



Fidelity Stock Plan Services

Your Guide to Offering an Employee Stock Purchase Plan

In today's tight labor market, where companies are exploring a range of potential benefits to help differentiate their offerings and keep employees engaged, employers are rediscovering the many reasons to use employee stock purchase plans (ESPPs).

Whether you're considering a new ESPP, or evaluating changes to an existing plan, this guide can help.



1 Why ESPP?

ESPPs have been a favorite way to share company ownership on a broad basis since the 1960s. Here's why they're so popular:



*Source: Fidelity Stock Plan Services 2018 Participant Research.

ESPP 101

ESPPs allow employees to purchase company stock (often at a discount) generally through payroll deductions. The plans are broad-based and may offer a tax qualification to U.S. employees.

2

Deciding on Tax Qualification

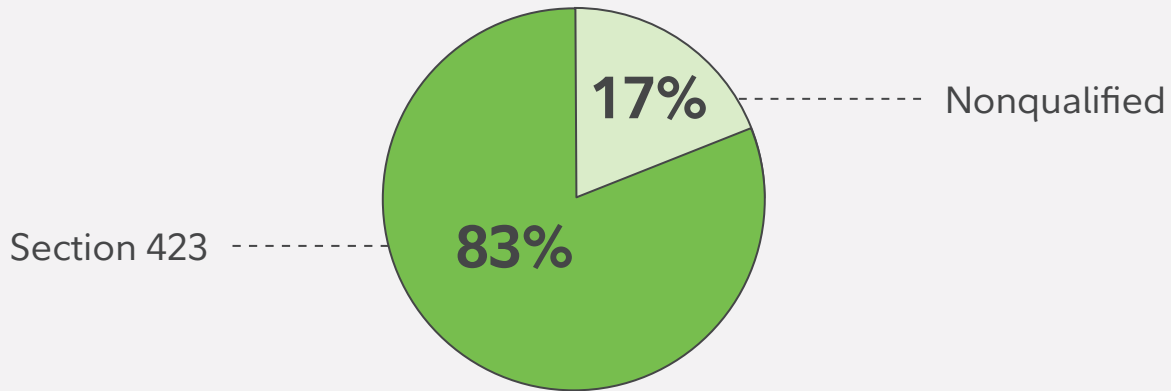
Are you thinking about a Section 423 or nonqualified ESPP?

Section 423 plans offer possible tax benefits for U.S. employees, but have design limitations, eligibility exclusions, extra reporting, and tax implications for participants.

Nonqualified plans are not subject to **as many** rules and restrictions and can simplify tax reporting for your employees, but these plans don't offer possible tax benefits and require withholding at purchase.

Section 423 plans far exceed **nonqualified (NQ) plans**, but NQ plans with similar design features can attract similar levels of employee participation—without plan reporting and tracking obligations.

PERCENTAGE OF TOTAL ESPPs*



PARTICIPATION RATE*



Section 423: 28%

423 plans with a 15% discount



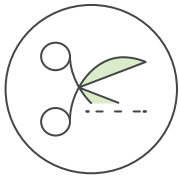
Nonqualified: 23%

NQ plans with a 15% discount
or a match feature

*Source: Fidelity Stock Plan Services 2022 ESPP data analytics.

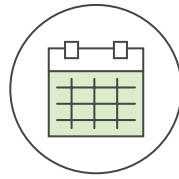
3 Mixing and Matching

There are three major design elements that need to be considered.



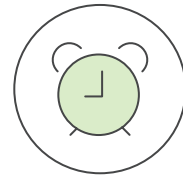
The Discount Helps Drive Participation

The higher the discount or match, the greater the participation. Section 423 plans permit a maximum discount of 15%.



A "Lookback" Can Be Beneficial

A lookback feature can stretch the discount when the stock price is appreciating by comparing the price at the beginning of the offering period to the price on the purchase date, then applying the discount to the lower price.



Your Offering and Purchase Period Decision

Most plans have an offering period that's equal to the purchase period (usually 3 or 6 months). With a lookback, this feature can deliver significant value to employees when the stock price is appreciating. For plans that don't have a lookback, longer offering or purchase periods don't make much sense.

TWO SCENARIOS OF A PLAN WITH A 15% DISCOUNT AND A LOOKBACK



- Price at the **beginning** of the period = \$10
- Price at the **end** of the period = \$12
- Employees purchase shares at **\$8.50** (85% of the \$10 price) when shares are trading at **\$12**, for a **41% return on investment**.



- Price at the **beginning** of the period = \$10
- Price at the **end** of the period = \$8
- If the stock price declines from **\$10** to **\$8** over the same period, the lookback doesn't kick in, and employees pay **\$6.80** for shares that are worth \$8 for a **17.6% return on investment**.

4

Show Me the Money

When considering an ESPP, follow these steps to better understand the compensation cost and share usage of a proposed plan:



1. CALCULATE THE EXPENSE PER SHARE.

Without a lookback, this is generally equal to the amount of the discount. With a lookback, an option pricing model can be used to estimate the fair value.



2. ESTIMATE YOUR PLAN PARTICIPATION.

Our [ESPP data analysis](#) is a great starting point for estimating participation based on your plan design features. Participation may also be affected by stock performance, company culture, and education and communication.

Remember:
plan design
helps drive
participation.



3. ESTIMATE CONTRIBUTION AMOUNTS.

Again, you can use our [ESPP data analysis](#) to estimate contributions based on your plan design features. You should consider your maximum contributions allowed and the disposable income levels of your participants in targeting your high- and low-end estimates.



4. ESTIMATE THE COST AND SHARE USAGE OF YOUR PLAN.

This involves some simple math:

- **Multiply your participation estimates by your dollar contributions estimates.**

This is the estimated amount that could be contributed to purchase shares.

- **Divide that by the price employees will pay (based on your plan design features).**

This is the estimated number of shares that will be purchased.

- **Multiply that by the expense per share calculated in Step 1.**

This is the estimated cost and share usage of your plan.

Looking for support determining the right ESPP design for your organization, including modeling the expense and share usage? [Fidelity Workplace Consulting](#) can help.

*Investing involves risk, including risk of loss.

5

Additional Considerations

When building your ESPP, there are a number of smaller details you'll ultimately need to address.



Eligible Compensation

Specify what's eligible — bonus, shift differential, commission, or other compensation. You'll also need to pick a minimum and maximum contribution percentage (usually from 1% up to 15%) that can be contributed from eligible compensation.



Fractional Shares

More than half of ESPPs purchase fractional shares.* With this arrangement, all employee contributions get used for share purchases, so you don't have to manage refunding or rolling forward any residual amounts.



Changes

You choose whether employees can increase, decrease, reduce their contributions to zero during the period, or withdraw altogether. Some changes can have accounting implications.



Purchase Limits

Under Section 423, qualified plans limit employees to purchasing no more than \$25,000 in value per calendar year. An additional share or dollar limit can be used to mitigate compensation expense and manage share usage.



Sale Restrictions

You can require employees to hold purchased shares for a fixed amount of time. These restrictions are relatively uncommon and can drive down participation rates, as employees may have concerns about liquidity.



Transfer Restrictions

With this approach, shares need to be sold from a Fidelity Account®. In Section 423 plans, this lets you maximize your corporate tax deduction and minimizes your administrative hassles.

*Source: Fidelity Stock Plan Services 2022 ESPP data analytics.



What's Next?

Evaluating a new ESPP can be an exciting time, and you may be eager to move forward quickly, but there are a couple of important considerations in planning your next steps:



Shareholders' Say

Section 423 requires shareholder approval, and listing requirements will likely mean that shareholders get their say, even on a nonqualified ESPP.

Good news: Historically, shareholders have nearly universally approved ESPPs.

Tips: Avoid an evergreen provision and keep an eye on any proxy advisory guidance about the size of the share request.



ESPP ≠ DIY

ESPPs require the involvement of many—internal stakeholders, including your stock administration team, payroll, HR, legal, treasury, employee communications, and financial accounting. Make sure you have the right personnel involved in drafting your plan documents.



Offering to Rest of the World

Plan for due diligence in each jurisdiction and the involvement of local payroll and HR. Depending on the number of jurisdictions you're targeting, you may want to consider a phased rollout.

[Around the World with ESPP](#) can help you plan for a global rollout.



Communication Is Key

Successful ESPPs with high participation are nearly always paired with comprehensive education and communication campaigns. Understanding how the plan works can help drive employees to take action.

Learn more about ESPPs.

ESPPs can help create a **differentiated** employee benefits package, establish a feeling of **ownership** among employees, and connect your **employees' future** to the potential success of the company.

Interested in learning more about ESPPs?

Contact your Fidelity Stock Plan Services representative.



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