NOVEMBER 16, 2022

For more information, contact:

Rob Marshall
+44 20 7551 2168
rmarshall@kslaw.com

Lauren Salas Mationg
+1 312 764 6955
lsalas@kslaw.com

King & Spalding

London
LLP
125 Old Broad Street
London EC2N 1AR
Tel: +44 20 7551 7500

Global Choice Programs with a Twist

Series 3, 10 in 10: Issue 7

Numerous multinationals allow their employees globally to elect whether to take their equity award grants as stock options and/or restricted stock units (RSUs). These "choice programs" provide employees with autonomy in their compensation structure and have been well received over the years. Companies have increasingly started including a cash compensation alternative in these choice program offerings, meaning participants can elect between stock options, RSUs and/or cash. Adding the cash option provides employees with ultimate flexibility but raises a number of global issues that need to be carefully considered in each country where the program is offered.

STRUCTURING A CHOICE PROGRAM

Companies typically structure global choice programs by providing each employee with a designated amount of compensation to "spend" within designated guidelines. A ratio is commonly used to differentiate between stock options and RSUs. Since RSUs are "full-value'" awards and do not require employees to pay an exercise price, RSUs are generally valued at three or four times as much as each stock option. For example, using a 4:1 ratio, an employee with $1,000 to 'spend' could choose to receive 250 RSUs or 1,000 stock options. Given the participants' ability to elect both award types, companies evaluating whether to implement a choice program should consider the following issues for both option and RSU grants:

- **Taxation**: Companies should ensure equity awards are taxed at exercise for a stock option and at vesting for an RSU (i.e., in the ordinary course) and not before that time. In most countries, this issue is resolved by requiring the employee to make the election before the relevant work period. In others, a participant's choices may need to be limited to avoid early taxation.
- **Securities Laws**: Companies should also confirm whether the equity award grant triggers any securities compliance filings. Allowing employees to choose their equity award is frequently viewed as a securities offering of the full number of stock options and RSUs that

the employee can potentially choose, rather than just the ultimate equity award granted to the employee. This becomes important in countries where compliance filings differ between stock options and RSUs or when securities law filings are required if a specific offer threshold is exceeded. Japan is the best example where a large stock option offering can result in substantial filing and continuous disclosure requirements, while RSUs do not require any compliance filings regardless of the offer size.

ADDING A CASH COMPONENT TO A CHOICE PROGRAM

In addition to the same tax and securities issues discussed above, adding a cash alternative to the global choice program raises a number of additional employment and benefit issues. As such, the following should be carefully considered before implementing a cash option to a choice program:

- **Employment Rights**: For companies offering a global choice program, a careful review of whether the issuer of equity awards might also be considered an employer under local law requirements should be undertaken. Further, the ability to argue that equity awards should be considered a separate contract between the issuer and the employee, and not part of the terms of employment with the actual employer, is diminished. This may have a number of consequences, including changing the amount of what is considered “salary” for the purpose of various employment rights, including severance and similar payments.
- **Employment Status**: Various aspects of a participant’s employment status can impact the structure of a choice program, including the ability to offer cash as part of the program. This includes employment type (i.e., employee versus consultant) and work permit status. For participants sponsored by a work permit, companies should implement restrictions to protect the participants’ work permit status and ensure participants disclose certain salary changes to immigration authorities.
- **Employee Benefits**: A participant’s employee benefits package may be affected based on an adjusted base salary amount. For example, if the cash election lowers the participant’s base salary, the benefits payable under certain life and disability policies may be reduced given that such policies are calculated using a participant’s base salary, which should be clearly explained to participants before they make their program elections. This same impact could apply to employer-sponsored pension plans. Employment law obligations regarding changes to base salary must also be observed.
- **Social Insurance Programs**: Participants should be aware of how their social security benefits may be impacted. Most countries calculate benefit amounts using a participant’s salary, but the definition of salary varies by country. As such, participants should confirm how salary changes may modify benefit calculations/amounts before making their elections.
- **Promotions, Relocations, and Leaves of Absence**: The impact of a participant’s role change (e.g., promotion/transfer) and/or relocation should be considered. Both domestic and international relocations could affect the value or tax treatment that applies to a participant. Similarly, companies should consider whether eligibility and/or the vesting schedule of such grants is adjusted during a leave of absence.

PRACTICAL TAKEAWAYS

Allowing employees to choose their compensation structure is attractive to most employees and a number of companies are exploring this approach. Employers should conduct a holistic evaluation of whether a choice program is sensible for their business model, employees and administrative capabilities. Most importantly, careful consideration of the tax, securities and employment issues is necessary to avoid compliance pitfalls in each of the countries where the program is offered.

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