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Rabbi Trusts: Benefits, Features & Key Considerations

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Rabbi Trusts

Rabbi trusts were first used as a structure to help compensate rabbis, which is how they got their name

Also known as **grantor trusts**, they are utilized by organizations to help safe keep assets for the intended recipients covered by the trust

IRS has developed a model document as a basic framework which initially included provisions around a corporate insolvency

Rabbi Trusts

Rabbi Trusts offer risk protection for key employees

- Non-Qualified benefit plans have two primary risks:
  - Bankruptcy
  - Change of Heart

- While a rabbi trust is not intended to protect against bankruptcy, it can help protect benefits designed for key employees from a Change of Heart by management

Current Environment

Merger & Acquisition activity, as well as insolvencies, are once again on the rise

This leads to increasing Change in Control provisions being triggered, or bankruptcy proceedings, for companies and their executive benefit plans

Current Environment

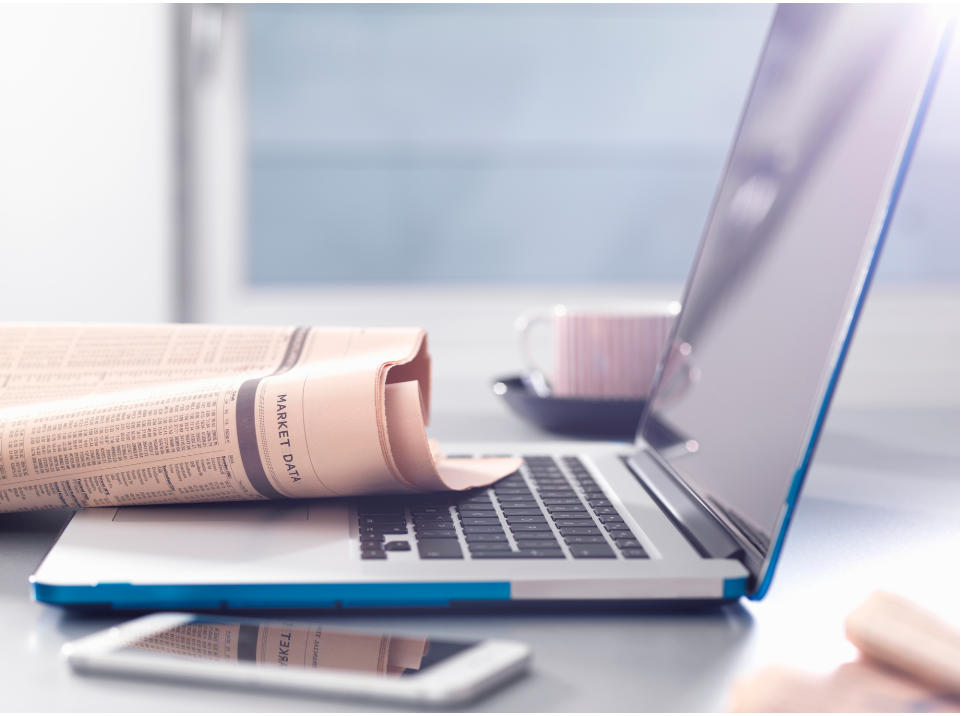
Companies typically have benefit arrangements or plans for executives containing “triggers” in the event of a Change in Control; most are unsecured promises to pay benefits

Employment Agreements	Change in Control Agreements	Executive Severance Plans	Deferred Compensation Plans	Supplemental Retirement Plans

Rabbi Trust and/or Custodial Considerations for NQ Plans

TRUST TYPE

- Revocable or irrevocable trust services



PREFERRED SERVICES

- Open architecture investment menu with ability to custody mutual funds, ETFs, COLI/BOLI, and company stock
- Support of company stock features
- Trust statements and online portal automation feature for efficiencies with account access via secure website
- Paying agent services including participant tax reporting for both W2 and 1099M reportable distributions
- Ability to track taxable income from taxable investments
- Report any trust taxable income earned annually via Form 1041 Grantor Tax Letter
- Ability to hold COLI/BOLI for safekeeping, tracking cash surrender values for annual corporate reporting

Rabbi Trust and/or Custodial Considerations for NQ Plans

LEGAL CONSIDERATION AND SECURITY OF BENEFITS

- Experience to act upon a Change in Control or Change of Heart to protect interest of plan participants
- Experience in handling corporate insolvency matters and administering the trust through such actions
- Reducing the potential for conflict of interest
- Tax deferral by employees with taxable income attributed to the employer
- Funds subject to the claims of the employer's creditors as the plan is a corporate asset
- Services provided are a core competency of the financial institution acting as trustee/custodian
- Dedicated client servicing staff with expertise in Non-Qualified plans
- Ability to strategically partner with various service providers allowing plan sponsor flexibility to use experts

Common Characteristics of a Protective Rabbi Trust

1. Irrevocable
2. Restricts company's ability to change investments after a Change in Control
3. May provide participants with a 3rd party, second opinion on benefit disputes after a Change in Control
4. Restricts amendments during and after Change in Control
5. Restricts activity in situation of insolvency

Key Considerations When Negotiating a Trust Agreement

New Trust vs Successor Trustee situations

Company’s flexibility to direct the trust and position it as it desires

Leverage legal/consultant/advisor expertise and insights for the various trust provisions in relation to the plan document

Good time to review the executive benefit features as intended and adjust as necessary

Company may participate in the direction of the investments (subject to Revenue Procedure 92-64)

Reversionary and reimbursement language

Participant consent provisions

Key Considerations for a Potential Change in Control

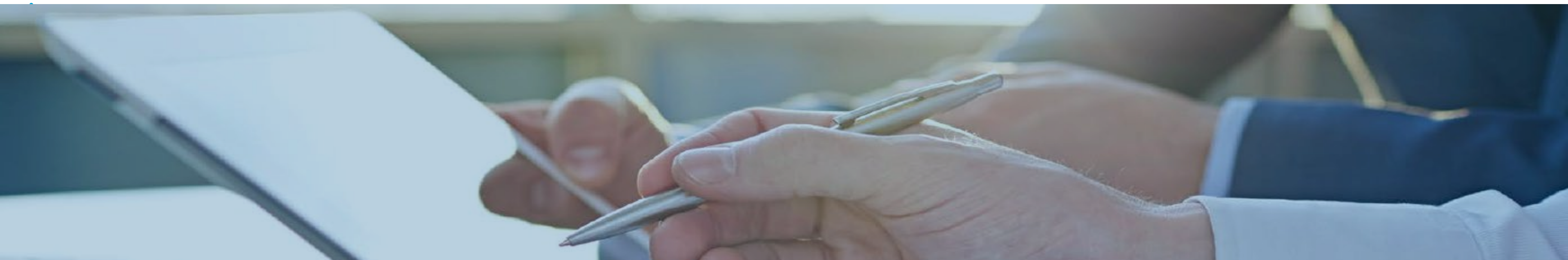
Generally this is the period after a merger has been announced but before the deal closes

Merger agreements generally prevent the company from creating new trusts or amending existing agreements without Buyer approval

Some trusts do not allow amendments without the consent of participants

Investments may still be handled primarily by the company

Key Considerations for a Post Change in Control Environment



- Trustee, pre-determined committee, or investment manager as defined within the trust agreement may become responsible for investment and/or other trust related decisions

- Participants may be provided with a 3rd party for benefit determination or second opinion on benefit disputes

- Amendments are restricted

- Annual true-up of trust assets may be required to ensure they at least equal liabilities

Key Considerations When Selecting a Rabbi Trust

- History, financial stability, and experience of the organization
- Dedicated line of business that understands NQ plans with complex designs & strategies
- Experience working with SMEs for legal, consulting, investment management and recordkeeping services
- Ability to act with investment discretion upon a Change in Control to support multiple asset types including: COLI, Mutual Funds/ETFs, and Employer Securities
- Potential conflicts of interest
- Fees for services

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