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Mpowerment Quarterly

News & Issues of Interest to Equity Compensation Professionals

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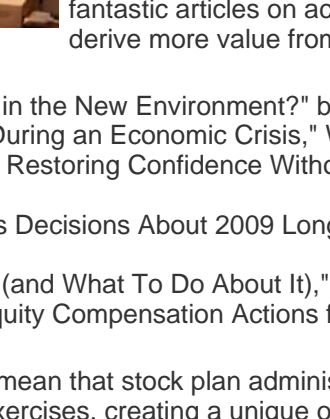
Welcome to the third issue of Mpowerment, Mission Mpower's quarterly newsletter.

In the last issue of Mpowerment Quarterly, we presented a reprint of an article by Dan Walter of Performance on the need to maintain accurate data in your administration platform. Since then, there have been many other articles on the same topic in the trade press. In addition to our timely content from myStockOptions.com, we are pleased to reprint an article from the NASPP Advisor on the critical need to ensure data integrity in your stock plan database.

These are perilous times in the financial sector so it is important you have as much information as possible. Stock plans face many issues. Our unique perspective presents issues that face the corporate administrator and provides articles of interest to the participant. You spend a considerable amount on equity compensation and we are committed to providing you with the best value for your dollar.

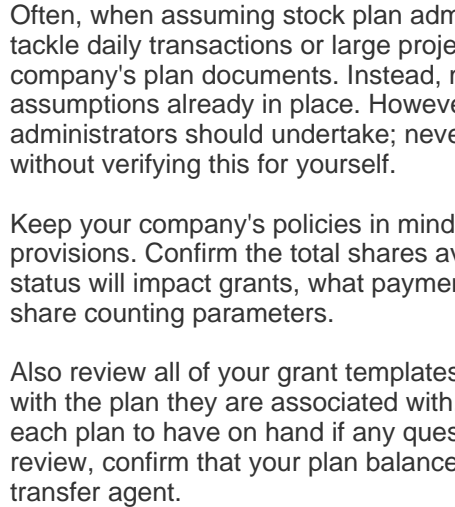
E-mail us your questions and comments as well as suggestions for articles in upcoming issues. Our growth depends on your satisfaction.

Broken Links



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Administrators' Corner By Rachel Murillo (rmurillo@naspp.com), NASPP



Keeping Busy in a Down Market

The repercussions of this economic downturn have caused many companies to take a closer look at how equity compensation is delivered, not only to executives but throughout the company. That may mean taking a closer look at how lower stock prices impact share usage, re-evaluating the mix of equity compensation, and assessing the effectiveness (and fairness) of performance goals. We've recently received several fantastic articles on actions companies can take now to derive more value from their stock plans:

- "What's the Role of Equity in the New Environment?" by Semler Brossy Consulting Group
- "Compensation Planning During an Economic Crisis," Workspan
- "Executive Compensation: Restoring Confidence Without Sacrificing Effectiveness," by Pearl Meyer & Partners
- "Down Market Complicates Decisions About 2009 Long-Term Incentive Grants," by Towers Perrin
- "The Trouble with Options (and What To Do About It)," by Presidio Pay Advisors
- "Weathering the Storm: Equity Compensation Actions for 2009," by Mercer

But, lower stock prices may also mean that stock plan administrators are finding a lull in stock plan activity, particularly option exercises, creating a unique opportunity to find time for special projects. Even if this period doesn't impact your company's daily transaction volume, there are a number of projects that you should find time to complete.

Review Plan Documents

Often, when assuming stock plan administrator responsibilities, it is necessary to immediately tackle daily transactions or large projects, leaving no time to complete a full review of the company's plan documents. Instead, most stock plan administrators work with policies and assumptions already in place. However, a review of all plan documents is something all administrators should undertake; never assume that plan parameters are being adhered to without verifying this for yourself.

Keep your company's policies in mind as you read over the entire plan, noting all of the provisions. Confirm the total shares available for grant, how terminations and other changes in status will impact grants, what payment methods are available, types of grants permitted, and share counting parameters.

Also review all of your grant templates, both current and historical, to ensure that they comply with the plan they are associated with. Create a quick-reference outline with the parameters of each plan to have on hand if any questions arise. If it is not already a part of your periodic review, confirm that your plan balances each match with the balances at your company's transfer agent.

Full Database Audit

Slow periods are a great time to complete a full audit of your stock plan database(s), looking for anomalies that may not be identified during periodic reconciliations. Take a close look at participant demographics, share usage, and historic corporate transactions and take this opportunity to audit your database against other sources.

For example, verify that the names and addresses for your current employees are consistent with your HR and payroll databases. Audit the hire, rehire, and termination dates for all participants as well as any other changes in status, such as leave dates or changes to/from part-time employment. Check to make sure that terminated employees have been rehired under the original employee ID rather than entered as a new employee. This is typically more of an issue internationally, where the social security number (or other taxpayer ID) is not used as an identifier. If your stock plan software offers a data integrity check, then run it with no date limitations. Keep a running list of any issues that cannot (or should not) be corrected so that you will not have to research them the next time you run a full data check.

Update Procedure Documentation

Documenting procedures is an essential component of your company's compliance controls and an integral step in your disaster recovery plan. But too often, the task of updating this documentation is neglected as your procedures change over time. Review your daily and periodic procedure documentation, making any updates to accommodate changes in your routine, plan administration, or segregation of duties.

Pay special attention to any spreadsheet data that you use on a regular basis since spreadsheets are typically the least documented process in a stock plan administration department. Document not only the process used to create spreadsheets that you work with, but also the standards by which exceptions are documented and archived. Include a standard for naming conventions, data validation, change requests for a spreadsheet, and access protection.

Meet with HR, Payroll, Finance, and Legal

Building solid working relationships with your partners in HR, payroll, finance, and legal helps to ensure efficient and accurate stock plan administration. Take time now to understand how information is entered into your company's HR database, how offer letters are created, and what additional contracts or agreements may be held by employees or contractors that could impact stock grants.

Meet with payroll to review the process for exchanging employee income and tax withholding information and to confirm that regular audits of year-to-date information are complete. Confirm with your finance and accounting teams that they are receiving all the information that they need from you. Check to see what manual processes may have been added to their standard procedures to see if there is a standard report that exists or a custom report that can be created to eliminate their manual processes. Conduct a thorough review of your company's insider trading policy, guidelines, and procedures (including Rule 10b5-1 trading plans).

This is also the perfect time for the stock plan administration team to become more closely involved with your company's equity compensation strategy. If there are any granting practices that you feel are ineffective or should be improved, meet with the decision makers to discuss actions your company can take to fully realize the benefits of your equity compensation program. Review the memos at the beginning of this article for ideas and keep an eye out for presentations on this topic through your local NASPP chapter and at the NASPP Annual Conference. Revitalize Employee Education and Communications.

Once you have reviewed your plan documents and are sure that grants are being handled correctly, do a thorough review of all your employee communications. Pay special attention to international communications to make sure that only applicable communications are available to employees from each country. Double-check your filing system to make sure that standard communications are clearly marked to avoid sending out the wrong communication to a group of people. Make sure that your communication program carries a consistent message that is in line with your company's equity compensation philosophy.

After that, get creative on how to rejuvenate interest in your equity compensation programs. Put together a "marketing campaign" to get your employees excited about their grants. This is especially effective for your ESPP program. Even in a down market, ESPP programs offer employees a unique opportunity to access the benefits of ownership in your company. Reassure your employees that the company is addressing how recent market conditions have impacted their compensation and create resources for financial planning that your employees can take advantage of to get through this period and plan for their futures!

Stock plan administration typically involves days of almost frenzied activity (like preparing for period-end, completing a purchase under the ESPP, or processing a large restricted stock vesting) interspersed with relatively calm periods. Taking full advantage of any (even momentary) reductions in trading volume by auditing data, reviewing policies, and preparing for upcoming events makes a tremendous difference in how smoothly your busy periods run.

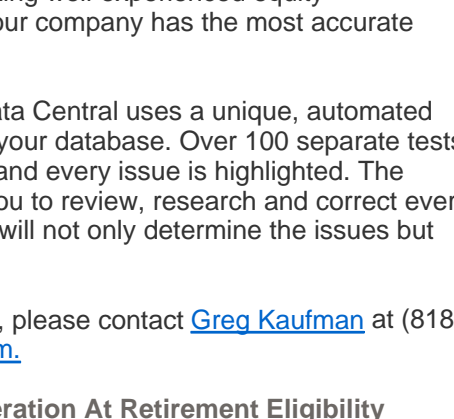
This article offers you just a few ideas on projects you should make time to complete, but there are many more opportunities to make full use of any down-time you might have. Keep a list of these types of projects handy, and categorize them by their complexity and importance. You may even attach business objectives to more time-consuming or long term projects. These are great pieces to add to your personal and departmental reviews to demonstrate the ways you are improving your company's equity compensation program, or even to demonstrate the need for more headcount! As you complete these types of reviews and projects, be sure all the stakeholders know what you have accomplished.

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How Is The Downturn Affecting Corporate Stock Grant Practices?

Changes in executive and equity pay practices during the current economic malaise may eventually be far more wrenching than those caused by the 2000-2002 market drop: more companies are affected this time, the dramatic drop in the stock markets has been accompanied by a steep rise in unemployment, and stricter rules on disclosure and shareholder approval are in place now. While [underwater stock options](#) tend to be the most high-profile issue, companies are also considering shifts toward more restricted stock and cash, modifications in performance share grants, and the advantages offered by ESPPs. Many are undertaking a review of the valuation approach they use to determine the size of new stock grants.



Amid fallen stock prices and [performance goals](#) that will probably not be met, retention grants for top officers have become a high priority. Even with the rise in unemployment, companies remain concerned that falling stock prices have diminished the role of stock options and other stock grants in retaining and motivating key employees. Most companies avoid any adjustments in outstanding performance share grants, but as part of their next round of grants they may add standard time-vested restricted stock and/or change the goal.

Many companies base [grant sizes](#) on either a target amount of compensation or a target number of shares. The problem for many companies in the downturn involves whether to adjust the target dollar value of their stock grants (converted into a specified number of shares/dollars/units) or to adjust grants that are usually a fixed target number of shares. Under the target value method, lower stock prices means companies need to grant many more options or shares to reach a target value. This, in turn, uses up shares much faster (i.e. increases the burn rate), raises dilution concerns, and creates too large a gain for executives if the price rises quickly. However, the target size approach, without an adjustment in the size, results in a grant with a much lower value.

For more details on approaches companies take, including recent survey data on corporate practices, see the [full FAQ on myStockOptions.com](#).

Mission Mpower Introduces Data Central

Data Central Makes Ensuring Data Quality as Easy as 1 2 3!

Step 1: Automatically review data
Expense allocation, grant dates, exercise dates, vesting schedules, term dates, cancellation dates, fair market value and over 75 other data exception checks.

Step 2: Guidance on correction
We are equity compensation experts. We provide a materiality ranking of each issue discovered and a roadmap for correction. Know WHAT to do and HOW to do it!

Step 3: We make the fixes
We know you are busy. We can provide a team of professionals to augment your administrative staff and get the project completed in a timely manner.

Sign off on your financial reports with confidence.

To paraphrase a wise man, "many of these older systems" don't know what they don't know." The systems' internal checking mechanisms often miss erroneous created items or data that were entered incorrectly. In addition, equity compensation professionals are required to know more and do more than ever before. All of this strains data quality and puts the company and executives at risk of providing inaccurate reports. It is essential that your data be reviewed regularly by experts who understand equity compensation.

It takes a multi-pronged approach to find and correct data problems.

- The Data Audit-This should be a systematic approach to reviewing data and providing a report on possible issues.
- The Correction Strategy-Each potential issue must be reviewed for materiality, immediacy, and complexity. A plan for correction or explanation must be created and put into place.
- Data Cleanup-Correct, explain, or notate each issue for future reference.
- Ongoing Maintenance-Audit and clean up data on a regular schedule.

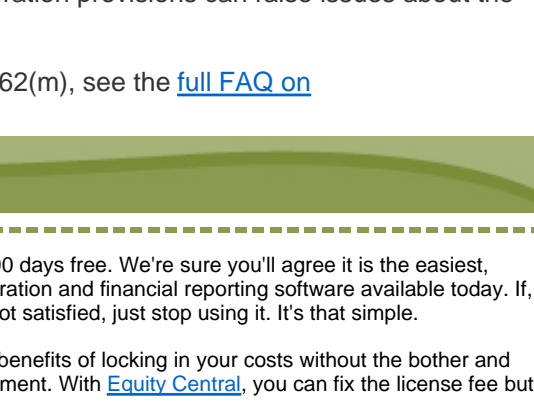
Are you certain that your data are clean? Does your system show exercise dates prior to corresponding grant dates? Do your grant prices match the actual stock prices on the data of grant? Are expenses properly recorded and accounted for? These days it is critical to ensure CFOs and CEOs have complete confidence when signing off on equity compensation data. Using a combination of cutting edge technology and utilizing well-experienced equity compensation professionals, is the only way to ensure your company has the most accurate data review possible.

Mission Mpower is pleased to introduce Data Central. Data Central uses a unique, automated approach to determine the hidden problems deep within your database. Over 100 separate tests are performed to make sure every condition is reviewed and every issue is highlighted. The output of this deep scan is a detailed report that allows you to review, research and correct every issue. We also offer a complete end-to-end process that will not only determine the issues but provide guidance and support to correcting them.

To see how reasonably priced this critical service can be, please contact [Greg Kaufman](#) at (818) 357-7286 or by e-mail at [gkaufman@missionmpower.com](#).

Restricted Stock: The Tricky Topic Of Vesting Acceleration At Retirement Eligibility

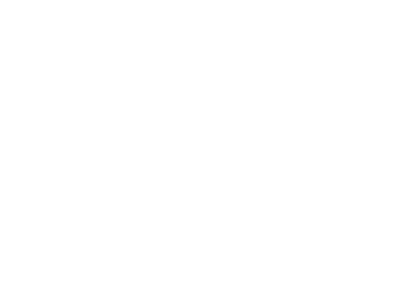
Uncertainty, and even inconsistency, surrounds the situation in which an employee with restricted stock becomes eligible for vesting acceleration at retirement but has not yet retired. For tax purposes it does not matter that the employee must actually retire to vest the shares. With [restricted stock, taxation](#) is triggered when the grant is no longer subject to a "substantial risk of forfeiture," and this end of the forfeiture risk can happen before vesting.



However, the employee cannot sell these shares to pay the taxes until he or she has left employment and the vesting accelerates. Any future dividends received on these shares will probably be taxed as dividend income and not as additional compensation. For improperly handled prior grants, the employee may need to file an amended tax return to report the income, and the company may issue an amended W-2.

If the grant agreement and stock plan merely allow acceleration (i.e., it is not automatic), becoming "retirement-eligible" without actually retiring is unlikely to trigger taxes. This interpretation applies, for example, if the board at its discretion must review each case before approving acceleration at retirement and does not give automatic approval to everyone. (The company's auditors would need to confirm this approach.) For more details on this tricky topic, including the different considerations for RSUs, see the [full FAQ on myStockOptions.com](#) and the section on [retirement planning](#).

Advantages In Granting Restricted Stock When The Share Price Is Low



For restricted stock, employees can make what the tax code calls a [Section 83\(b\) election](#), which is not available for [restricted stock units](#). This taxes the value of the award immediately at grant instead of taxing the value at vesting, when the stock price, and thus a participant's tax rate, may be much higher.

Before employees make the decision, they should realize that the 83(b) election must be made with the local IRS office within 30 days of grant, and that it is nearly impossible to rescind or revoke the election. Also, if they make the election, they will be unable to sell any of the stock to pay the taxes. Furthermore, if an employee leaves the company before the vesting date and thus forfeits the grant, he or she will not get back the taxes paid. Therefore, there are [risks](#).

However, the election can make sense if the company's stock price were to rise significantly between now and vesting.

Example: An employee will be granted 5,000 shares of restricted stock when the stock price is \$17. If she is in the current 35% federal tax bracket, after making the Section 83(b) election her federal tax at the \$17 price (\$85,000 total grant value) will be \$29,750. Instead, if she waits to pay taxes until the price per share at vesting is \$50 (\$250,000 total) three years from now, her tax bracket will probably be 39.6% (up from the current 35%), and thus she will owe \$99,000 in taxes. Assuming she sells the stock at \$50 per share, making the Section 83(b) election would allow her to convert \$69,250 (\$99,000 - \$29,750) into capital gains that would be taxed at the probable rate of 20% (\$13,800). Making the election would therefore result in \$43,550 (\$29,750 + \$13,800) of total taxes: a savings, before considering the opportunity costs of paying taxes up front, of \$55,450 (\$99,000 - \$43,550).

However, it is important for employees to remember the risks and to be realistic about the company's stock price. For further details of this analysis, see a [related article](#) on myStockOptions.com.

Performance Share Grants In Corporate M&A

For a change in control (e.g., a merger or acquisition), the performance period for measuring whether goal(s) are reached is cut short. Commonly, [performance share plans](#) do not continue after a merger or acquisition, as the companies usually integrate in some way that affects the performance metrics.

The plan can still partly pay out the award (pro-rated) as of the acquisition date, issue/vest the full number of shares (or predicate this on the participants not being offered similar employment with the new company), or turn the performance shares into standard time-vested restricted stock in the acquirer. When the size of the payout is determined on a sliding scale according to actual performance, usually the award size triggered by the change in control is just the target number of shares.

Accelerated payout of these awards to senior executives in an acquisition can trigger the "golden parachute" tax rules. For performance-based awards, the parachute value is higher than it is with time-based awards such as restricted stock because the entire value of the award is considered, not just the value of the accelerated shares.

Apart from any acceleration in a change of control, for senior executives with compensation over \$1 million (either before or including value of these grants), or at companies that have accepted TARP money from the US government, the acceleration provisions can raise issues about the company's tax deduction under [Section 162\(m\)](#).

For more detail on the treatment under Section 162(m), see the [full FAQ on myStockOptions.com](#).

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