RESTRICTED STOCK UNITS

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Equity compensation has been around for decades, first through Stock Options for senior executives and directors. Over time, however, the use of equity compensation moved down the pay scale. Today companies large and small issuing Restricted Stock Units has become one of the most common forms of equity compensation. If you have received, or expect to receive, Restricted Stock Units from your employer, you should understand how they work.

> **Designed to encourage employee ownership in company stock, they align employee and company interests towards financial success.**

WHAT ARE RESTRICTED STOCK UNITS?

Restricted Stock Units (RSU) are a type of equity compensation issued by your employer. Designed to encourage employee ownership in company stock, they align employee and company interests towards financial success. RSUs give employees interest in company stock, essentially a bookkeeping entry, but offer no tangible value until vesting periods are complete and the company issues shares. RSUs should not be confused with Restricted Stock or Stock Options, different kinds of equity compensation that come with their unique characteristics.

HOW DO RSUs DIFFER FROM RESTRICTED STOCK?

Restricted Stock differs from RSUs in at least four ways.

- The recipient of Restricted Stock takes ownership of the shares at the time of grant. Shares are held in escrow until the employee meets vesting goals.
- The recipients of Restricted Stock enjoy voting rights associated with their shares from the time of grant.
- Restricted Stock will receive dividends.
- With Restricted Stock, you can elect when to be taxed; the grant date or the vesting date. If you think the shares are likely to grow in value, the distinction can be material.

HOW DO RSUs DIFFER FROM STOCK OPTIONS?

Stock options differ in several important ways.

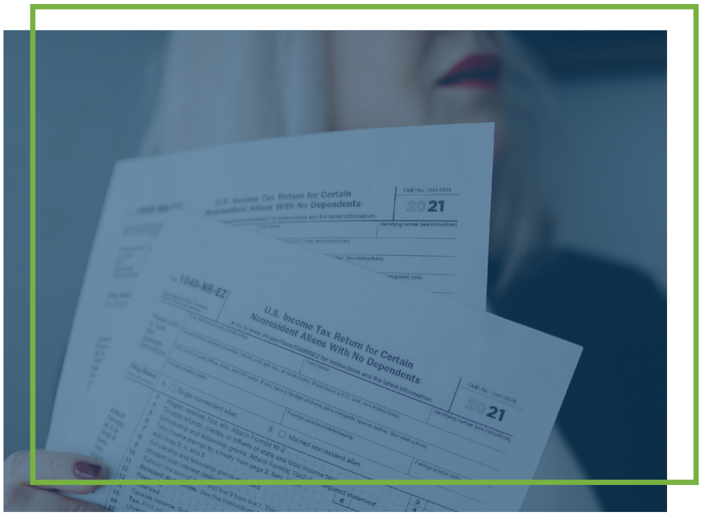
- Stock options come with an expiration date. If the options are unexercised by that date, they will expire with no value.
- Stock options can be worth nothing if the strike price is higher than the market price. RSUs will always have some value unless a company's shares drop to zero.
- You can exercise Stock Options at your discretion. There is no waiting or vesting period.
- Exercising a Stock Option requires an upfront payment from the employee to purchase the shares at the strike price, which is the selling price agreed by the company.

HOW ARE RSUs ISSUED?

Granting RSUs is the first step. The share value on the date of grant times the number of shares will determine the grant value. For example, if you are granted 10,000 shares at $2, your grant is valued at $20,000. The company will make a bookkeeping entry to reflect its commitment. When the grant vests, they will issue shares, and you will take ownership. When the shares vest, you can sell them immediately or decide to keep them to sell at a future date.

HOW DOES VESTING WORK?

The rules set by your company determine the vesting schedule. One example is time-based vesting. A simple plan could look something like this. The company grants you 10,000 shares that will vest 25% over each of the next four years. After year one, 2,500 shares will vest and are yours to sell or keep for later. If you leave the company after three years, 7,500 shares will have vested. The remaining 2,500 RSUs will expire, or the company will reallocate them to other employees.



Other vesting schedules might employ monthly, quarterly, or one-time cliff vesting. Some plan designs encourage employees to stay longer through vesting schedules reflecting 10% in year one, 20% in year two, 30% in year three, and 40% in year four.

Another example is milestone-based vesting based on checking off value-creating achievements. More often seen in smaller start-up companies, designated milestones achieve goals sooner than later. Challenges include defining the milestones and addressing shifting priorities inside a rapidly growing company. In addition, how to handle situations where achieving poorly defined milestones is debatable.

Until they vest, RSUs offer neither voting rights nor pay out dividends. Only when vested are RSUs paid out and converted into common shares of the company.

HOW DO I SELL RSUS?

Once your RSUs vest, shares are deposited in your brokerage account. When you are ready to sell the shares, you provide instructions to the broker to sell the shares on your behalf.

Deciding when to sell the shares is a broader question that depends upon several factors specific to your overall situation. Some company cultures may frown on employees selling RSUs at any point before leaving their employment, believing it breaks down the alignment goals of the RSUs in the first place. You will also have more personal financial considerations about when to sell. Are the RSUs carrying unrealized losses or gains? What other securities in your portfolio can offset these losses or gains to any degree? And how much of your portfolio is represented by the RSUs? Working with a financial advisor can help answer these and many other questions.

HOW ARE RSUS TAXED?

RSUs are taxed twice. The life of an RSU passes through three milestone dates: the date of grant, the date of vesting, and the date of sale. No taxes derive from the first, but tax liabilities will arise from the second and third.

When RSUs vest, you will pay ordinary income taxes on the value of RSUs. For example, if the RSUs issued above are worth $3 upon vesting, the value of the shares is worth $30,000. That is now taxable income upon which you will pay ordinary income taxes. In most cases, the company will handle the taxes on your behalf. They will automatically sell some of the vested RSUs and leave you with the balance. The rules of your program may offer alternative payment methods from which to select other than selling a portion of your vested shares.

You may decide to hold those shares and sell them later for $4 per share. Now your RSUs are worth $40,000, which will result in a $10,000 capital gain upon which you will owe capital gains taxes. Keep in mind, however, that capital gains taxes are usually lower than ordinary income taxes. You may also elect to sell your shares immediately at the value on the day of vesting, alleviating any possible capital gains and associated taxes. If your shares decline below the price on the day of vesting, you now have a capital loss you can use against capital gains elsewhere in your portfolio.

Receiving Restricted Stock Units as part of your total compensation can help make meaningful strides towards saving for retirement. Take the time to understand the rules of your company plan and make informed decisions. If you need help, find a trusted advisor to help guide you.