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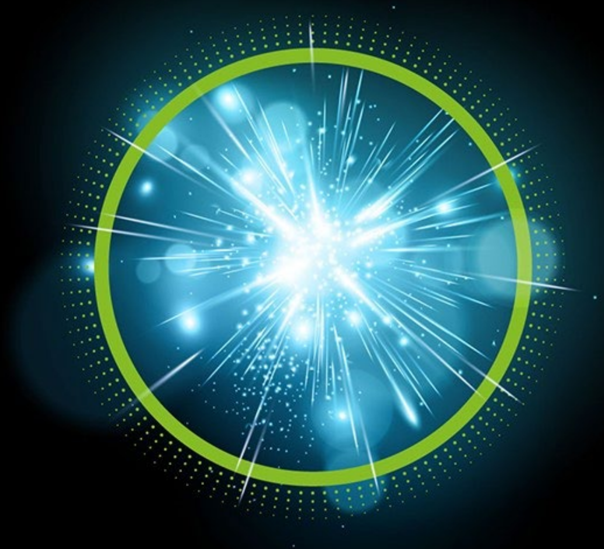

DELOITTE'S TAKE ON THE MOVE TO T+1 SETTLEMENT AND IMPACT ON STOCK-BASED COMPENSATION

As the introduction of T+1 settlement draws closer following the SEC's adoption of new rules, companies and brokers are considering the impact the change will have on equity compensation plans.

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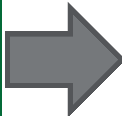
There is increasing pressure on employers to ensure broker-dealers are equipped with the data points to settle certain employee equity award transactions. Equity award settlement involves coordination amongst multiple stakeholders (broker, payroll, tax and transfer agent, to name a few), and in a decreasing window of time. The updates on the horizon to settlement timing suggest employers should assess and determine whether their equity compensation programs are operating in a manner that not only allow the employer to meet its tax compliance obligations but also meet employee expectations.

Securities settlement timing overview

The SEC has adopted rule changes to shorten the standard settlement cycle for most broker-dealer securities transactions from two business days after the trade date (T+2) to one (T+1).

- **The effective date for the final rule is May 28, 2024.**



Impact on Equity Compensation Plans

The change to T+1 applies to "broker-dealer transactions", and it will therefore impact certain employee equity awards, notably:

- Stock-settled restricted stock units (RSUs) subject to tax withholding
- Exercises of stock option or stock appreciation rights (SARs) utilizing a same-day-sale arrangement

The SEC rule change provides an opportunity for employers to review equity operations in the context of tax compliance, efficiency and employee expectations.

What are the key considerations for equity compensation plans?

While there are several impacts to the broader employee share plan industry, a few notable areas for consideration include:

Tax withholding

With a shortened settlement cycle for broker-assisted equity transactions (e.g., same-day-sale option exercises or RSU vests subject to withholding), employers may have to review their approach to tax withholding.

US tax remittance

If the U.S. 'next day deposit' rule applies, employers have until the day after settlement to remit employment taxes to the IRS, provided settlement occurred within two days of payment being initiated. Going forward, because settlement will occur a day earlier, the same tax remittance would also be due a day earlier (i.e., on T+2 instead of T+3).

Employee experience

We have seen many employers in recent years increasingly prioritize employee experience in the context of their share plans. These employers are focusing on education and financial wellbeing programs as well as employee expectations around award settlement.

What can companies be doing to prepare?

Looking at the considerations noted earlier, employers who issue equity-based awards may want to consider some of the areas below in preparation for the arrival of T+1 (May 28, 2024).

Review end to end settlement process

Initially, employers should ensure they have a robust process in place for timely tax withholding to meet broker settlement deadlines.

- Employers typically have processes in place for tax withholding for domestic employee populations to facilitate real-time withholding (e.g., through tax profiles within broker systems). However, this is not always the case, and less common for mobile employees.
- Employers should review their tax withholding processes (for both domestic and mobile employees) to assess capability for taxes to be in the broker system prior to T+1 settlement.
- Where possible, automation of withholding processes and leveraging technology can provide significant acceleration of processing times.

Prepare to accelerate remittances

Even if employers are comfortable with their tax withholding processes, there may be difficulty with U.S. next day deposit deadlines (when applicable).

- The current process may result in timely remitting employment taxes to the IRS that is compliant with current T+2 settlement timelines. However, employers should consider whether such processes will continue to enable timely remittances under a shortened window.
- To handle potential issues, strategies may be utilized such as making estimated remittance payments for withholding taxes or opting for net settlement over sell-to-cover.
- The IRS has not announced if current administrative relief for non-compliance with next day deposit rules will be updated to reflect the SEC settlement period of T+1.

Consider the employee experience

Employee experience in the context of equity awards continues to be a key issue to address.

- Employees may be (or become) aware of the T+1 changes and reach out to understand how their equity awards might be impacted.
- Proactive communication to employees explaining changes (if any) to their exercise processes following the introduction of T+1 may be useful.

There are various items for employers to consider when it comes to assessing the impact of settlement timing being reduced to T+1. In explaining the reduced settlement cycle, the SEC signaled consideration of an eventual shift to a T+0 settlement cycle. Employers may want to consider the potential for future rule changes when designing their equity processes. **For now, however, it is critical for employers to coordinate with key stakeholders, including stock plan administrators and payroll, to confirm they are aware of the new settlement process timing and how this may affect compliance with payroll and employment tax deadlines and processing.**

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