Restricted Stock Units - Case Study

Case Study – *Using Your Deferred Compensation Plan to Create a Personalized Restricted Stock Wealth Management Program (RS WMP)*

The Challenge

ABC Corporation had an existing Deferred Compensation Plan (DCP) that permitted the deferral of cash compensation (salary and bonus) and restricted stock units. However, less than 20% of those eligible were participating and no one was deferring RSUs.

The 48-year-old CFO had been receiving significant RSU grants each year, which vested over a 3-year period. She complained to the SVP of HR about the tax hit upon vesting, but stated her key concern about the DCP:

> "If I were to defer my RSUs, I wouldn't want to lock them up until retirement – that's 15+ years away. And I don't want to lose control over the RSUs and the ability to sell at least a portion of them to meet some of my shorter-term financial objectives – which would be the case if I deferred them."

Background

The CFO's situation highlights two common scenarios we often encounter:

- First, the CFO was unaware of the flexibility already built into ABC Corporation's DCP. It's true that participants could elect to defer until retirement. But the plan also permitted shorter-term deferrals – for ABC Corporation, the minimum deferral period was 2 full years beyond the year of deferral.

  Second, ABC's DCP did permit the deferral of RSUs, but like most plans today, the RSUs had to be paid out as restricted stock upon distribution. This meant that while deferred, RSUs could not be sold – or diversified – and allocated to other investment options available under the plan.

Diversification of RSUs

The requirement that deferred RSUs be paid out as restricted stock upon distribution is typically driven by financial considerations, as allowing for the settlement of RSUs as cash effects the accounting treatment of deferred RSUs. Paying RSUs out as restricted stock allows the company to use favorable fixed accounting for the RSU liability, eliminating any potentially volatile impact on the P&L. Unfortunately, without the ability to diversify RSU's while in a DCP account, many executives have been reluctant to defer for fear of having to hold company stock through a negative event.

However, EBS has worked with plan sponsors to implement a methodology that permits diversification while still addressing financial concerns about DCP accounting. With diversification of RSUs as a plan feature, executives are more interested and comfortable in taking advantage of the tax benefits of deferral because they retain the ability to sell RSUs that are held in their DCP account.

EBS worked with ABC Corporation to add the RSU diversification feature to their DCP. This then gave the CFO the confidence to defer RSUs, knowing that the units could be sold while in her deferral account.

Short-Term Savings

The CFO's understanding of ABC's DCP was incomplete in that she believed any deferral could not be distributed until retirement. Actually, ABC's plan had been updated 5 years ago, and "In-Service Accounts" had been added. In-Service Accounts allow for distributions while working, which can be helpful in meeting shorter term savings goals, like funding college tuition payments.

Deferring Restricted Stock Units

For the 48-year-old CFO, understanding that she could defer for as little as 2 years, as opposed to perhaps 15 or more years until retirement, was a huge plus. Coupled with the ability to diversify RSUs in her deferred compensation account, she could now see herself using the DCP to defer both cash and equity compensation.

The Light Bulb Goes On – Redeferring Short Term Elections

One of the most useful features of Section 409A (the section of the Internal Revenue Code that pertains to deferred compensation plans) is the ability to redefer a scheduled distribution. For example, assume an executive has established an In-Service Account that is scheduled to be distributed on January 1, 2026. The executive can change the distribution date of that account, so long as the following conditions are met: (a) the new distribution date must be at least 5 years later than the current one; and (b) the election to make the change must be submitted at least 12 months prior to the current distribution date that is being changed.

Bringing this feature to the CFO's attention led to a radical shift in her understanding of how flexible the DCP could be. Her initial view was that the DCP was very inflexible in that it only permitted deferrals until retirement. And because of her age, retirement was still a fairly distant event. Learning that compensation could be deferred under ABC Corporation's DCP for as little as 2 years convinced her that the plan could be useful to her.

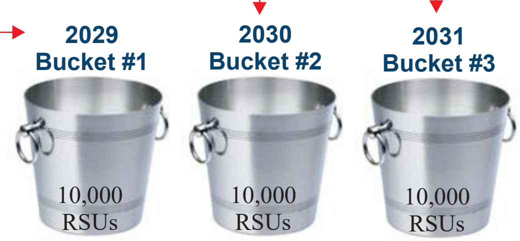
But when EBS educated the CFO on how to use the redeferral option in her planning to enhance flexibility and control over her deferred compensation account, the light bulb truly went on: defer all RSUs for the minimum period of time permissible under the plan. Then, 12 months prior to their scheduled distribution, if not needed, redefer them for an additional 5 years. Repeat this process every year. The result: **The Restricted Stock Wealth Management Program (RS WMP).**

The next section describes how the CFO planned to set up her own RS WMP and assumes that she continued to receive about 30,000 restricted stock units each year.

Establishing the RSU Wealth Management Program

The first step in establishing the Restricted Stock Wealth Management Program is to ***defer the receipt of next year's RSU grant for the minimum period-of-time permissible under the Company's DCP***. ABC Corporation's earliest distribution date per the plan document is January 1 two full calendar years after the date of deferral. ABC Corporation grants RSUs each March that vest over a three-year period, and each tranche can be separately deferred. So, the first tranche granted in March 2025, vests in March 2026, and must be deferred until at least January 1, 2029. The other two tranches of the 2025 grant are deferred until January 1 of 2030 and 2031. Each bucket below represents a separate In-Service Account with a unique distribution date:

2024	2025	2026	2027	2028
December Open Enrollment	March Annual Grant 30,000 RSUs	Tranche 1 Vests 10,000 RSUs	Tranche 2 Vests 10,000 RSUs	Tranche 3 Vests 10,000 RSUs

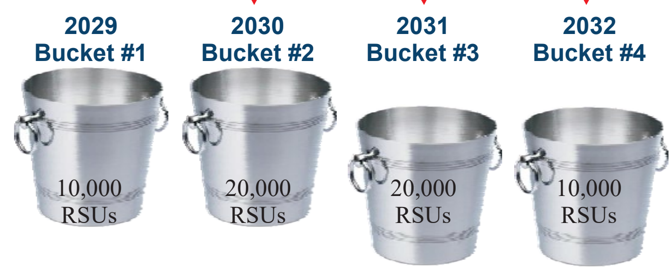


Deferring Restricted Stock Units

Year Two and Three – Continue to Defer RSUs the Minimum Number of Years Permissible

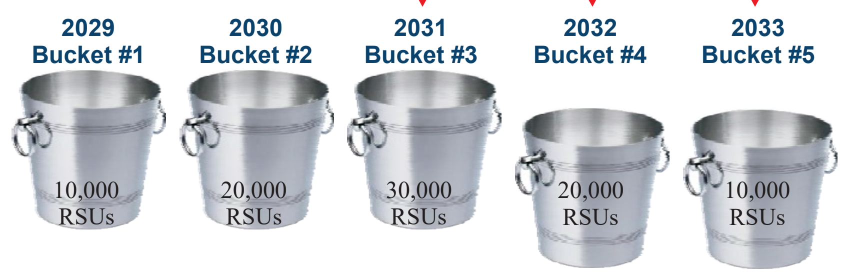
In the next enrollment period in December 2025 the process of deferring RSUs the minimum number of years permissible continues. A fourth bucket, or In-Service Account, is added to capture the third tranche of the 2026 grant. Additional RSUs can't be added to the first bucket because its distribution date is prior to the minimum deferral period for the first tranche of the 2026 grant:

2025	2026	2027	2028	2029
December Open Enrollment	March Annual Grant 30,000 RSUs	Tranche 1 Vests 10,000 RSUs	Tranche 2 Vests 10,000 RSUs	Tranche 3 Vests 10,000 RSUs



The same process is continued for a third year for the enrollment period in December 2026, with a fifth bucket being added. A total of 90,000 RSUs will have been deferred (30,000 times 3 years):

2026	2027	2028	2029	2030
December Open Enrollment	March Annual Grant 30,000 RSUs	Tranche 1 Vests 10,000 RSUs	Tranche 2 Vests 10,000 RSUs	Tranche 3 Vests 10,000 RSUs

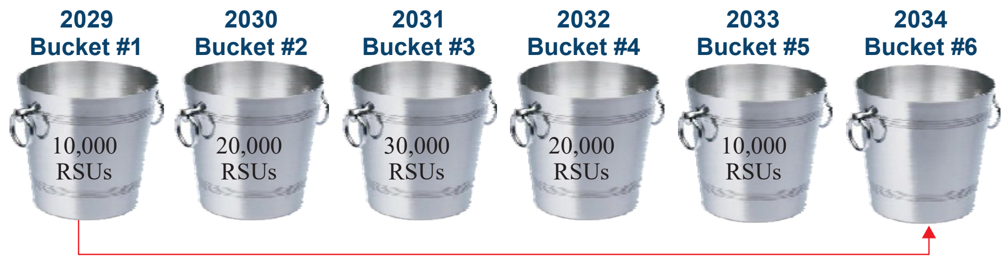


Deferring Restricted Stock Units

Year Four - The First Redeferral Election

During enrollment in December 2027 a decision must be made by the executive. The first In-Service Account – Bucket #1 with 10,000 RSUs – is scheduled to be distributed in January 2029. If the executive would like to continue to benefit from tax-deferral and has the financial means, the RSUs can be redeferred for the minimum five years permissible under 409A to January 2034. A new In-Service Account – Bucket #6 – can be created:

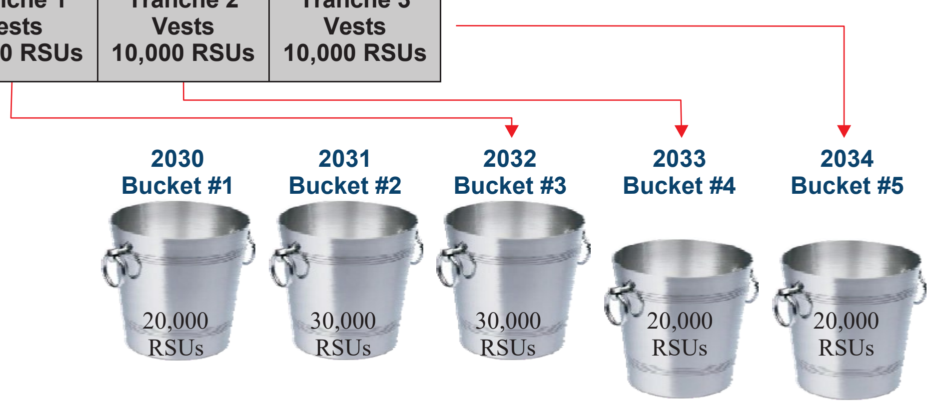
2027	2028	2029	2030	2031
December Open Enrollment	March Annual Grant 30,000 RSUs	Tranche 1 Vests 10,000 RSUs	Tranche 2 Vests 10,000 RSUs	Tranche 3 Vests 10,000 RSUs



Redefer RSUs Scheduled to be Distributed in Jan 2029 for 5 Additional Years (Jan 2034)

The initial Bucket #1 is eliminated, and all the buckets are renumbered. After the redeferral election is made, the executive makes the normal enrollment period elections, and ends with 120,000 RSUs deferred under the plan:

2027	2028	2029	2030	2031
December Open Enrollment	March Annual Grant 30,000 RSUs	Tranche 1 Vests 10,000 RSUs	Tranche 2 Vests 10,000 RSUs	Tranche 3 Vests 10,000 RSUs



Now Defer and Redefer

From the fourth enrollment period forward, the same yearly process can then be followed: (1) A redeferral decision is made with respect to the upcoming distribution 13 months away; (2) A deferral election is made for next year's grant. Five annual buckets of RSUs will continue to fill, with access to the RSUs in the first bucket just about a year away if needed. This structure provides much better access to wealth than a simple defer to retirement strategy.

A Closer Look at the Annual Redeferral Decision

As time goes on, In-Service Accounts for a particular year will contain RSUs from multiple grants. The scheduled distribution of the RSUs in a particular In-Service Account can be postponed. However, with some plans, the redeferral decision doesn't have to apply to all grants in the In-Service Account. Some plans use “class year” deferrals, allowing some of the RSUs in a particular account to be redeferred and some distributed as scheduled. This structure allows more flexibility in creating a Restricted Stock Wealth Management Program.

Restricted Stock Units - Case Study

Deferring Restricted Stock Units

Conclusion

So, what would the CFO's deferred compensation account look like after 10 years of deferring RSU grants? The exhibit below assumes 30,000 units continue to be awarded each year and that the initial stock price of $10.00 per share grows 10% per year. All grants are deferred the minimum time permissible under the plan and are continually redeferred for 5 years in order to postpone distribution.

As of December 31, 2033, after 10 enrollment / election periods, a total of 300,000 RSUs would have been deferred into 5 In-Service Accounts scheduled to be distributed on January 1 of 2036, 2037, 2038, 2039 and 2040, as follows:

Scheduled Distribution Date	# of RSUs	Grant Value	Current Value
1/1/2036	60,000	864,079	1,414,769
1/1/2037	60,000	950,487	1,414,769
1/1/2038	60,000	1,045,535	1,414,769
1/1/2039	60,000	990,715	1,414,769
1/1/2040	60,000	930,412	1,414,769
Totals	**300,000**	**4,781,227**	**7,073,843**

As of the 10th year of the CFO's Restricted Stock Wealth Management Program, she has rolling near term access to 60,000 RSUs, valued at about $1.4M. Assuming she continues to defer new grants, the number of units she has access to continues to grow. With the ability to diversify now added to the DCP, she can under certain conditions "sell" RSU's in her account, and reallocate to the other investment options available in the plan.

In the past, when vesting occurred, she sold about 40% of her RSU grant in order to pay taxes. By deferring the RSUs, she continues to hold the 40% that would have otherwise been sold, so rather than having only 180,000 RSUs after 10 years, she has 300,000 RSUs. ABC pays a dividend equivalent to about 2.0% of share price, so the value of the dividends on the 120,000 shares that would have been sold is substantial, and is also being accumulated tax-deferred in her DCP account.

With the establishment of her own Restricted Stock Wealth Management Program, the CFO has become a major proponent of the DCP, and participation among eligible participants has increased significantly.

Wrap-up

Look for EBS's case study on the financial advantages of deferring Restricted Stock Units, which is available in the Resources section of our website at www.executivebenefitsolutioins.com.

You can also contact Chris Wyrtzen, Managing Director of EBS-Boston, with any additional questions or comments or to request a copy of the EBS RSU Modeler, a simple to use Excel tool that allows you to create a financial comparison of deferring versus not deferring a particular RSU grant. Chris is available at **339-832-0510**, or by email at cwyrtzen@ebs-boston.com.

Executive Benefit Solutions

EBS is an independent executive benefits consulting firm which provides total plan management services with respect to programs specifically designed for key employees and professionals. Those services include:

- Consulting with respect to plan design
- The structuring of related financing and benefit security arrangements
- The design and management of the participant communication, education and enrollment processes
- Management of any informal funding assets
- Ongoing plan administration and technical support

More information about the firm can be found at: www.executivebenefitsolutions.com.

CONTACT INFORMATION:

EBS-Boston
75 Arlington St., Ste 500
Boston MA 02116
617.904.9444

Christopher Rich
Managing Director
339.221.0555
crich@ebs-boston.com

Chris Wyrtzen
Managing Director
339.832.0510
cwyrtzen@ebs-boston.com

Christopher W. Rich
Managing Director
508.228.0102
cwrich@ebs-boston.com

EBS-West
1902 Wright Place, Suite 200
Carlsbad, CA 92008
760.788.1321

William L. MacDonald
Managing Director
760.340.4277
wmacdonald@ebs-west.com

Don Curristan
Managing Director
760.788.1321
dcurristan@ebs-west.com

Trevor K. Lattin
Managing Director
949.306.5617
tlattin@ebs-west.com

National Administration
801 East Plano Parkway, Suite 216
Plano, TX 75704
972.422.8298

Bonnie Barnes
Vice President of Plan Administration
bbarnes@ebs-boston.com