

How Does Equity Compensation Fit Into Your Financial Plan?

The Best Time to Plan Is When Stock Options, Restricted Stock or Other Benefits Are Granted to You – Not 10 Years Down the Road

Congratulations! Your employer is rewarding you with “equity compensation” – so, what exactly is it, and how could it impact your financial plan?

Companies are increasingly using equity compensation such as stock options and restricted stock to attract and recognize top employees. Simply stated, it’s a form of non-cash compensation that represents ownership in the company. Depending on the type, you’ll either receive company stock or the option to purchase it at a future date.

It can be tempting to let your equity benefits sit on autopilot, especially if you have no immediate plans to sell the stock or can’t exercise your benefits for several years. However, equity compensation usually comes with unique rules, tax implications and liquidity challenges, so it’s important to take a strategic approach to these benefits and

incorporate them into your broader wealth management plans.

Here are a few questions and opportunities to consider when you’re ready to incorporate your equity compensation into your financial plans:

WHAT’S YOUR TIME HORIZON FOR YOUR FINANCIAL GOALS?

To make the most of your equity benefits, revise your financial plan when the benefits are granted – not years down the road. Think about your personal goals, when you’d like to realize them and the money you’ll need to make them happen. Your equity compensation could influence those goals. Here are a few related points to consider:

- When will you own actually own company stock? If you have stock options, you will not own shares until you exercise an option to purchase the ►

How Does Equity Compensation Fit Into Your Financial Plan? *continued*

stock. With restricted stock, you will be issued shares of stock right away or in the future, but you cannot sell them until a vesting date.

- How long do you plan to stay at your current company? What happens to your benefits if you leave?
- When do your equity benefits expire, if ever? (Note: stock options generally have 10-year terms.)

UNDERSTAND YOUR RISK TOLERANCE

While your tolerance for risk may change over time, it's important to think about your current risk tolerance for your specific situation. Generally speaking, older investors, or those close to retirement, often have a lower tolerance for risk in their investments. On the other hand, younger investors tend to be more aggressive in their investment strategies as they strive to build wealth through investments that entail more risk.

It's also helpful to pause and think about unexpected scenarios. For example, your company could continue to grow and succeed, but its stock price could also dip. How would a big decline in your company's stock price impact your vested and unvested shares? How comfortable would you be with wide swings in the value of your equity benefits? Your thoughts are clues to your risk tolerance.

WHAT ARE YOUR LIQUIDITY NEEDS?

Life is expensive, and your "liquidity needs" simply refers to how much money you need to cover everyday expenses, upcoming purchases and unexpected bills. If you have shorter-term goals like paying down student loans or buying a home, your liquidity needs may be high.

If you plan to rely on your equity compensation for any future needs, it's very important to plan ahead. The stock you sell and when you sell it will largely depend on your liquidity needs for future years.

INCORPORATE PRICE TARGETS INTO YOUR STRATEGY

You don't need to exercise all your equity benefits at once. In fact, it's often wise to incorporate multiple price targets, or stock prices at which you'll take a specific action, into your financial plans. This approach enables you to benefit from rising stock prices while also protecting your assets from downside risk.

It's also important to consider the tax implications of exercising your equity benefits. For example, exercising all your options at once could lift you into a higher tax bracket and land you with a bigger tax bill. A methodical, price-driven approach to exercising your equity benefits over time can help to reduce your tax exposure.

DIVERSIFICATION IS KEY

A diversified portfolio includes investments in multiple areas of the market, whether it's different stocks, sectors, investment vehicles or another measure. Owning too much stock of any one company can expose you to heightened risk. This is true even when it's the stock of a company you know very well, like your employer. While diversification alone does not necessarily protect you against financial losses, it's a critical part of the financial planning process.

When your employer recognizes your contributions with equity compensation, it's a moment to be proud of accomplishments as well as a significant planning opportunity. Your Baird Financial Advisor can help you craft a thoughtful financial plan that integrates your equity compensation with your overall goals.

Please reach out if you or anyone you know would benefit from discussing this topic further.