

The Compensation Recovery Plan: A Creative Solution to the COVID-19 Impact on Compensation



The impact of COVID-19 on the employment status of Americans across our country has been unprecedented. Millions of people have lost their jobs, been furloughed, or been substantially cut back in terms of their compensation.

Also, traditional performance bonuses executives normally would have a high probability of attaining, will likely be lost due to low 2020 performance.

Most corporations are cutting executive pay between 20-50%, including over 9-million people expected to be furloughed. Given the overall compensation impact and mental stress caused as a result of companies unanticipated forced actions, we have taken a thoughtful approach toward a solution for making people whole from a compensation perspective. What can be created and designed to recapture compensation lost once things normalize? There are two approaches:

- 1. Informally, go back and make up compensation lost due to COVID-19.**
- 2. Formally, create a plan that provides for a binding legal right for one to recapture compensation lost due to COVID-19.**

Creating a formal plan, which we will call the Compensation Recovery Plan (CRP), allows a company to credit dollars to a [deferred compensation plan](#) that is not taxable to the employee today and does not require any immediate cash flow from the company. Yet, it gives employees assurance now that current reductions in compensation may be recovered in the future.

Benefit to the Employee:

- Opportunity to recover compensation that otherwise would have been permanently lost
- No tax impact until dollars are paid
- Amount of compensation recovered can be based on continued service and future corporate performance, aligning executive and company interests in future recovery – i.e. we are in this together
- Ability to earn a rate of return during the deferral/ vesting period
- Ability to elect to further defer one's recovered compensation 12-months prior to scheduled vesting date
- Ability to select a payout option (separation of service, retirement, specified date) and length of payout of deferred amounts

Benefit to the Company:

- Retains key people by providing an opportunity for employees to recover up to 100% of their compensation
- Boosts morale and incentivizes employees to successfully navigate through unprecedented events
- No immediate cash flow or P&L impact until dollars become vested
- Vesting of one's account balance can be based on continued service and/or corporate performance, varying by plan participant
- Amount of recovered compensation paid can be based on revenue that the company has recovered or some other financial measure
- Dollars allocated to the plan are subject to substantial risk of forfeiture in the event the employee does not remain employed or the company does not recover financially as expected

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Plan Mechanics

While the CRP is similar to other long-term incentive plans or deferred compensation plans, we are recommending that the CRP be established as a separate plan which can roll into an existing longer term deferred compensation plan after vesting. A company contribution would be made into the plan as a separate class of bonus (e.g. recovery bonus) and vest based on the realization of certain key recovery performance indicators. This approach will also eliminate any issues associated with mid-year elections as it relates to IRC §409A.

Financial Impact

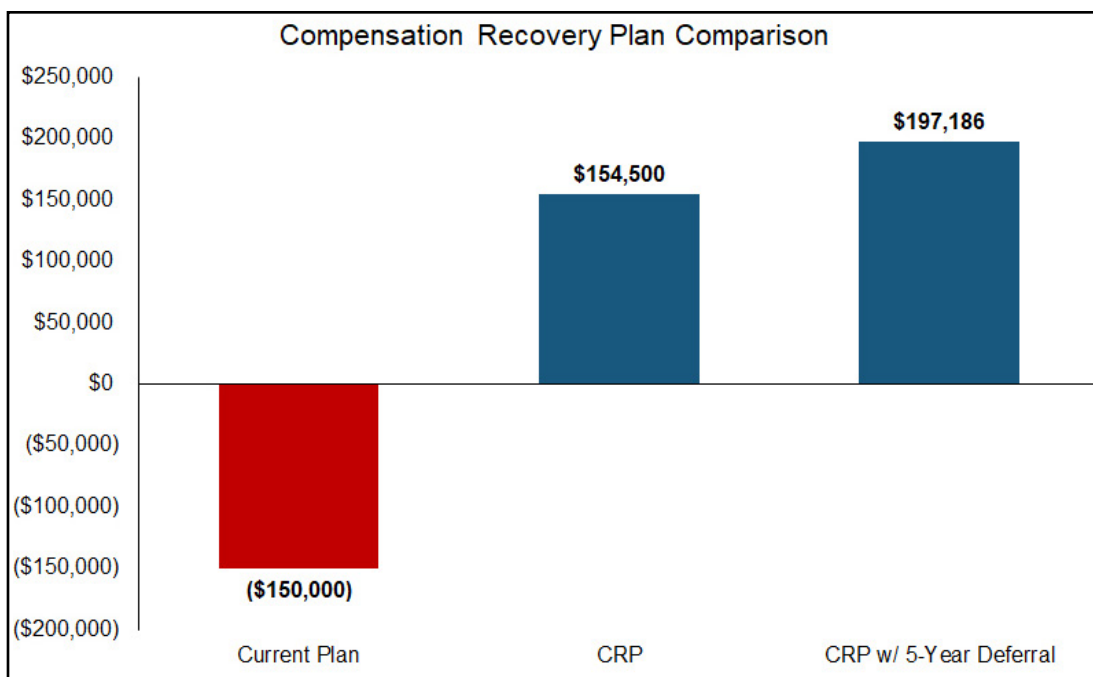
It is important to note that the company contribution amounts will be “unvested”. As a result, no cash flow will be required immediately and there is effectively no P&L impact associated with the plan until benefits actually vest. Vesting can occur based on continued service and/or company performance, over a period of time. The plan can also be designed to recover less than 100% of compensation, based on how well the company has recovered. This plan is not an all or nothing value proposition to the employee.

Cash flow payouts may be structured based on the participant’s election. If the participant elects to further defer their recovery compensation, then cash flow may be necessary at the time of vesting to fund for the benefit obligation inherent in the company’s deferred compensation plan. A well designed and funded deferred compensation plan should have no impact on the company’s P&L.

Benefit Economics

Being furloughed or having one’s pay substantially cut could temporarily impact an employee’s lifestyle. Cutting back on expenses and re-evaluating one’s needs is an exercise that many people are going through and/or have implemented.

The silver lining is that if the CRP is designed appropriately, one could receive even more compensation than expected. Moreover, if one elects to continue to defer their income, it will positively impact the employee’s long-term financial position. The graphic below depicts the economic impact of the CRP to a plan participant.



Assumptions: \$300,000 salary at a 50% reduction, CRP 12-month recovery with a 3% earnings rate; CRP 5-Year Deferral with a 5% earnings rate.

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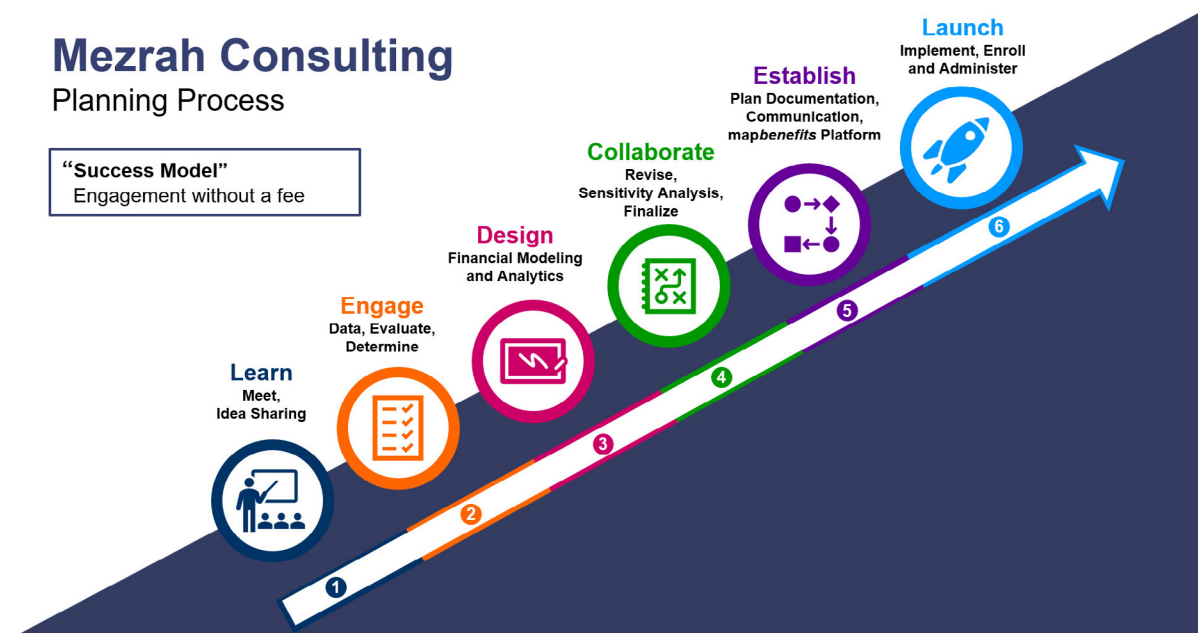
Eligible Group

While it is common for nonqualified deferred compensation plans to be implemented for highly compensated employees, short term deferral plans can also be implemented for non-highly compensated employees, without violating applicable tax and labor laws. Similar to deferred compensation plans for highly compensated employees, employers have the ability to enhance the benefits provided to non-highly compensated employees, so long as, the contribution amounts comply with IRC §409A and are not subject to the Employee Retirement Income Security Act of 1974 (“ERISA”). However, non-highly compensated employees will not be able to roll vested bonus amounts into top-hat retirement plans for which they are not eligible.

How can a benefit plan that can vary by employee, dollar amount and vesting schedule not be subject to the scrutiny of ERISA or IRC §409A? The answer to this question is simple: structure the plan as a short-term deferred bonus plan so that dollars vest and get paid out over less than 10 years. Bonus plans may vary compensation based on individual performance rather than having to meet rigid discrimination rules applicable to ERISA retirement plans. The shortened deferral period of the Compensation Recovery Plan is similar to a long-term bonus plan. The plan can operate for any number of years up to 10 years, by which point all vested dollars will be distributed.

Implementation Process

The graphic below outlines the process involved in establishing a CRP.



There are several points to consider before implementing a CRP:

1. When accounting for the plan, at what point will a liability reside on the employer’s balance sheet and will that liability be matched at some point by an asset?
2. Administering the plan for a large number of employees, possibly including the crediting interest and processing payouts, will require an enterprise, user-friendly administration platform. Ideally, [a cloud-based admin platform](#) that can be scaled based on the client’s needs.
3. Providing online access to plan participants for simplified enrollment, streamlined communication, the ability to view plan provisions and benefit amounts, ensures successful implementation and management of a CRP.

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Executive Summary

A Compensation Recovery Plan should be considered by companies who are focused on retaining key employees and rewarding them for successfully navigating through the economic impact of COVID-19. The cost of the initial plan is minimal if certain service and performance thresholds are achieved down the road, and the cost of recovering compensation can be more than justified. Moreover, the value proposition of delivering an encouraging incentive during these challenging times can be extremely positive both psychologically and economically to each plan participant.

[Schedule a time to connect with us](#) to discuss how we can work together to create a Compensation Recovery Plan that works for your company.

Company Overview

Mezrah Consulting (MC) is a national executive benefits and compensation consulting firm based in Tampa, Florida. Mezrah Consulting's work is predominantly focused on executive benefits planning for sizable publicly traded and privately held companies. MC is a knowledge company offering its clients highly creative and innovative solutions. MC uncovers value and recognizes risks that other firms typically do not see.

MC specializes in the design, funding, implementation, securitization and administration of non-qualified executive benefit programs. MC has been engaged in this consulting niche for over 25 years, advising companies in over 27 states and providing custom non-qualified plan administration on its proprietary cloud platform.

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