Living on Easy Street
Innovative Ideas to Make Your Life Easier

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Agenda

- Cheater, Cheater
- Be Mindful of Grants, Size, Timing
- What a Difference a Day Makes
- Don’t Sweat the Small Stuff
- Automatic Exercise at Expiration
- Simplify Accounting for Equity
- Email Auto-Reply
- Engage Excel
- Mandate a Tax Payment Method
- Beneficiary Designations
- Set Reasonable Deadlines
- Don’t Re-invent the Wheel
Cheater, Cheater
Good Reasons for Cheating with a Cheat Sheet

- Multiple plans, ongoing changes, varied provisions
- Identify key items that are frequently requested and/or complex and create a cheat sheet
  - Additional share allocations – date and amounts
  - Changes to share counting – date and ratio
  - Available for grant
  - Approaching vest/expiration
  - Peer group
  - Grace periods for different terminations
- Update routinely
Cheater, Cheater
Good Reasons for Cheating with a Cheat Sheet

- Summary of multi year view
  - Grant date, price, LTIP value transfer, LTP as % of goal, EE count, Participant Count, % participation, average value

- By product
  - PSUs granted, target value transfer, % of value transfer, payout, earned, threshold/max goal/payout, metrics
  - SOP/SAR – granted (units and value), BS Value, Totals
  - RS – granted (units and value); At vest – vested, participation, per share value, accrued dividends, total value transfer
Cheater, Cheater
Good Reasons for Cheating with a Cheat Sheet

- Value transfer analysis
  - Allowance by vehicle
  - Annual grant LTIP
  - Retention/special – committed and available
  - Total planned value transfer
  - Dividend reinvest
  - Total shares
- Plan usage
  - Multi-year view of usage by product, type
Be Mindful of Grants, Size, and Timing

- **ESPP**
  - Avoid year end (company shut down, market holiday), fiscal quarter end (already busy enough and likely in a trading blackout), and payroll period end (gives you more time to import and verify contributions)
  - Avoid black-out periods
  - Avoid June 30 and Dec 31 = long line at the transfer agent!

### When do purchases occur in ESPP?

- **Month-end**: 38%
- **Quarter-end**: 27%
- **Dec 31**: 23%
- **Payroll period end**: 15%
- **Fiscal year-end**: 14%
- **Avoid all of these**: 29%

Data from NASPP October 2013 Quick Survey
Be Mindful of Grants, Size, and Timing

- Numbers matter
  - Set minimum grant size
    - Administrative burdens aren’t worth the benefits for small grants
    - Small grants are often demoralizing for employees

Data from the 2013 NASPP Domestic Stock Plan Design Survey (co-sponsored by Deloitte Consulting LLP)
Be Mindful of Grants, Size, and Timing

- **Grant/Vesting**
  - Open window
  - Avoid ESPP dates
  - Avoid quarter and year-ends
  - Aim for fewer (rather than more) vesting events
    - Swap monthly for quarterly or annual vesting
    - Bonus! Reduces time/effort for calculating period expense
  - Require all awards to vest on same date in month or quarter
    - If one date per quarter, select dates that coincide with open trading windows
  - Eliminate leave of absence suspensions
    - Not enforceable in all jurisdictions and causes vesting dates to become misaligned
    - If not eliminated, establish policy for restart of vesting that ensures alignment
  - When assuming awards in an acquisition, tweak vesting dates to align with your existing awards
What a Difference a Day Makes:  
A Case for Considering Prior Day Close as FMV

- What is FMV used for?
  - Grant pricing
  - ESPP purchase pricing
  - RS/PS tax calculations

- Why not previous day (except where country specific FMV is required)?
  - Start processing, auditing, reconciling 24 hours earlier

- Who’s in:
  - Huge opportunity to move to Easy Street – less than 10% of companies use previous day close for FMV.
What a Difference a Day Makes: A Case for Considering Prior Day Close as FMV

- How is the FMV for W-2 reporting of stock option exercise gain and for tax withholding determined for exercises that do not involve a sale (e.g., cash exercises or net exercises)?

Data from the 2013 NASPP Domestic Stock Plan Design Survey (co-sponsored by Deloitte Consulting LLP)
Poll: Which describes your thoughts on prior day close?

- Wowzer. I never realized what a benefit prior day FMV could be. I’m going to look into this.
- I love our current method. I’m not convinced this would benefit me.
- We already use prior day close. Love it.
- Tried. Couldn’t get it approved.
- Show me the answers… I’m a service provider.
Don’t Sweat the Small Stuff: Know Your Materiality Threshold

- Not everything is material
  - Don’t waste time on trivialities

- Accounting
  - Consider percentage of total compensation expense
  - EPS is easy: less than $.01 is immaterial
    - Shares necessary to change EPS = Net income divided by EPS, plus or minus .005
  - Issues related to executives can be materials, regardless of amount

- Taxation
  - Underwithholding is more of a concern than overwithholding
  - Some states require withholding to be rounded to nearest dollar anyway
  - Calculations for mobile employees: is close good enough?
Don’t Sweat the Small Stuff: Know Your Materiality Threshold

- **Section 16 reporting**
  - Where original form is timely filed, not all amendments are considered material enough to trigger item 405 disclosure
    - Errors in reporting holdings do not trigger item 405 disclosure, provided all transactions and holdings have been reported
    - Other minor errors may not be material
  - Rules for reporting transactions are not always as clear cut as you might think

- **Benefits offered to employees**
  - What benefits do employees care the most about?
  - Not all plan features are material to employee satisfaction and/or perceived value
    - Focus groups can be useful for determining what is really important to employees
Automatic Exercise at Expiration

Why?
- No reversal of compensation expense
- Potential litigation
- Possible tax expense
- Time and resources
- Avoids need for 10b5-1

Considerations
- In the money
  - Percentage
  - Dollar amount
- Authorization
  - Net exercise vs. sell to cover
- Plan provisions
- Terminated employees

Huge opportunity to move to Easy Street – between 5% and 15% of companies offer
Data from the 2014 NASPP Stock Plan Design Survey (co-sponsored by Deloitte), indicating where companies offer automatic exercise for all options, some options, are in the process of implementing, or are currently considering automatic exercise.
Automatic Exercise at Expiration

- Why not?
  - Retired/"lost" employee population
  - Small, responsible (i.e. executive only) population of SOP participants
  - Need shares cancelled to maintain pool of available shares
  - Tax considerations
  - Employee litigation concerns
    - No actual examples
Poll: What do you think of automatic exercise?

- Interesting. I think this is worth some investigation.
- We have automatic exercise in place.
- We tried to get it approved but there were some concerns.
- Not interested. Employees are adults and should be capable of exercising before expiration.
- As a service provider, I’m just here to learn.
Email Auto-Reply

- Anticipate most common questions employees are likely to ask and include in email auto-reply
  - Auto-reply is always on
    - Sets expectation for a response
    - Includes links to online resources
  - Answers most common questions, e.g.:
    - How do I get additional copies of statements?
    - How do I reset my password to the website?
  - Questions can change over time, based on needs
    - E.g., if a merger, stock split, or other corporate transaction has been announced, update information in email to address questions about these events
Simplify Accounting for Equity

- Courtesy of the PENDING FASB changes…
  - Withhold to cover up to the \textit{maximum} statutory withholding rates
  - Account for forfeitures as they occur
  - Avoid the APIC – book directly to income statement.

\textbf{Warning!}

The proposed rules don’t make everything easy! Changes to the accounting treatment regarding minimum statutory withholding don’t impact the IRS rules (IRS Publication 15) that limit permissible withholding to the flat rate (25%/39.6%) or the W-4 rate (see IRS Information Letter 2012-0063).
Poll: Do you plan to let employees request excess withholding?

- Heck yes! Employees are beating down my door and I’m glad to finally have this flexibility.
- No way. I know the IRS rules… and IRS and FASB aren’t on the same page.
- Not a chance. This would trigger too much additional cash required for tax payments.
- Not sure. I was intrigued, but this session has opened my eyes to some potential concerns. I love that the NASPP keeps me on the top of my game.
- I’m a service provider and waiting for the results to display.
Engage Excel

- Data reconciliation is an important and time-consuming task in stock plan administration
- Microsoft Excel can be a powerful tool for reconciling reporting discrepancies
  - Significantly faster and more accurate than a manual comparison
  - Formulas allow you to compare amounts (even amounts from two different spreadsheets) to isolate discrepancies
  - For example:
    - Compare the same report exported on two different dates to find changes
    - Unamortized expense from last quarter to unamortized expense plus period expense this quarter
- Not as hard to learn as you think
  - Many courses offered, as well as free online tutorials and videos
  - Your own company many even offering training
Excel Tips from Contest Entries

- Use Microsoft Access to compare a new dataset to a prior dataset to find discrepancies
  - Generate discrepancy report in format that can be easily imported to your stock plan database
  - This can be done in Excel too (Vlookup and Index/Match are your friends—get to be on a first-name basis)!

- Create an ESPP contribution template that all payrolls are required to use
  - All data is in the same place in each worksheet
  - Add proofs that check the data (conversion, rounding, maximums) and protect those cells so that the formulas can't be changed or overwritten.
  - Don’t re-invent the wheel! Check provider resources first.

- Use macros to automate processes
  - Color coding for option receivables journal entries
  - Format files for import into stock admin system
  - Identify accounts that are subject to the Additional Medicare Tax
  - Audit equity transactions imported into Payroll system
Mandate a Tax Payment Method

- Specify a required method for paying taxes on awards
  - Share withholding or sell-to-cover
  - Eliminates need to collect tax elections, follow up with employees about elections, track changes to elections, collect cash from employees, change tax payment method when cash isn’t received, etc., etc.

Other ways to simplify tax elections

- RSUs: Require deferral elections to be all or nothing (or all, 50%, or nothing)
- RSAs: Require Section 83(b) elections to be all or nothing, or prohibit Section 83(b) elections. Better yet, grant RSUs!

49% of respondents to the NASPP’s 2013 Stock Plan Design Survey (co-sponsored by Deloitte Consulting), don’t offer a choice in tax payment methods for awards.
Beneficiary Designations

- Some (but not all) problems with beneficiary designations
  - Effect of marriage or divorce on previously executed beneficiary designation.
    - Beneficiary forms can override next of kin estate laws, so if you are going to use, be sure to remind employees they exist and may need updating
  - Impact of community property laws
  - Impact of simultaneous death laws
  - Impact of Killer and similar statutes?
  - What if the beneficiary is a minor or incompetent?
  - What if the form is filled out only partially or incorrectly?
  - Problems when the plan specifies beneficiaries

- ESPP!

- Non US employees
  - Many non US jurisdictions don’t consider beneficiary designations to be valid or enforceable.
Beneficiary Designations

- What to do without designations?
  - ESPP - Refund unused ESPP contributions and distribute with final paycheck
  - Other – distribute to employee’s estate
  - Use selectively – permit where special circumstances may warrant a designation

In 2009, the Supreme Court ruled that a deceased man's pension plan was to be paid to his ex-wife, based on a 27 year old beneficiary designation filled out shortly after the marriage. The divorce decree years later divested her rights to his pension plan, but he never changed the beneficiary with the plan administrator, resulting in what appears to be an unintended payment to his ex-spouse rather than to his estate.
Beneficiary Designations

Do you allow beneficiary designations?

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<td>Stock options</td>
<td>43%</td>
<td>57%</td>
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<td>RS/RSUs</td>
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<td>64%</td>
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<td>ESPP</td>
<td>37%</td>
<td>63%</td>
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Data from NASPP February 2014 Quick Survey
Set Reasonable Deadlines

- Set reasonable deadlines on the actions employees need to take with respect to their stock plan participation
  - Deadlines do not make the plan less competitive or less valuable to employees
  - Deadlines mitigate risk by preventing the last-minute scramble on your end

- Examples:
  - Enrolling in ESPP or making changes to ESPP participation
  - Completing tax elections, funding brokerage accounts for cash exercises or tax payments
Set Reasonable Deadlines

**Enrollment Cutoff in Relation to Offering Beginning**
- Day of, 11%
- At least two days before, 50%
- Day before, 25%
- Other, 14%

**Withdrawal Cutoff in Relation to Purchase Date**
- Day of, 11%
- Day before, 22%
- Two or more days before, 57%
- Other, 10%

**Which Payroll Period Are Contribution Changes Effective In?**
- Next Subsequent, 56%
- Current, 29%
- Second Subsequent, 4%
- Other, 12%
Set Reasonable Deadlines

- Require employees to initiate option exercises a specified number of days before expiration
- Impose a short black-out period over the last few days of the year
  - Especially if the rest of the company is “shut down”
- Reduces cost associated with additional payroll runs in the first week of the new year to add last-minute transactions to Forms W-2
- Stock plan administration can enjoy the holidays just like everyone else
Don’t Re-invent the Wheel

- Utilize the resources you have available
  - Service provider
    - Video
    - Communications
    - Tax information
  - Webinars / Newsletters / Resource Center
  - NASPP
    - Sample plan documents, presentations, FAQs, employee memos, and many other communication materials
    - Process checklists and timelines
    - Wealth of survey data
    - Q&A Discussion Forum
  - Phone a friend
    - Network, network, network
    - Someone else has likely already done what you need to do
One Final Bit of Advice…

Do everything in the simplest way possible!
Questions and Contact

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