

BoardEx Execucomp Summary

January 2022

Types of Long-Term Incentive Plans (LTIP)

- We focused on options.
 - Options – Buy stock at a strike price sometime in the future. Usage has fallen since 2008.
 - LTIP Options – Awarded based if performance criteria satisfied. Preferred nowadays. Essentially a step added prior to giving an option.
- Other types of plans we did not look at:
 - Equity Matching Scheme
 - Employer matches whatever stock you already own in company
 - Equity Issued
 - Typically no vesting period
 - Cash Plan
 - Not sure yet what this is exactly
- Important to note that the data we have is about exercising a stock option. No idea how long an executive holds onto a stock.
 - Holding for awhile vs. selling immediately both are common strategies.

Options Timeline Example



Options and Taxes

- The granting of an option is not subject to tax. Neither is holding an option.
- Exercising option and sell stock **within same year**
 - You pay ordinary income tax on the gain from the strike price, ie the difference between the strike price and value of the stock when option is exercised.
 - You pay capital gains on the difference between the price you sell the stock and the value of the stock when option was exercised.
- Exercising and holding stock **beyond a year**
 - You pay capital gains, rather than ordinary income, on the difference between grant price and the sale price.

Example of exercising option and selling in same year

- Number of options: 100
 - Strike price: \$10
 - Fair market value when exercised: \$50
 - Fair market value when sold: \$70
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- When stock price is \$50, you exercise all the options. Your stock options cost \$1,000 (100 share options x \$10 grant price).
 - Next month you sell the all the stock for \$70.
 - Pay ordinary income tax on the difference between the grant price (\$10) and the full market value at the time of exercise (\$50). In this example, \$40 a share, or \$4,000.
 - Pay capital gains tax on the difference between the full market value at the time of exercise (\$50) and the sale price (\$70). In this example, \$20 a share, or \$2,000.

Options plans are very heterogeneous

- Several different plans typically awarded in same year.
- Plans differ in size, when vesting period starts and length, strike price, expiry date.
- Most option plans are NOT exercisable when issued -- executive must wait.
- But sometimes there are plans that are exercisable immediately.
- Very common to have strike price LOWER than stock price when issued.

All I was looking at was *quantities* of options per exec

- **OPT_EXER_NUM:** Number of options exercised by the executive during the year.
- **OPT_UNEX_EXER_NUM:** The aggregate number of unexercised options held by the executive at fiscal year end that were vested.
- **OPT_UNEX_UNEXER_NUM:** The aggregate number of unexercised options held by the executive at fiscal year end that were not yet vested.

Looked at exercised options out of total options held:

Ratio = OPT_EXER_NUM / (Total of all 3)

And

Ratio = OPT_EXER_NUM / (OPT_EXER_NUM + OPT_UNEX_EXER_NUM)

Problems we ran into

- Execucomp prevents us from seeing the heterogeneity in plans issued.
- We don't know the strike price of these options. Can not be backed out.
- Do not know the expiration date nor the vesting period length.
- Essentially all we can see is the aggregate **number** options for each individual.

We turned to BoardEx...

- Pros

- Shows options awarded by plan.
- Public and private companies. Executive and non-executives.
- Detailed plan info: We have vesting period start date (when option becomes exercisable), expiration date, strike price, stock price
- We have base salary, annual bonuses, etc.

- Cons

- Do NOT know when the option is exercised. Only know the period when it could be exercised.

BoardEx Analysis – Results were not very informative.

- Like with Execucomp we look at the ratio
 - $\text{Options Exercised} / (\text{Options Exercised} + \text{Unexercised Exercisable Options} + \text{Unexercised exercisable options})$
 - And
 - $\text{Options Exercised} / (\text{Options Exercised} + \text{Unexercised Exercisable Options})$
- **I constructed:** Options Exercised (all assumptions listed in next slide), Unexercised Exercisable Options, and Unexercised unexercisable options.
- I needed to make an assumption about when options were exercised.
- I only looked at numbers of options exercised/number unexercised. Not able to determine the value.

Assumptions of when options were exercised.

1. Median Vesting Year

- a. Assume that executive exercises option package at the median vesting period in the dataset (around 7-8)

2. Spread Out Package over Vesting Period

- a. If an executive has 1 over and a vesting period of 5 years then they exercise 0.2 of that option in each vesting year.

3. Executive exercises option package when stock value is highest during vesting period.

- a. Would be an upper bound case.
- b. Never programmed this. It is harder than it sounds.

Problems with BoardEx

- Not knowing when options were exercised really limited analysis.
- We discovered that after 2009 BoardEx surveyed fewer executives. Hard to distinguish whether options exercised were growing over time or sample getting smaller.
- **Not really a problem but good to know:** Also discovered that options are not longer popular. LTIP options are preferred now. LTIP option information is available in BoardEx.