

Have You Completed Every Step of Your 409A Compliance Process?



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Rules Applicable to Three Different Categories of Compensation and Benefits

- For most clients, the new Section 409A regulations create *three categories of compensation and benefits* about which to worry, with different (albeit, overlapping) issues applicable to each:
 1. Deferred compensation and retirement benefits, generally provided under nonqualified plans,
 2. Separation pay, generally provided under employment and change in control agreements and severance plans, and
 3. Equity-based compensation, generally provided under stock incentive plans and awards.

Action Items Before Year End

- Consider the various design alternatives available under Section 409A in order to redesign your deferred compensation and other nonqualified plans.
- Section 409A is not like some of the changes in past laws where a client could simply instruct it's lawyer to make the required changes. Amending a plan for 409A requires the company to make several design decisions. (The company also needs to consider design alternatives for employment and change in control agreements and severance plans.)
- Conduct participant meetings to communicate the changes.
- Use 409A as an opportunity to educate participants about plans and create goodwill.
- Turn lemons into lemonade by implementing a complicated new law in a way that actually gives executives a better understanding of the benefit the company is providing them. (Many executives lack a full understanding of the nonqualified benefit you are providing to them.)

Action Items Before Year End...*continued*

- Implement procedures necessary to qualify for 409A correction program.
- The IRS has made available a program for correcting inadvertent operational errors without penalty.
- However, employers use of this program is limited unless they establish practices and procedures reasonably designed to ensure that such errors do not occur and recur.
- Include special language in plan documents to prepare for future corrections.
- Verify that all stock option and SAR grants were made at fair market value.

Action Items Before Year End...*continued*

- Before 409A, there were several good reasons why valuing company stock at the time of an award was critical, including:
 - Avoiding an accounting charge against earnings,
 - Avoiding an SEC finding of cheap stock problems in the event the company ultimately went public, and
 - Ensuring the availability of incentive stock option treatment, where desired.
- Under Code Section IRC § 409A, it is not just a good idea - it's the law.

Action Items Before Year End...*continued*

- Design plans to permit the maximum flexibility in distribution elections.
- The new rules make it very difficult for executive employees to change their distribution elections once made (because of the five-year postponement rule).
- The executive's goals should be to protect themselves and their families, while also preserving maximum flexibility to revise the distribution strategy in the future as circumstances change.

Action Items Before Year End...*continued*

- Executives need to spend more time planning, and give greater thought to their distribution election strategy.
- Provide tax, financial, and estate planning advice to executives as part of the "last chance" distribution election process.
- You may be short-changing your executives if you simply amend the plan and drop the new election forms on them.

Action Items Before Year End...*continued*

- Obtain board or compensation committee approval for all required changes.
- Update systems to ensure compliance with tax reporting and withholding requirements going forward.
- Determine whether SEC reporting requirements apply to the modified agreements or plans.
- Seek a second opinion to ensure compliance.

Action Items Before Year End...*continued*

- Revise employment agreements
- Revise severance plan and agreements
- Revise consulting agreements
- Revise change in control agreements
- Revise director fee deferrals
- Revise bonus and incentive plans
- Revise all stock-based compensation plans
- Revise all deferred compensation plans
- Revise excess and supplemental benefit plans

Action Items Before Year End...*continued*

- Get your act together for elections as to performance-based compensation.
- In the case of "performance-based compensation," a participant's initial deferral election may be made no later than six months before the end of the period.
 - For example: deferral election as to 2007 annual bonus payable in early 2008 could be made as late as June 30, 2007
- "Performance-based compensation" is compensation in the amount of or entitlement to which is contingent on the satisfaction of pre-established organizational or individual performance criteria relating to a performance period of at least 12 months.
- Also make changes required by the new Code Section 162(m) ruling [Rev. Rul. 2008-13].

Turn Lemons Into Lemonade with New Design Features

- Convert short-term “class year” distribution elections into buckets
- Tighten up benefit security with “Moglia*” language in Rabbi Trust
- Change bonus elections
- Allow re-deferrals
- Revisit investment elections and funding
- Consider offer Executive Roth features

* In the case of Bank of America N.A. v. Moglia [330 F.3d 942 (7th CIR 2003)], executives with assets in a Rabbi Trust prevailed against secured creditors.

Q uestions & A nswers



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Biography – Michael S. Melbinger

Mike Melbinger is a partner in the law firm of Winston & Strawn LLP, and global head of the Firm's Executive Compensation and Employee Benefits Department. He also is an Adjunct Professor of Law at Northwestern University School of Law and the University of Illinois College of Law.

Mike is the author of the *CCH* treatise on "Executive Compensation" (2004), and "Melbinger's Compensation Blog" for *CompensationStandards.com*. He is also the author of the *American Bankers Association's* "Compliance Guide to Employee Benefit Trusts" (1997), and more than 50 articles on executive compensation and employee benefits topics. Mike is also the Contributing Editor of *Thompson's* "Flex Plan Handbook", and on the editorial board of *Practical Tax Strategies*.

Mike practices exclusively in the area of executive compensation and employee retirement benefit issues for corporations, partnerships, executives, boards of directors, and fiduciaries. He also handles employee benefits and compensation litigation matters and the benefits and compensation aspects of change in control and public offering transactions.

Mike is a fellow in the American College of Employee Benefits Counsel. He is also a member of the ABA, NASPP, and NACD. He also handles *pro bono* matters for Adoptive Families of America, the Muscular Dystrophy Association, and Chicago Volunteer Legal Services. He serves on the Board of Directors of the University of Illinois College of Law Alumni Association and the Glenview Hangar One Foundation.

Mike received a B.A. from the University of Notre Dame in 1980 and a J.D. from the University of Illinois College of Law in 1983.

Biography – William L. MacDonald

Mr. MacDonald founded Retirement Capital Group, Inc. (RCG) in San Diego in 2003, where he serves as Chief Executive Officer, and Chairman of the Company's Board of Directors. He also founded Compensation Resource Group (CRG) in 1978. CRG was acquired by a NYSE company in 2000; Mr. MacDonald then presided as President and Chief Executive Officer of the executive benefits division until 2003.

Mr. MacDonald has consulted on executive compensation and benefit issues for more than 25 years for numerous public and privately-held firms across a variety of industries, including a large number of Fortune 500 companies. He wrote a book, *Retain Key Executives*, published by CCH and has authored numerous articles on the subject of executive compensation and benefits. In addition, Mr. MacDonald has been quoted frequently in *The Wall Street Journal*, *The New York Times*, and *Bloomberg*, as well as in a number of industry trade journals.

A frequent lecturer, Mr. MacDonald has spoken on the subject of compensation and benefit planning to various organizations, including The Conference Board, World-at-Work, Forbes CEO Forum, and the Young Presidents' Organization.

Mr. MacDonald serves on the Board of Directors for the San Diego Boy Scouts of America, National Association of Corporate Directors, and the Board of Visitors for the Graziadio School of Business at Pepperdine University. He is also a member of the World Presidents' Organization, San Diego Harvard Alumni Club, and Financial Executives International.

Mr. MacDonald graduated from Northeastern University, and The President's Program on Leadership from Harvard Business School.

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