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The single source for your total executive benefit needs

Greenbook Tax Code Proposal Could Affect Future Purchases of COLI and BOLI

In January, the United States Treasury Department issued the General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals (commonly referred to as the "Greenbook"). It included a significant proposal to amend Internal Revenue Code Section 264(f) that, if enacted, would decrease the advantages of corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) purchased after December 31, 2011.

Operation of Current Section 264(f)

Section 264(f) provides that interest deductions of a business are reduced to the extent the interest is allocable to unborrowed policy cash values. The allocation is based on the proportion that unborrowed cash value bears to the sum of unborrowed cash value plus the tax basis of the corporation's other assets. There is an important exception, however, for contracts that cover individuals who are officers, directors, employees, or 20-percent owners of the taxpayer. The original purpose of Section 264(f) was to prevent Fannie Mae from engaging in a program which would have insured mortgage borrowers. It was not intended to affect, nor has it affected, purchases of COLI or BOLI since its enactment.

Action Alert

The passage of the Section 264(f) proposal in its current form would have no effect on companies that already own life insurance contracts or that purchase life insurance contracts prior to January 1, 2012. Any client considering purchases of new COLI contracts should monitor the progress of this proposed legislation and consider the potential adverse effects of the proposed legislation if purchase is delayed beyond the effective date of any new legislation.

Securities offered through M Holdings Securities, Inc., a registered Broker/Dealer, member FINRA/SIPC.
M Financial Group is the parent company of M Benefit Solutions and M Holdings Securities, Inc.

The Proposed Amendment

Citing concerns that leveraged businesses can fund deductible interest expenses with tax-exempt or tax-deferred income credited under life insurance contracts insuring the lives of their employees, officers, directors or owners, the proposed amendment would repeal the exception from the pro rata interest expense disallowance rule for contracts covering employees, officers or directors.

The proposal, if enacted, would eliminate a percentage of a company's interest deduction. The percentage eliminated would equal the ratio of the company's life insurance cash values (for contracts purchased after the effective date) to the tax basis of the company's other assets.

Effective Date for Proposal

The proposal would be effective for contracts purchased after December 31, 2011.

History of Proposal

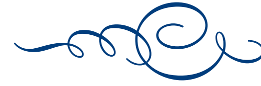
A similar proposal was put forth in the late 90s by the Clinton administration. It was rejected by Congress on a bipartisan basis.

Timetable for Consideration of the Proposal

There is no timetable but it could be brought forward at any time. It is projected to be a revenue raiser.

Action by M Benefit Solutions

M Benefit Solutions is working with its parent company, M Financial, as well as various life insurance carriers and other trade groups, to educate Congress on the negative impact this proposal would have both on employers and the life insurance industry itself. M Benefit Solutions will monitor this proposal throughout the remainder of the year and will keep you informed as to its progress.



The Importance of Rabbi Trusts in Protecting Participants' Benefits After a Sale

A recent court decision (***Feinberg v. RM Acquisition, LLC***, 7th Circuit, January 6, 2011) is the latest example as to why it is important to fund nonqualified deferred compensation benefits through a rabbi trust.

In ***Feinberg***, the plaintiffs were former executives of Rand McNally who participated in the Rand McNally Supplemental Executive Retirement Plan (SERP). In 2003 Rand McNally filed for bankruptcy protection; however, the SERP liabilities were not discharged as part of that process. As a result, the participants assumed their contractually-promised benefits were protected and that they would eventually receive the promised benefits.

Subsequently, in 2007, Rand McNally entered into an asset purchase agreement with RM Acquisition, LLC ("RM"). The agreement specifically stated that RM, although acquiring all of Rand McNally's assets, would not acquire the SERP liabilities. The SERP and all benefits were terminated as of the date of sale.

Six former executives sued RM for their benefits based on the theory that RM became the "de facto plan administrator" when it purchased the Rand McNally assets. The court stated that the purchaser of

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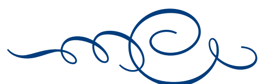
a company's assets does not automatically become the owner of the seller's liabilities. RM would have had to consent to taking over the SERP liabilities in order to be a proper party to this suit. The executives' lawsuit was dismissed and all their promised benefits under the SERP were lost.

Had Rand McNally established a properly drafted and funded rabbi trust for the SERP participants, the participants would have had a dedicated fund from which SERP benefits could have, and would have, been paid upon the sale of Rand McNally's assets.

Executives need to remember this case whenever it is suggested a rabbi trust is unnecessary to protect their benefits.



Enhanced Compensation Structure Reporting Applicable to Banks and Other Covered Financial Institutions

Proposed Rules

Proposed rules to implement Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) are being considered by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC); and the Federal Housing Finance Agency (FHFA), collectively, the Agencies.

All of the listed Agencies have yet to approve the draft of the proposal. This summary is based on a draft of the proposal dated February 4, 2011. If approved by the Agencies, the proposed regulations will be published in the Federal Register and a 45-day comment period will begin.

The rules would apply to banks with more than $1 billion in assets and other financial institutions (see below).

Section 956 of Dodd-Frank—Overview

Disclosure of Incentive-Based Compensation Arrangements

Section 956 of Dodd-Frank requires that the Agencies jointly prescribe regulations or guidelines to require each "covered financial institution" to disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements offered by such covered financial institutions sufficient to determine whether the compensation structure:

- Provides an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or
- Could lead to material financial loss to the covered financial institution.

Prohibition of Certain Compensation Arrangements

Dodd-Frank Section 956 also required the Agencies to jointly prescribe regulations or guidelines that prohibit any type of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions:

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- By providing an executive officer, employee, director, or principal shareholder of the covered financial institution with *excessive compensation, fees, or benefits*; or
- That could lead to *material financial loss* to the covered financial institution.

Under Section 956, "Covered financial institution" means:

- A depository institution or depository institution holding company, as such terms are defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);
- A Broker/Dealer registered under Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o);
- A credit union, as described in Section 19(b)(1)(A)(iv) of the Federal Reserve Act;
- An investment advisor, as such term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11));
- The Federal National Mortgage Association;
- Any other financial institution that Agencies, jointly, by rule, determine should be treated as a covered financial institution for purposes of this section.

Exemption: The requirements of Section 956 do not apply to covered financial institutions with assets of less than $1 billion.

Proposed Regulations

Disclosure of Incentive-Based Compensation Arrangements. The proposed regulations would require that an annual report be filed by each covered financial institution containing:

- A clear narrative description of the components of its incentive-based compensation arrangements applicable to covered persons (executive officers, employees, directors, and principal shareholders) and specifying the types of covered persons to which they apply;
- A succinct description of its policies and procedures governing its incentive-based compensation arrangements;
- For "larger covered financial institutions," a succinct description of any specific incentive compensation policies and procedures for the institution's executive officers, and other covered persons whom the board or a committee thereof determines individually to have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance;
- Any material changes to the its incentive-based compensation arrangements and policies and procedures made since the covered financial institution's last report was submitted; and
- The specific reasons it believes the structure of its incentive-based compensation plan does not provide covered persons incentives to engage in behavior that is likely to cause the institution to suffer a material financial loss, and does not provide covered persons with excessive compensation.

Prohibition on Excessive Compensation. Compensation for a covered person will be considered excessive when amounts paid are unreasonable or disproportionate to, among other things, the amount, nature, quality, and scope of services performed by the covered person. In making such a determination, the Agencies will consider:

- The combined value of all cash and non-cash benefits provided to the covered person;
- The compensation history of the covered person and other individuals with comparable expertise at the covered financial institution;
- The financial condition of the covered financial institution;

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- Comparable compensation practices at comparable institutions, based upon such factors as asset size, geographic location, and the complexity of the institution's operations and assets;
- For postemployment benefits, the projected total cost and benefit to the covered financial institution;
- Any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered financial institution; and
- Any other factors the Agency determines to be relevant.

Prohibition on Taking Inappropriate Risks that May Lead to a Material Financial Loss. This prohibition will apply only to those incentive-based compensation arrangements for individual covered persons, or groups of covered persons, whose activities may expose the covered financial institution to a material financial loss. Such covered persons include:

- Executive officers and other covered persons who are responsible for oversight of the covered financial institution's firm-wide activities or material business lines;
- Other individual covered persons, including non-executive employees, whose activities may expose the covered financial institution to a material financial loss (e.g., traders with large position limits relative to the covered financial institution's overall risk tolerance); and
- Groups of covered persons who are subject to the same or similar incentive-based compensation arrangements and who, in the aggregate, could expose the covered financial institution to a material financial loss, even if no individual covered person in the group could expose the covered financial institution to a material financial loss (e.g., loan officers who, as a group, originate loans that account for a material amount of the covered financial institution's credit risk).

The proposed regulation provides that an incentive-based compensation arrangement established or maintained by a covered financial institution for one or more of the above covered persons does not comply with the regulations unless it:

- Balances risk and financial rewards, for example by using deferral of payments, risk adjustment of awards, longer performance periods, or reduced sensitivity to short-term performance;
- Is compatible with effective controls and risk management; and
- Is supported by strong corporate governance.

These three standards are consistent with the principles for sound compensation practices in the Banking Agency Guidance.

Larger Covered Financial Institutions

Larger covered financial institutions (generally those with $50 billion of assets or more) are subject to further specific requirements.

Deferral Arrangements Required for Executive Officers

50 percent of Incentive-based Compensation Deferred for 3 Years

At larger covered financial institutions, at least 50 percent of the incentive-based compensation of an "executive officer," would have to be deferred over a period of at least three years. The proposed regulation also requires that deferred amounts paid be adjusted for actual losses or other measures or aspects or performance that are realized or become better known during the deferral period.

Rationale for Deferral

The Agencies believe that incentive-based compensation arrangements for executive officers at larger covered financial institutions are likely to be better balanced if they involve the deferral of a substantial portion of the executives' incentive compensation over a multi-year period in a way that reduces the amount received in the event of poor performance.

Consistent with International Standards

Requiring deferral for executive officers is also consistent with international standards that establish the expectation that large interconnected firms require the deferral of a substantial portion of incentive-based compensation (identified as 40 to 60 percent of the incentive award, or more) for certain employees for a fixed period of time not less than three years and that incentives be correctly aligned with the nature of the business, its risks and the activities of the employee in question.

Large Organizations Pose Greater Risk to Financial System

Furthermore, in enacting the Dodd-Frank Act, Congress recognized that larger organizations may pose a greater risk to the financial system by requiring the creation of enhanced prudential standards for certain nonbank financial companies with total consolidated assets greater than $50 billion.

Pro-Rata Payments or Vesting Over 3-Year Period

A covered financial institution may decide to release (or allow vesting of) the full deferred amount in a lump-sum only at the conclusion of the deferral period. Alternatively, the institution may release the deferred amounts (or allow vesting) in equal increments, pro rata, for each year of the deferral period. However, in no event may the release or vesting be faster than a pro rata equal-annual-increments distribution.

Special Review and Approval Requirement for Other Designated Individuals

The proposed regulation also requires that, at a larger covered financial institution, the board of directors, or a committee thereof, identify covered persons (other than executive officers) that individually have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance.

The Covered Persons

The proposal notes that these covered persons may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals that have the authority to place at risk a substantial part of the capital of the covered financial institution.

Board Approval of Compensation Arrangements

The proposed regulation would require that the board of directors, or board committee, approve the incentive-based compensation arrangement for such individuals, and maintain documentation of such approval.

Required Board Finding that Compensation Arrangement Balances Rewards and Risks

Under the proposal, the board (or committee) of a larger covered financial institution may not approve the incentive-based compensation arrangement for an

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individual identified by the board (or committee) unless the board (or committee) determines that the arrangement, including the method of paying compensation under the arrangement, effectively balances the financial rewards to the employee and the range and time horizon of risks associated with the employee's activities.

Methods of Balancing Rewards with Risks

The proposal recognizes that the methods used to balance the rewards and risks of the individual's activities may include deferral of payments, risk adjustment of awards, reduced sensitivity to short-term performance, or extended performance periods, or other appropriate methods. However, the board (or committee) must determine that the method(s) used effectively balance the financial rewards to the employee and the range and time horizons of the risks associated with the employee's activities. In performing its duties in this regard, the board, or committee thereof, must evaluate the overall effectiveness of the balancing methods used in the identified covered person's incentive compensation arrangements in reducing incentives for inappropriate risk taking by the identified covered person, as well as the ability of the methods used to make payments sensitive to the full range of risks presented by that employee's activities, including those risks that may be difficult to predict, measure, or model.

Rate Information

Moody's Long-Term Corporate Bond Yields

	2/28/2011	HIGH—PAST 12 MONTHS	LOW—PAST 12 MONTHS	FEBRUARY AVERAGE	JANUARY AVERAGE
Average—all risk ratings	5.51%	5.81%	5.05%	5.66%	5.56%

U.S. Consumer Price Index

		PERCENT CHANGE FROM	
	FEBRUARY 2011 INDEX LEVEL	JANUARY 2011	FEBRUARY 2010
All items	221.309	0.5	2.1
Core	223.011	0.4	1.1

Prime Rates (U.S. Effective Date: December 16, 2008)

			52-WEEK	
	LATEST	WEEK AGO	HIGH	LOW
U.S.	3.25	3.25	3.25	3.25

London Interbank Offered Rate, or Libor (March 25, 2011)

			52-WEEK	
	LATEST	WEEK AGO	HIGH	LOW
One month	0.24825	0.25350	0.35406	0.24688
Three month	0.30750	0.30900	0.53925	0.28438
Six month	0.46000	0.46000	0.76113	0.43938
One year	0.77650	0.77050	1.22413	0.75525

Source for CPI, prime rate, and LIBOR: http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html (accessed March 28, 2011).

The information incorporated into this presentation has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy.

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