



## Fifth Circuit Case Highlights Tension Between Compensation Plans and ERISA

JULY 18, 2014

This week, the Fifth Circuit in *Tolbert v. RBC Capital Markets Corporation* held that a company's wealth accumulation plan (WAP) was a pension benefit plan for purposes of ERISA because the plan permitted participants to defer distributions to termination of employment or beyond. The WAP provided for participant deferrals (mandatory and voluntary) and matching contributions that were to be distributed to the participant when the amounts vested. Participants had the option, however, to defer distribution until a later in-service distribution date or until termination of employment. Three plaintiffs who forfeited their WAP benefits upon termination of employment (two of whom were financial consultants at the company and one of whom was an administrative assistant) sued to recover those benefits by claiming that the WAP's forfeiture provisions violated ERISA. The company argued that the plan was not subject to ERISA because it was not a pension benefit plan. The Fifth Circuit disagreed and remanded the case to the District Court to determine if the WAP qualifies as a "top hat" plan (more on that term below).

This case highlights two important issues that arise regularly in plan design and operation. Most plaintiffs who sue in connection with a compensation plan will target one or both of these issues, so it is worthwhile to revisit them here.

The first issue is whether the compensation plan qualifies as a "pension benefit plan" for purposes of ERISA. The most common form of pension benefit plan is a qualified retirement plan, but other arrangements also can be pension benefit plans under ERISA. ERISA defines a pension benefit plan very broadly to include "any plan, fund, or program...which either (i) provides retirement income to employees or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment and beyond." Plans that do not defer income to one's termination of employment (for example, annual bonus plans) are not pension benefit plans and generally are not subject to ERISA. Great care must be taken in designing compensation plans to determine whether the arrangement is, or may be, a pension benefit plan. If a plan is a pension benefit plan, then the plan generally must either (a) comply with all of the onerous restrictions and requirements that ERISA imposes to protect the retirement expectations of the American worker – requirements that mirror IRS requirements for a qualified retirement plan, or (b) satisfy the "top hat" plan exemption from ERISA.

Top hat status is the second of the two important issues. ERISA provides an exception for plans that are "unfunded and maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees." Such plans are commonly referred to as top hat plans and are exempt from virtually all of ERISA's substantive provisions. Most importantly, top hat plans are not subject to ERISA's

funding requirements. That funding exception allows an employer to provide a tax-deferred nonqualified retirement plan on an “unfunded” basis, but only so long as the plan is primarily for the purpose of providing deferred compensation to a select group of management or highly compensated employees. (In case you ever wondered why nonqualified retirement plans are typically offered only to executives, it’s because ERISA effectively requires it!)

What qualifies as a “select group” of management and highly compensated employees is unclear, as there is limited guidance on the issue. The Department of Labor has indicated that the top hat exception applies where the protections of ERISA are not needed, such as for executives who are in a position to influence the design and operation of the plan. Therefore, the risk of losing top hat status increases when a plan is extended down deeper into the employee ranks.

It is advisable for all plan sponsors to revisit their various compensation plans (i) to determine whether the plan could be a pension benefit plan under ERISA and (ii) to ensure that any pension benefit plan that is not a qualified retirement plan restricts its eligibility to protect the plan’s top hat status.

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[Erin Haldorson Weber](#)

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