Equity Compensation: Preparing for a Liquidity Event

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You're in line to receive a major payday thanks to your company's impending IPO. Or maybe your RSUs are finally vesting, and you're about to be worth a life-changing amount of money. It's a great position to be in – but not planning for it can leave you with more than a missed opportunity.

Helping clients with their equity compensation – negotiating it, managing it strategically for maximum benefit, and winding down concentrated positions – is something we spend an increasing amount of time on. As equity has become a common part of total compensation, particularly at tech and fintech companies, understanding the ins and outs of your grant or plan, and being intentional with its role in your wealth-building toolkit, is key to leveraging and maximizing the long-term financial benefits.

I've written about different types of equity compensation, the risks of being too concentrated in company stock, and how to weigh cashing out or holding on to your equity. But those all relate to handling your stock compensation after the fact. What you do before that is equally important.

Planning for a liquidity event

It can be really exciting when your company first hits the markets. Or maybe, you joined after the IPO, and your restricted stock units (RSUs) have finally vested. Whatever your situation, taking some time to plan before you cash in will set you up for long-term wealth-building, or at least to maximize the financial benefits. Crucially, it can help you avoid painful and expensive mistakes.

What should you know and do in the runup to a liquidity event? Here are five must-dos.

1. Make sure you know all the details of your equity comp agreement.
Everything from when your shares vest, to what the vesting requirements are, to your tax withholding options, what brokerage you are required to use, trading policies (restrictions on selling/blackout windows), and expiration dates will be outlined in your plan documents. If going through these details sounds daunting, and it can be, contact a financial advisor to help you understand all the nuts and bolts of your grant.

2. Outline your most important financial goals.
Is it paying off your student loans as quickly as possible? Maybe it's saving for a house, buying an investment property, or taking early retirement? Whatever they are, having a clear intention for how you want to use your new wealth, how much of it you will need to reach your goals, and in what timeframe (how quickly do you want or need to hit it?) is super important. It can help keep you from making impulsive decisions with it.

3. Plan for the unexpected.

To make sure you and your loved ones are taken care of, think through how you'd like your assets handled. Who would you like to benefit from your wealth? Who do you need to take care of? What kind of legacy do you want to leave? This could include charitable and/or religious giving goals if you have them. At a minimum, you want to designate beneficiaries for your stock plan assets. This estate planning document checklist can help you think through some of the considerations. You'll want to work with an attorney to draft and execute your personalized estate plan, especially if you have a partner, spouse, child, or other dependents.

4. Spread it around.
One surefire way to put your newfound, or any wealth, at risk, is to be overly concentrated in a single investment. Holding a large chunk of company equity and being employed by that firm leaves you doubly exposed. The best way to set yourself up for long-term growth and preserve your wealth, is to take steps to create a diversified portfolio. That means one that has a good mix of asset classes (stocks, bonds, real estate, etc) and individual investments. Your financial advisor can help you come up with a plan for regular equity sales that will reduce your concentration and direct your assets to the things that are important for you.

5. Plan for taxes.
It's important not to let tax considerations drive your decisions. Your hard-earned wealth should be about giving you more options, no pun intended, not boxing you in. But you still need to understand the tax impact of decisions you make. For instance, different types of equity get taxed differently. How long you hold your

equity comp after you vest matters to. Don’t rely on your friend who seems to have done well managing her own stock sales or even on your company’s HR team. You need an expert, ideally two. One should have experience not only with general tax preparation, but also specifically with equity compensation. Additionally, a financial advisor can create a comprehensive financial plan for you that includes your equity compensation and outlines big picture strategies.

Whatever you do, the key is not to go it alone. Lean on your experts to help you think through and plan for your new wealth. Their expertise won’t come free of course, but they can make sure you don’t fall into common traps like:

- leaving money on the table by not knowing key details of your compensation plan like, when your options expire;
- selling shares or ISO’s without a plan for how you’ll use the cash; and
- getting stuck with an unexpectedly large bill you can’t pay because you didn’t plan in advance for taxes.

That way, your money and assets can work for you, not against you.