purchase date
- Voluntary participation, but often limited based on employment duration
- IRS cap of \$25,000 per calendar year

Additional considerations

Attracting the C-suite: Keys to success

- Build your competency in this area
- Identify key advocates at local companies
- Read the plan agreements to develop company expertise
- Provide CE offerings to CPAs, attorneys, HR officers
- Use public filings to identify potential clients

Resources

- *The Executive Compensation Handbook*, Kristi Anderson
- *The Complete Guide to Executive Compensation*, Bruce Ellig
- *Managing Concentrated Stock Wealth*, Tim Kochis
- *Consider Your Options*, Kaye Thomas
- *The Complete Guide to Employee Stock Options*, Frederick Lipman

Appendix

CHART

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HYPOTHETICAL EXAMPLE

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED BELOW. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM.

ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS WHICH CAN ALSO ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS AND ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS.

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CMR2020-0928-1345660