BLOG

Make a New Year’s Resolution to Review Your Top Hat Plans

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Recently, my colleague Mike Melbinger, encouraged readers of his blog to review the coverage of their non-qualified pension and deferred compensation plans. This generated a lot of interest and discussion among his subscribers, so we wanted to bring this topic to the readers of the Benefits Blast as well. First, you need to understand why it is important to review your top hat plans and, second, you need to know what to look for.

Most importantly, your plan must be a top hat plan to qualify for exemptions from certain qualified retirement plans rules. An inadvertent failure to satisfy the top hat requirements can have serious repercussions. For example, employers typically impose a vesting schedule under their non-qualified deferred compensation plans that is at least as strict as the schedule in their qualified retirement plans. In fact, many employers apply a stricter schedule, including the threat of forfeiture for “bad boy” terminations or breach of a non-compete/non-solicit. In other words, employers may apply a vesting schedule and forfeiture conditions that would not be allowed under a qualified plan. Courts will uphold the longer vesting schedule and forfeiture provisions of a non-qualified deferred compensation plan, but only if that plan is exempt from ERISA as a top hat plan. If a plan is found not to be a top hat plan, ERISA’s minimum vesting requirements (along with additional disclosure and fiduciary requirements) will apply.

To be exempt as a top hat plan, the non-qualified deferred compensation plan must limit eligibility to “a select group of management or highly compensated employees.” ERISA does not define this phrase. The following is an informal list of key factors, based on existing case law, DOL views, and experience with clients, for determining whether a plan limits coverage to a select group:

1. Number of employees covered by the plan.
2. Percentage of total workforce covered by the plan.
3. Compensation of lowest levels of employees covered by the plan and the location of the employees covered by the plan (e.g., $100,000 in annual compensation means something different in Manhattan, NY than it does in Manhattan, Kansas).
4. Title/responsibilities of covered employees.
5. Extent to which the employees were “selected” by the Board or management, as opposed to being covered because they fall within a general plan definition. (Note, that the latter situation could be countered by evidence

showing the selection process preceded the definition.)

6. Extent to which covered employees have a say in management or any other ability to influence management decisions.

We strongly recommend that you periodically review the coverage of your non-qualified deferred compensation plan to ensure that it continues to satisfy these requirements.

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Author

Erin Haldorson Weber

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Erin Haldorson Weber

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