NASPP - Philadelphia Chapter

January 6, 2015

Mandatory Post Vest Holding Period Restrictions

Radford

iSPAdvisors
GLOBAL EXECUTIVE COMPENSATION
CONSULTING > ADMINISTRATION

Agenda

- Your Presenters: At a Glance
- Post Vest Holding Restrictions
    - The Basics
    - Governance Considerations
    - Structure and Design
    - Technical Considerations
    - Grant Sizing Considerations
    - Administrative Considerations

Radford: At a Glance

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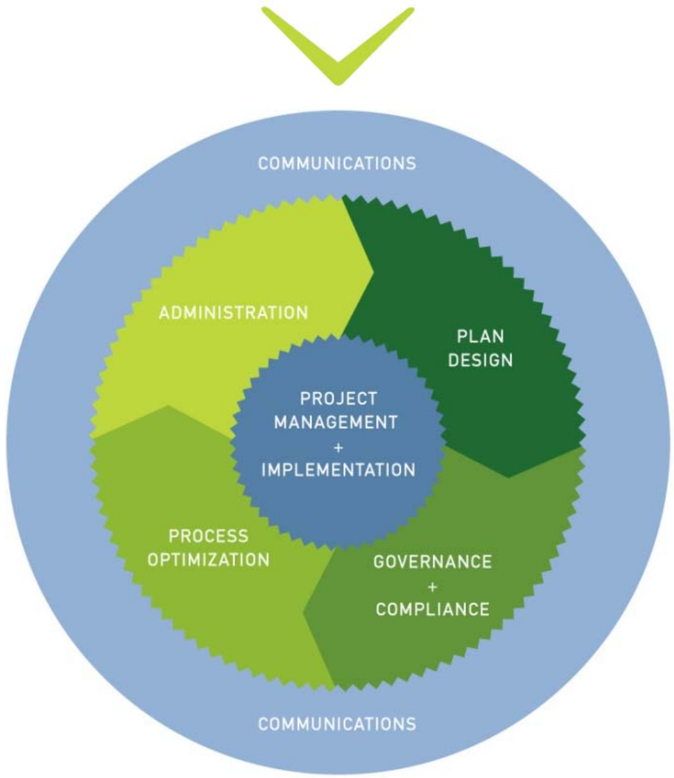
Some firms specialize in executive compensation strategy, governance and technical matters. Others concentrate on plan operations and administration. We do both. We understand the rules governing global equity and incentive compensation plans, as well as the functionality of the vendor platforms that support them. As a result, we're able to offer an inherently holistic approach to executive compensation planning.



Post Vest Holding Restrictions

THE BASICS

What are they?

- Share retention policies
  - AKA “holding requirements”
  - Require retention of a set amount of shares following the exercise of options or vesting of other equity-based awards
  - Not limited to executives
    - Can apply to non-employee directors, as well
  - Often used in tandem with share ownership guidelines

Share Ownership Guideline + Share Retention Requirement = SHARE OWNERSHIP POLICY

Post Vest Holding Restrictions

THE BASICS

What are they?

- Share retention policies (cont.)
  - Generally 3 forms of holding restrictions

Type	Description	Example
Pre-Guideline	Requires holding a percentage of stock received upon option exercise / full value award vesting until stock ownership targets satisfied	Gap "Executives not meeting the requirement must retain 50% of after-tax shares acquired through stock compensation programs until the requirement is reached."
Post-Guideline	Requires holding a percentage of stock received upon option exercise / full value award vesting after achievement of targeted share ownership level. Retention period (e.g., "until retirement") also specified.	Lincoln Financial Group " . . . once an executive has met the minimum share ownership levels, they are also required to retain an amount equal to 25% of the net profit shares resulting from equity-based long-term incentive plan grants for five years from the date of exercise for stock options or the date of vesting for other awards."
General	Share retention requirement independent from ownership goal (if any)	AT&T "Executive officers are required to hold 25% of the AT&T shares they receive (after taxes and exercise costs) from an incentive, equity, or option award granted to them after January 1, 2012, until one year after they leave the Company."

Post Vest Holding Restrictions

THE BASICS

An example

SHARE OWNERSHIP POLICY

Lincoln Financial Group

Ownership Guideline

Structure	Multiple of Base
Multiple Applied	CEO – 7x Tier 2 – 4x Tier 3/4 – 1x Directors – 5x
Accumulation Period	None
Shares Counted	Outright Stock Ownership Unvested Time-Based RS/RSUs In-The-Money Stock Options (EEs Only) RS/RSUs 401(k) Holdings NQDC Holdings 33% of Vested Stock Options (Directors Only)
Shares Excluded	Underwater Stock Options Performance Shares
Measurement – Frequency	Once Annually
Measurement – Stock Price	12/31 close
Penalties for Noncompliance	"Disciplinary Action" (Including Payment of Cash Bonus in Shares)
Once-Meet-Always-Meet	No
Hardship Exception	Yes

Retention Requirement

Pre-Guideline Retention	50% of Shares Awarded
Post-Guideline Retention	25% of Shares Awarded for 5 Years (CEO & Tier 2 Only)

Post Vest Holding Restrictions

GOVERNANCE CONSIDERATIONS

Why do they exist?

Good corporate governance

Holding requirements ensure that individuals entrusted by shareholders to run a company have ***aligned interests*** and an appropriate ***long term focus.*** They also create ***path for recovery in the event of a clawback.***

Post Vest Holding Restrictions

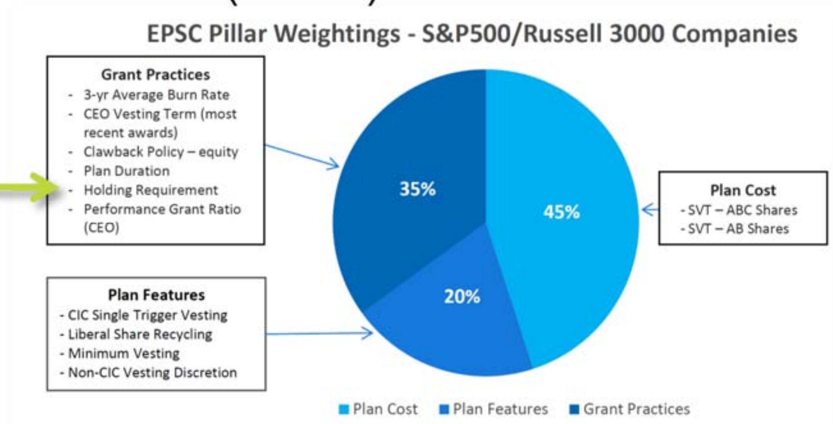
GOVERNANCE CONSIDERATIONS

Why do they exist (cont.)?

- Shareholder Advisory Firms are Big Fans
  - ISS Equity Plan Scorecard (EPSC)

NOTE

"Whether the company has established post exercise / vesting shareholding requirements" is one of the specific grant practices considered



  - ISS QuickScore Ratings
    - Gives positive credits for holding requirements
  - The Conference Board Blue-Ribbon Commission on Executive Compensation
    - Share retention by senior executives is a "best practice" without regard to whether ownership targets are met
  - Other governance groups
    - Have recommended a "hold until retirement" or even beyond retirement policy for the most senior executives

Post Vest Holding Restrictions

GOVERNANCE CONSIDERATIONS

Why do they exist (cont.)?

- Stock Retention Shareholder Proposals
  - For those companies late to the share retention game, some activists have tried to force their hand
    - See Comcast's 2012 Proxy
    - One of the more common comp-related proposals
      - Among Russell 3000, 30 companies in 2014 and 46 companies in 2013
  - But these efforts have not been met with success
    - In all cases, the proposals failed or were withdrawn

Share Retention
Comcast

RESOLVED: That shareholders of Comcast Corporation (the "Company") urge the Compensation Committee of the Board of Directors (the "Committee") to adopt a policy requiring that senior executives retain a significant percentage of shares acquired through equity compensation programs until reaching normal retirement age and to report to shareholders regarding the policy before the Company's 2013 annual meeting of shareholders. For the purpose of this policy, normal retirement age shall be defined by the Company's qualified retirement plan that has the largest number of plan participants. The shareholders recommend that the Committee adopt a share retention percentage requirement of at least 75% of net after-tax shares. The policy should prohibit hedging transactions for shares subject to this policy which are not sales but reduce the risk of loss to the executive. This policy shall supplement any other share ownership requirements that have been established for senior executives, and should be implemented so as not to violate the Company's existing contractual obligations or the terms of any compensation or benefit plan currently in effect.

SUPPORTING STATEMENT: We believe there is a link between shareholder wealth and executive wealth that correlates to direct stock ownership by executives. According to an analysis conducted by Watson Wyatt Worldwide, companies whose CFOs held more shares generally showed higher stock returns and better operating performance. (Alix Stuart, 'Skin in the Game,' CFO Magazine, March 1, 2008.)

Requiring senior executives to hold a significant portion of shares obtained through compensation plans as long as they are members of senior management would focus them on the Company's long-term success and better align their interests with those of the Company's shareholders. In the context of the ongoing financial crisis, we believe it is imperative that companies reshape their compensation policies and practices to promote long-term, sustainable value creation. A 2009 report by the Conference Board Task Force on Executive Compensation stated that hold-to-retirement requirements give executives "an ever-growing incentive to focus on long-term stock price performance." (http://www.conference-board.org/pdf_free/ExecCompensation2009.pdf).

Our Company has a minimum stock ownership guideline requiring executives to own Company stock valued at a multiple of salary. CEO Brian L. Roberts is required to own five times his annual base salary. We believe this policy does not go far enough to ensure that equity compensation builds executive ownership. We view a retention requirement approach as superior to a stock ownership guideline because a guideline loses effectiveness once it has been satisfied.

Several major companies have already adopted this best practice, including Citigroup, Goldman Sachs, and Morgan Stanley.

We urge shareholders to vote **FOR** this proposal.

Post Vest Holding Restrictions

STRUCTURE AND DESIGN

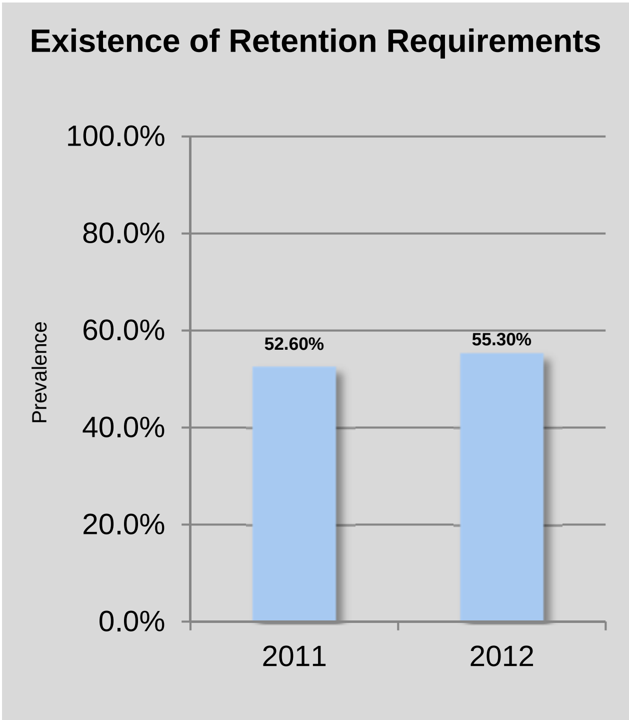
Who has them?

(Executives)

A Borderline Majority Practice for Execs . . .

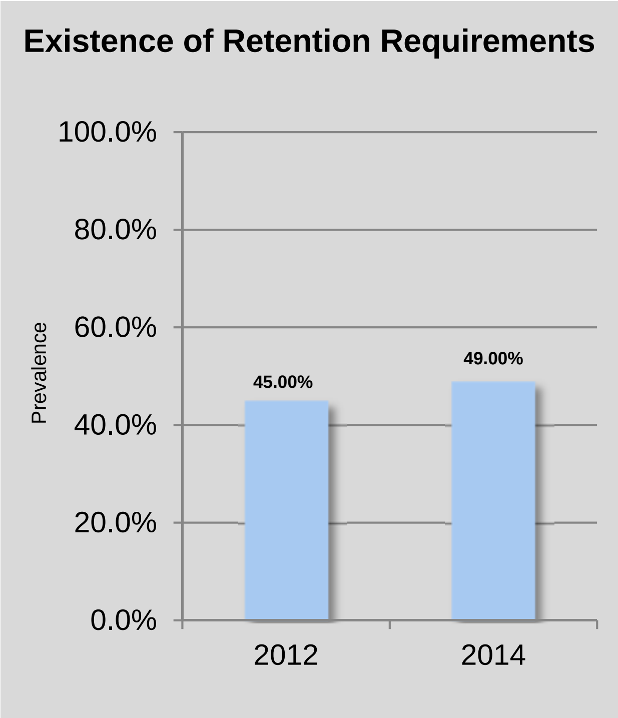
2013 Equilar Survey

- Survey scope: Fortune 100
- Based on FY 2012 Proxy Disclosures



2014 Ayco Survey

- Survey scope: 450 mostly large, U.S. public companies
- Based on CY 2013 Proxy Disclosures



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Post Vest Holding Restrictions

STRUCTURE AND DESIGN

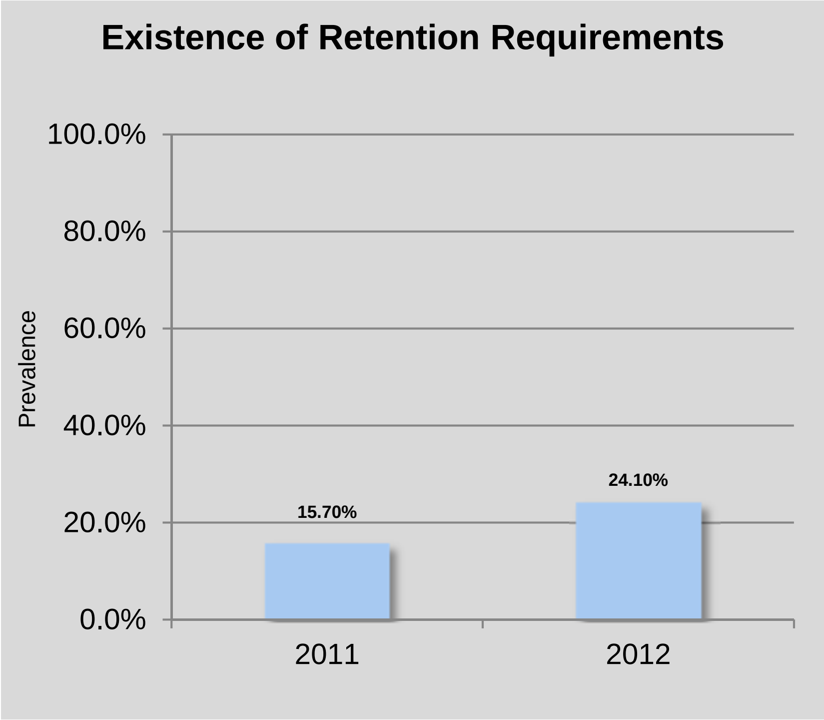
Who has them?

(Directors)

An Emerging Practice for Directors . . .

2012 Hay Group Survey

- Survey scope: Top 300 U.S. public companies
- Based on FY 2012 Proxy Disclosures



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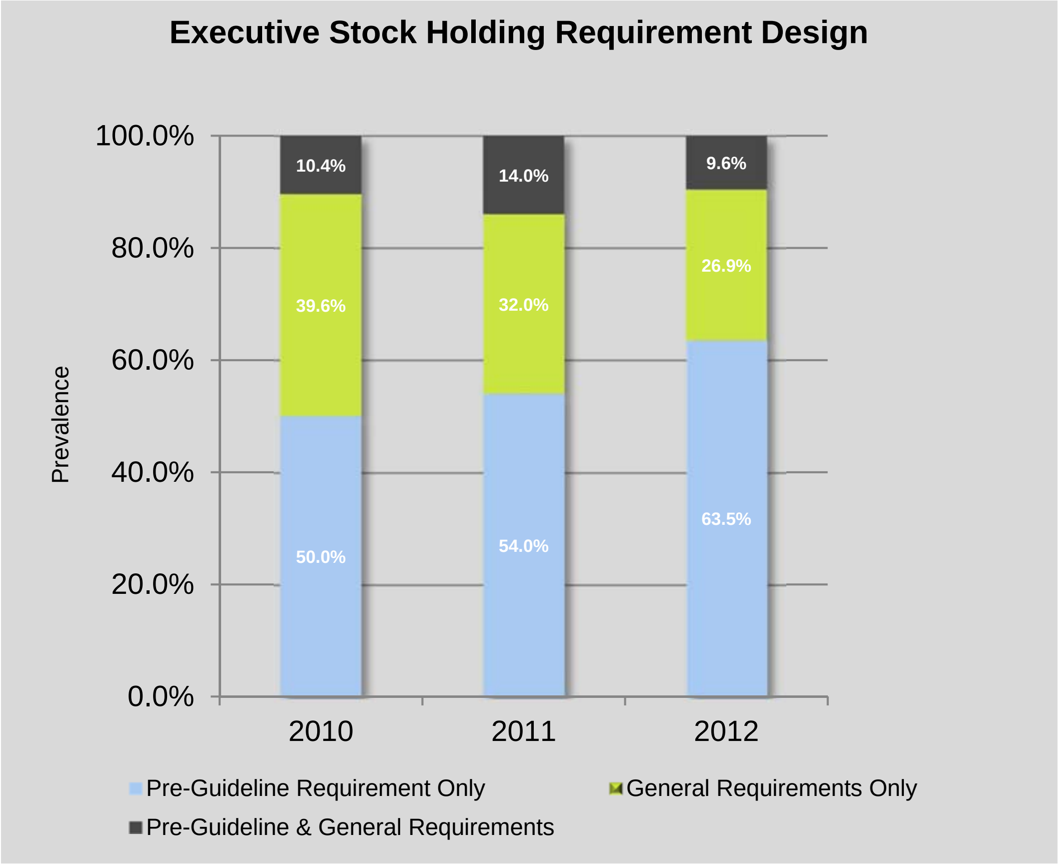
Post Vest Holding Restrictions

STRUCTURE AND DESIGN

And in what form?

Pre-Guideline Requirements Are Most Common . . .

2013 Equilar Survey



Post Vest Holding Restrictions

STRUCTURE AND DESIGN

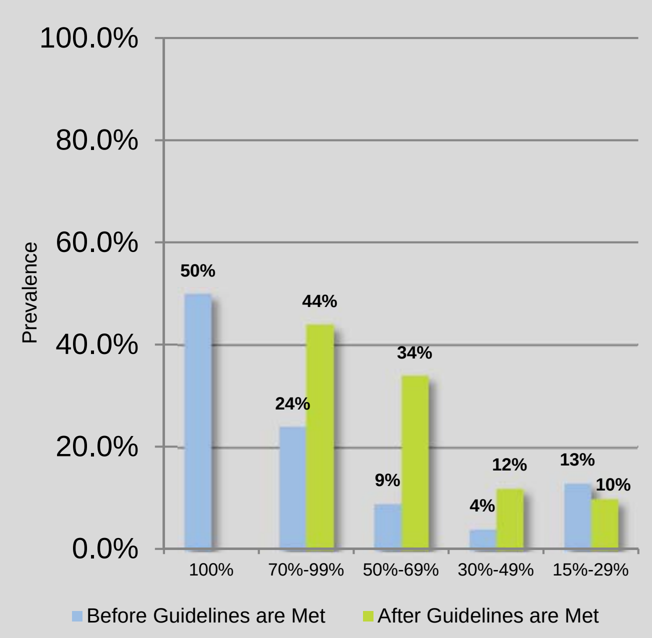
And in what form (cont.)?

Higher ratios and shorter periods prevail . . .

2010 F. Cook Survey

- Survey scope: Fortune 100
- Based on FY 2010 Proxy Disclosures

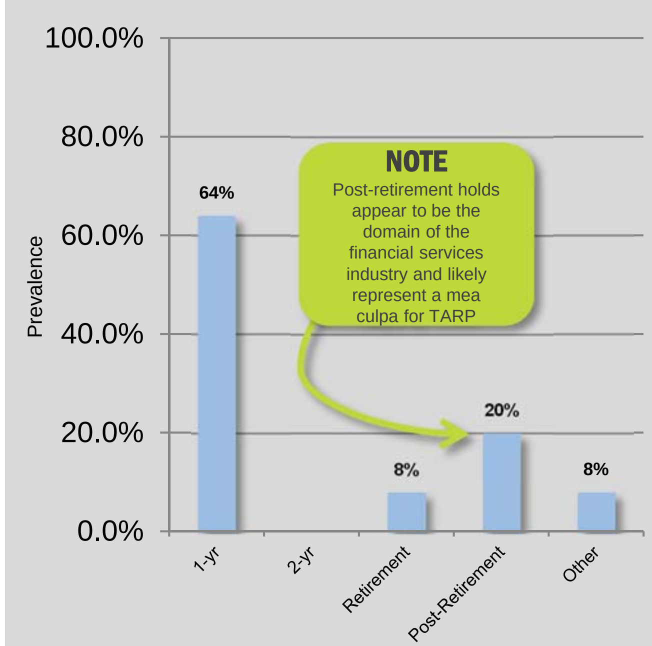
Shares Subject to Retention Requirement (Executive)



2014 CAP Survey

- Survey scope: 100 Fortune 500 companies across 9 industry groups
- Based on CY 2014 Proxy Disclosures

Length of General Retention Requirement (Executive)



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Post Vest Holding Restrictions

TECHNICAL CONSIDERATIONS

A High-Profile Example – Goldman Sachs

On 2/28/2014 Goldman Sachs filed their 10-K with the SEC

THE GOLDMAN SACHS GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The total number of shares of common stock that may be delivered pursuant to awards granted under the 2013 SIP cannot exceed 60 million shares, subject to adjustment for certain changes in corporate structure as permitted under the 2013 SIP. The 2013 SIP will terminate on the date of the annual meeting of shareholders that occurs in 2016. As of December 2013, 59.3 million shares were available for grant under the 2013 SIP.

Restricted Stock Units

The firm grants RSUs to employees under the 2013 SIP, which are valued based on the closing price of the underlying shares on the date of grant after taking into account a liquidity discount for any applicable post-vesting transfer restrictions. RSUs generally vest and underlying shares of common stock deliver as outlined in the applicable RSU agreements. Employee RSU agreements generally provide that vesting is accelerated in certain circumstances, such as on retirement, death, disability and conflicted employment. Delivery of the underlying shares of common stock is conditioned on the grantees satisfying certain vesting and other requirements outlined in the award agreements. The table below presents the activity related to RSUs.

	Restricted Stock Units Outstanding		Weighted Average Grant-Date Fair Value of Restricted Stock Units Outstanding	
	Future Service Required	No Future Service Required	Future Service Required	No Future Service Required
Outstanding, December 2012	8,689,521 [4]	15,390,351	$116.07	$121.99
Granted [1, 2]	**6,230,961**	**11,226,808**	**125.49**	**120.98**
Forfeited	**(785,926)**	**(152,194)**	**120.54**	**117.56**
Delivered [3]	**—**	**(11,369,831)**	**—**	**129.01**
Vested [2, 4]	**(5,907,687)**	**5,907,687**	[illegible]	**121.45**
Outstanding, December 2013	**8,226,869** [4]	**21,0**[illegible]	**118.91**	**111.**[illegible]

1. The weighted average grant-date fair value of RSUs granted during 2013, 2012 and 2011 was $122.59, $84.72 and $141.21, respectively. The fair value of the RSUs granted during 2013, 2012 and 20[illegible] includes a liquidity discount of 13.7%, 21.7% and 12.7%, respectively, to reflect post-vesting transfer restrictions of up to 4 years.

- To summarize, Goldman Sachs applies a liquidity discount for post-vesting transfer restrictions:

  The weighted average grant-date fair value of RSUs granted during 2013, 2012 and 2011 was $122.59, $84.72 and $141.21, respectively. The fair value of the RSUs granted during 2013, 2012 and 2011 includes a liquidity discount of 13.7%, 21.7% and 12.7%, respectively, to reflect post-vesting transfer restrictions of up to 4 years.

- Based on 6.2M shares granted, this amounts to approximately $120M of compensation expense reduction.

Accounting Considerations under ASC 718 and IFRS 2

"To satisfy the measurement objective in paragraph 16, the restrictions and conditions inherent in equity instruments awarded to employees are treated differently depending on whether they continue in effect after the requisite service period. A restriction that continues in effect after an entity has issued instruments to employees, such as the inability to transfer vested equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date – Paragraph 17 of FAS 123R"

- To take the discount, the restriction <u>must</u> be directly linked to the security (rather than an ownership requirement for the executive)

Post Vest Holding Restrictions

TECHNICAL CONSIDERATIONS

Regulatory Guidance

Regs	
FASB	17. To satisfy the measurement objective in paragraph 16, the **restrictions** and conditions inherent in equity instruments awarded to employees are treated differently depending on whether they continue in effect after the requisite service period. A restriction that continues in effect after an entity has issued instruments to employees, such as the inability to transfer **vested** equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date. 21. A nonvested equity share or nonvested equity **share unit** awarded to an employee shall be measured at its fair value as if it were vested and issued on the grant date. A **restricted share** awarded to an employee, that is, a share that will be restricted after the employee has a vested right to it, shall be measured at its fair value, which is the same amount for which a similarly restricted share would be issued to third parties. A7. Fair value is defined in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* as follows: The amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. (Concepts Statement 7, Glossary of Terms) That definition refers explicitly only to assets and liabilities, but the concept of *value in a current exchange* embodied in it applies equally to the equity instruments subject to this Statement. Observable market prices of identical or similar45 equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees. For example, awards to employees of a public entity of shares of its common stock, subject only to a service or performance condition for vesting (nonvested shares), should be measured based on the market price of otherwise identical (that is, identical except for the vesting condition) common stock at the grant date. B74. Certain post-vesting restrictions, such as a contractual prohibition on selling shares for a specified period of time after vesting, are essentially the same as restrictions that may be present in equity instruments exchanged in the marketplace. For those restrictions, either a market price of a similar traded instrument or, if one is not available, the same valuation techniques used to estimate the fair value of a traded instrument are to be used to estimate the fair value of a similar instrument awarded to employees as compensation. However, the most common restriction embodied in equity instruments awarded to employees, the inability to transfer a vested share option to a third party, rarely, if ever, is present in traded share options.

Post Vest Holding Restrictions

TECHNICAL CONSIDERATIONS

Regulatory Guidance (cont.)

Regs	
SEC	*"One analysis that may sometimes be difficult in valuing any security, not just those issued in share-based payment arrangements, is determining which assumptions should be incorporated in the valuation because they are attributes a market participant would consider (it is an attribute of the security), versus an attribute a specific holder of the security would consider. For example, one common term we see in share-based payment arrangements is a restriction that prohibits the transfer or sale of securities. If the security contains such a restriction that continues after the requisite service period, that post-vesting restriction may be factored as a reduction in the value of the security. As a reminder, the staff has previously communicated that the discount calculated should be specific to the security, and not derived based on general rules of thumb."* December 10, 2007 - Remarks before the 2007 AICPA National Conference on Current SEC and PCAOB Developments, Washington, D.C.
AICPA	*"7.24 As discussed in the following paragraphs, there are many quantitative and qualitative methods for assessing a discount for lack of marketability. The most popular quantitative methods estimate the discount as a function of the duration of the restriction (time) and the risk of the investment (volatility). In most cases, the researchers developing each method then validated the results via a regression analysis using data from restricted stock placements."* *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, 2013

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Regulatory Guidance (cont.)

Regs	
IASB	*"For shares granted to employees, the fair value of the shares shall be measured at the market price of the entity's shares (or an estimated market price, if the entity's shares are not publicly traded), adjusted to take into account the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value in accordance with paragraphs 19–21)."* *"For example … if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share."* http://eifrs.ifrs.org/eifrs/bnstandards/en/2014/ifrs2.pdf
IRS	Although valuations for tax and financial reporting purposes frequently differ, the IRS has provided a rigorous quantitative roadmap for applying a discount. *As is always the key, facts and circumstances surrounding the subject interest are what determine the level of DLOM, if any. DLOM studies, methods and models can be complex, can indicate widely diverse conclusions, and may be appropriate in only certain limited situations. The business valuation profession does not identify acceptable or unacceptable methods for estimating marketability discounts, although some individual practitioners have their own preferences and frequently disagree as to the best approach. This job aid does not provide guidance on the best DLOM approaches, but is meant to help the reader understand and make an informed decision about DLOM.* http://www.irs.gov/pub/irs-utl/dlom.pdf

Empirical Data - Discounts Seen by Market Participants

- There are two widely recognized types of data that provide empirical market evidence of the magnitude of the discounts market participants require to compensate them for the additional risk inherent in an illiquid security:
  - Transactions in Rule 144 stock, and
  - Pre-IPO discount studies
- A summary of the observed discounts are summarized below[1]

Rule 144 Restricted Stock Studies

Study	Time Period Studied	Number of Observations	Average Discount	Median Discount
Bajaj, Denis, Ferris and Sarin	1990 - 95	88	22.20%	na
Bruce Johnson	1991 - 95	72	20.00%	na
Columbia Financial Advisors	1996 - 97	23	21.00%	14.00%
Columbia Financial Advisors	1997 - 98	15	13.00%	9.00%
FMV Opinions, Inc.	1980 - 97	243	22.10%	20.10%
FMV Opinions, Inc.	1980 - 2005		22.00%	
FMV Opinions, Inc.	1997 - 2005		21.60%	
FMV Opinions, Inc.	2002 - 2005		14.60%	
LiquiStat	2005 - 2006	61	32.80%	34.60%
Management Planning, Inc.	1980 - 2000	259	27.40%	24.80%
Management Planning Inc.	2000 - 2007	1,600	14.60%	na
Michael Maher	1969 - 73	34	35.40%	33.00%
Milton Gelman	1968 - 70	89	33.00%	33.00%
Robert Moroney	1968 - 72	146	35.60%	33.00%
Robert Trout	1968 - 72	60	33.50%	na
SEC Institution Investor	1966 - 69	398	25.80%	23.60%
Standard Research Consultants	1978 - 82	28	na	45.00%
Trugman Valuation Associates	2007 - 08	80	18.10%	14.40%
Willamette Management	1981 - 84	33	na	31.20%
William Silber	1981 - 88	69	33.80%	35.00%

Emory & Co. - Pre-IPO Studies

Time Period Studied	Number of Observations	Average Discount	Median Discount
1997-2000 *	53	54.00%	54.00%
1995-1997	91	43.00%	42.00%
1664-1995	46	45.00%	45.00%
1991-1993	54	45.00%	44.00%
1990-1992	35	42.00%	40.00%
1989-1990	23	40.00%	40.00%
1987-1989	27	45.00%	45.00%
1985-1986	21	43.00%	43.00%
1980-1981	13	60.00%	66.00%
All 9 Studies	363	46.90%	46.60%

*dot-com companies

1. Based on information available through October 1, 2014.

Empirical Data - Discounts Seen by Market Participants

- Below we summarize the observed discounts from all transactions in Rule 144 stock included in the BVR Resources - FVM Opinions database, regardless of holding period

Recorded Transaction Statistics (All Available Holding Periods)	Discount from Average Traded Price during Transaction Month	Publicly-Traded Stock Price Volatility
25th Percentile	5.32%	46.60%
Median	10.07%	64.30%
Mean	13.12%	68.16%
75th Percentile	16.87%	85.63%

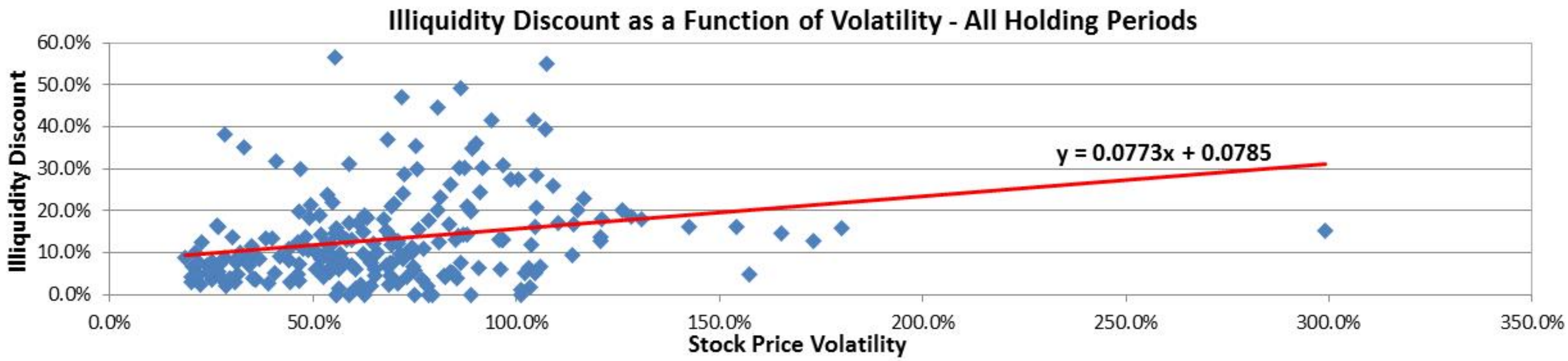
- Below we summarize the observed discounts from all transactions in Rule 144 stock included in the BVR Resources - FVM Opinions database, for transactions that were completed since the hold period was reduced from one year to six months

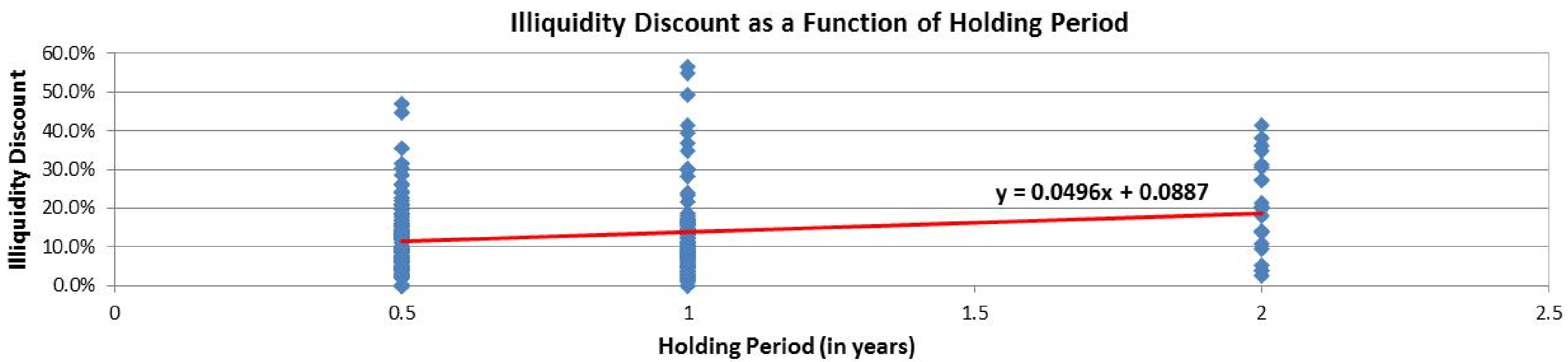
Recorded Transaction Statistics (6 month Holding Period)	Discount from Average Traded Price during Transaction Month	Publicly-Traded Stock Price Volatility
25th Percentile	5.80%	53.10%
Median	10.00%	71.00%
Mean	12.02%	76.22%
75th Percentile	14.53%	90.60%

1. Based on information available through October 1, 2014.

Empirical Data - Discounts Seen by Market Participants

- Below we fit a regression line to the data summarized on the prior page
  - Consistent with published surveys, the coefficients for volatility and holding period are statistically significant





1. Based on information available through October 1, 2014.

Theoretical Valuation Techniques

Model	Pros	Cons
Longstaff	• Discounts in line with empirical market data for low volatility stock	• Assumes perfect market timing • Can yield discounts greater than face (not intuitive)
Chaffe	• Reductions in line with empirical market data for holding periods of two years and volatilities of 60% to 90%	• Conceptually also provides "downside protection"
Finnerty	• Reductions in line with empirical market data for holding periods of one year or more and volatility of between 45% and 75%	• Understates the size of the discount for stocks with a volatility below 45% and above 75%
Collared Strategy (cost of carry)	• Simple and straightforward as reductions equate to the risk-free rate of return over the holding period	• Valuations not in line with market data • Counter-intuitive as results are not a function of volatility

Estimated Discount – One Year Holding Period / 2% Risk Free Rate

- The estimated discounts for lack of marketability for a one year holding period produced by the different models, under a range of expected volatility assumptions, are summarized below

	Expected Volatility			
Model	20%	40%	60%	80%
• "Longstaff"	(17.0%)	(36.1%)	(57.6%)	(81.5%)
• "Chaffe"	(6.9%)	(14.7%)	(22.4%)	(29.8%)
• "Finnerty"	(4.6%)	(9.1%)	(13.3%)	(17.3%)
• Collared Strategy (cost of carry)	(2.0%)	(2.0%)	(2.0%)	(2.0%)
• Regression of Empirical Data[1,2]	(7.2%)	(9.9%)	(12.8%)	(15.6%)

1. Based on information available through October 1, 2014.
2. Based on a statistical regression analysis of transactions in Rule 144 stock with a one year restriction period, the estimated illiquidity discount equals 4.35% + 14.1% * *Volatility*

Estimated Discount – Two Year Holding Period / 2% Risk Free Rate

- The estimated discounts for lack of marketability for a two year holding period produced by the different models, under a range of expected volatility assumptions, are summarized below

	Expected Volatility			
Model	20%	40%	60%	80%
• "Longstaff"	(24.6%)	(53.7%)	(87.7%)	(100.0%)
• "Chaffe"	(9.2%)	(19.9%)	(30.3%)	(40.1%)
• "Finnerty"	(6.5%)	(12.6%)	(18.2%)	(22.9%)
• Collared Strategy (cost of carry)	(3.9%)	(3.9%)	(3.9%)	(3.9%)
• Regression of Empirical Data[1,2]	(10.9%)	(14.8%)	(18.8%)	(22.7%)

1. Based on information available through October 1, 2014.
2. Based on a statistical regression analysis of transactions in Rule 144 stock with a two year restriction period, the estimated illiquidity discount equals 6.9% + 19.8% * Volatility

Summary of Valuation Concepts

- The method used to estimate the discount for lack of marketability should produce greater discounts for:
  - Stocks with higher expected volatility
  - Longer post vest holding periods
- The validity of the model used to develop the estimated discount for lack of marketability depends on the model's ability to replicate the discounts observed in market transactions
  - A common criticism of option pricing model based approaches to estimating a discount for lack of marketability is the models conceptually overstate the discount because the purchase of a put option also hedges away downside risk
  - Because the discounts produced by the Chaffe method and Finnerty model match the observed market discounts this criticism is irrelevant
- Mandatory post vest holding periods represent an absolute prohibition on sale, while the restrictions on Rule 144 stock only represent a limitation on the number of potential buyers during the restriction period
  - In theory the discount a market participant would require for a share that is subject to a mandatory holding period would exceed the discount for Rule 144 stock

Approaches to Estimating Discounts for Lack of Marketability

- We do not anticipate relying on the Longstaff model because we do not believe that perfect market timing is an appropriate assumption
- We do not anticipate relying the "Cost of Carry" collared strategy because it violates a core principle that the discount should increase with increases in expected volatility assumption. Additionally, participants in equity-based compensation programs are typically prohibited from hedging their position, which eliminates the applicability of this approach
- In the paper discussing the 2012 revision to the model, Dr. Finnerty stated the model-predicted discounts understate the magnitude of the illiquidity discounts observed in market transactions for stocks with volatility below 45% or above 75%
- Depending upon the volatility of the underlying stock and the length of the holding period, we anticipant relying upon the discount produced by the Chaffe protective put method and/or the discount produced by the Finnerty model – depending upon the specific facts and circumstances of the award being valued
- Greater weight will be placed on the discount produced by the Chaffe method for stocks with volatility below 45%
- Greater weight will be placed on the discount produced by the Finnerty model for stocks with volatility between 45% and 75%

Additional Examples from Public Disclosures (other than Goldman Sachs)

- PrivateBancorp (NASDAQ: PVTB) – approximately a 20% DLOM reduction
- BankUnited (NYSE: BKU) – approximately a 10% DLOM reduction
- Celanese Corporation (NYSE: CE) – approximately a 30% holding reduction.
- RE/MAX Holdings, Inc. (NYSE: RMAX) – implied discount of 14%
- JMP Group (NYSE: JMP) – discount of 15%
- Ares Management, L.P. (NYSE: ARES) – implied discount of 15%
- Marcus & Millichap, Inc. (NYSE: MMI) – Deferred stock units (DSUs) – "fair value of the DSUs was based upon the Company's IPO price, discounted for the sales restrictions in accordance with ASC 718"

Tax Considerations

- Stock Options and Restricted Stock (RS)
  - Governed by IRC §83
    - Timing: Can't defer taxable event beyond vesting (RS) / exercise (options)
    - FMV: Not as accommodating as the accounting literature when it comes to marketability discounts
      - Reduced valuation only permitted for "non-lapse" restrictions
      - While post vest holding restrictions may be lengthy (i.e., until retirement and beyond) – they are always temporary in nature ("lapse" restrictions)
- Restricted Stock Units (RSUs)
  - Governed by IRC §409A
    - Timing: Not subject to income tax until the award is settled
      - Illiquidity discount can be applied to all shares without creating a hardship for employee

NOTE
Yet another example of a tax / book disconnect

Property transferred in connection with performance of services

(a) **General rule**. If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property,

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

An Opportunity for More?

- If companies develop target grant sizes through accounting values, this creates an interesting trade-off. What would you rather have?

100 Target Shares (no holding restrictions)	vs.	110 Target Shares (1-year holding requirement)

- We submit many executives would opt to implement mandatory holding periods, as the loss in perceived value is less than the reduction in accounting valuations – especially when coupled with ownership requirements
- If companies do not develop target grant sizes through accounting values, then this can be a pure P&L savings, as well as a reduction in total compensation in the Summary Comp Table.

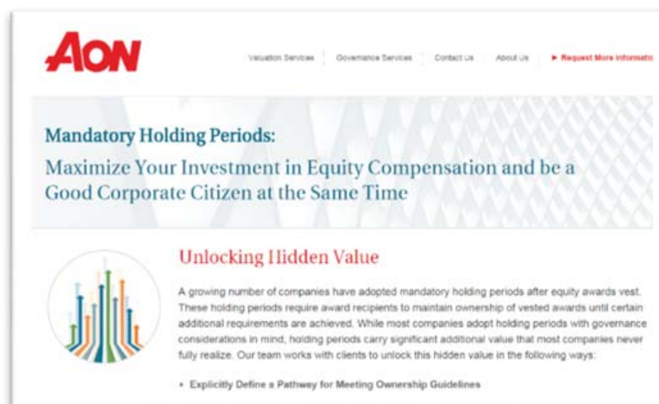
Tracking & Enforcement

- Some vendors / solutions are better equipped than others to enforce post vest holding restrictions
  - Most vendor systems geared toward executing on pre vesting restrictions
  - As a result, manual workarounds often required to enforce post vesting holds
- Participant experience may not suffer since population impacted is likely already subject to a less automated pre-clearance process

To Summarize . . .

- Viewed favorably through institutional investors and governance groups
- Material reduction in accounting costs
  - For performance equity w/ values > than face (FV>100%), can be another tool to help create valuations closer to FV
- Minimal loss in HR/employee perceived value when paired with executive ownership requirements
  - When coupled w/ larger target grant sizes creating cost neutral accounting cost, can be viewed positively
- Creates path for recovery in the event of a clawback
- May require manual tracking / enforcement
- Significant free educational collateral can be found at . . .

www.HoldAfterVest.com



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