2020 Advisory Council on Employee Welfare and Pension Benefit Plans

Examining Top Hat Plan Participants and Reporting

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Written statement - BIO:

I have a 40 + year career in the financial services and retirement plan industries, creating a value proposition that is a diversified integration of credentialed education, experience-based knowledge and industry leadership. My fiduciary based business model focuses on enhancing my ability to act as a trusted advisor and subject matter expert to high net worth individuals, families, businesses and their mission critical employees in addition to retirement plan sponsors and their participants through my private practice, the Advanced Strategies Group based in Powell, Ohio. In addition, I am the Chief Business Development Officer for Independent Financial Partners headquartered in Tampa, Florida. My duties include being available as a Subject Matter Expert (SME) to our 250 financial professionals and their clients across the county on matters related to qualified and nonqualified plan matters.

I have also been very active in my volunteerism within the National Association of Plan Advisors (NAPA) having served as the Chair of the Government Affairs Committee, a member of its Leadership Council and ultimately as President of the organization. I still serve the organization and its members as Chairman of NAPA's nonqualified plan certificate program, for which I authored the curriculum, and the program's corresponding annual conference. Finally, I am currently an active member of the Board of Directors of NAPA's parent organization, the American Retirement Association.

Written statement - Opening Comments:

The scope document provided for this session focused on several recommendations directed to the DOL by the GAO based upon their report on this same topic dated January 2020. One of the recommendations to the Department was it "**should determine whether employers are inappropriately including rank-and-file employees in top hat plans."** I would suggest the other two recommendations to **"determine whether its reporting requirements for top hat plans should be modified to provide additional information"** and **"determine whether the Department should provide specific instructions for companies to follow to correct eligibility errors that occur when rank-and-file employees are found to be participating in top hat plans"** would be best addressed after arriving at a conclusion as to how or even whether to pursue the first determination.

A logical assessment of the first recommendation would lead one to ask, "Has including rank and file employees in nonqualified plans proven to be a pervasive problem leading to negative scenarios or outcomes that need addressing?" A cursory overview of the majority of cases that have made it to court do not seem to indicate a problematic inclusion of rank-and-file employees seeking court-ordered remedies. As such, I would suggest before issuing new regulations that define the top-hat group, perhaps a survey of settled court cases would be in order to determine what the actual more

problematic issues were found to be to avoid the unintended consequences of any potential overreach of inconsequential or ineffective guidance.

However, in acknowledgement of the GAO recommendation, a root cause of the potential issue is the absence of any "bright-line" definition of who should be excluded from a "select group of management or highly compensated employees." Without such guidance in place industry service providers and subject matter experts have long looked to court cases to help define best practices in drawing defensible parameters of inclusion and correspondingly exclusion. Unfortunately, this approach has led to inconsistencies in interpretation as the decisions reached by the various circuit courts have proven inconsistent themselves after considering the unique facts and circumstances of each case.

In light of this, if the Department decides it should offer guidance to alleviate court case inconsistencies, to help protect rank and file employees from being included in a NQDC plan and to provide the industry with helpful guidelines to advise their clients with, what type of information would be needed, useful and appropriate to consider?

- **Compensation** -- a definition of "highly-compensated" outside of the HCE level set for qualified plans as a comparative would seem arbitrary as the term itself means something different depending on location, industry, profession, etc.
- **Select Group of Management** -- Will this definition be determined merely by job title? Just as with defining a Key Employee for purposes specific to qualified plans, a job title or corporate officer status may not properly describe an employee's duties, responsibilities or importance within an organization.
- **Type and Purpose of the Plan** -- Nonqualified Plans can be very flexible in their design, but fundamentally are established based upon the objective of either 1) the voluntary deferral of compensation by the plan participant (NQDC) or 2) the Employer assuming the responsibility for the funding of a promise to pay a future benefit based upon agreed upon performance or longevity expectations of the participant (e.g. SERP, Golden Handcuffs, etc.) set forth by the Employer. **Ultimately, plan design will be driven by plan purpose**. Is the purpose to allow highly compensated employees the opportunity to better prepare for their financial future by deferring more current income than their qualified plan would allow (assuming one is available to them)? Or is the purpose to provide the plan sponsor a tool to recruit, reward and retain a "select group of management" who are deemed mission critical to the organization's success? The latter being a more facts and circumstance driven assessment.
- **Available Qualified Plan Options** -- it is uncommon to find a qualified plan defined "Non-Highly Compensated Employee" (who would likely be considered rank-and-file by the GAO) with sufficient free cash flow to allow them to fully maximize the qualified plan deferral limits and still be desirous of additional personal salary or bonus deferral opportunities via a nonqualified plan. However, let's assume for a minute this same employee was deemed by a small-to-mid size Employer to be part of a "select group of management" and offered the ability to participate in a nonqualified plan driven primarily by an Employer funded SERP design providing potential benefits over and above their participation in the available qualified plan. Would it not be detrimental to this employee to be excluded from participation due to compensation if it can be documented they were indeed part of the Employer's select group of management based upon specific facts and circumstances?
- **Size of Plan Sponsor** -- Industry surveys and experts would indicate that salary deferral plans are most common within larger companies, many of which are publicly traded companies, who have their own tax bracket given their "C" Corporation status. Within the small to mid-size business cohort NQDC plans are less prevalent because of the tax implications driven by this group's use

of pass-through entity structures (i.e. S Corporation, LLC, Partnerships). These structures mean deferrals by non-owner participants are potentially taxable income to the entity owners who in turn have no salary deferral benefits, as deferred salary simply means more pass-through income. However, it is common for these small to mid-size businesses to be very concerned with retaining mission critical employees deemed to drive enterprise value and profitability, thus the prevalence of more Employer funded benefit designs incorporated over and above current year salary and bonus.

Considering the above bullet points without clearly defining "rank and file", "select group of management" or "highly-compensated" leaves us with a facts and circumstances analysis of who qualifies for inclusion in the top-hat group. This lack of clear-cut definitions creates a dilemma for the Department in attempting to execute on the GAO recommendation to implement precautionary measures so rank-and-file employees are not included in NQDC plans without having a bright line test of who these employees are and if they need protection.

If the Department determines they should provide guidance so they can execute on this recommendation, one suggestion would be to utilize a baseline "Safe-Harbor" type approach tied to the compensation thresholds applicable to qualified plans for consistency. If the department felt they needed to go further, the Safe-Harbor could integrate a quantitative measure similar to what some courts have used (e.g. no more than 8% to 10% of employees based on compensation). With those parameters in hand, if an Employer doesn't feel the compensation based Safe Harbor option accomplishes the purpose of the plan, because certain members of an Employer determined "Select Group of Management" will be excluded, they could forego Safe-Harbor status. They could then design plan inclusion based upon their interpretation of defensible facts and circumstances rooted in past court cases as is the current approach with most "gray area" situations.

The GAO report also says: *"Without reviewing or clarifying its reporting requirements to allow the agency to collect more useful information on executive retirement plans, DOL will continue to lack insight into the composition of these plans and, as a result, may be missing opportunities to ensure that companies with executive retirement plans are meeting the eligibility requirements for the plan."* They cite the 2016 *Bond v. Marriott* case as one in which rank-and-file employees may have been denied ERISA's protections but ultimately the 4th Circuit Court of Appeals did not rule on the top-hat issue. This perspective of the report is most assuredly driving the recommendations that the Department **"determine whether its reporting requirements for top-hat plans should be modified to provide additional information"** and **"determine whether the Department should provide specific instructions for companies to follow to correct eligibility errors that occur when rank-and-file employees are found to be participating in top-hat plans."**

However, to reiterate my opening comment, I would suggest determining how to address the second and third recommendations are predicated upon the Department deciding whether or how to address the first recommendation of determining whether Employers are inappropriately including rank-and-file employees in top plans and regardless, would guidance in general be beneficial to all parties involved with these types of plans.