PART I

Sales

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Chapters 1 through 6 focus on the many and complex barriers to managing concentration risk and the most fundamental techniques for dealing with concentrated stock: selling the stock and not buying more. The simplicity and immediacy of this response often stuns clients—and their advisors. In all cases, it's the right place to start—and in many, it's where you can stop.

CHAPTER 1

Constraints on Managing Concentration Risk

Clients face many constraints in addressing the risks of concentrated stock positions: Taxes, contractual limitations, legal requirements, employer mandates, and—perhaps trickiest of all—an array of psychological barriers that complicate the process. Third-party observers are often stymied as to why concentrated stock positions are such a challenge. To demystify things, let's walk a short distance in the shoes of those who feel burdened by concentrated positions, get a feel for the shape of the obstacles they face, and uncover ways to surmount them. For advisors to those other clients who feel empowered by the concentrated position, bear with us. We'll have more to say on that as the story unfolds. For now, you, especially, should pay close attention because the shift from empowerment to burden can be swift and unexpected since so much depends on factors (market values) beyond anyone's real control.

Finding solutions to concentrated stock problems means navigating some dangerous shoals. In the following chapters, we'll examine many of these obstacles in far more detail. Indeed, real-life examples of these constraints and how firms like Aspiriant have dealt with them form the core of the various management strategies explored throughout the book. But first, let's get a basic understanding of why concentrated wealth can be so difficult to manage.

Taxes

No less an authority than Supreme Court justice Oliver Wendell Holmes observed in *Superior Oil Co. v. State of Mississippi*[1] that every person has the right to minimize his exposure to tax and to take advantage of every opportunity to avoid tax liability. "The very meaning of a line in the law," said Holmes, "is that you may get as close to it as you can if you do not pass it." This completely legitimate, even laudable, tax avoidance must be distinguished from the criminal activity of tax evasion, such as not reporting income or reporting fraudulent information. Although evasion can sometimes be a strong temptation, no advisor, of course, can encourage or condone such behavior for clients. No one will find any suggestions in this book to encourage any violation of the tax or any other law. Plenty of lawful and effective strategies for managing concentration risk are available. There is no need to go beyond those boundaries.

Still, a deep vein of aversion to tax liability runs through our culture, particularly among those who, as least as they see it, created their own wealth. Many clients dread incurring tax liability so much that they will bear the significant (and sometimes even acknowledged) risk of concentration just to avoid it. This isn't always the case, of course; some clients are quite willing to bear the tax cost, seeing it as an acceptable and indeed small price to pay for their financial success. Some even go to the opposite extreme and see taxes as a vehicle for giving back to society as a whole. As one of my tax professors at the University of Michigan Law School, L. Hart Wright, often told his students, "The federal government is my favorite charity." We all believed that he meant it. In any event, it was important to hear him repeat it, giving his eager young law students the proper perspective on their future responsibilities: not to beat the system but to take pains to understand it and make sure it operates as intended.

But this tax-as-charitable-gift point of view is not the perspective that typically brings clients to your office—at least not those looking for solutions to their concentration problems. Instead, it's often their aversion to the income tax exposure that the concentrated position presents. They are often surprised to learn that the gift and estate tax regime can also come into play (sometimes to their advantage but often involving additional costs). Be careful not to overwhelm your client with too much tax detail up front. We've had several clients, not savvy about tax law, become frightened by the intricacies and retreat to their former comfort zone, abandoning, at least for a time, any attempt to seriously address the tax issues around managing concentration risk.

So once you have the client's attention—or are able to regain it—make sure you're in command of the facts about the client's concentrated position. Ask these four key questions:

1. **What kind of asset is it?** Not every asset qualifies as a capital asset. Whether it is or isn't has to do with facts and circumstances specific to the client. To an art dealer, a painting may be a piece of inventory (no capital gain, but ordinary income at sale); to the art collector who buys it from that dealer, it may be a capital asset. What's more, some assets, like depreciable real estate, must have some or all of any prior depreciation recaptured at sale as ordinary income, with only the balance, if any, taxed as capital gain. And some categories of assets simply aren't eligible for the favorable 0, 15, and 20 percent rates (underlying the ObamaCare 3.8 percent surtax where it applies). Capital gains on gemstones and precious metals, for example, are taxed at the underlying 28 percent maximum rate.
2. **Does the holding qualify for long-term capital gains treatment?** In general, if it's been held more than one year, the federal long-term capital gains rates apply:
   - Zero percent until the generally applicable ordinary income tax bracket exceeds 15 percent
   - Fifteen percent for gains until the generally applicable ordinary income tax bracket exceeds 35 percent
   - Twenty percent for gains that cause total taxable income exceeding the level where the generally applicable ordinary income tax bracket is 39.6 percent

   If it has not been held that long, then it may be a short-term capital gain, subject to tax at ordinary income rates, but like a long-term gain, it can first be offset by capital losses before the tax rates actually apply. For example, if in one taxable year, your client has both a short-term capital gain of $100,000 and a long-term capital loss of $75,000, only the $25,000 net amount is taxed—but at ordinary income rates.

   This illustrates the common strategy of taking any available tax losses—by selling loss positions—to offset gains that may be necessary to achieve the diversification of an appreciated concentrated stock position. Clients are prone to seeing each piece of their overall portfolio in isolation. Many are very happily surprised to realize that the tax burden of diversification is not so bad after all, once the available loss positions in their portfolio are taken into account.

State tax laws usually follow the same more-than-one-year rule if they provide a special capital gains rate. Some states tax capital gains just like any other form of income.

3. **What is the basis?** Income taxes are only a problem for concentrated positions if there is an actual capital gain in excess of the asset's basis. A longtime client retired as chief executive officer of a public company and was immediately approached by a large brokerage firm to participate in an exchange fund it was assembling. To the brokerage firm's surprise, the aggregate holding was at a loss. "Never mind," was the broker's reaction. Now, no longer constrained by his position as CEO, our client was finally free to simply sell, at no tax cost. See our discussion of Exchange Funds and similar structures in Chapter 14.

   Capital gains and losses are measured from the asset's basis. Generally this is the amount the client paid for it, but capital additions or depreciation can move the basis up or down. Probably, the largest volume of contemporary concentration problems are the result of first generation wealth creation in public companies, especially in *newly* public companies, and there may be even more in private companies on their way to becoming public. Much of this wealth has a basis close to zero. Nevertheless, many large concentrated positions result from gifts or inheritances of previously created wealth. Generally, gifts carry over the basis of the donor and, under current law, transfers of assets at death carry the date-of-death value as the asset's basis in the hands of the recipient, commonly known as "step-up" in cost basis. If your client has a $10 per share basis in stock now worth $100 per share and gives that stock to a family member as a gift, that family member will then have the same $10 per share basis. If, instead, the client died and willed the stock to that family member, then the basis for that family member would be $100 per share. For reasons that we will explore in more detail, that basis improvement ("step-up"), by itself, does not mean that the transfer at death is the better strategy. Usually, it is not.

   Many clients believe it's wise to plan to hold a highly appreciated concentrated position until their death, so the basis can be stepped up to the value at that time and thus eliminate any income tax on the gain. We'll have more to say about taxes and basis in Chapter 2, "Sale and Diversification"; Chapter 7, "Gifts to Family"; and Chapter 9, "Gifts to Charity." For now, it's enough to say that waiting for basis step-up at death is rarely optimal even under the current basis rules. It will be even more unlikely to be a worthwhile strategy if the basis rules change in the future as is commonly threatened as part of an overall structuring

of the estate law. In any event, to achieve basis step-up, assets must be exposed to the federal estate tax. Those estate tax rates, when they apply, apply to the asset's *entire* value (capital gains rates only apply to the gain *portion*) and are nearly as bad as the highest income tax rates, 40 percent for transfer taxes versus 43.4 percent for federal income tax. Managing around that set of tax exposures is often even more urgent an issue for very wealthy clients than dealing with the concentrated stock position.

4. **What timing and location flexibility is available?** The state tax on capital gains can be a very significant factor in determining when and where your client sells highly appreciated stock. The state tax is deductible in calculating *regular* federal taxes (but not taxes under the Alternative Minimum Tax [AMT]) and can yield federal tax savings at a higher *rate* than the rate on the capital gain itself. This is possible if the client's ordinary income in the same tax year exceeds the state tax owed (or paid) on the capital gain and other taxable income. For example, assuming no special complications, in a state with a 5 percent tax on capital gain, the *total* capital gains tax would be 26.82 percent for a client in the highest tax bracket. Note that we are using 23.8 percent as the highest federal long-term capital gains rate, which includes the 3.8 percent ObamaCare tax on net investment income. We will use this rate in examples throughout the book, unless otherwise indicated:

Federal tax	23.8 percent
State tax	5.00
Deduction for state tax (.396 × .05)	(1.98)
	26.82 percent

But special complications abound. The state tax is deductible in the year in which it is *paid,* not the year the liability for the tax arises. So you must be careful to determine whether it's better to pay some or all of the state tax in the current year or wait until the following April 15. Complicating things even more is the fact that state taxes are not deductible for the AMT calculation and do not create a minimum tax credit to be used in some later year. Depending on the size and character of your client's *other* income in the year of the capital gain transaction and in the year that follows, state taxes may apply at their full force with no offset from federal tax savings.

This potential state tax burden often prompts thoughts of moving in advance of the sale to a state with low or no income tax. Many California

clients (with a current capital gains tax as high as 13.3 percent) consider a move to Nevada, for example—a state with no income tax—until they contemplate all the factors that must be accomplished to make such a change of domicile legitimate (having a believable principal residence in the new state, mailing address, club memberships, religious congregation, driver's license, voting registration, etc.). Quite a few clients plan such a move for their eventual retirement, but for clients still actively involved in creating wealth, it rarely works as a strategy for ameliorating a specific capital gain exposure. And to be clear, changing one's domicile would work only for an intangible asset, such as a concentrated stock position. The original, high-tax state would still collect its tax on the sale of local real estate for example.

And taxes aren't the only menace.

Pre-IPO Illiquidity

The number of private VC-backed companies with billion-dollar plus valuations, (monickered "unicorns" by Aileen Lee of Cowboy Ventures)[2] have been on the rise in recent years. Some important findings from Lee's recent work: only 0.14 percent (that's right, only 14 in 1,000) of tech startups reach "unicorn" status; only 39 percent of those have liquidity events (IPOs or acquisitions), and it takes about seven years on average before those events happen. This means a long, arduous, and very risky journey, with the circumstances for private companies smaller than "unicorns" no doubt worse. For those clients building their wealth via equity ownership in private companies (via founders' shares, common or preferred stock, stock options, or convertible debt), the challenge of managing concentration risk may be most severe. The techniques for dealing with the non-public stock environment can be different and sometimes a good deal more complex than dealing with public company stock. We'll touch on several as we proceed.

Post-IPO Lockups and Other Market Considerations

The founding owners, directors, and senior managers of companies that do issue public stock are usually subject to an agreed-upon period following an initial public offering (IPO), during which they may not sell any of the newly public stock. Six months is typical, though it may be as short as a few months or as long as a year. To the surprise of many, these lockup periods are not

required by law but are part of the conventional practice of public offerings in U.S. markets. Lockups are part of the deal made by the issuing company with its investment bankers to induce the investment bank to sell the shares in the public market and to do so in a reasonably orderly fashion during the time that the stock's price may be most vulnerable to significant volatility.

The initial pricing dynamics of an IPO are typically set in order for the company to have a successful IPO in the public's eyes. The trading activity and volatility often seen in the early days of an IPO is the result of short-term holders who are not subject to lockups. Instead, it's often the "friends and family" IPO stock holders. Of course, insiders of newly public Company A, subject to a lockup on Company A shares, may receive purchase opportunities for newly public Company B shares on which that insider can capture large short-term profits in the first days of trading. But if your client holds a large position in Company A stock and can't sell it because of a lockup, your client may still have a problem in need of a solution.

The expiration of the lockup is usually not a complete solution. The market is well aware of how much stock is locked up, for whom, and for how long, and can of course anticipate sales pressure once the lockup is lifted. Moreover, if the stock is subject to SEC Rule 144 and other notice requirements, your client has to inform the market in advance of an intention to sell. So even a client that is now free by law and by contract to sell shares may be unwilling to allow the expectation of the sale itself to depress the market price. Many believe that sales should occur slowly and gradually to minimize the market impact.

Realistically, however, for most individual clients the purchase, or sale, of stock rarely if ever has an effect on the market price of the stock. The transactions are just too small, relative to the overall volume of trades, to have any noticeable effect on the price. For example, Apple traded more than 44 million shares on an average day in mid-2015. Even just 1 percent of that volume, or 440,000 shares, would amount to more than $39 million at the 52-week low price of Apple stock at that time. Unless your client is Steve Jobs's estate, it's unlikely that your client's transaction could have a market impact on Apple's price.

Large holdings of much smaller companies, however, with much thinner trading volumes, could be affected by your client's transactions. Consequently, in those cases, you should help your client plan to sell at a measured pace, consistent with prevalent trading volumes and using limit orders to eliminate the risk of unacceptable market price declines.

Not all the implications of such transactions are negative. Another practical implication for large trades of concentrated stock is the opportunity to

negotiate low transaction costs with the brokerage firm that will execute the trades. Consistent with many examples of economic efficiency that provide cost-control benefits, very large stock transactions offer the opportunity to negotiate a volume discount. Brokers are often willing to accept as little as one to three cents per share to sell very large blocks of stock ($500,000 in value is a reasonable threshold for "large" in this context). Sometimes, especially for new accounts, they'll do the sale for free, expecting plenty of business in the form of transactions for the proceeds of the concentrated stock sale.

SEC Constraints, the Sarbanes-Oxley Act, and Dodd-Frank

Helping your client meet the requirements of the securities laws, and the Sarbanes-Oxley Act of 2002 and Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, will be of great importance to advisors working with senior officers and directors of public companies. What follows is a quick overview of the five key elements that every advisor needs to understand regarding the constraints that securities and other laws impose on managing concentrated stock risk. Please note, however, that these rules are complex and some are still relatively new. Be sure to rely on competent legal counsel as you assist your clients with these issues. The legal officers of the companies involved in clients' concentrated stock positions are usually a very good resource for help in these matters.

Notice and Reporting

Some clients are among those large and influential shareholders who must give the market notice of the intent to sell their shares. This notice alerts the market not only to the potential sales volume but also to *who* is planning the sale. Immediately after the sale, the seller must publicly report the change in the stock ownership—again, so that the market is adequately informed. The corporation itself must be a party to this announcement, since it must approve the intended sale and it must forward information about the result to the Securities and Exchange Commission. Under Sarbanes-Oxley, any transaction in the company stock by these stockholders must be reported on SEC Form 4 almost immediately, that is, by the end of the second business day following the date of the transaction.

Dodd-Frank requires greater public disclosure, generally, of compensation for executives of financial services companies and in some cases requires shareholder approvals of pay packages and "Golden Parachute" arrangements.

Companies are required to disclose whether executives have opportunities to hedge stock and stock-related compensation.

Controlled Sales of "Founder Stock"

Closely related to the notice and reporting requirements are the limitations imposed by Rules 144 and 145. For certain officers, directors, founders, and so on, who acquire company stock by means other than open-market transactions, or whose stock is acquired by the company in a merger or acquisition, only so much stock can be sold, and only so frequently, into the public market (generally no more than 1 percent of the shares outstanding in any three-month period).

No Trading on Material, Nonpublic Information

Under Rule 10b5, no one may legally buy or sell stock based on important information about the company that is not publicly available. This sweeping restriction usually comes as a surprise to the lay investor. "Isn't that what smart investing is all about, being a step or two ahead of other investors?" Well, yes, if by that one means paying better attention to or making more insightful interpretation of *public* information. But it is illegal (both civil and criminal penalties can apply) to trade on information that the public market just doesn't have. Senior corporate executives and corporate directors routinely possess just such information about their companies and, consequently, are not permitted to transact for as long as that situation of important nonpublic information prevails. No one else in possession of that nonpublic information may do so either. A friend, a relative, even someone reading a crumpled scrap of paper tossed into a wastebasket is equally constrained. The notion of a legitimate "hot tip" is part of the fantasy lore of investment, not an opportunity permitted under the law. Martha Stewart was accused of just such a violation and went to jail for lying about it. Even more dramatic and less "innocent" was the multiparty prosecution involving accusations of insider trading at S.A.C. Capital in 2008.

No "Short-Swing" Profits for Corporate Insiders

Under Rule 16b, certain senior corporate executives, directors, and very large stockholders are considered insiders of the company and aren't permitted to keep profits that occur as a result of sales and purchases of shares within six months of each other. If such a set of transactions (in either direction: a

purchase followed by a sale or a sale followed by a purchase) produces a profit, it belongs to the corporation and must be recovered from the offending insider.

Certain kinds of acquisitions (for example, stock-option exercises) are generally exempt from being considered purchases. But an open-market purchase precludes a sale of a corresponding volume of shares for at least six months. People subject to this rule usually have a great deal at stake in avoiding bad publicity, so *any* market purchase, however small, effectively precludes *any* sale for at least six months. If your client needs to sell a concentrated position, make sure he doesn't do any additional buying, at least not for more than six months before or after. See the story in Chapter 6 about how even well-informed and well-advised clients can make innocent, but very costly errors in this regard.

In a similar vein, Sarbanes-Oxley now prohibits corporate insiders from buying or selling company stock during any period in which employees generally are "blacked out" from making investment changes in their 401(k) plans or other retirement plans. These blackout periods usually occur only when there is a change in plan administration but, at least in the past, these periods of investment paralysis for employees have sometimes been fairly long. Now, at least with regard to transactions in the company stock, the senior executive ranks must be equally constrained.

No Favorable Financing for Senior Executives

Before Sarbanes-Oxley it was common practice for public companies to provide large loans, under reasonably favorable terms, to senior executives to facilitate the purchase of company stock, or exercise of options, or to provide general liquidity for executives to compensate for their continuing to hold the stock. Companies may no longer directly provide—or arrange for a third party to provide—financing that is not available to employees generally.

Employment/Career Constraints

Many companies expect their directors to hold a minimum value of the company's stock. This expectation is rarely a major challenge for directors because the amount is usually not very substantial and the director status is a voluntary proposition for people who are typically fairly well to do.

But that's not necessarily the case for senior executives of those companies. For senior officers, the expectation is more of a *requirement* and the amounts are usually large, perhaps many times the executive's annual cash

compensation. Similarly, companies are increasingly establishing formal stock-compensation arrangements that require long holding periods. According to Compensation Advisory Partners,[3] 98 percent of Fortune 500 companies now require either or both a minimum amount of company stock for their senior executives and a requirement that some portion of option exercises and restricted stock or stock units vesting be retained for some period of time, sometimes even beyond termination of service. Since Sarbanes-Oxley eliminated the practice of providing company loans, usually with very favorable terms, to facilitate acquiring and holding these large stock positions, the burden has increased twofold.

Even when there are no formal requirements to hold company stock, there is often an informal—but very clear—expectation of concentrated stock exposure as a condition of career success. On several occasions, I've met with cold refusals from CEOs in response to my advice not to own quite so much of their company's stock, and I've nearly been thrown out of more than one CEO's office for pointing out that their subordinate officers can afford the concentration risk even less.

It's important to recognize that there are several legitimate arguments in favor of corporate executives having concentration in their company's stock. Stock analysts, the investing public, and politicians and regulators are eager to make sure that senior corporate officers have their fortunes closely linked to *durable* financial results for the corporation's shareholders. This notion of common financial interest has always been at the core of stock-based compensation arrangements. The newer elements speak to the *durability* of that alignment. In reaction to extreme cases of senior corporate executives capturing vast wealth on short-term price spikes, the prevailing trend today is to force executives to hold stock for much longer terms.

As appealing as such strictures may appear on the surface, they create a giant disparity between the investment flexibility of those corporate executives and all other shareholders of the corporation's stock who, wisely or not, can sell at any time. Executives are forced to accept a risk that no other shareholder faces. As a consequence, the overall investment exposure (risk *and* return) of shareholders and executives may not really be aligned. And, one could argue that the much publicized increased *volume* of executive compensation (cash and stock-based) is a response to that heightened risk. The more burdensome the risk becomes, the more *total* compensation the executive marketplace demands in order to tolerate it.

But the bigger problem perhaps lies in the potentially damaging effect on corporate decision making itself. Not every decision about corporate opportunity or threat will reflect the long view. If the senior decision makers are

forced to hold very large holdings of the company's stock, their decisions may take a decidedly short-term, "play it safe" tone, especially because Sarbanes-Oxley makes the chief executive and chief financial officer *personally liable* for the "appropriate" and "fair" presentation of the company's financial condition in "all material respects" in the company's financial statements. Shareholders in general might benefit more in the long term by the decision makers' greater willingness to take risks in the short term. Corporate decision makers with disproportionate amounts of their wealth tied up in the company's stock may be—albeit subconsciously—unwilling to take those risks.

Helping your corporate executive clients find the right balance for their own portfolios will mean helping them to manage the challenge of these increasingly onerous constraints.

Chapter 16, on opportunistic concentration, will address the other side of this coin, using employer stock concentration as a deliberate career advancing and wealth building strategy.

Psychological Barriers

People's general psychological framework, of course, influences all their decisions. This is no less true in the realm of investment and becomes especially apparent when it comes to acknowledging the risk of stock concentration. Many clients have significant blind spots about a *particular* stock holding even though they would scoff at the foolishness of holding any major position in many other stocks.

Richard Thaler, Terrance Odean, Dan Ariely, and other behavioral theorists[4] have observed the "legacy effect," "anchoring," and other irrational behaviors of many investors who cling to investment holdings only because they are familiar. In our experience, the resistance to change is especially pronounced when the holding is a true legacy: "My grandfather willed these shares to me; they've been in the family forever"; or, "My husband always handled these investments; we always did well." In such situations, achieving diversification is greatly complicated by the powerful emotions of affection, gratitude, and grief. Although clients will rarely admit it, many are unwilling to show disrespect for their benefactor's investment wisdom or ingratitude for their generosity by daring to sell the position. Others are simply convinced that the benefactor knew best.

In one case, we saw this kind of bias actually written into the provisions of an irrevocable trust. Two clients, both in their twenties, were the beneficiaries of an irrevocable trust established by their mother, who died when they

were both quite young. For some reason that's no longer clear, the trust provided that its largest holding by far, a broadly traded very-large-cap domestic stock, could not be sold by the trustee prior to any trust distribution. Only after the distribution could the holding be sold by the beneficiary. So, meanwhile, we used puts in other, nontrust assets (see Chapter 15 on derivatives) and a tax-managed account, set to avoid purchasing any more of this stock (see Chapter 13 on index-proxy management), to moderate this risk while the trust distributions were pending. We encouraged these clients to rapidly diversify this holding as soon as installment distributions occurred at ages 25, 30, and 35. These young clients were victims not of their own psychological impediments but of their mother's (or of her advisors', who had long since left the scene).

Anchoring, another form of dysfunctional investment psychology, is the belief that somehow the market is aware of the investor's historic, higher price for the stock and owes him a recovery to that price. Some clients just can't bring themselves to sell at a loss. Despite the financial benefits of capturing a capital loss for tax purposes, selling a position below the original cost confirms a perceived failure that such clients are loath to admit. When the potential risk that concentration presents—loss of value—in fact occurs, it can paralyze clients. The lower the price goes, the more convinced of a recovery they become. To keep clients from falling prey to such faulty thinking, advisors should urge them to set boundaries for the tolerable price declines of concentrated positions. Boundaries should be tied to the required remaining value necessary to accomplish the client's crucial objectives. Once the boundary is reached, the client should be committed to selling to avoid even greater, and now unaffordable, losses.

The investment maxim that over time, broadly diversified equity portfolios must increase to reflect long-term fundamental economic growth does *not* apply to any *one* company. Poor management, lack of innovation, aggressive competition, or just plain bad luck can cause any company to just limp along or even fail—even in the midst of a generally robust, growing economy.

Another troublesome blind spot afflicts many corporate employees at all levels, not just the senior executives who may be compelled to own large positions in an employer's stock. For novice investors, the tendency may reflect a lack of awareness of the many investment alternatives available. So many companies make purchase of their stock broadly available, through discounted stock-purchase plans, 401(k) matching contributions, restricted stock units throughout employee ranks, and restricted stock, performance shares, and stock options for senior employees, that the first stock most

people ever own is probably the stock of the company they work for. These ready-made opportunities to acquire stock combine with a natural sense of team spirit to cause most employees to end up with a far larger share of their employer's stock in their total portfolio than any objective investor would think wise. What's more, the employees—and their employers—generally take pride in this choice.

The stock price debacles of Enron, WorldCom, and others, where employees lost virtually the entire value of their 401(k) plans, haven't completely cured this dangerous myopia. In 2013, the prevalence of company stock in 401(k) plans was still 7 percent of the total value (down from 19 percent at the end of 2000), but some employees are still heavily exposed. According to EBRI research[5], 30 percent of employees use some level of company stock if the choice is offered, somewhat over 10 percent of 401(k) participants have more than 50 percent of their plan holdings in company stock, and two-thirds of those have more than 90 percent! In 2014, the U.S. Supreme Court in its Fifth Third Bank decision[6] removed the former exemption from ERISA fiduciary responsibility for plan sponsors regarding company stock. Consequently, further reductions in this particular ERISA regulated arena of concentration exposure can be expected. Still, in the worst case, the collapse of a company can destroy an employee's job, devastate the employee's portfolio, and threaten retirement plan assets all at the same time.

Such overweighting is by no means limited to the naive rank and file. Many otherwise sophisticated, experienced, and wealthy corporate executive clients remain convinced that their company's stock represents an investment opportunity that surpasses any alternative. They may, of course, be right; but your clients cannot trust their instincts here. They are too close to the trees of their own company and its industry to see the forest that other, objective investors see. Their very connection to—and even dependence on—their company's current investment performance and their intimate familiarity with its plans for the future can be an investment handicap. The stock price doesn't hinge on what your client knows about the company, but on what all of those millions of other actual or potential investors around the world *think* they know about it.

Some years ago, we worked with a number of executives at a company whose stock had been advancing at a market-beating rate for a number of years. (This was a very well established, "old economy" company, not some high-tech recent IPO.) These clients were becoming rich, of course, and increasingly optimistic about the stock's future—and all the more impatient with our urgings to diversify. Eventually, a news report of misstated earnings in a then recently acquired subsidiary caused the stock to decline by

50 percent—in one day. It has never fully recovered. Needless to say, this was not the way to reduce ongoing concentration risk.

Chapter Notes

1. 280 U.S. 390 (1930).
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5. Employee Benefit Research Institute, Research Brief #408, December 2014.
6. *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014).