Client Alert

New Strategy to Protect Deferred Compensation Balances from Bankruptcy

The current economic environment caused by the COVID-19 pandemic has taken a significant toll on corporate revenues and balance sheets, leading much of the public to be concerned about the futures of the companies for which they work. Naturally, individuals are revisiting their financial planning and identifying concentrations of risk. While non-qualified deferred compensation plans offer an unparalleled ability to save income for retirement pre-tax, bankruptcy is one significant risk they present over more limited qualified pre-tax savings opportunities. Since participants are unsecured creditors of their employer, a bankruptcy of that company may result in loss of some or all of a participant's nonqualified plan balance. Those with unsecured retirement balances, such as nonqualified deferred compensation, are searching for options to protect those balances.

Techniques to Protect Nonqualified Balances

Over the years, there have been efforts to protect plan participants from bankruptcy risk. Most prominently, during the 1980s plan sponsors funded "secular trusts" which were held separately from the assets of the company. However, the result of the funding meant that participants were immediately taxed on contributions, eliminating the benefit of the deferred compensation plan itself. There have also been some insurance companies offering bankruptcy insurance contracts to individual participants, but many of them were cost prohibitive and/or so limited in coverage that they were ineffective.

Options are still limited, but a relatively new strategy for protecting deferred compensation balances is through risk pooling, offered by StockShield. By entering a risk pool offered by StockShield, a specialist in financial risk pooling, participants diversify their risk of loss across several companies and industries with similar credit ratings. The result of pooling allows participants to effectively "insure" a large portion of their balance for a more reasonable cost than has been offered in the past while maintaining the tax deferred status of the plan.

MBS has been receiving several inquiries about options to protect balances. If you as a plan sponsor are fielding similar questions and would like to discuss how to communicate options, please feel free to reach out to your MBS consultant.

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