

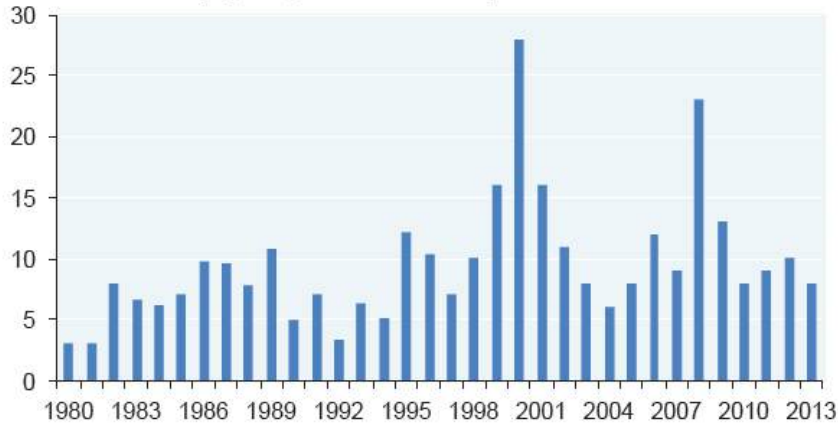


# Introduction to Stock Protection Trusts

May 2019

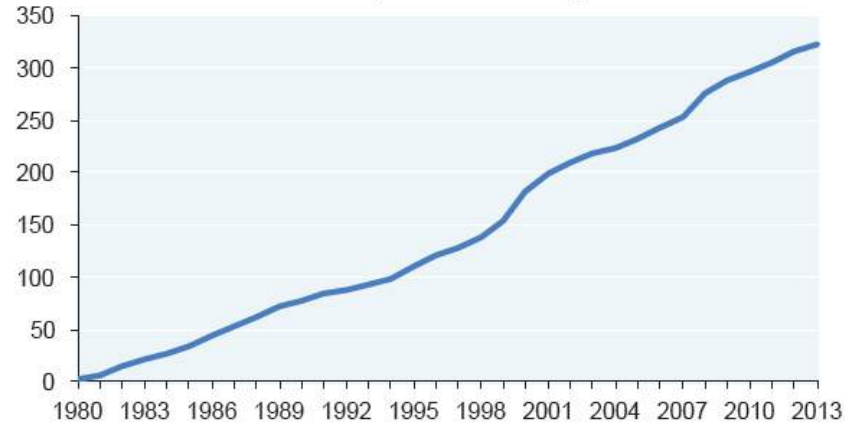
# Stock Concentration = Underestimated Risk of Large Losses

**Number of companies removed from the S&P 500 due to distress by year, Number of companies**



Source: FactSet, Bloomberg, Standard & Poor's, JPMAM. 2013.

**Cumulative number of companies removed from the S&P 500 due to distress, Number of companies**



Source: FactSet, Bloomberg, Standard & Poor's, JPMAM. 2013.

Sector	Total % of companies experiencing "catastrophic loss", 1980 - 2014
All sectors	40%
Consumer Discretionary	43%
Consumer Staples	26%
Energy	47%
Materials	34%
Industrials	35%
Health Care	42%
Financials	25%
Information Technology	57%
Telecommunication Services	51%
Utilities	13%

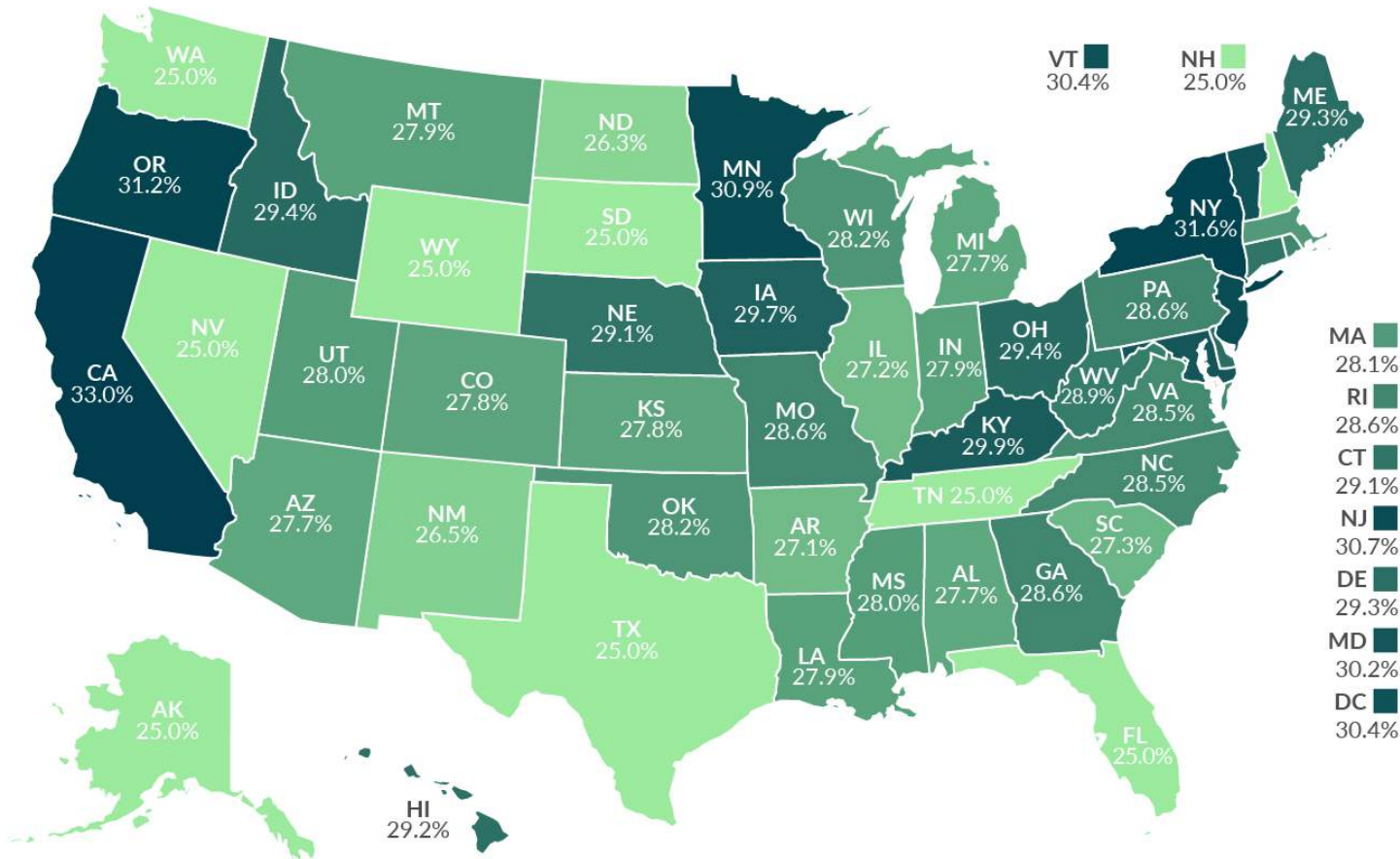
Source: FactSet, J.P. Morgan Asset Management.

**"No matter how well you know your industry and your company, no one is impervious to event risk and industry changes. The factors outside management control...are a formidable list, and have grown in complexity since we first drafted this report 10 years ago. *This is perhaps the most important epiphany we gained from the study: that exogenous forces may overwhelm the things we can control.*"**

Source: *The Agony & The Ecstasy: The Risks and Rewards of a Concentrated Stock Position*, by Michael Cembalest, J.P. Morgan Asset Management

# Tax Consequences of Selling are Substantial

Many investors have large unrealized gains while the tax cost of selling can exceed 30%



Note: Accounts for state and local tax rate on capital gains income, the 3.8 percent Net Investment Income Tax, and the marginal effect of the Pease limitation on itemized deductions. Alabama, Iowa, and Louisiana allow one to deduct federal income taxes from state taxable income.

Source: Tax Foundation, IRS Statistics on Income, Commerce Clearing House



# Potential Estate Planning Benefits

Stepped-up basis provides opportunity to eliminate the tax on unrealized gains

2018 Federal Estate Tax Exclusion Amount

11.2 Million

INDIVIDUAL

22.4 Million

MARRIED

Source: Odgers Law Group

## What is stepped-up basis?

When you inherit property, its value is readjusted for tax purposes. Your cost basis is the value of the property on the date of your benefactor's death, rather than the value at the time it was acquired. This generally saves you from owing capital gains tax if you sell it right away.

**This tax break applies to inherited securities, too. Consider it a gift from Uncle Sam.**

Bankrate  
Designed by: Amanda Trost

**Sell now and pay a 30% tax or sidestep *both* capital gains and estate taxes through estate planning and risk management?**

# Dedicated Stockholders are Committed to their Position

- **Some investors reluctant to sell for reasons other than taxes**
  - Belief stock will further appreciate
  - Dividend yield
  - Strong emotional attachment to stock
  - Restrictions compelled by securities laws/regulations or contractual provisions (IPO-lock-up, merger or employment agreement)
- **For dedicated stockholders, it seems prudent to:**
  - Preserve unrealized gains
  - Defer triggering a taxable event, and possibly eliminate the capital gains tax
  - Retain all future appreciation and dividend income
- **Difficult to find a solution that can fulfill these objectives over a long-term period**
- **Traditional techniques (e.g. Puts, Collars, and Forwards) are expensive, tax-inefficient, and not optimal for long-term use; Exchange Funds require forfeiture of the stock and mutualize both downside risk and upside potential**
- **Investors looking for new tools to address concentration risk**

# An Alternative Solution: The Stock Protection Trust (SPT)

- **What is a Stock Protection Trust?**
  - Patented long-term solution for cost-efficient risk management
  - Preserves stock's unlimited upside potential
  - Full or partial refund if many of the protected stocks appreciate
  - Free of the complexities of Options, Variable-Share Prepaid Forwards, and Exchange Funds
- Each investor contributes cash into a cash pool which is used to reimburse losses (if any)
- Investor can sell their protected stock at any time
- Investor's stock remains with the investor and not encumbered in any way
- Does not trigger the "tax straddle" or "constructive sale" rules; does not disqualify Qualified Dividend Income (QDI); and does not involve any counterparty risk
- Based on the time-tested principles of both modern portfolio theory and risk-pooling



# The Mechanics of How SPTs Work – An Overview

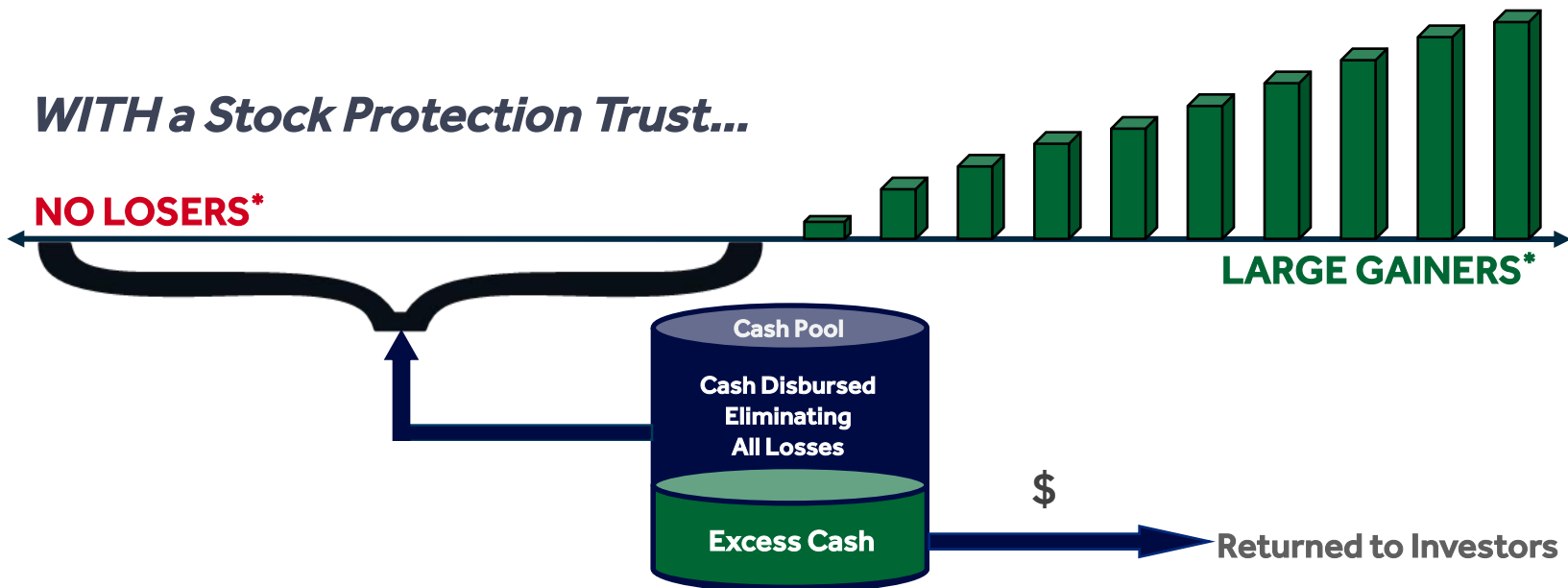
- 20 stockholders – each owning a different stock in a different industry – contribute cash (not stock) into a Cash Pool
- For example, 20 stockholders – each protecting \$5 million of stock – create a Cash Pool of \$10 million (20 X \$500,000 = \$10 million)
- Investors also pay a one-time placement fee equal to 1% of their protected stock value (e.g. \$50,000 for a \$5 million position) and a one-time 1% set-up fee
- The Cash Pool is invested for 5 years by U.S. Bank in 5-year U.S. Government Bonds
- After 5 years, the Cash Pool is disbursed according to 1 of 2 possible scenarios:
  - Cash Pool > Stock Losses
  - Stock Losses > Cash Pool

# Scenario 1 of 2: Cash Pool Exceeds Stock Losses

*WITHOUT a Stock Protection Trust...*



*WITH a Stock Protection Trust...*



\*Gross of SPT fees  
STRICTLY PRIVATE & CONFIDENTIAL

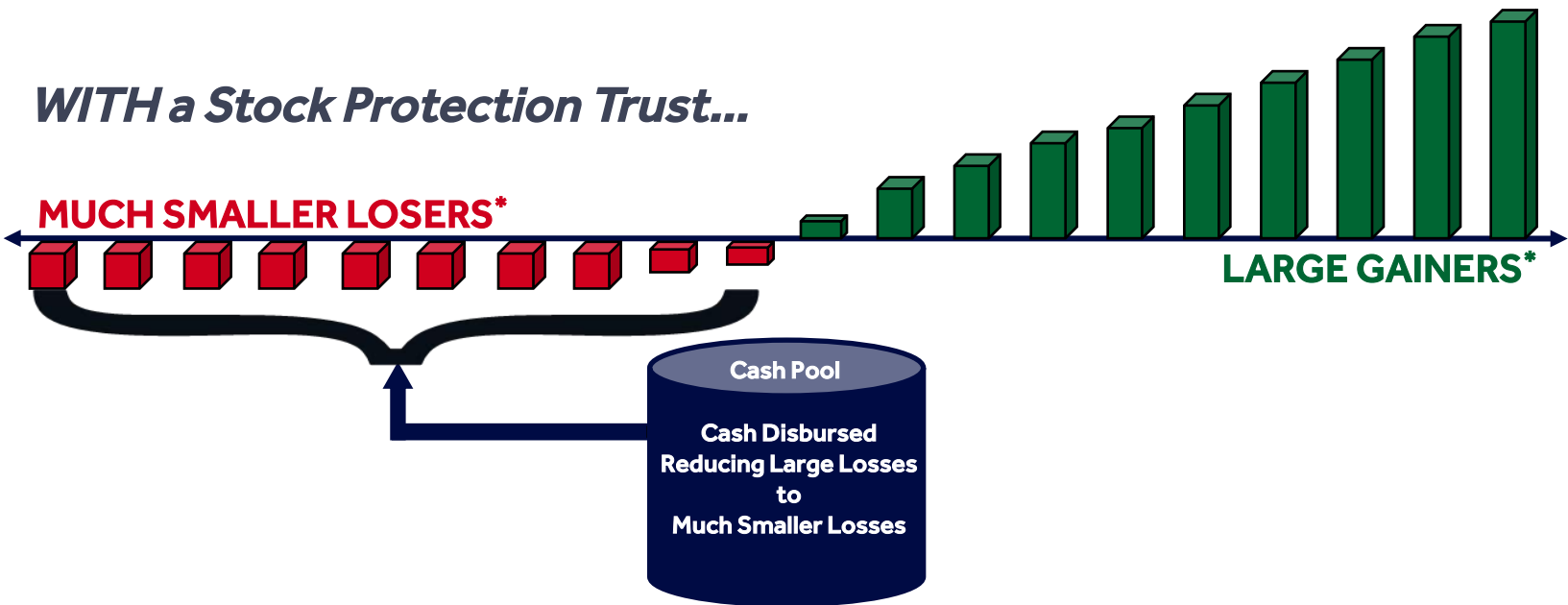


# Scenario 2 of 2: Stock Losses Exceed Cash Pool

*WITHOUT a Stock Protection Trust...*



*WITH a Stock Protection Trust...*



\*Gross of SPT fees  
STRICTLY PRIVATE & CONFIDENTIAL

# The Mechanics of How SPTs Work – An Example

Showing Cash Contribution of 2% per annum or \$0.5 Million Paid Up-Front by 20 Investors – Each Protecting a \$5 Million Stock Position for 5 Years  
 ...Resulting in a Maximum Stock Loss of 0% (i.e. All Losses are Fully Reimbursed by the Cash Pool)\*

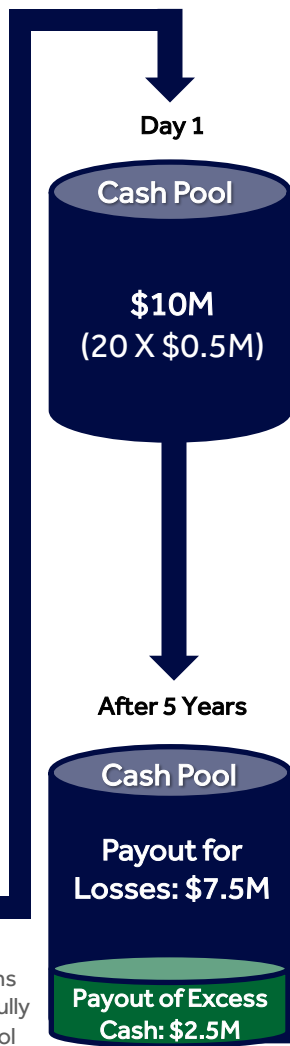
## INITIALLY (DAY 1)

20 Investors with 20 Different Stocks In 20 Different Industries		
Investor	Stock Protected	10% Cash Contribution
1	\$5M	\$0.5M
2	\$5M	\$0.5M
3	\$5M	\$0.5M
4	\$5M	\$0.5M
5	\$5M	\$0.5M
6	\$5M	\$0.5M
7	\$5M	\$0.5M
8	\$5M	\$0.5M
9	\$5M	\$0.5M
10	\$5M	\$0.5M
⋮	⋮	⋮
20	\$5M	\$0.5M
<b>TOTAL</b>	<b>\$100M</b>	<b>\$10M</b>

\* Gross of SPT fees

\*\*Assumes Investors 11-19 have positive total returns

\*\*\*Assumes the annual cost of operating the SPT is fully paid for by interest income generated by the Cash Pool



## AFTER 5 YEARS

**Investor	Without a Protection Trust		With a Protection Trust		Total Payout + Stock Value
	Stock's Total Return		***Total Payout		
	%	\$	Loss	Excess Cash	
1	-50%	-2.5M	\$2.5M	--	\$5M
2	+140%	+7.0M	--	0.167M	\$12.167M
3	-20%	-1.0M	\$1.0M	--	\$5M
4	-30%	-1.5M	\$1.5M	--	\$5M
5	+60%	+3.0M	--	0.167M	\$8.167M
6	+20%	+1.0M	--	0.167M	\$6.167M
7	-10%	-0.5M	\$0.5M	--	\$5M
8	+180%	+9.0M	--	0.167M	\$14.167M
9	+70%	+3.5M	--	0.167M	\$8.667M
10	+10%	+0.5M	--	0.167M	\$5.667M
⋮	⋮	⋮	⋮	⋮	⋮
20	-40%	-2.0M	\$2.0M	--	\$5M
			<b>\$7.5M</b>	<b>\$2.5M</b>	

# Why SPTs Work

**MODERN PORTFOLIO THEORY (MPT)** tells us that over time there is substantial dispersion in individual stock performance...



- Different stocks in different industries perform very differently
- It's impossible to predict the performance/outcome for a particular stock
- In a world of substantial uncertainty and bubbles, the only certainty is that diversification is the best defense in managing/mitigating downside risk

**RISK POOLING** spreads similar financial risk evenly among the participants in a self-funded plan designed to protect against catastrophic loss

- Any one investor who sets aside cash lacks the powerful benefit of risk mutualization
- If you set aside cash yourself, in the event of loss, only your money is available to reduce your loss
- In a risk pool, the combined pool of deposits from all contributors is available to reimburse losses

**Combining the properties of MPT and Risk Pooling provides a cost-efficient risk management solution for concentrated stock owners**

# Benefits of Using SPTs

- **Cost-effective**
  - Affordability enables investors to embrace a **long-term, strategic approach** to mitigating their stock's specific company risk while retaining 100% of its appreciation and dividends\*
- **Tax-efficient**
  - Not a statutory or common law "constructive sale"
  - Not a "straddle" - any gain is LTCG and any loss is currently deductible against capital gains
  - Dividends remain "qualified" and are taxed as LTCG
- **Shares can be sold anytime**
  - Shares are not pledged nor subject to liens/security interests of any kind and therefore can be sold by the investor at anytime during the term of the SPT
- **Shares can be held in custody wherever each shareholder chooses**
- **Simple to use, easy to understand, and completely transparent (i.e. daily mark to market)**
- **Potentially Cashless**
  - Investors can borrow against their shares to fund their contribution to the SPT
  - Investors can write covered calls to help fund the cash contribution
- **No dealer counterparty credit risk**

# SPTs Compare Favorably to Traditional Strategies

	Cost-Effective	Keep 100% of Stock's Upside	Tax-Efficient	Completely Transparent	Low Complexity	Long-Term Solution (5 Years or Longer)	No Credit Risk	Able To Sell Shares Anytime
Stock Protection Trusts	Green	Green	Green	Green	Green	Green	Green	Green
Put Options	Red	Green	Red	Red	Red	Red	Red	Green
Collars	Red	Red	Red	Red	Red	Red	Red	Red
Variable Prepaid Forwards	Red	Red	Red	Red	Red	Red	Red	Red
Exchange Funds	Red	Red	Green	Red	Red	Green	Green	Red

**Green = Yes Red = No**

# Who We Are



BRIAN YOLLES  
Founder & CEO



KAMRAN NOURI  
General Counsel



JOHN BERGER  
Chairman



KAREN GENDRON  
Financial Principal

- StockShield provides solutions for advisors who are working diligently to solve a significant fiduciary challenge they face with key clients
- Awarded 5 U.S. patents for our innovations, including the Stock Protection Trust and Deferred Compensation Protection Trust
- SEC-registered and FINRA-regulated
- Unblemished regulatory history in 10+ year operating history
- CEO and General Counsel both Yale graduates
- Board includes several members with over 30+ years in financial services



# Contact Information



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