USING A BLIND TRUST TO SELL RESTRICTED STOCK

Publicly traded companies often include corporate stock and stock options in key employees' compensation packages. As a result, corporate directors, officers, and executives may find that, over the term of their employment, a large portion of their net worth becomes concentrated in the employer's stock. The risks associated with holding a concentrated position in any one stock are well known, and a diversified portfolio is generally the advised solution. For corporate insiders, this requires coordinating sales within the context of securities regulations that don't apply to most shareholders.

How can you reduce the risk associated with a concentrated portfolio—without violating insider trading rules or sending a bearish signal to the market? A blind trust might be the answer.

What is a blind trust?

Under the provisions of a blind trust, the shareholder has no discretion over how the trust assets are managed. Rather, the trustee retains sole control of the trust's management. No communication about the company or the investment activities of the trust may take place between the shareholder and the trustee. The trustee has full discretion over the liquidation of the securities, including the number of shares to be sold, the price at which to sell, and the time frame. By disengaging from the asset management process, the shareholder guards against any appearance of impropriety that could result if he or she had control over the liquidation of the shares.

Blind trusts are commonly used in the public sector to ensure that officials cannot breach their fiduciary duty by catering to their own interests. Likewise, corporate shareholders can use blind trusts to diversify their portfolio holdings without violating insider trading laws. Essentially, a blind trust allows for proactive management of the stock outside of the company's "open windows"—the periods when shareholders are deemed not to be in possession of material nonpublic information and may sell their restricted shares.

Blind trust or 10b5-1 trading plan?

The goal of a blind trust is to remove the shareholder's ability to influence the trading of his or her restricted shares. If your goal is to liquidate the restricted shares, it may be worth considering another option: a 10b5-1 trading plan.

About 10b5-1 plans. In October 2000, the SEC enacted Rule 10b5-1, which allows owners of restricted stock to create a trading plan for selling restricted shares. A 10b5-1 plan is a written agreement between the shareholder and the company that specifies the parameters under which trades will be executed, such as the dates trades are to be made, the number of shares, and the limit price. Some 10b5-1 plans may even incorporate a complex algorithm or computer-generated program to initiate the trades. Regardless of the formula, the shareholder cannot have any influence over the execution of trades once the plan is established.

At the time the plan is drafted, the shareholder must not be in possession of any nonpublic information that could influence future transactions under the plan. The employer must review and approve the plan prior to the execution of any transactions.

Advantages of a blind trust. Blind trusts offer certain advantages over 10b5-1 trading plans. The creator of a blind trust can establish a trading plan for the trustee to execute, but, unlike a 10b5-1 plan, it doesn't need to incorporate a formula to determine the number of shares, price, and timing of trades. Rather, the trustee has full discretion over when to sell, how much to sell, and at what price. This can be advantageous in maximizing the sales price, allowing the trustee to incorporate professional money management into the trust administration.

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Another benefit of using blind trusts to liquidate restricted shares is the neutralizing effect it can have on the market. These trades aren't perceived in the negative light that may accompany other sales of restricted stock. Because the shareholder is completely removed from the decision-making process, trades executed from the blind trust are less likely to lead investors to believe that an insider is "bailing out."

Finally, blind trusts can be a useful tool in estate and tax planning. A blind trust can take the form of a revocable trust, but it may be advantageous to establish an irrevocable grantor trust in order to reduce your gross estate.

Is a blind trust for you?

A multipurpose planning tool, a blind trust can provide access to wealth held in restricted shares, proactive asset management, and gift and estate tax benefits. Please consult with your financial advisor to learn more about this strategy and whether it makes sense for you.