Managing the Wealth You've Accumulated in One Stock

Alternatives to Help Meet Your Investment Goals

How Much Is Too Much?

Holding a large position in one stock increases your risk level compared to a well-diversified portfolio. In 2006, Congress posed (through the Pension Protection Act) that if an investor had more than 20% of a portfolio in one security or industry, the portfolio may not be properly diversified. Your specific risk tolerance may allow for more or less than 20% of one security. But it's important to discuss with your investment professional how much of any one security or industry is too much for you.

As an investor with a significant portion of your wealth in one particular stock, you may find that you want to:

- Increase cash flow
- Reduce your portfolio's risk by diversifying your investments
- Protect a particular stock against possible price declines
- Reduce adverse income and estate tax consequences
- Provide a benefit for your favorite charity

We can help you manage a large position of publicly traded stock in your portfolio. Although appropriate solutions depend heavily on your circumstances, the following descriptions give you an overview of the range of strategies available to you.

Understanding Your Alternatives

You may have accumulated your concentrated position in a number of ways, such as:

- Equity compensation, including stock options and restricted stock
- Building sizable positions of company stock in your employer-sponsored retirement plan
- Being a corporate insider with minimum holding requirements or selling restrictions
- Selling your business and receiving stock in a publicly traded company in return
- Inheriting sizable stock positions built over multiple generations

Regardless of your situation, your investment professional can help you sort through your circumstances and work toward your objectives for managing your large concentration of stock.

We believe you should understand your potential alternatives. The suitability of each alternative, however, depends primarily on your individual circumstances. In fact, one or more of the alternatives may be inappropriate for your situation. The appropriateness of certain alternatives also depends on market behavior and the availability of particular contracts, stocks, or products. Your investment professional, working with your tax and legal advisors and the professionals at our corporate headquarters, can help evaluate these strategies.

Strategies to Consider

Here are some of the alternatives you may want to consider for managing your concentrated equity position:

- Gradually selling and repositioning
- Option-based alternatives
- Estate planning and charitable techniques
- Borrowing against your stock
- Other strategies

Gradually Selling and Repositioning

Sometimes the simplest solution is the best. You can gradually sell shares and reinvest the proceeds into investments that will better meet your changing needs. By selling over time, you can:

- Spread your gain (and corresponding tax liability) over time, perhaps several tax years (discuss this with your tax advisor)
- Diversify your portfolio, maintaining full control of after-tax proceeds
- Retain control of your financial situation, stopping and starting the sale of shares as needed
- Give yourself the chance to reinvest proceeds over time, adjusting your investment selections as appropriate

You may want to combine this basic strategy with more advanced strategies, such as hedging or establishing a charitable remainder trust. Your investment professional can work with your tax and legal advisors to help you evaluate variations of this approach and combine strategies that meet your needs.

If you begin selling your shares, keep in mind that your shares' sales price may vary, and this strategy will require careful record keeping and tax planning. You will also need to set aside the time necessary to liquidate your shares, which could take a number of years.

Option-Based Alternatives

Several option-based alternatives can help you manage your concentrated equity position. You may want to explore these alternatives in more detail if your goals for your position include protecting your position from price declines, generating additional income, setting price targets at which to sell your position, or creating liquidity. Please keep in mind that option investors may lose the entire amount committed to the option strategy in a relatively short period of time. Some of these strategies include:

- **Selling covered equity call options —** The covered call is a strategy in which an investor writes a call option contract while at the same time owning an equivalent number of shares of the underlying stock. A covered call writer foregoes participation in any increase in the stock price above the call exercise price and continues to bear the downside risk of stock ownership if the stock price decreases more than the premium received. Keep in mind that if the stock price falls, you are still a stock owner and are subject to the full loss of your stock investment, reduced only by the credit from the sale of the call. Covered call writing is not a protective strategy. Also, keep in mind when writing an option on a stock with a low cost basis, there are tax consequences to consider upon exercise.
- **Buying protective put options —** This strategy consists of buying a put option contract while at the same time owning an equivalent number of shares of the underlying stock. The protective put establishes a floor price under which the investor's stock value cannot fall. If the stock keeps rising, the investor benefits from the upside gains. Yet no matter how low the stock might fall, the investor can exercise the put to liquidate the stock at the strike price. Also note that buying protective puts or creating a collar results in any dividends received being taxed at ordinary income tax rates.

- **Creating a collar —** A collar is the simultaneoous sale of a covered call and purchase of a protective put contract. The investor adds a collar to an existing long stock position as a temporary hedge against the effects of a possible near-term decline. The long put strike provides a minimum selling price for the stock, and the short call strike sets a maximum price. Transaction costs may be significant in multi-leg option strategies as they involve multiple commission charges.

Options involve certain risks and may not be suitable for you. Before opening an option position, a person must receive a copy of "Characteristics and Risks of Standardized Options." Copies of this document may be obtained from our firm, from any exchange on which options are traded, or by contacting The Options Clearing Corporation, One North Wacker Dr., Suite 500 Chicago, IL 60606 (1-888-678-4667). Keep in mind that commission costs are an important consideration. Supporting documentation for any claims, comparisons, recommendations, statistics, or other technical data, will be supplied upon request.

Estate Planning and Charitable Techniques

Many individuals with substantial positions in one stock look for strategies that will help reduce overall income and estate tax liabilities and achieve philanthropic goals. There are charitable giving strategies that can provide you a current income tax deduction, a continuing source of income for you or your heirs, and a way to avoid paying immediate capital gains tax on appreciated assets. Some strategies also shield the donated assets from estate taxes, if applicable. And when you consider current income tax rates and estate tax rates, you and your heirs may benefit substantially from these techniques.

Giving to charity can satisfy your desire to help those less fortunate than you, enrich your life and the life of the recipient, and help you give back to your community. While you intend for your gift to help others, you can benefit at the same time. The following pages highlight four common strategies, but keep in mind that there are many others available. Consult your tax and legal advisors before undertaking any of these strategies.

Direct Gifts of Appreciated Stock

Consider making your annual charitable gifts or pledges with long-term appreciated stock instead of cash. You will conserve your cash while avoiding the taxable capital gains you would create by selling the stock outright. You will receive an income tax deduction based on the market value of the shares on the day the gift is completed.

Charitable Remainder Trusts

A charitable remainder trust lets you donate stock to charity, retain an income interest, and receive a current income tax deduction. First, you transfer low-cost-basis stock (held long-term) into the trust. Then the trustee (usually a professional trust company) sells the stock and purchases other investments to provide you or your beneficiaries current income for your lifetime(s) or for a specified number of years. Because the sale of the stock occurs under the charitable trust umbrella, you incur no immediate capital gains tax liability when the stock is sold.

Charitable Remainder Trust

Advantages

- You benefit a favorite charity.
- You avoid immediate capital gains tax liability at the time of sale.
- You can diversify a concentrated position.
- You can increase your income stream.
- You receive a current income tax deduction.

Disadvantages

- The cost of having an attorney draft the trust documents.
- Without an irrevocable life insurance trust, the stock is given away with no wealth replacement for beneficiaries.
- If you combine a charitable remainder trust with an irrevocable life insurance trust, gifts representing premium amounts are irrevocable.

This technique can increase your current income while providing some diversification and ultimately reducing estate taxes. You receive a current income tax deduction based on the present value of the future benefit of the stock you donate. Further, you can set the level of income paid out of the trust (within IRS guidelines). Often the trust income you receive is higher than the income the donated stock previously generated.

Obviously, you've given away a significant portion of your wealth to the charity and lost control of this stock for your lifetime. A second trust — an irrevocable life insurance trust (ILIT) — can help you replace this wealth in your estate, as illustrated below.

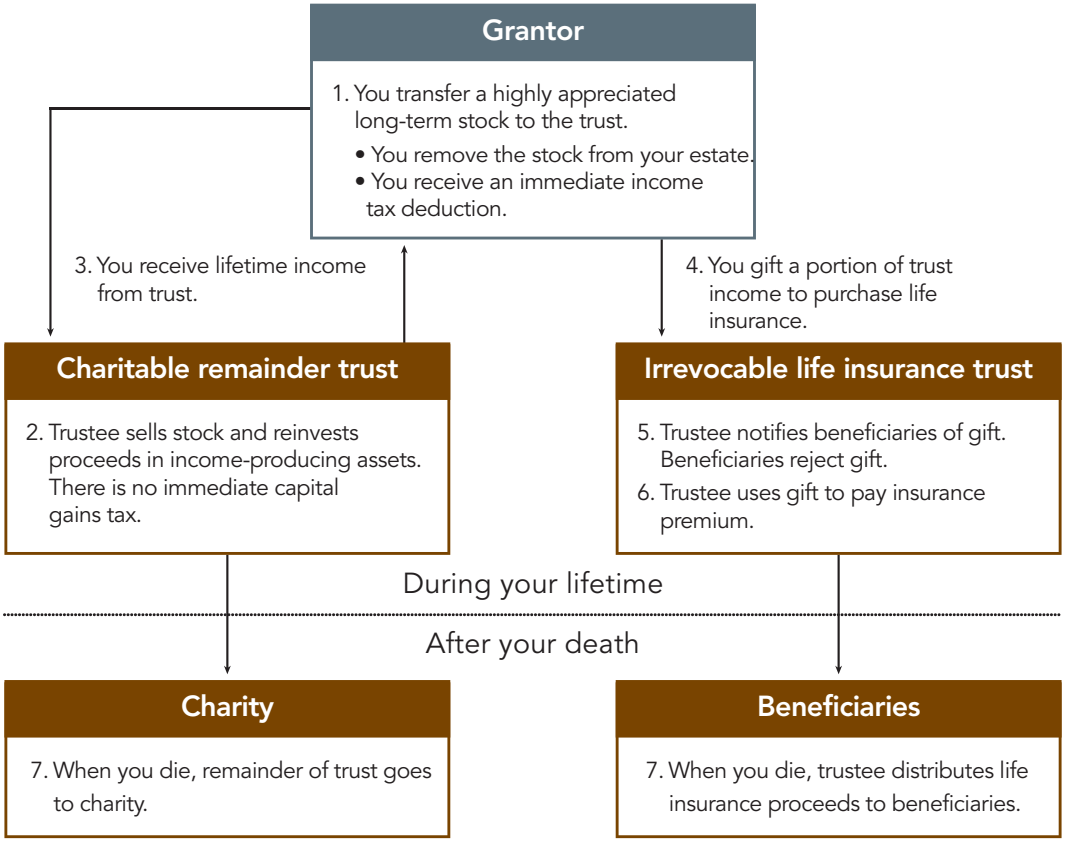
For more information about how this strategy can meet your objective for your concentrated position in one stock, talk with your investment professional.

Charitable Foundations

A charitable foundation lets you create an enduring vehicle for your family's charitable gifts, achieve certain tax advantages, and maintain a greater degree of control over donated stock. Depending on the type of foundation you establish or the type of assets you donate, contributions to a foundation may be 100% deductible (although, as with any charitable deduction, certain limitations apply).

Because many regulations govern charitable entities, especially private foundations, you will need to work closely with your attorney. You may also consider choosing an independent trustee who can act in conjunction with your family and help you avoid obstacles. If this strategy interests you, ask your investment professional for a copy of our report, "Private Foundations."

Charitable Remainder Trust With an Irrevocable Life Insurance Trust



Borrowing Against Your Stock

Advantages

- You obtain cash without selling your stock.
- You avoid current capital gains tax liability.
- You can diversify your holdings if you use loan proceeds to purchase other stock.
- You may be able to deduct interest charges from your taxes if you offset the charges with investment income.
- You can replace the gift's value in your estate.

Disadvantages

- A decline in your stock's value may require an additional deposit of shares or cash.
- A decline in your stock's value may require liquidation of shares.
- If the stock is liquidated because of a margin call, it is a taxable event (gain or loss).
- You can borrow only a fraction of your stock's total value.
- The amount of the loan may be limited, depending on the stock.
- You must pay interest on the loan.
- You can lose more money than you deposit into your account.
- Your brokerage firm can increase its margin requirements at any time without contacting you.

Charitable Gift Funds

Some mutual fund companies provide either a pooled-income fund or a donor-advised fund. These funds let you donate long-term appreciated stock, generate a current income tax deduction, and designate certain charities to receive your gift now and in future years. Depending on the type of fund you choose, you can also potentially receive a current income stream. These funds' underlying concepts are similar to those of a charitable remainder trust and private foundation. A gift fund may be the preferred alternative when the costs or commitment to establishing or maintaining a charitable remainder trust or private foundation are a concern. Ask your investment professional for more information about these types of gift funds.

Additional Gifting Strategies

A range of additional gifting programs can also help you meet your objectives for preserving wealth across generations. Ask your tax and legal advisors about whether family limited partnerships, charitable lead trusts, or generation-skipping trusts can help you work toward your goals.

Borrowing Against Your Stock

This alternative helps you:

- Generate cash without selling your stock
- Avoid generating a current tax liability
- Diversify your portfolio by purchasing other stocks with the loan proceeds

It is important to stress the possible downside of this strategy. You must maintain a minimum amount of market value or equity in your collateral account. Equity is the market value of the stocks minus the amount you borrowed. If your collateral stock's price drops below required levels, you will be obligated to bring your account into balance by depositing cash or other stocks immediately. Otherwise, you may be forced to liquidate all or a portion of your position then incurring capital gains taxes. Your brokerage firm may sell your securities without contacting you. Also, you are not entitled to choose which securities are to be sold. Keep in mind that you will have to pay interest on the amount you borrow.

Your investment professional can provide more information about borrowing on margin and how it may help you achieve certain short-term goals. Remember that this strategy is not appropriate for everyone.

The comparison listed to the left presents the advantages and disadvantages of borrowing against your stock to help you determine whether this strategy is right for you.

Other Strategies

Depending on the stock you own, alternative strategies may be available to you. For example, if you have substantial personal investable assets, alternative strategies may help you diversify your portfolio without an immediate taxable event. These alternatives may require you to contribute a substantial amount of stock, and the stock you intend to contribute could be subject to approval. Using such a strategy may raise liquidity concerns; to avoid unfavorable tax consequences, withdrawals or sales may be restricted for a number of years — sometimes up to seven.

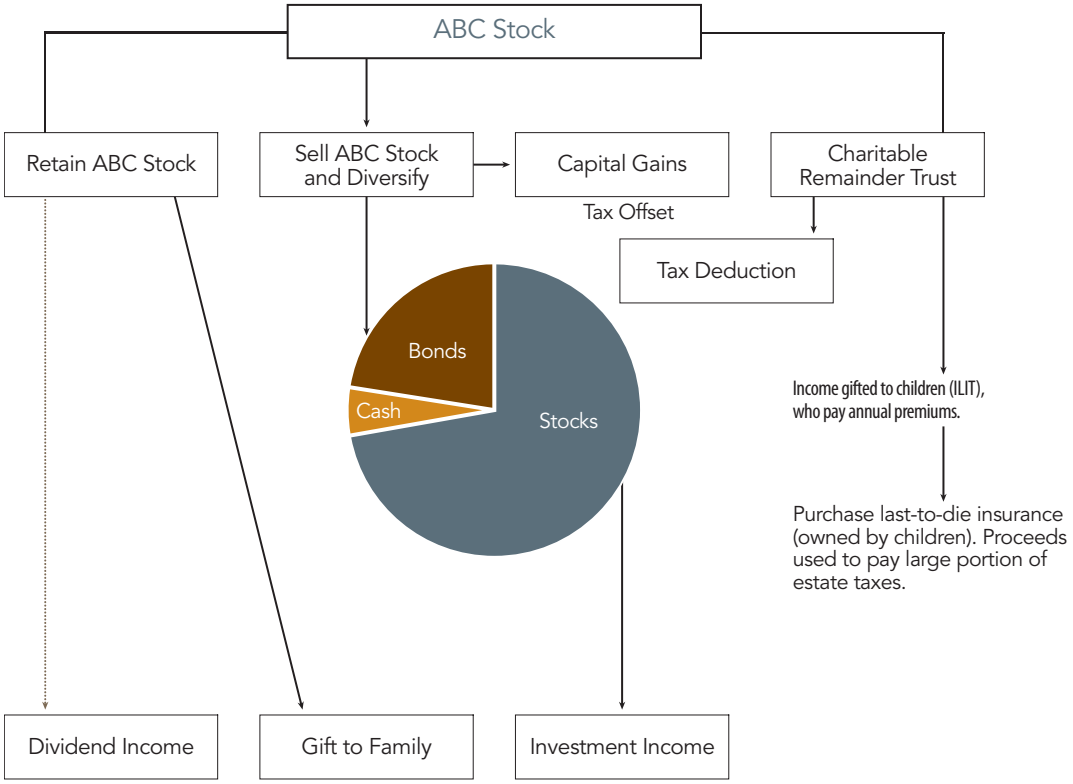
Combining Strategies

The strategies presented in this report are not exclusive of each other; in fact, many investors holding a substantial equity position combine multiple strategies to achieve varying goals.

The schematic illustrates a hypothetical way you may divide and manage your large concentration of stock into three parts:

- You may earmark one portion of stock to hold for the long term, generating dividends to help diversify the portfolio through reinvestment or provide income.
- You may earmark a second amount of stock to sell over time, using a covered call writing program to target your price and reinvesting the proceeds into a diversified portfolio.
- The third amount of stock you may use to achieve your charitable gifting objectives, generating some current income tax deductions to help reduce the tax consequences.

Combining Strategies When Diversifying a Concentrated Position



Ask for a Personal Consultation

Determining which of these solutions is appropriate for your circumstances requires an in-depth evaluation of the stock you own, any restrictions you may be subject to, your financial position, and your objectives.

Talk with your investment professional about your situation. Using the information he or she gathers, your investment professional will evaluate your situation and provide a range of strategies for you to consider to help you work toward your goals.

Our firm is not a tax or legal advisor.

All estate planning services are provided with the participation of your personal attorney, who should review all such materials. Our firm does not prepare will and trust documents; these must be drafted by your attorney. Insurance products are offered through non-bank insurance agency affiliates and are underwritten by unaffiliated insurance companies. Trust services are available through banking and trust affiliates in addition to nonaffiliated companies of our firm

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