



EXECUTIVE BENEFITS:

**A GUIDE FOR MERGERS,
ACQUISITIONS, AND DIVESTITURES**

Executive Benefits: A Guide for Mergers, Acquisitions, and Divestitures

Companies involved with a merger, acquisition, or divestiture must address many important issues. One of the most challenging, complex, and sensitive matters is harmonizing executive benefits programs cost effectively to retain and attract quality, high-producing executives. The finance, human resources, and legal departments all will play important roles.

This white paper reviews those challenges and discusses steps that companies should take, suggesting processes that should be implemented and outlining the financial, administrative, and legal issues involved.

Because every situation is different, understanding the scope of challenges and approaching them in a collective manner allows companies to use their time efficiently, while putting together the best executive benefits solutions.

REVIEW EXISTING AGREEMENTS

It is important to gather and review all documents that govern executive benefit plans. Many companies will have several types of non-qualified retirement and specialty plans, including:

- Supplemental executive retirement plans (SERPs)
- Deferred compensation, including Mirror 401(k) plans, and benefit restoration plans
- Equity award deferral plans
- Director deferral plans

Often, the information is readily available, but sometimes, especially for benefits provided to a small number of executives, it may be necessary to track down the contractual and related information.

Prepared companies make sure they already have this information available, both in anticipation of a transaction and as a sound management practice.

DEVELOP A PLAN

Whatever the situation, there should be a documented and well communicated plan with a deadline for assessing and addressing various matters related to the transaction. This will keep the respective parties on track, while reducing uncertainty and stress.

DESIGNATE LEADERS AND THE TEAM

Companies should name a project leader for the changes taking place with the executive benefits programs. This person should have the standing and the backing to obtain key information from the finance, human resources, and legal departments and outside parties and be able to ensure that the participants work together.

There also should be a point person to address executives' questions that may arise. This may be the same person or persons helping with changes to qualified plan benefits. The point person should be able to ensure that executives will get comprehensive advice and guidance for organizing and managing their executive benefits.

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ASSESS THE RABBI TRUST

Many companies protect executive retirement plans with a rabbi trust. This irrevocable trust ensures that the funds set aside for executive benefits will be paid when specific conditions are met, such as the executive's retirement or an acquisition. The rabbi trust prevents a company from arbitrarily rescinding the benefits.

Many companies have informally funded executive benefit plans because they have found it to be a sound financing strategy. While doing that, they also set up a rabbi trust to increase benefit security.

Current funding levels and historical patterns, as well as trust provisions, should be analyzed before an acquisition. An important point to consider: Is there a trigger in the rabbi trust that requires the company to fully fund the non-qualified plan liabilities?

DETERMINE THE CHANGE OF CONTROL STATUS

Payments from a rabbi trust often trigger when a change of control event takes place. If that happens, the plan begins to unwind, the trustee distributes benefit payments, and the executive's participation in the plan is terminated.

Benefit distributions need to be made based on the language in the plan document. Often, such payouts are lump sums and result in significant income tax.

Many non-qualified retirement plans remain in place after the transaction. In this case, there may be a large number of new participants who want to join. Planning for the next enrollment is both challenging and important.

DETERMINE 409A RAMIFICATIONS

The Internal Revenue Code's Section 409A contains extensive rules that non-qualified deferred compensation plans must meet in order to qualify for deferred compensation. The penalties for non-compliance are severe and affect the participants, not the sponsoring company: immediate taxation for amounts deferred in the current year and all previous years, interest and penalties, and a 20 percent additional income tax.

Section 409A governs the timing of distributions, the acceleration of benefits, and the timing of deferral elections. If a company is looking to make a benefits payout as part of a change in ownership, it will be critical that the plan is 409A compliant.

Understanding the complex rules and regulations of 409A has always been important. Compliance, as many companies do regularly, should be assessed before and in conjunction with an acquisition, merger, and divestiture.

ASSESS FINANCING ALTERNATIVES

In addition to reviewing the plan provisions, trust agreements, and related regulatory issues, a plan financing assessment should take place as well. Key questions include:

- How do the assets track with the corresponding plan liability?
- Should the goal be to maintain the same level of funding following a merger, acquisition, or divestiture?

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- Is the rabbi trustee aware of the company's funding evaluation and future plans?
- Does the rabbi trust's funding trigger require the company to fully fund the non-qualified plan liabilities?
- In divestitures, what is the timing for transferring assets to ensure that, as part of a tax-free reorganization, there is no inadvertent tax triggered? In most situations, the assets need to be transferred to the new organization/s before the divestiture is legally finalized.

DECIDE WHETHER TO KEEP, REVISE, OR TERMINATE PLANS

With a merger, companies likely will have at least some overlapping plans. To reduce costs and ensure that executives are focused on team objectives with similar rewards and incentives, existing plans often will be replaced with another company's offering or an entirely new offering.

In many cases, executives prefer to keep a plan in place instead of receiving a lump-sum termination payment since they have deferred and accumulated a substantial sum. The lump sum payout could create a significant tax event versus having the benefits distributed over many years as originally elected.

To address this, some companies provide a full or partial gross-up to assist in the tax payment. Because of the high tax impact of the terminated plan, many executives find it important to have a new deferred compensation vehicle in place so that they can accumulate and replace these funds for retirement.

DECIDE HOW TO BEST ADDRESS TERMINATED EXECUTIVES' PLANS

Companies may want to keep a plan but terminate some executives as part of the re-structuring process. It is important to decide whether these executives should receive lump sum payments or be allowed to stay in the plan longer. The legal documents governing the plan may specify what actions the company can take.

Companies clearly should think through the best way to manage the cash flow in executive retirement plans, but they also need to factor in the effect on morale for those executives remaining in the plans, as well as the costs of potential legal challenges when handling terminated executives' account balances.

ASSESS THE BEST RECORDKEEPING APPROACH

When companies have different executive benefit service providers following a merger, there are important recordkeeping matters to address for a smooth transition to one provider.

There must be a precise reconciliation of plan liabilities and assets before the transaction is completed and after a triggering change-of-control event occurs.

The eventual provider must show it has the personnel to understand and address the old plan requirements. Furthermore, it must prove it understands the plan design, mechanics, and can run an efficient enrollment program with effective communications.

In all likelihood, new enrollment material will be necessary. The components of this should be identified early with ample time for review and production.

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ESTABLISH A COMMUNICATIONS REGIMEN

One thing is clear – the transition to a new executive benefits program will not be easy and will require input from many parties inside and outside the company. The point person for program implementation should have a schedule for receiving updates from the key parties and proactively resolve potentially difficult problems early on.

Weekly or bi-weekly updates for several months are advisable. It is far easier to identify and address problems early on than to be surprised by an eleventh hour plan revision..

ASSESS EXECUTIVE INSURANCE BENEFITS

In addition to high value supplemental retirement plans, there are other important programs that companies need to determine whether and how they continue. These plans include:

- Supplemental disability plans
- Long-term care insurance plans
- Death benefit plans
- Key person insurance
- 162 executive bonus plans

Some of these plans are portable, so the individual executive will determine the future of the program.

If the underlying group insurance program is tied to a group of executives who are being integrated with another company, it will be necessary to work with carriers and plan administrators to determine future costs and options.

MASTERING REPORTING REQUIREMENTS

Once the plans have been re-designed, adjustments made in financing, and related administrative and record-keeping changes implemented, reporting and communications will be critical. There are legal, including Securities and Exchange Commission involvement for public companies, accounting, human resources, treasury, and other reports that must be issued with the new plan, usually annually. Many boards will want to be apprised of changes when they occur as well.

By having a full understanding of the required reports, and an overview of their preparation, companies can be more efficient and consistently prepare these important documents.

CONTINUOUS ATTENTION

Supplemental, non-qualified retirement plans will play an increasingly important role in corporate America as many aging baby boomers approach retirement and place greater emphasis, indeed value, on such plans. When a company undergoes a merger, acquisition, or divestiture, there are many issues and challenges that must be faced in the determination of how to transition to new programs and implement those programs.

By taking a comprehensive approach in evaluating these issues, at the earliest stages, companies can smoothly implement change and help retain and motivate high-quality executives who will help lead the company to new levels of prosperity.