Cooley

Restricted Stock Unit (RSU) Considerations

Making the switch to RSUs in your equity program may seem straightforward but can be fraught with traps for the unwary. Proactive cross-functional collaboration is key to ensuring that your RSU program is designed to provide optionality and reduce friction as your organization scales.

RSUs overview

- RSUs are designed to deliver (or "settle") shares upon satisfaction of vesting conditions.
- Taxes are generally due upon settlement.
- When granted by private companies, RSUs are typically structured as "two-tier" or "liquidity event" RSUs so that vesting and settlement (and thus taxation) occur only when there is liquidity to cover tax withholding obligations.
    - The first requirement is typically service-based.
    - The second requirement consists of a liquidity event condition, such as a change in control or an IPO, either of which must occur before the RSU expires.
    - Both requirements must be met for an RSU to vest.
- Two types of two-tier/liquidity event RSUs have evolved:
    - "Need not be present to win" RSUs where, upon a qualifying termination of service, an employee retains the RSUs that have met the service-based requirement, with those RSUs vesting and being settled upon a liquidity event, if any, occurring prior to expiration of the award. (The liquidity event must not be "probable" at the time of grant, and the term of the award must generally be no longer than seven years.)
    - "Stay to play" RSUs, where the individual must be in service as of the liquidity event, and forfeits all RSUs upon a termination of employment prior to the liquidity event.

Put the right equity support in place

- An experienced head of equity can save significant time and cost, particularly in the lead-up to an IPO.
- Select an equity administration platform that also can serve as your public company platform and captive broker.
- Consult with your equity team and outside counsel on the pros and cons of the different market players for transfer agent and captive broker services.

Lay the groundwork early for an eventual IPO

- Discuss with your finance and technical accounting teams and outside auditors when to switch to "must be present to win" RSUs.
- Begin educating employees about the basics of RSUs and their taxation.
- Engage early with the finance, accounting and HR teams on the optimal approach for settling RSUs that will vest in connection with an IPO, given the multitude of downstream impacts from that decision.
- Companies may elect to net share settle, as opposed to sell to cover, due to relative logistical and disclosure simplicity, visibility into net dilution effect, and minimal impact on post-IPO float.
    - However, net share settlement at IPO continues to pose risks for funding the withholding payment due in connection with IPO closing, particularly for companies without sufficient cash on hand (before accounting for receipt of IPO net proceeds).
- Revisit your equity plan and form of RSU award agreements.
- Give your board or compensation committee as much flexibility as possible in determining settlement date, method and fair market value for withholding purposes.
- Consider setting vesting dates to fall in anticipated open trading windows to facilitate sell-to-cover transactions.
- Understand the eventual stock-based compensation impact on your post-IPO quarterly results and ensure appropriate disclosures regarding this expected impact are reflected in your IPO prospectus.
- Account for interplay with any early lockup release in your IPO, including by understanding the capabilities (and limitations) of your captive broker's equity administration platform.