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BALTIMORE NEW YORK WASHINGTON, D.C..

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## Executive Compensation Legal Issues

*Susan S. Risinger, Smith & Downey, P.A.*

## Best Practices When Dealing With Agency Investigations

*Barry K. Downey, Smith & Downey, P.A.*



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## Recent Activity

- Section 457 Proposed Regulations
  - Applicable to State/local governments and tax-exempt employers
  - A few updates to governmental 457(b) Plans; Mostly impacts arrangements under 457(e)(11) (Bona Fide Severance) and 457(f) (“Ineligible” Deferred Compensation Plans)
  - Guidance on bona fide vacation and sick leave

## Recent Activity

- Section 409A Proposed Regulations
  - Clarifies existing guidance
  - Increased flexibility with respect to the payment of death benefits

## Section 457 Proposed Regulations – Bona Fide Severance

- Rules largely follow 409A rules for Involuntary Separation Pay Plans
- Need 3 things
  - Involuntary Severance from Employment
  - Amount payable cannot exceed two times the individual's annualized compensation
  - Entire benefit must be paid by the last day of the second calendar year following severance from employment

## Section 457 Proposed Regulations – Ineligible Deferred Compensation Plans

- Calculation of taxable benefit on vesting date
- Substantial Risk of Forfeiture definition (not precisely aligned with 409A)
  - Tax-deferred salary reduction contributions permitted
  - Non-compete agreements
  - Rolling risk of forfeiture
- Exemption for “short term deferrals”

## 409A Updates

- Separation from Service (when employee becomes independent contractor)
- Distribution on death – by December 31 of the following calendar year
- Allows accelerated payments to death benefit beneficiaries if the beneficiary dies, becomes disabled or experiences an unforeseeable emergency

## Tricky Areas

- Severance
  - Compliance with ERISA, 409A and 457(f)
  - Post-Employment Health and Welfare Coverage
- Incentive Bonus Programs
- PTO Programs
- Employment Agreements



## 409A Self-Correction Programs

- Operational and Plan Document failures
- Reduction or elimination of 409A penalties
- Requires:
  - Early detection/correction
  - Correct all failures
  - Notices to IRS (by employer and affected participants)

## Recommendations

- Take inventory of all agreements, plans and programs that provide compensation outside of salary to determine:
  - Whether they can be enhanced in light of recent guidance
  - Whether ERISA/457(f)/409A rules apply, and if so, whether they comply
  - Whether administration is consistent with the terms of the written documents and with legal requirements
- Correct all identified errors ASAP



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## Best Practices When Dealing With Agency Investigations

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## Things to avoid (in order of increasing cost/liabilities)

- IRS Audit
- DOL Audit
- Litigation

## Get in Compliance and Stay in Compliance

- Plan document
- Summary Plan Description
- Administrative Forms and Policies
- Self Audits (Annual for some issues)
- Plan updates and Summary of Material Modifications
  - End of IRS Five-Year Approval Process
  - Replaced with Prior (and Better) Process
  - Makes Individually Designed Plan More Cost Effective and Efficient

## How to Respond to a Notice from IRS/DOL/Litigation

- File Power of Attorney First
- Respond to Request for Plan Documents/Information within 30 days
- Respond to IRS/DOL by Date in Notice or Request More Time
- Don't Ignore

## Top IRS Issues

- Definition of Compensation
- Updating plan documents
- Employee eligibility
- Plan loans
- In-service distributions
- Distribution process/paperwork
- Suspension of benefits
- Nondiscrimination testing
- Vesting
- Minimum required distributions
- QDRO procedures

## Top DOL Issues

- Target date funds
- Revenue sharing
- Float
- Investment management
- Late contributions (“as soon as they can be reasonably segregated” from the employer’s general assets) (fewer than 100 participants “7 business days safe harbor”; larger plans 2-3 business days standard)
- ERISA fidelity bonds
- Blackout period notices
- Investment policy/guidelines
- Plan committee meetings
- Changing recordkeepers



## Top Litigation Issues (DOL and participant lawsuits)

- Breach of Fiduciary Duties
  - Failing to have best possible plan investments
  - Failing to have best possible vendor fees
  - Failing to have best possible vendor service quality

## Best Practices to Avoid/Win Litigation

- Regularly/Vigorously Benchmark Administrative and Investment Fees
- Select Service Providers Professionally and Prudently
- Keep Extensive and Permanent Files Memorializing Everything
- Use these same practices to select and monitor investment options, and for 404(c), QDIA and Fee Disclosure compliance

## Protections for Decision Makers

- Review all vendor agreements and plan documents to ensure no personal liability
- Ensure appropriate and adequate insurance and indemnification are in place
- Ensure decision makers are following written procedures/guidelines
- Provide continuing education for decision makers

## Questions and Comments

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