Statement of J. Mark Poerio, Esq.
Before the ERISA Advisory Council

"Examining Top Hat Plan Participation and Reporting"

Poerio Statement dated October 22, 2020

Good afternoon. My name is Mark Poerio. My 35 years in private practice have focused primarily on executive compensation. I am currently Senior Counsel with the Wagner Law Group (a national ERISA boutique firm), and before that, I spent almost 20 years heading the ERISA and executive compensation practice for Paul Hastings Law Firm.

While serving in those roles, I also taught three different executive compensation courses as an adjunct professor at Georgetown Law School, and served as outside counsel to the American Benefits Council for executive compensation matters. I also served on the executive policy board for the American Benefits Council, which (as you likely know) advocates for plan sponsors, connecting public policy and private-sector solutions to shape employee benefits for the evolving global workforce.

I appreciate the opportunity to testify before this working group, and thereby to share my thoughts how the Department of Labor's top hat rules and regulations could be updated. The recommendations that I am making today are basically twofold, namely:

EXECUTIVE SUMMARY

Recommendation #1: Enhance Risk Disclosures for Participants. Without another reference, many top hat plans determine eligibility by reference to a limit as low as the Internal Revenue Code's threshold ($130,000 for 2020) for determining highly-compensated employees. Over the years, that threshold has meant that top hat plans cover employees who are often not in a position either to fully appreciate the risks associated with non-qualified plans, or to negotiate for appropriate protections. That leads to my recommendation that the Department of Labor protect plan participants by requiring that employers provide a short-form disclosure along the line that I will further describe momentarily.

Recommendation #2: Create a Safe Harbor for Top Hat Status. There are rules of thumb that employers tend to follow to establish top hat status. It would seem beneficial to employers and participants for the Department of Labor to get out in front of this issue by establishing a well-considered safe harbor for top hat status.

DISCUSSION

Recommendation #1: Enhance Risk Disclosures for Participants.

There was a time, long ago, when annual compensation above $130,000 indicated that an executive had "*the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan, taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of Title I.*"[1] Times have changed.

In its January 2020 report to Congress, the General Accounting Office noted that "Recent industry surveys we reviewed have suggested some companies may be extending employee eligibility to a relatively high percentage of their workforce—in some cases, more than 30 percent—and to relatively lower-paid or lower-ranked employees." ("Private Pensions - IRS and DOL Should Strengthen Oversight of Executive Retirement Plans," page 51.). In my own experience, many top hat plans determine eligibility by reference to the limit, $130,000 for 2020, by which Code Section 414(q)'s limit and therefore cover broad groups of executives. Here is supportive survey data drawn from several recent publicly-available reports:

Published Report (date)	Data about Eligibility for Non-qualified Plan
Prudential-PLANSPONSOR Benefits survey (2019.09.09)	48% of surveyed participants had a base salary below $175,000 per year, per participant. That percentage was 68.9% per 2017 survey results.
Fulcrum Partners LLC: Trends in Nonqualified Deferred Compensation. 2017	*Annual Compensation for Participants:* • *30% below $150,000* • *48% between $150,000 - $300,000*

[1] 29 C.F.R. section 2520.104-23.

Published Report (date)	Data about Eligibility for Non-qualified Plan
Newport Group Current Practices in Non-Qualified Deferred Compensation 2017	"Generally, most plan sponsors use a minimum range of $125,000–$150,000 as the low end of the total compensation level. In addition, the maximum number of eligible participants in an NQDC plan is typically held at no more than 10%–15%." Minimum Total Compensation for Eligibility: ◦ Less than $150,000 for 40% of surveyed companies ◦ [D]ata from 113 public and private companies

As you may have noticed from my background, I am not a social scientist, and cannot point to statistical support for what I next say. But I believe there is little doubt that, in the United States today, many of those earning between $130,000 and $200,000 do not have the power to affect or to substantially influence the terms of the non-qualified plans in which they participate.

What I do know from my executive compensation practice is that top hat plan participants often under appreciate the risks associated with their benefits. Right now, my firm and I are counsel representing different retiree groups making top hat claims in Chapter 11 bankruptcy proceeding. Many of the retirees are aged and facing unexpected financial hardships because their top hat plan benefits are being extinguished for pennies on the dollar. Many of them struggle to identify the plan and administrators who are responsible for their plans. That is not because the retiree has stumbled. The problem often arises over time - from corporate mergers and acquisitions that cloud the history behind inherited top hat plans.

My focus on retirees reflects surveys such as those listed above — and other ones — that seem consistent in reaching conclusions such as the following:

- "Retirement continues to be the #1 reason to participate in the [non-qualified] plan, and a top reason for employees to increase their contributions" (Trends in Nonqualified Deferred Compensation: 2019 research results, Principal, February 2020).

- "It's all about retirement. The trend continues to show that a NQDC plan is important in helping participants reach their retirement goals. In fact, progress toward their retirement savings goal continues to be the primary reason to participate, and plays the largest role in deciding how much to contribute." (Fulcrum Partners LLC: Trends in Nonqualified Deferred Compensation, 2017).

Given the long-term, retirement-oriented purpose for top hat plan participation, it seems sensible for the Department of Labor to assure that top hat plan participants receive sufficient information from the plan sponsor to understand the most significant risks and ERISA rights associated with their plan benefits. For instance, in my experience, many top hat plan participants misunderstand the extent to which their benefits are subject to forfeiture risks based on either the employer's insolvency or the participant's alleged misconduct (such as for cause termination or breached restrictive covenants, e.g. non-competes). They do not need all of the protections of ERISA Title 1, but I believe they need some basic safeguards.

It is consequently my suggestion that the Department of Labor should initiate a short-form summary plan description requirement for top hat plans. The required content could be scaled back significantly from 29 CFR § 2520.102-3. For instance, it would seem reasonable and suitable to require that the sponsors of top hat plans make disclosures to participants about the following:

1. Where to find the governing document for their benefits, including any associated rabbi trust or other funding vehicle.

2. A summary of forfeiture risks as well as bankruptcy risks that could result in a reduction or loss of benefits.

3. A summary of any previously undisclosed material modifications to the plan.

4. Whom to contact for further information about plan benefits.

5. The procedures that govern benefit claims, and a statement of ERISA rights.

Recommendation #2: Create a Safe Harbor for Top Hat Status.

There is a fundamental split in the federal circuits over how to define who constitutes a "select group" for top hat plan purposes. Is an individual's ability to negotiate plan terms required for an ERISA top hat plan? The 3rd Circuit has disagreed with the 2nd, 6th, and 9th Circuits - and agreed with the 1st Circuit in finding that bargaining power is not necessary because the test for top heavy status depends only on weighing these two factors: (1) quantitatively, does the plan cover "relatively few employees," and (2) qualitatively, does the plan restrict participation to "a select group of management or highly compensate employees." For detailed analysis of these considerations, see Sikora v. UPMC (876 F.3d 110, 3rd Cir., 2017).

Today, I mention the split between the federal circuits because participants and plan sponsors would benefit from a safe harbor that the Department of Labor could create by regulation. Building from the *Sikora* decision referenced above it seems suitable to identify two main components for the safe harbor - one based on a percentage (such as 15% on a controlled group basis) of the plan sponsor's workforce, and the other based on a minimum level of compensation indicative of highly-compensated status (such as the Internal Revenue Code's 414(q) limit that I previously mentioned - applicable to retirement plans - $130,000 for 2020).

The Code Section 414(q) standard seems particularly suitable because it already applies to public and private employers, as well as tax exempt organizations.

A regulatory safe harbor would discourage employers from establishing non-qualified plans that cover too broad a segment of their population, and would provide a standard by which plan participants, employers, and courts could measure whether a plan qualifies for top hat status. That would not obviate the need for facts-and-circumstances analysis in the event of disputes, but a safe harbor should reduce the likelihood for such disputes.

Here is one final note to consider should a regulatory safe harbor for top hat plans be pursued: if a top hat plan covers one (or more) employees who are outside the safe harbor criteria, the safe harbor should not be lost. Instead, some form of self-correction mechanism seems right – noting that this may need coordination with the Treasury Department to assure compliance with Section 409A and other deferred compensation tax laws and principles.

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Having brought the foregoing points to your board for consideration, I want to express thanks for today's opportunity to address you, and to answer any questions you may have.