

October 16, 2020

ERISA Advisory Council
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave NW
Washington, DC 20210

Re: Examining Top Hat Plan Participation and Reporting

ERISA Advisory Council Members:

Issue Chair Jason Bortz, Issue Vice-Chair Marcy Supovitz, Drafting Team members John Harney, Bill Johnsen, Bridget O'Connor and Peter Wiedenbeck, and other members of the ERISA Advisory Council, thank you for the opportunity to present the Plan Sponsor Council of America's (PSCA) Non-Qualified Deferred Compensation (NQDC) survey results and to offer insight from a plan sponsor perspective.

The Issue statement seeks input regarding three specific concerns, whether:

- Top hat plan reporting requirements should be modified to provide additional information;
- Employers are inappropriately including rank-and-file employees in top hat plans; and
- The Department of Labor (Department) should provide specific instructions on how to correct eligibility errors when rank-and-file employees are found to be participating in top hat plans.

NQDC programs are contractual, unfunded agreements that may or may not be retirement plans.¹ Where payout is made after retirement (versus deferrals for a specified period of years), the contract may become a retirement plan and tax-qualified plan requirements (vesting, etc.) would apply unless the plan is a "top hat" plan – "which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees".² Otherwise, plans that meet "top hat" requirements may incorporate unique features - a non-compete clause, forfeitures where terminated for cause³, change in ownership provisions, etc.

The alternative method of compliance reporting has been adequate for 45+ years. Participants have access to information concerning rights and obligations, and by virtue of their position or compensation level, they "... have 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."⁴

The Department recently reviewed these requirements and did not change the content requirements.⁵

¹ 29 U.S. Code § 1002(2)(A), DOL regulation 29 CFR § 2510.3-2 define pension plans: "... any plan, fund, or program ... established or maintained by an employer or by an employee organization, to provide retirement income to employees, or results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, ..."

² 29 U.S. Code §1051(2).

³ So-called "bad actor" clauses.

⁴ DOL Advisory Opinion 90-14A, 1990 WL 123933 5/8/90. Accessed 10/14/20 at:

<https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/advisory-opinions/1990-14a.pdf>

⁵ Employee Benefits Security Administration, Department of Labor, Electronic Filing of Notices for Apprenticeship and Training Plans and Statements for Pension Plans for Certain Select Employees, 29 CFR § 2520.104-22, 84 FR 27952, 6/17/19.

PSCA NQDC survey responses found that “top hat” plans comply with applicable requirements to constrain and limit eligibility to exclude “rank and file” employees. Consequently, the data doesn’t suggest, nor do we see a need for a correction process.

PSCA Survey Data

NQDC survey reports (2018, reflecting information as of December 31, 2017, and 2019 reflecting information as of December 31, 2018) were provided to the Issue Chair and Vice Chair. Once complete, the 2020 Report (reflecting information as of December 31, 2019) will also be provided.

The 2019 survey includes responses from 127 plan sponsors of that have account balance NQDC plans. Nearly all responding organizations, 97.1%, offer a 401(k) plan.⁶

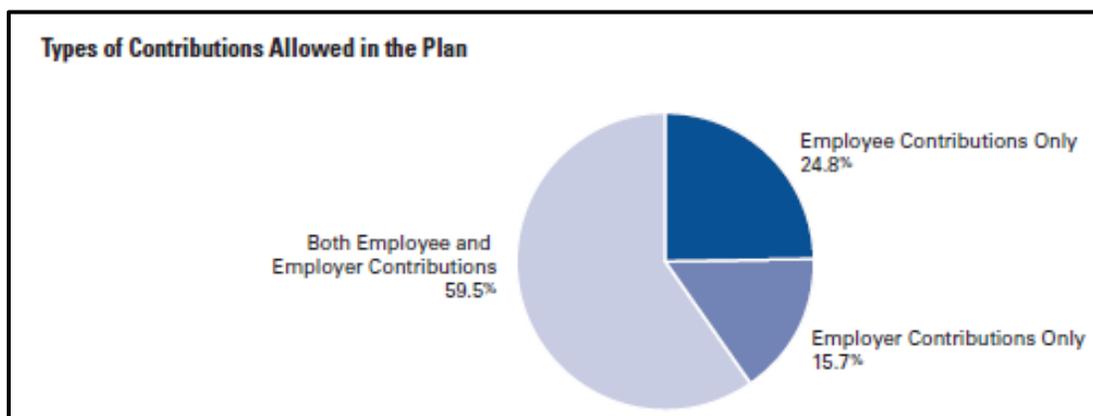
So, among the survey respondents, NQDC participation is additive – providing benefits in addition to those offered in the tax-qualified plan.

Most of the data in this statement is focused on the 2019 report reflecting year-end 2018 data - eligibility, communications and disclosures. In some instances, I have included information from the 2018 report. Note that each year there is turnover in the organizations who participate in PSCA surveys.

PSCA NQDC survey results include excess plans and other plans that are not “top hat” plans.

Because 97% of survey respondents offer a 401(k) plan, it isn’t surprising to find that the most common plan design offers a restoration match (32.8% of plans) designed to “gap fill” for the match excluded from the tax-qualified plan due to non-discrimination testing and/or contribution limits (17.2% of plans provide a match of employee deferrals, 19.8% of plans provide for a discretionary employer contribution). Other plan sponsors provided information regarding Excess Benefit Plans (Excess) and Supplemental Executive Retirement Plans (SERPs), that fill gaps from annual addition limits.⁷

More than half of surveyed plans include both employer contributions and employee deferrals.



⁶ Of the survey respondents, 33.3% also offer a traditional defined benefit pension plan, 20.3% offer a cash balance formula defined benefit pension plan, 5.8% offer a Money Purchase Pension Plan, 15.9% offer a Profit Sharing Plan, 4.3% offer a 403(b) Plan and 49.3% offer a Long Term Incentive Plan.

⁷ Internal Revenue Code (IRC) - IRC §§401(k), 401(m), 402(g), 401(a)(17)).

The 2018 report had similar results, only 27.9 percent of plans allowed employee contributions, 15.5 percent allowed only employer contributions and 56.6 percent allowed both employee and employer contributions.

Eligibility

The PSCA NQDC survey instrument focuses on eligibility criteria in questions 5, 8, 9, 11, 38 and 39.

The Government Accountability Office (GAO) report⁸ cited our 2018 NQDC study, concluding:

“... 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. For example, results from a recent survey of executive retirement plan sponsors suggested that just over 8 percent of respondents offer eligibility to between 20 to 30 percent of their workforce and just over 4 percent offer eligibility to more than 30 percent of their employees. Further, over 20 percent of respondents indicated that over 15 percent of their workforce was considered highly compensated employees and eligible to participate in an executive retirement plan....”

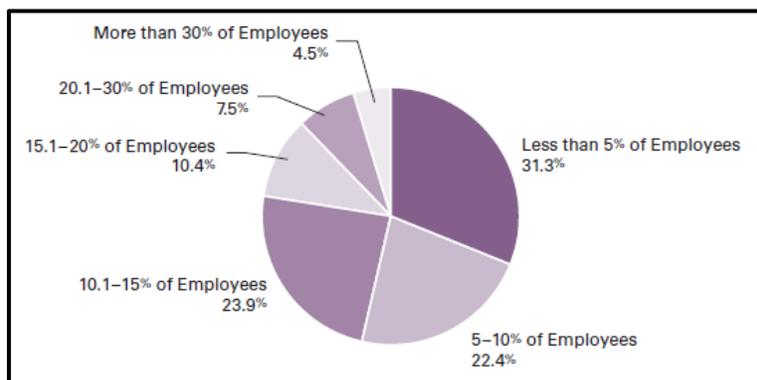
However, the GAO report did not clarify that our survey includes more than “top hat” plans!⁹

The 2019 survey questions are provided below along with survey results:

Question #8: How many total full-time U.S. workers does your organization employ?

Question #9: How many total employees are eligible to participate in the organization’s non-qualified plan?

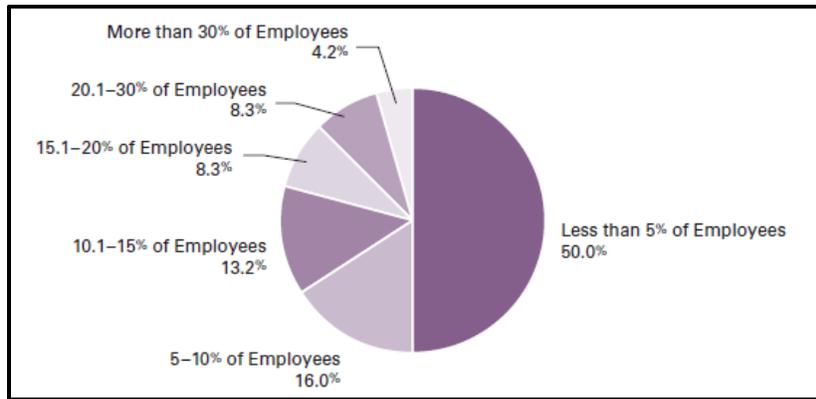
2019 Data: Percentage of employees eligible to participate in the Plan



⁸ Government Accountability Office (GAO), PRIVATE PENSIONS, IRS and DOL Should Strengthen Oversight of Executive Retirement Plans, GAO 20-70, January 2020. Accessed 10/13/20 at: <https://www.gao.gov/assets/710/704097.pdf>

⁹ The GAO also cites *Darden v. Nationwide Mut. Ins. Co.*, 717 F. Supp. 388, 396-97 (E.D.N.C. 1989) where the district court noted that the plan covered an average of 18.7 percent of employees during a certain period to be “too large to be considered ‘select.’” However, GAO failed to note that the United States Supreme Court reversed and remanded the case, *Nationwide v. Darden*, 503 U.S. 318 (1992) in part because that non-qualified deferred compensation plan only applied to insurance salespersons who were independent contractors, not employees!

2018 Data



Survey responses confirmed that NQDC participation averaged less than 5% of all employees.¹⁰

Question #5a: (Multiple choice) Approximately what percentage of employees are considered highly compensated employees (HCE's)? **Answers:** 0-5%, 6-10%, 11-15%, 16-20%, 21-30%, 30+%.

2019 Data – Approximate percentage of employees that are considered highly compensated:

Percentage of Employees	All Plans
Less than 5%	31.3%
5-10%	22.4%
10.1-15%	23.9%
15.1-20%	10.4%
20.1-30%	7.5%
More than 30%	4.5%

2018 Data

Percentage of Employees	Percentage
	All Plans
Less than 5%	50.0%
5-10%	16.0%
10.1-15%	13.2%
15.1-20%	8.3%
20.1-30%	8.3%
More than 30%	4.2%

Because the PSCA NQDC survey includes smaller employer plans, excess plans and plans that are not top hat plans, it was not surprising to find that 12% of survey responses had populations where 20+% of employees were considered highly compensated.

¹⁰ DOL, Note 4, Supra. The Department has interpreted the word “primarily” as modifying the purpose of the plan, rather than the composition of eligible individuals. See also: DOL Advisory Opinion 92-13A, May 19, 1992. However, see: Demery v. Extebank, 216 F.3d 283 (2nd Cir. 2000), decided after Advisory Opinions 90-14A, and 92-13A: “...we think it significant that the statute defines a top hat plan as “primarily” designed to provide deferred compensation for certain individuals who are management or highly compensated. ... It suggests that if a plan were principally intended for management and highly compensated employees, it would not be disqualified from top hat status simply because a very small number of the participants did not meet that criteria ... ”

Question #5b: (Multiple choice) If yes, what criteria do you use to determine who is an HCE? **Answers:** IRS Limit of \$120,000 in 2018, Other limit.

Criteria	All Plans
IRS Limit	71.2%
Other Dollar Limit	9.6%
Other Criteria	19.2%

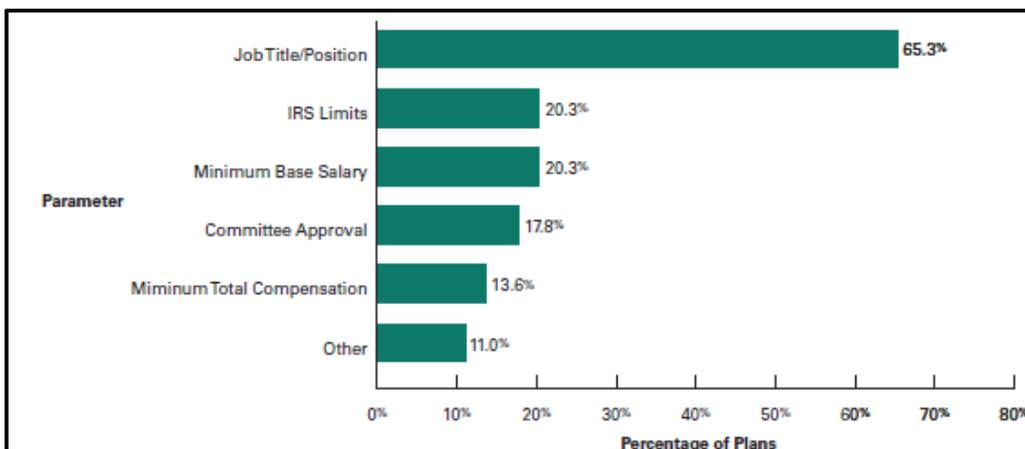
Question #10: (Data) How many of those eligible employees listed in question 9 participate in the plan (have an accrued plan balance)?

Percentage of Eligible Employees	All Plans
Less than 25%	24.0%
25–50%	26.0%
50.1–75%	19.8%
75.1–99.9%	14.6%
100%	15.6%

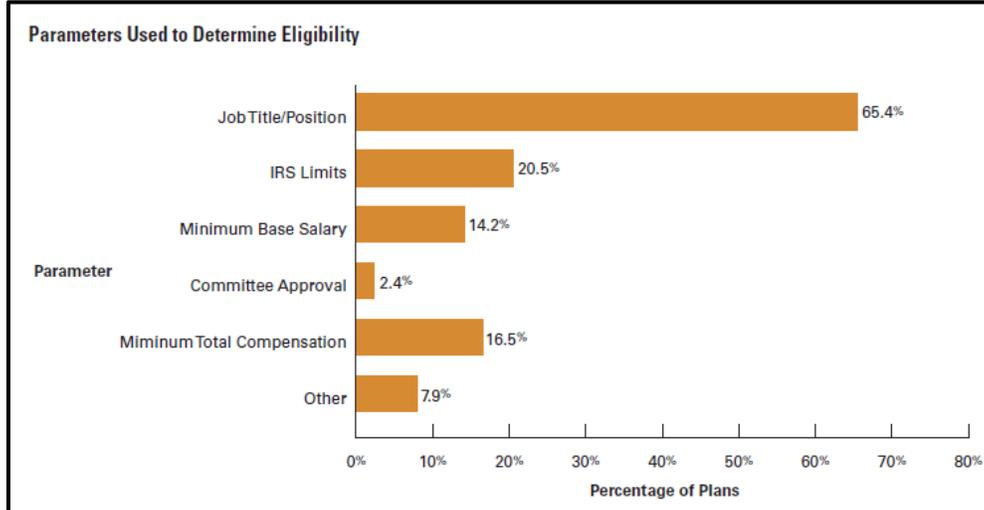
In 2019, the average participation was 29.9 percent among eligible employees for plans that only allowed participant contributions; 55.8 percent for plans that offered an employer matching contribution. In 2018, the comparable averages were 40.1 percent and 55.2 percent.

Question #11: (Multiple Choice) Which parameters are used to determine eligibility to participate in your non-qualified plan? Select all that apply. **Answers:** Job title/position, Minimum base salary, Minimum total compensation, IRS limits, Committee approval.

2019: Parameters used to determine eligibility



2018



The survey data confirm that many plans use multiple criteria in determining eligibility (sum > 100%).¹¹

Question #11a: (Data) If minimum base salary, what is the minimum?

Where a minimum base salary is part of the eligibility determination, the average was \$154,318 among survey respondents – with a range of \$100,000 to \$275,000 and a median of \$150,000.

Question #11b: (Data) If minimum total compensation, what is the minimum?

Where a minimum total compensation is part of the eligibility determination, the average among survey respondents was \$194,074 – with a range of \$100,000 to \$300,000 and a median of \$200,000.

Question #38: (Multiple Choice) What changes did your organization make in 2018, if any? Select all that apply. **Answers:** Changed eligibility criteria, Changed employer contribution formulas, Changed investment options, Changed recordkeepers, Changed other providers/consultants, Changed financing methods, Benchmarked/evaluated recordkeepers, Changed distribution options, Other plan design changes, Implemented education, Implemented advice, None, Other (Please list).

5.6% of surveyed plans indicated that they changed eligibility criteria in 2018.

¹¹ Demery v. Extebank, Note 7, Supra “... In terms of being established for a “select group,” although the Plan was offered to a relatively large percentage of the workforce, all participants were selected officers of the bank, were in management positions, and were highly compensated in comparison to bank employees at large. ... we require the district court to conduct a fact-specific inquiry, analyzing quantitative and qualitative factors...” In finding the nonqualified deferred compensation plan to be a “top hat” plan, the court noted that the plan was a supplement to a tax-qualified pension plan, not a substitute for a tax-qualified plan and that the plan was established not so much to assist in retirement preparation but to “retain valuable employees,” in that all participants were officers of the bank, in management positions, and highly compensated – relative to all other bank employees.”

Question #39: What changes is your organization making (or planning to make) in 2019, if any? Select all that apply. **Answers:** Changed eligibility criteria, Changed employer contribution formulas, Changed investment options, Changed recordkeepers, Changed other providers/consultants, Changed financing methods, Benchmarked/evaluated recordkeepers, Changed distribution options, Other plan design changes, Implemented education, Implemented advice, None, Other (Please list).

4.6% of surveyed plans indicated that they made or planned to make changes to eligibility for 2019.

My individual experience is substantially different compared to the industry experts interviewed by GAO – NQDC eligibility requirements are carefully drafted and regularly scrutinized. Responses to questions 38 and 39 confirm that plan sponsors regularly review their eligibility criteria for participation in NQDC plans. The diversity of eligibility criteria, purpose, options, etc. is noteworthy.

The issue statement states: “... the Department has not addressed the eligibility criteria for appropriate inclusion of employees in a top hat plan, for example, the types of jobs, roles, salary levels, access to information, or sophistication that are necessary to influence or negotiate the plan provisions on behalf of their interests. Additional approaches to defining eligibility also may be worthy of consideration. ...”

Arbitrary definitions are as likely to add confusion as they are to add clarity. Indeed, we do not at present see a need for a definition.

However, if the Department decides to craft a “top hat” definition, it may want to avoid incorporating bright line objective standards such as limitations based on job titles or arbitrary tax code numerical limits such as those at IRC §§ 414(q), 401(a)(17) or a specific workforce percentage.¹² And, the Department may want to consider *separate* definitions for each of the terms:

1. **Select** – often defined as “... to pick out or single out ...”. Select does not suggest a numerical limit. Select suggests a qualitative determination. Here, it may be as important to reconfirm who in our voluntary benefits system should make such qualitative determinations in “picking out” or “singling out” individuals.
2. **Group of management** - typical meanings often include but are not limited to those who supervise, direct, lead, control, executive. Again, defining “group” and “management” does not suggest a numerical limit; but a qualitative determination.
3. **Highly compensated employees** – “high” ... a distant upward, farther from a reference point, at or near the peak ...” However, “highly compensated” often depends on a decision-makers’ vantage point. Some define it in relative terms - the top .1%, in excess of the “middle class”, etc.¹³ Others use an arbitrary demarcation such as IRC §414(q)(1)(B)(i) (\$130,000). Others might use a “facts and circumstances” definition - such as the standard adopted in Demery that “highly compensated” should be determined by taking the average compensation for NQDC eligibles and comparing it to the average for all others who are ineligible for the NQDC.¹⁴

¹² For example, in a small firm of say 100 employees, an arbitrary percentage such as 10% would be 10 employees, which might not cover all the management team. And, in a large firm of say 1,000,000 employees, 10% would be 100,000 employees which would likely include a substantial number of “rank and file” employees.

¹³ For example, some define the middle class as those earning between two-thirds and double the median household income – households with earnings between \$40,500 and \$122,000.

¹⁴ Demery v. Extebank, Note 7, Supra See also: Duggan v. Hobbs, 99 F.3d 307, 312 (9th Cir.1996) (holding that the “select group” requirement includes “more than a mere statistical analysis”); See also: Senior Executive Benefit Plan Participants v. New Valley Corp. (In re New Valley Corp.), 89 F.3d 143, 148 (3d Cir.1996) (considering “both quantitative and qualitative restrictions”).

Arbitrary definitions may only add confusion, not clarity. So, if the Department decides to define “top hat”, it may want to specifically confirm, as it did when interpreting the word “primarily”, that the term “select group of” only applies to “management” and not “highly compensated employees” – allowing for employer-specific or fact-specific determinations.

At the same time, adopting a fact-specific and/or an employer-specific definition of “highly compensated” may produce noticeably different outcomes. For example, consider two firms with similar average and median compensation, with a similar range of compensation and similar total compensation, but where graphing the populations results in “bar bell” and “normal” distributions.

Finally, if the Department decides to define “top hat”, it may want to be careful to avoid creating eligibility standards for NQDC plans that are not “top hat” or pension plans. Where such NQDC plans exist, they are often designed to meet the needs of an individual “caught in the middle” – those in positions where they are impacted by the IRC §402(g) limits or earned enough so that ADP test results affect their participation, but where their management position and/or their compensation is not high enough to qualify as a member of a “select group of management or highly compensated employees.”

Disclosures

The issue statement confirms that: “... Under a regulatory exemption under Part 1 of Title I of ERISA ..., an employer maintaining a top hat plan is also eligible to utilize an alternative reporting option, which is satisfied through the filing of a one-time registration statement with the Department of Labor that identifies the employer, the plan administrator and the number of plans the employer maintains, and certifies that the plan only covers a select group of management or highly compensated employees...”

The PSCA NQDC survey did not ask a question regarding the alternative reporting option.

PSCA Survey data show that 64.2% of survey respondents use the same recordkeeper for qualified and non-qualified plans. Many consolidate account disclosures using a “single view” – where the service provider’s website provides information for all plans. PSCA NQDC surveys do not ask questions regarding the frequency of disclosures regarding plan provisions, account balances and other participant information, however, my personal experience as well as information offered by PSCA NQDC Committee members confirms that many, perhaps most service providers offer disclosures beyond those provided to tax-qualified plan participants.

Table 43 | Organizations providing education to participants specifically on the non-qualified plan (separate from other retirement plan education)

	Number of Total Employees				
	1-199	200-999	1,000-4,999	5,000+	All Plans
Percentage of Organizations	*	36.4%	68.2%	75.0%	55.9%

*Sample size too small to calculate.

The percentage of plan sponsors offering NQDC-specific education dropped to 55.9 percent in 2019, from 70 percent in 2018, returning to 2016 levels (53 percent). Some of that increased education likely resulted from the adoption of the Tax Cuts and Jobs Act of 2017 at the end of the 2017 calendar year.¹⁵

¹⁵ Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, 12/22/17.

Education methods and topics typically used in non-qualified deferred compensation plans often vary substantially from those of tax-qualified retirement plans. My experience confirms that NQDC plan sponsors perennially:

- Re-confirm eligibility,
- Conduct a full positive re-enrollment, or prompt participants to reconfirm existing elections,
- Assist eligible individuals in determining how much to defer from the coming year,
- Specifically highlight distribution timing whenever making/renewing deferral elections,
- Ensure NQDC information “dovetails” with the information provided for tax-qualified plan,
- Explore how NQDC investments may vary from the choices in the tax-qualified plan, and
- Confirm via affirmative disclosures the risk of participating - that NQDC plans are not funded and that participants are general creditors of the organization.

In contrast, an ever-increasing number of plan sponsors of tax-qualified plans have adopted automatic features to prompt participation, escalation and investment.¹⁶

As a plan sponsor and participant in tax qualified and NQDC plans, I did not encounter issues that would call for new mandated disclosures from plan sponsors or to plan participants. Similarly, my experiences as a plan sponsor and participant would not justify the imposition of arbitrary definitions of “rank and file”, “top hat” and/or “highly compensated”.

Thank you for the opportunity to share Plan Sponsor Council of America Non-Qualified Deferred Compensation Survey results and my experiences as a NQDC plan sponsor and participant.

The comments regarding my experiences in NQDC plan sponsor roles and as a NQDC plan participant are my own, and do not necessarily reflect those of any employer or trade association that I have been employed by or associated with, past, present or future.

Sincerely,

J. M. (Jack) Towarnicky
Research
American Retirement Association

¹⁶ PSCA, 62nd Annual Survey, 2019