Concentrated Stock

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FINANCIAL PLANNING

A concentrated stock position occurs when an investor owns shares of a stock (or other security type) that represent a large percentage of his or her overall portfolio. The investor's wealth becomes concentrated in a single position which creates individual security risk. A concentrated stock position can happen for a number of reasons. Perhaps you worked at the same firm for many years and accumulated a large quantity of the company stock as part of your compensation. Or maybe you purchased a high-flying stock many years ago that has grown substantially in value. You now find yourself with a substantial percentage of your portfolio represented by single stock. There are many challenges associated with a concentrated stock position. A single stock position of 10% or more of your portfolio may increase the risks from market losses and the effects of portfolio volatility on returns. There are several strategies you can use to manage a concentrated stock position.

1. **Selling your Shares** – Selling all or a part of the stock may be a viable solution to free funds to buy other securities. However, one must proceed cautiously as there are often adverse tax consequences, legal constraints or contractual obligations that complicate the situation.

2. **Hedging your Position with Options** – You may wish you keep your stock and reduce the impact of possible market losses.

   Protective Put Options: Buying put options that can be exercised at a price below the stock's current market value can limit potential losses while still allowing you to receive dividends paid. The risk is that you would lose money on the option if the stock price remains above the put strike price.

   Covered Calls: Selling covered calls with a strike price above the market price can provide additional income to cover potential losses. If the shares reach the strike price, you are obligated to sell. However, if the shares never reach the strike price, you can keep the premium. Appreciation is limited to the call's strike price.

   Collars: A collar involves buying protective puts to reduce the possible losses while also selling call options that have a premium that offsets the cost of the puts. However, if the call's strike price is reached before the collar's expiration date, you would lose the premium paid and you would have to pay capital gains tax on the sale of the shares you must sell.

3. **Exchanging Shares** – Trade your highly appreciated stock for shares in an exchange fund with other investors. This takes the form of a private placement limited partnership with various contingencies and restrictions. An exchange fund, also known as a swap fund, is an arrangement between concentrated shareholders of different companies that pools shares and allows an investor to exchange his or her large holding of a single stock for units in the entire pool's porfolio.

4. **Prepaid Variable Forward Agreement (PVF)** – Contract to sell your shares later at a minimum specified price with a PVF. You receive a large portion of the payment when the agreement is signed, while your stock is held as collateral until the agreed upon expiration date when you must settle with either cash or shares.

5. **Donating to Charity** – If you are philanthropically minded, you can donate your shares, thereby eliminating your capital gains tax liability. You can donate to charities, private foundations or trusts. There are several other charitable options to consider including charitable remainder trusts, charitable lead trusts and donor advised funds.

There are many options to consider when managing the risk of a concentrated stock position. There are legal and tax ramifications associated with each choice. Some options are more suitable for your situation than others. Consult with your tax attorney or financial advisor to find the best plan for your portfolio.

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