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The biggest risk with a nonqualified deferred compensation plan, as explained in the Funding: Security section of myNQDC.com, is the possibility of the company's bankruptcy. The Chapter 11 bankruptcy filing by Eastman Kodak raises questions about what will happen to the amounts deferred into its nonqualified retirement plan and what actions the company and its executives have been taking in relation to the plan during the past several years.

Kodak's Actions

The plans covered are the elective nonqualified deferral plan and the two unfunded ERISA excess plans (see pages 60–62 of its 2011 proxy statement). Kodak had frozen the receipt of new deferrals for existing participants and newly eligible participants beginning with the 2007 plan year. Until its bankruptcy, Kodak had left distributions as scheduled and had not terminated its elective plan. All distributions from the plans stopped on the date of the bankruptcy filing. We have learned that all participants were informed that their interests will become an unsecured claim in the Chapter 11 proceedings and that they will receive instructions on how to file a claim in the future.

Executives' Actions

We have been unofficially told that, over the past few years, concerns about Kodak's financial condition led many executives to take accelerated distributions from the nonqualified plan with a 10% "haircut" in their NQDC accounts for amounts that were deferred and became vested before January 1, 2005. For amounts vested or deferred from that date forward, the notorious Section 409A of the Internal Revenue Code makes it just about impossible to accelerate distributions of any future deferrals. That is why most NQDC plan providers have set up segregated accounts for pre-2005 deferrals and deferrals after January 1, 2005. Kodak has also been paying the ERISA excess unfunded pensions to executives as lump sums upon separation without exception for several years.

Quick Review: Bankruptcy Law & Nonqualified Plans

If the nonqualified deferred compensation payments were to be made out of the company's general assets and no specific money was put aside in a rabbi trust, then this money will be subject to the claims of all the company's creditors. A rabbi trust set up for the NQDC plan can potentially create a basis for receiving some payments. Depending on its terms, the funds in it may be subject only to the claims of "unsecured general creditors" (i.e. not just the company's creditors), which include the plan participants (for additional protections, see the FAQ about rabbi-trust provisions).

Under the rabbi-trust agreement, the company must notify the trustee of its inability to pay debts or of a pending bankruptcy. We do not know much about the rabbi trust at Kodak. We have informally heard, but not confirmed, that it may have a change-incontrol trigger. When the bankruptcy notice is received, the trustee must stop making distributions, and that is what happened at Kodak.

With a Chapter 11 reorganization, the company and its creditors may determine that the incentives and retention features of the NQDC plan justify some continuation. Any change in a fixed distribution payment schedule because it would endanger the company's ability to continue as a "going concern" is allowed under Section 409A as long as it occurs in the first year during which its finances improve. Any accelerations in payment could fit only into the rules and procedures for liquidating or terminating the NQDC plan.

Funds that have already been distributed can be subject to creditor claims if they are distributed soon before a bankruptcy filing. Bankruptcy laws allow the trustee to reverse any transfer of corporate assets within 90 days of bankruptcy. When an "insider" is involved (i.e. senior management), this can go back 12 months. We have also informally heard that this is a concern for Kodak executives that have received distributions in the past year.

For more on NQDC in corporate bankruptcy, see a new article at myNQDC.com. For approaches to assessing and managing bankruptcy risk in nonqualified plans, see another article on the site, along with a related FAQ.

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