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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Non-Qualified Deferred Compensation Plans – Draft Carefully to Avoid Undesirable ERISA Application.

MARKET TREND: Even with the enactment of Internal Revenue Code ("Code") §409A, the area of non-qualified deferred compensation ("NQDC") plans remains fluid and continues to fall within the shadow of ERISA.

SYNOPSIS: In *Tolbert et.al. v. RBC Capital Markets Corporation*, the Fifth Circuit Court of Appeals found that a deferred compensation plan was actually a "pension plan" under ERISA and potentially subject to its stringent requirements.

TAKE AWAYS: When developing NQDC programs, advisors should be aware of not only the intended financial attributes associated with such plans, but also the need for such programs to be properly drafted in order to achieve the desired result and preserve ERISA exemption.

MAJOR REFERENCES: *Brenda Tolbert; Joseph Rice Newhaus, Jr.; and Lawrence Gift, Jr. v. RBC Capital Markets Corporation*, 758 F. 3d 619, Court of Appeals, 5th Circuit, July 14, 2014.

As illustrated by a recent federal appellate court decision, imprecise drafting of the provisions of a NQDC plan can risk subjecting that plan to stringent ERISA requirements for tax-qualified employee pension benefit plans (e.g., eligibility, vesting, funding, fiduciary duties, etc.).

CASE OVERVIEW & LOWER COURT DECISION

In *Tolbert et.al. v. RBC Capital Markets Corporation*, the District Court for the Southern District of Texas granted RBC's motion for summary judgment, finding that the RBC Wealth Accumulation Plan ("**WAP**") was not an "employee pension benefit plan" under ERISA.

The language of RBC's WAP allowed (1) voluntary deferrals (eligible employee elective compensation deferrals), (2) mandatory deferrals (company dictated compensation deferrals), and (3) company contributions, generally payable at termination of employment or as otherwise elected. The WAP provided that voluntary deferrals were fully vested, whereas mandatory

deferrals and company contributions were subject to forfeiture. Forfeitures would occur upon a termination for cause or in the event specified separation criteria were not met.

The plaintiffs claimed that the WAP was an ERISA pension plan and, therefore, the forfeiture provisions were invalid. RBC argued that the primary purpose of the WAP was to attract and retain key employees and was not meant to provide retirement or deferred post-termination income. The District Court agreed with RBC's characterization of the plan.

FIFTH CIRCUIT'S REVERSAL – KEY FACTORS

On appeal, the Fifth Circuit reversed the District Court's decision. The Fifth Circuit found, based on a close look at the WAP provisions, as actually written, that the express terms of the WAP provided it was a "deferred compensation plan," which allowed employees "to defer receipt of a portion of their compensation to be earned with respect to the upcoming Plan Year." Consequently, the Fifth Circuit determined that the WAP met the requirements of ERISA §3(2)(A)(ii), and so constituted an "employee pension benefit plan" under ERISA.

The Fifth Circuit's outcome is not surprising because the opinion, by specifically referencing the plan language used, shows how the plan could be misinterpreted.

The WAP document contained a provision stating it was "a non-qualified, deferred compensation plan pursuant to which a select group of management or highly compensated employees of [RBC] may be offered the opportunity to elect to defer receipt of a portion of their compensation to be earned with respect to the upcoming Plan Year." This is a typical provision of an ERISA "top hat plan," which is generally exempt from ERISA, other than its reporting requirements. Until now, including this type of provision has been understood to be sufficient to preserve the general ERISA exemptions for NQDC plans.

Unfortunately, the WAP also provided the following: "Although the [WAP] is not intended to be a tax-qualified plan under [26 U.S.C. §] 401, the [WAP] might be determined to be an "employee pension benefit plan" as defined by ERISA. If the [WAP] is determined to be an "employee pension benefit plan," [RBC] believes that it constitutes an unfunded plan of deferred compensation maintained for a select group of management or highly compensated employees and, therefore, exempt from many ERISA requirements." This is not a common NQDC plan provision and could have swayed the Fifth Circuit's decision. As a best practice, the statement concerning the non-qualified nature of a plan should be clearer and more definitive.

The WAP further provided that the "[WAP] is designed to provide an opportunity for [the select group of management or highly compensated] employees to invest a portion of their compensation in tax-deferred savings and investment options…" This also is not an advisable NQDC plan provision. An employee's control of investments under such a plan has been determined by the IRS to be effective of constructive receipt resulting in a possible cessation of deferral.

The Fifth Circuit determined it to be significant that the WAP generally provided for full vesting of contributions and payment of benefits at separation of service and beyond, even though the WAP contemplated vesting during an employee's period of service and allowed employees to elect distribution dates during employment, as most NQDC plans do.

The Fifth Circuit also reviewed the specific employee pension benefit plan exceptions provided for in ERISA (for example, current bonus programs) and concluded the WAP did not meet any of the exception requirements, contrary to the stated purpose of the document.

Based upon the above factors, the Fifth Circuit determined that, because the WAP satisfied the requirement of ERISA §3(2)(A)(ii), it was an "employee pension benefit plan" subject to ERISA, thereby reversing the District Court's summary judgment on behalf of RBC. Because of factual issues involved, the Fifth Circuit remanded the case to the District Court for a determination of whether the ERISA "top hat plan" exemption might apply to the WAP.

LESSONS LEARNED

In drafting NQDC programs, employers and advisors should, among other things, clearly state that:

1. The plan's purpose is to provide non-tax qualified deferred compensation;
2. Participation is limited to a select group of management or highly compensated employees;
3. The plan is not intended to provide retirement income;
4. Income deferral is not required to or beyond the termination of employment; and
5. Participants do not control plan investments.

TAKE AWAYS

- In Tolbert, the WAP was not as definitive as possible to clearly support the pension plan exemption from ERISA and contained provisions that were contrary to NQDC plan design.
- The design and establishment of NQDC plans require careful consideration and preparation to preserve the ERISA exemption.
- Advisers can provide valuable assistance to employer-clients by advising them that plan terms must be precisely drafted to meet the requirements for NQDC plans to be exempt from ERISA.

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