



## The Time Has Come for ESPP!



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## Webcast Materials

[www.sos-team.com/PDFS/espp.pdf](http://www.sos-team.com/PDFS/espp.pdf)

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## The Walrus and The Carpenter

"The time has come," the Walrus said,  
"To talk of many things:  
Of shoes--and ships--and sealing-wax--  
Of cabbages--and kings--  
And why the sea is boiling hot--  
And whether pigs have wings."

– Lewis Carroll

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## The ESPP and The Stock Plan Manager

"The time has come," the CC said,  
"To talk of many things:  
Of stock -and match –and shareholders--  
Of good discounts -- and offering--  
And why dispositions must be tracked--  
And the joys of expensing."

– SOS

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## Agenda

- The Case for ESPP
  - Statistics
  - Benefits for employees & company
- Plan Design, Administrative & Accounting Issues
- Steps to Implement
  - Research / Design
  - Board Approval
  - Vendor Selection
- Case Study – EMCOR Group

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## Survey Details


- [www.naspp.com](http://www.naspp.com) | Member Area | Surveys | Stock Plan Design Surveys
  - NASPP/KPMG: 2004 Stock Plan Design and Administration Survey
  - NASPP / Deloitte Consulting: 2007 Domestic Stock Plan Design and Administration Survey
  - NASPP / Deloitte Tax LLP: 2008 International Stock Plan Design and Administration Survey

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## Survey Details

- NCEO / CEPI 2009 Employee Stock Purchase Plan Survey
  - 412 companies responded
  - National Center for Employee Ownership
    - [www.nceo.org](http://www.nceo.org)
  - Certified Equity Professional Institute; at Santa Clara University
    - [www.scu.edu/business/cepi/](http://www.scu.edu/business/cepi/)
  - Comprehensive survey results available by contacting the NCEO or CEPI

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## THE CASE FOR ESPP

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## ESPP Facts...

- Studies show ...
  - Companies with broad-based equity plans show better results than those with narrowly focused plans<sup>1</sup>
- Satisfaction
  - Majority of respondents believe that the ESPP is positive: 30% describe it as “net beneficial” and 35% call it “an excellent use of corporate resources.”<sup>2</sup>

<sup>1</sup> Public Companies with Broad-Based Stock Options: Corporate Performance from 1992-1997, Blasi, Kroumova

<sup>2</sup> NCEO./ CEPI .2009 ESPP Survey

## ESPP Facts...

- Employee ownership tends to...
  - Improve company performance by aligning interests of workers and managers
  - Serving as collective incentive to improve teamwork and information sharing
  - 66% feel more invested in their jobs\*
  - 50% say ESPP made them less likely to change jobs\*
  - 65% say shows employer truly values employees\*

\*Data from "Bridging the Gap", July 2008, Fidelity Stock Plan Services

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## ESPP Facts...

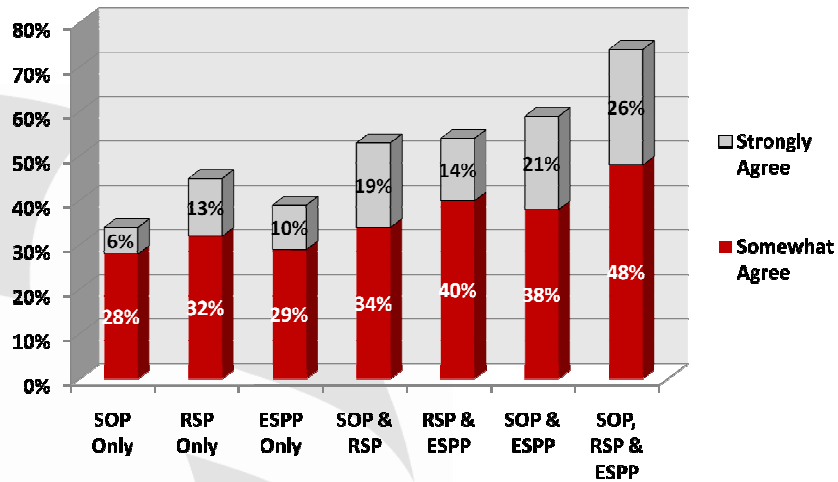
- Projected that 17% of US employers offer a stock purchase plan
  - As opposed to
    - 16% stock option plans
    - 9% restricted stock
- Are employees satisfied?
  - "very satisfied" or "somewhat satisfied"
  - 76% with plan performance
  - 79% with plan design

\*Data from "Bridging the Gap", July 2008, Fidelity Stock Plan Services

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“How much do you agree or disagree that you are more loyal to your current employer as a result of the...plan your company has awarded you?”



\*Data from “Bridging the Gap”, July 2008, Fidelity Stock Plan Services

## ESPP Facts...

- ESPPs produce cash flow to the company
  - Employees contribute post-tax via payroll contributions to purchase stock
- ESPPs are never underwater
  - With discount / match / look-back, they are always a bargain - sometimes an incredible bargain!
- Company Tax Deductions
  - For qualified plans from disqualifying dispositions
  - Or for company match on non-qualified plans
- Encourages employees to save
  - Without “locking them in”

## ESPP Overview

- What is an employee stock purchase plan (ESPP)?
- An ESPP is a type of broad-based stock plan that allows employees to acquire shares of their company's stock by electively contributing after-tax payroll deductions.
- Often include:
  - Benefit of a discount on the purchase price or a matching contribution made by the employer

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## Concerns: Expensing ESPP

- ESPP Expense is a non-cash expense
- Pre FAS 123(R) studies indicate expensing has little effect on stock price\*
  - Study 1: companies voluntarily adopting: Stock price increased average 3.65% over six-day window around announcement
  - Study 2: companies voluntarily expensing, conclusion – does not impact stock price
  - Study 3: 140 companies, results not statistically significant...
- Post FAS 123(R) studies\*:
  - 53% of sell-side analysts don't consider FAS 123(R) expense
  - Share prices for companies with significant expense underperformed the S&P 500 by about 2%
- Many feel plan's return outweighs effects of expensing

<sup>1</sup>NCEO Issue Brief: The State of Broad-Based Equity Plans, Corey Rosen, NCEO, 2008

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## Concerns: Shareholders

- 2003 Hager Study;
  - 91 companies in Canada and 54 in the US were surveyed:
  - Institutional and individual shareholders: more likely to look favorably upon broad-based stock plans than plans that just reward a few employees.
  - Returns found to be higher by about 1.78% in the US & 2.13% in Canada when broad-based plans announced

<sup>1</sup>NCEO : [Stock Option Grant Announcements and Shareholder Value](#)

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## Why Now?

- In difficult economic times,
  - ESPPs can be a great motivational tool
  - Build
    - Company morale
    - Employee loyalty
    - 'we're all in this together attitude'
- Right now, ESPP gives employees benefit of purchasing potentially undervalued company stock at a discount

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## Why Now?

- No bonuses this year?
  - ESPPs provide companies a way to compensate their employees
  - Without having to raise salaries
- Is business slow?
  - ESPP raise capital / cash inflow
- Recent large sweeping changes?
  - Timely introduction of ESPP may help energize employees to contribute to new projects, initiatives, etc.

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## PLAN DESIGN, ADMINISTRATIVE & ACCOUNTING ISSUES

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## Plan Design: Qualified? Or Non?

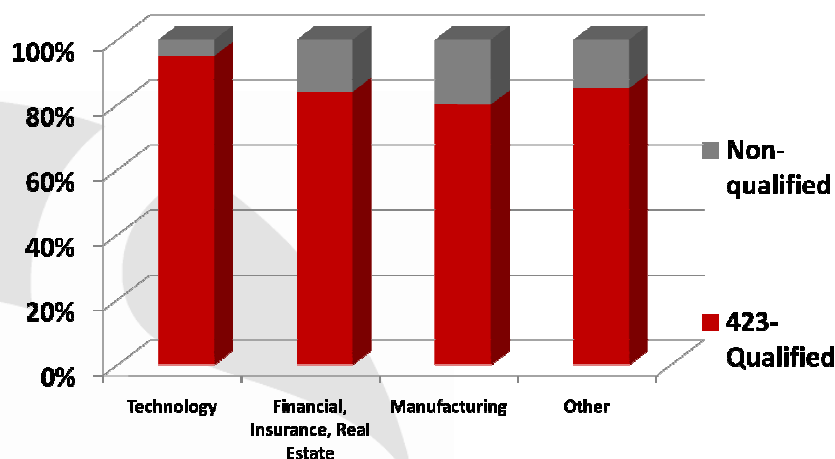
|               | Pros   | Cons  |
|---------------|--|---|
| Qualified     | <ul style="list-style-type: none"> <li>Higher participation levels by approx. 10%<sup>1</sup></li> <li><u>Opportunity</u> for favorable tax treatment at purchase</li> </ul>                                       | <ul style="list-style-type: none"> <li>Tracking dispositions (for all time)</li> <li>Regulatory requirements (6039, W-2 reporting, etc.)</li> <li>Must be non-discriminatory</li> </ul>   |
| Non-Qualified | <ul style="list-style-type: none"> <li>More flexibility in design/participation</li> <li>Fewer regulatory requirements</li> <li>Simplified accounting treatment</li> <li>Easier to explain to employees</li> </ul> | <ul style="list-style-type: none"> <li>No opportunity for favorable tax treatment at purchase</li> <li>Some may expect qualified, depending on industry/ prior experience</li> <li>Shareholder perception may be an issue?</li> </ul> |

<sup>1</sup>2007 NASPP./ Deloitte Survey .

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## Qualified or Non-qualified?



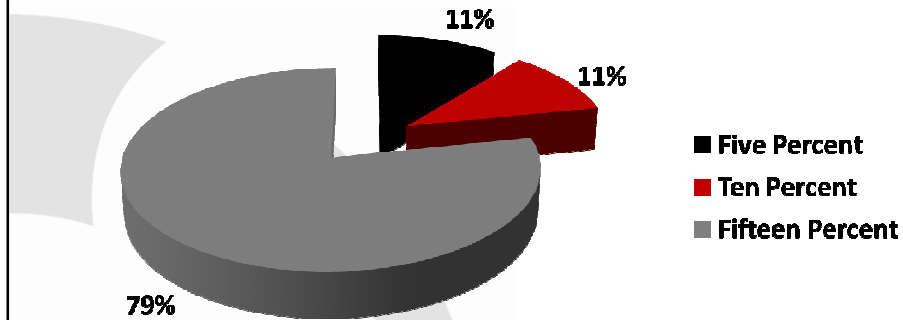
\*Data from NCEO/CEPI 2009 ESPP Survey.

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## Plan Design: Discount?

Percent of Companies Offering Discount (n=28)



\*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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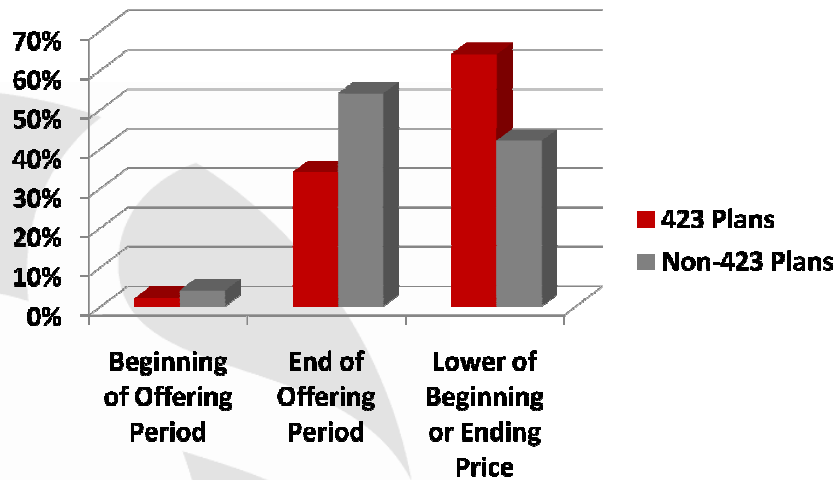
## Plan Design: To Lookback or Not?

|              | Pros   | Cons   |
|--------------|--|--|
| Look-back    | <ul style="list-style-type: none"> <li>Better benefit to employees</li> <li>Better participation?</li> </ul>                                     | <ul style="list-style-type: none"> <li>Requires expensing</li> <li>Increases expense</li> <li>Fewer employees understand/value</li> <li>Reduces cash inflow</li> </ul> |
| No Look-back | <ul style="list-style-type: none"> <li>Reduces expense</li> <li>Can be considered non-compensatory (no expensing) if discount &lt; 5%</li> </ul> | <ul style="list-style-type: none"> <li>Lower participation?</li> <li>Opportunity for employee gain less</li> </ul>   |

<sup>1</sup>2007 NASPP./ Deloitte Survey .

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## Lookback: When is purchase price determined?



\*Data from NCEO/CEPI 2009 ESPP Survey.

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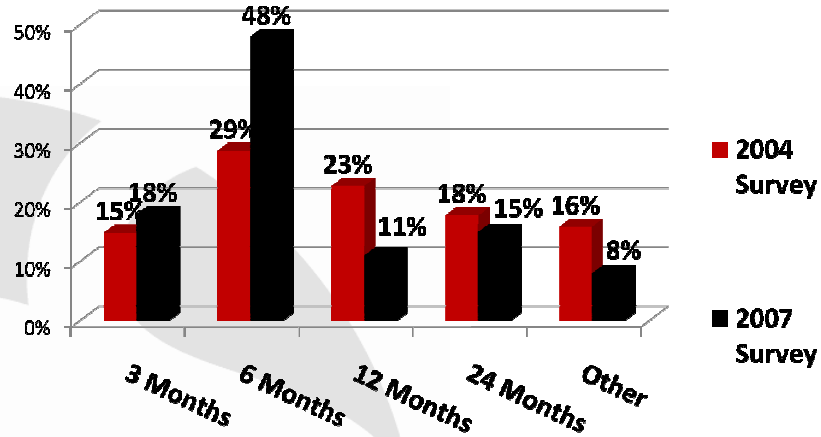
## Plan Design: Length of Offering

- Three months to... 27 months...
- No reason for longer offering if no lookback offered
- Shorter offerings: Employees become shareholders faster and see benefit faster
- Employees less worried about share plans because more variance in purchase price with more frequent purchases

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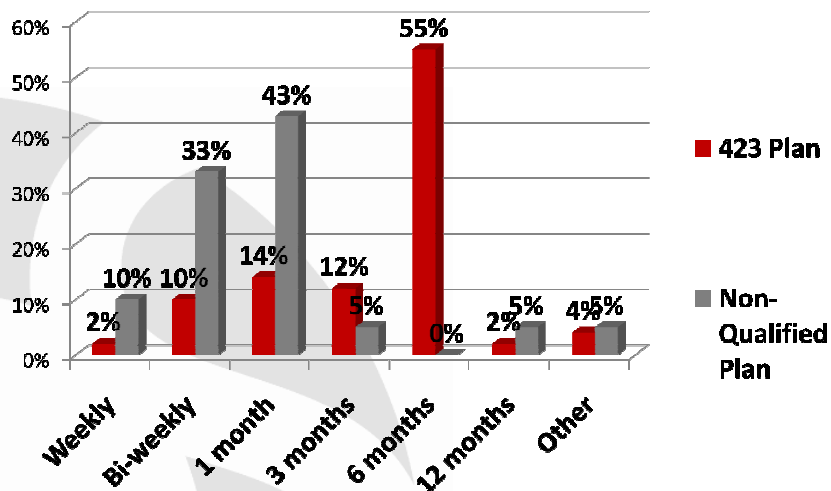
## Length of Offering Period: Trends



\*Data from 2004 & 2007 NASPP./ Deloitte Surveys .

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## Frequency of Purchase



\*Data from 2008 NASPP./ Deloitte Tax International Stock Plan Survey.

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## Accounting for 423-ESPP: Overview

- FAS 123(R)
  - If “option-like” features OR > 5% discount = compensatory
    - Grant-date Fair Value – basically Black-Scholes but...
    - Three components:
      - Discount,
      - Call,
      - Put
    - Created using Enrollment Date market value
    - No “expected” term – term is known
  - Non-compensatory – no fair value, no expense

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## ESPP Fair Value Components

| Plan Feature             | Description  | Fair Value Component      |
|--------------------------|--|---------------------------|
| Discount                 | % of discount  | Discount                  |
| Lookback                 | Ability to purchase at LOWER market value between beginning of offering period market value & purchase date market value.<br>Ability to benefit from <u>increase</u> in stock price. | Call Black-Scholes Option |
| No beginning price limit | Ability to purchase MORE shares if price declines (number of shares to be purchased not limited by<br>Ability to benefit from <u>decrease</u> in stock price.                        | Put Black-Scholes Option  |

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## Plan Design: Participation

- Qualified Plans:
  - To ensure plan is non-compensatory,
    - Exclude 5% owners, but include virtually all of your remaining employees with the exception of:
      - Part time employees (less than 20 hours per week)
      - Employees who have been employed less than 2 years
      - Employees who work less than 5 months each year
      - Highly-compensated employees
      - Employees of foreign subsidiaries
  - Groups can be excluded, however many companies try to include all full-time employees even if they have been employed less than 2 years
- Non-qualified – Can include/exclude as design decision

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## Plan Design: Shareholder Approval

- 423-Qualified Plans
  - Required for 423-qualified plans
  - Required within 12 months, before or after the plan approved by the Board
  - Approval is only required once except for an increase in the number of shares
- Non-qualified Plans
  - Required by NYSE / NASDAQ – Changed in 2003
  - Even if “arguably” de minimis potential for insider compensation OR material dilution for shareholders

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## Plan Design: Enrollment Period

- Choices
  - Window
    - Open window during which employees may enroll in new offering period and make changes to elections.
    - Enrollment choices made for one period roll into next period unless employee elects to make a change
    - Outside of window, employees only allowed to withdraw
  - Providing employees with the most flexibility will result in higher overall participation
    - No one wants to be locked in for long periods of time
    - But more administrative burden
    - Depending on changes allowed – may increase expense

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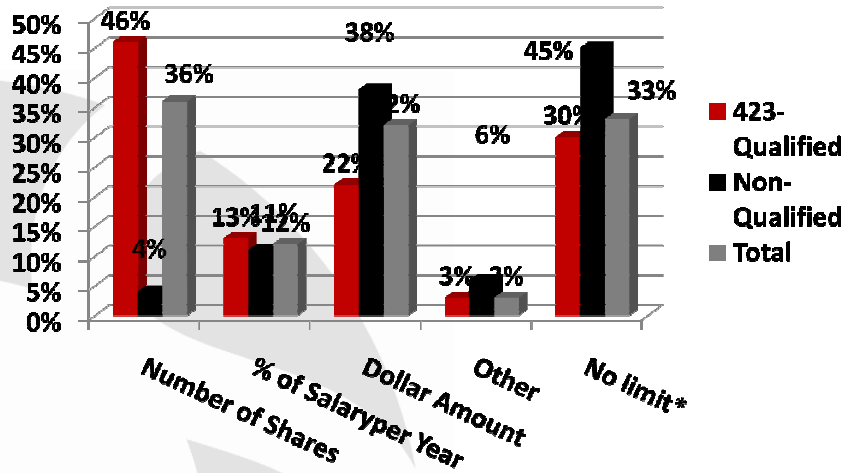
## Contribution Limit

- Qualified plans
  - \$25K contribution limit
  - Based on the value of shares purchased in the calendar year based on the FMV at the beginning of the offering period
- Companies also limit
  - Number of shares to manage dilution share reserve
  - Share limits not required
  - Add complexity to plan administration and employee communication process
  - May be best practice – can control burn rate
  - May be required for qualified plans under proposed 423 regulations

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## Types of Limits



\*Data from NASPP / Deloitte 2007 Survey.

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## Plan Design: Contribution Type

- Percent or \$ Amount?
  - Dollar amount easier to understand ?
  - Employees know exactly how much will be deducted from their pay each period.
  - Percentages or a combination of both require the employee to calculate the amount of the deduction and can be cumbersome.

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## Impact of Changing Discount / Look-back

- ESPPs administered by Fidelity that reduced their discount rate from 15% to 5%
  - Average participation rates dropped 50%<sup>1</sup>
- Other Changes:
  - Lowering discount to 10%
  - Removing lookback, or
  - shortening the offering period
  - had "no substantial impact" on plan participation<sup>2</sup>

<sup>1</sup>Fidelity StockSense Spring 2007 Newsletter

<sup>2</sup> NASPP Stock Plan Advisor, September-October 2007

## Automatic Resets

- If price drops during offering period, after next purchase
  - Price is reset or
  - Participant is automatically re-enrolled at new, lower price
- Excellent benefit to participants, but...
  - Triggers modification accounting
  - Few systems can support
  - Manual workarounds/spreadsheets often required

## Plan Design: Share Funding

- Treasury/Reserve (authorized/unissued) is most common
- Open market purchase
  - May have an impact on your stock price based on the number of shares required for purchase / trading volume

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## Plan Design: Restrictions

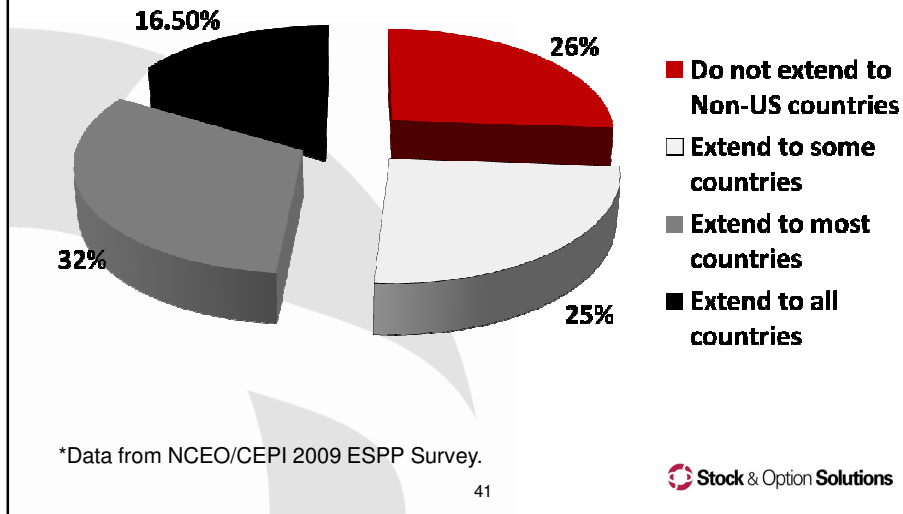
- Often done to ease tracking dispositions for 423-plans
  - Any restriction on transfer/sale
  - Direct impact on the level of participation
  - Vendors can assist with disposition tracking to avoid any restrictions on sales or transfers
- Also used to encourage ownership
  - Instead of flipping shares immediately after purchase for quick gain

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## International Plans

Do you extend your ESPP to non-US countries?



## Ways to Reduce Expense

- Fair Value
  - Shorten offering period
  - Eliminate lookback
  - Reduce discount
  - Eliminate automatic reset
  - Limit employee ability to change contributions
- Administrative
  - Leverage your provider – disposition tracking, communication, etc.

|   | Characteristics   | Tax Benefit  | Provides Discount | Used in Performance Incentive Program | No Shareholder Approval Required |
|---|---|--|-------------------|---------------------------------------|----------------------------------|
| <b>Qualified</b>  |   |  |                   |                                       |                                  |
| Section 423- Qualified Plans  | Stock offered to <u>all</u> employees, often at discount, using treasury or authorized / unissued shares.       | X  | X                 | X                                     |                                  |
| <b>Non-qualified</b>  |   |  |                   |                                       |                                  |
| Contributory Plans  | Company contributes specified \$ amount and/or non-qualified \$ toward employee stock purchased on open market. |  | X                 | X                                     |                                  |
| Discount / Match Plans  | Stock offered to employees at a discounted price or can contribute % or all in a match.                         |  | X                 | X                                     | X <sup>1</sup>                   |
| Open Market Plans   | Shares purchased on open market with payroll deductions. No discount or company contribution.                   |  |                   |                                       | X                                |
| <sup>1</sup> Required by NYSE / NASDAQ for many plans.<br>Grid adapted from Computershare ESPP materials. |   |  |                   |                                       |                                  |



## IMPLEMENTING ESPP



## Steps for Implementing

- Determine Plan Design
  - Type of plan (qualified/non-qualified)
  - Amount of discount or match
  - Offering and purchase frequency
  - Amount of shares required & type (treasury, open market, authorized/unissued)
- Present to Board of Directors
- Seek shareholder approval
- Select a provider for administration and communication

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## Presenting to Board and Shareholders

- Highlight benefits of offering an ESPP
  - For employee AND
  - Company
- Provide high-level estimate of cost of implementing an ESPP (can vary based on the amount of discount/match)
  - Number of expected participants
  - Amount of discount/match
  - Administrative costs
- Engage an expert to gauge likelihood of shareholder approval

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## Selecting a Provider

- Industry experience
- Partnership approach
- User-friendly systems and reports
- Communication expertise
- Fees

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## Implementation Overview

- Prepare implementation project plan with timeline and milestones
- Discovery process and procedural requirements
- Database and administrative platform setup
- Establish system interfaces with payroll and HRIS systems/employee and plan sponsor website/IVR
- Prepare communications strategy

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**CASE STUDY: ESPP AT EMCOR GROUP, INC.**



**EMCOR Group, Inc.**

- Fortune 500 Company with over 25,000 employees
- A leading provider of critical infrastructure systems
- EMCOR builds, powers, services and protects for maximum performance
- Markets include energy, transportation, health care, water, government, education, technology, hospitality

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## EMCOR's ESPP

- Background
  - EMCOR has annual management conference each fall
  - Employees submit questions for a company-wide webcast
  - In Fall of 2006, commitment was made to employees to explore offering an ESPP

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## Process -- 2007

- Explored alternatives, design issues, cost and administration methods
- First: Winter 2007
  - Established purpose of ESPP
  - Fleshed out design alternatives and associated requirements (i.e., qualified/non qualified, FAS 123R, tax considerations) for presentation to executive management committee (EMC)

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## Process -- 2007

- Next: Spring – Fall 2007
  - 3 discussions with EMC
    - First meeting to provide full scope of alternatives and sense general direction
    - Second discussion to narrow down alternatives and follow up on questions
    - Third discussion to solidify decisions
      - Numerous scenarios were presented to model various levels of company match/discount, participation and stock price assumptions
  - Initial proposal presented to BOD by CEO to gain approval to proceed

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## Process -- 2008

- Winter 2008
  - Vetted final design with stock plan consultant
  - Determined number of shares to reserve
  - General Counsel determined type of shares to reserve for Plan (authorized/unissued shares)
  - Final proposal approved by Board of Directors

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## EMCOR's ESPP Design

- Nonqualified ESPP
  - offer only to non-union employees (around 8,000)
  - Offer a flexible design
- Quarterly offering periods; monthly purchases
- Employees contribute 1 – 6% of pay
- 10% company match
- No holding periods required
- Purchase whole and fractional shares

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## Implementation Process -- 2008

- Searched for consultant to partner with on vendor search
- Selected consultant and commenced search in April
- Consultant had robust, diligent selection process
- Obtained shareholder approval in June
- Selected Vendor in June

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## Implementation Process -- 2008

- Held first kick-off meeting with Consultant and Vendor teams in July 2008
- Held weekly team meetings with EMCOR, Consultant and Vendor
  - Vendor prepared enrollment guide to supplement plan document & prospectus (from Legal)
- Successfully implemented ESPP on time for October 1, 2008 quarterly enrollment
- Held subsequent weekly meetings with Vendor and Consultant until November

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## Enrollment Statistics

- 4 quarterly enrollment periods
  - October 2008: 500 participants (6.2%)
  - January 2009: 600 participants (7.7%)
  - April 2009: 675 participants (8.1%)
  - July 2009: 700 participants (8.5%)
  - Average contribution 3.5%
- Introduced in tough economy
- Expect participation to grow over time

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## Contact Information



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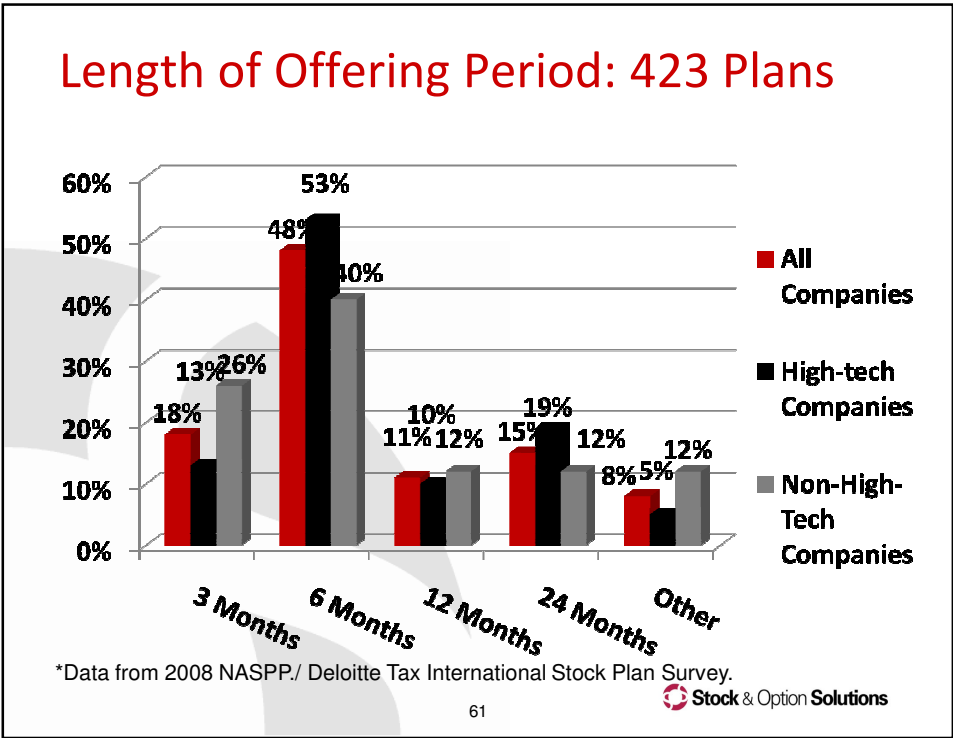


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## APPENDIX



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### Ways to Reduce Expense

| Method                                | Impact   | Why?  |
|---------------------------------------|--|---|
| Shorter Offering Period               | Reduces Fair Value                             | Shorter "expected term" = lower valuation   |
| Reduce / Eliminate Lookback           | Eliminates / reduces "call" part of fair value | <ul style="list-style-type: none"> <li>No benefit from increase in stock price</li> <li>Participants MAY not value lookback as much as discount.<sup>1</sup></li> </ul> |
| Eliminate auto-reset                  | Eliminates modification accounting             | No changes to "grant" after enrollment – no incremental expense or additional expense for additional shares   |
| Limit Ability to Change Contributions | Eliminates modification accounting             | No changes to "grant" after enrollment – no incremental expense or additional expense for additional shares<br>No "wasted" expense                                      |
| Limit Transfers                       | More tax deductions                            | Capture ALL the tax deduction to which company is entitled<br>Reduce survey costs   |

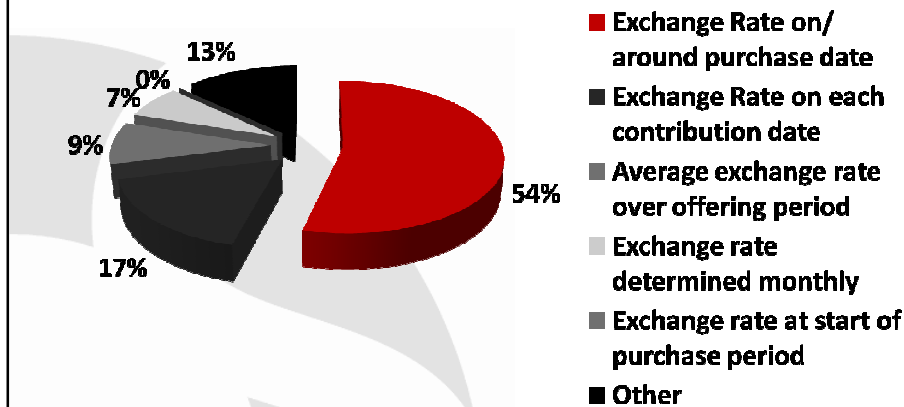
<sup>1</sup>Fidelity StockSense Spring 2007 Newsletter

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## Which Exchange Rate?

Which Exchange Rate do you use? (n=60)



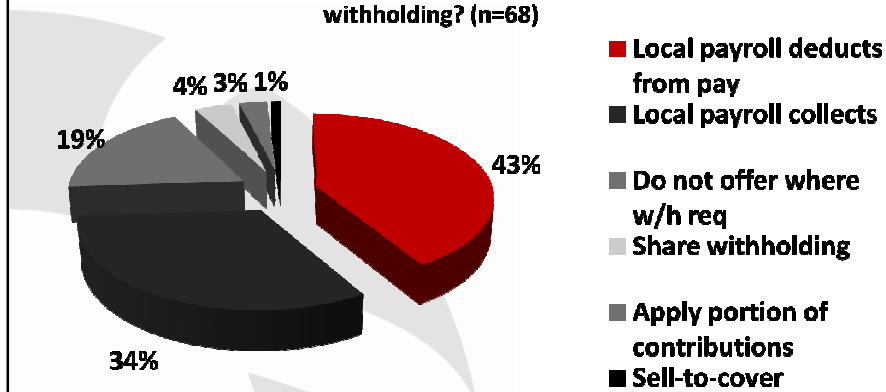
\*Data from 2008 NASPP/ Deloitte Tax International Stock Plan Survey.

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## How withholding is done?

For countries that require tax withholding on purchases under ESPP, how do you collect the tax withholding? (n=68)



\*Data from 2008 NASPP/ Deloitte Tax International Stock Plan Survey.

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