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A Piece of the Invisible Pie: Phantom Stock & SARs

By Rob Barton

When I was a child, one of six in my family, we became conditioned to be the first one in the kitchen after something came out of the oven. Whether it was a batch of cookies, a cake, or a freshly baked pie, we knew that resources were limited and we needed to stake our claims on the biggest pieces. Without exception, there would eventually be a scenario where the number of remaining slices didn't equal the number of family members present. I remember one incident when I tried to convince my little sister into taking an invisible slice of pie, so I could have the last piece. It didn't work of course, but what if it had worked? What if she took that invisible slice of pie and was completely satisfied with it, complimented my mom on how great it tasted, and then remarked on how full she was afterwards? Well, that is the same principle behind Synthetic Equity Plans, more commonly known as Phantom Stock or Stock Appreciation Rights plans.

Aligning the goals of the shareholders and employees of a company can be a challenge. One great way to do this is to make the employees actual shareholders. For closely held community banks however, this isn't always an option. Dilution of ownership and voting rights are oftentimes something that current shareholders may want to avoid. Perhaps it is a family-owned bank, and would like to remain so in the future. These scenarios make giving stock grants or options to employees less desirable to current ownership. Synthetic Equity Plans help resolve these problems.

Synthetic Equity Plans typically fall under two categories, Phantom Stock and Stock Appreciation Rights (SAR). Phantom Stock plans can be compared to a typical stock grant, while SAR plans are more like a stock option plan. But in both plans, no actual stock switches hands; it's like a slice of invisible pie. Ownership remains the same and key employees instead are given synthetic stock. Synthetic stock is basically imaginary shares that hold real value, they act like stock, appreciate (or depreciate) like real stock, they can even reinvest dividends, but they carry no actual ownership or voting rights. Rather, the dollar value of the shares is held in a liability account on the banks books to be paid out at a later time, usually retirement.

These plans are commonly used in community banks as both incentive and retirement plans. Phantom shares or fractions of phantom shares are awarded annually, dependent on an individual's performance in a given year. As years go by, and the employee has accumulated an attractive amount of shares, typically payout of the cash value of those shares occurs when the employee retires from the bank, thus rewarding them annually for their performance and years of service to the bank, all done while current owners see no dilution of their ownership. Leaving the original pie totally intact.

If you would like to learn more about Phantom Stocks or SAR Plans, please contact Rob Barton at Bank Compensation Consulting at rob.barton@bcc-usa.com or at 1-800-781-2099 or direct at 214-919-2927.

Rob Barton has been advising community banks in the areas of nonqualified benefits and Bank-Owned Life Insurance (BOLI) for over a decade. He has worked with banks nationwide and has extensive experience in the design, administration and regulatory requirements of nonqualified retirement plans.

Rob earned his B.S. from Brigham Young University, his J.D. from the University of Minnesota Law School, and his MBA from The Carlson School of Management at the University of Minnesota, where he emphasized in finance and strategic management.