The Bonus/Incentive Plan Drama Continues: Six Factors to be Used When Evaluating ERISA Status of a Bonus or Incentive Plan

Our blog post of December 19, 2025 ("Bonus Plan or Deferred Compensation? DOL Reaffirms Bonus Plan Exception to ERISA") discussed uncertainty around the critical determination of whether an incentive compensation program will be considered an ERISA-exempt bonus plan or will instead be subject to ERISA's reporting, claims, vesting timing and funding provisions. A DOL Advisory Opinion concluded that a Morgan Stanley bonus program designed to reward certain financial advisors for long-term service, that was unsecured and not guaranteed and for which there was no accrual, was not a pension plan but was instead an incentive plan, and thus not subject to ERISA's minimum standards for participation, vesting, benefit accrual, and funding. The DOL Advisory Opinion conflicted with two earlier decisions in the U.S. District Court for the Southern District of New York (*Shafer v. Morgan Stanley*, No. 20-cv-11047-PGG, 2023 WL 8100717 (S.D.N.Y. Nov. 21, 2023), and 2024 WL 4697235 (S.D.N.Y. Nov. 5, 2024) that found the compensation programs in question to be governed by ERISA and, as a result, amounts awarded under such compensation programs could not be forfeited by participants upon termination of employment. Because there are many compensatory schemes that are styled as bonus incentive plans that could arguably be characterized as ERISA-governed deferred compensation plans, the stakes for clarifying the standard for a non-ERISA bonus plan are high.

While the Morgan Stanley dispute is still pending in the Southern District of New York, recent developments in the Fourth Circuit have indirectly affirmed the conclusion of the Advisory Opinion by establishing certain factors that the court used to determine ERISA versus non-ERISA status with respect to compensatory arrangements. In Kelly Milligan v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (4th Cir. Apr 14, 2025), the Fourth Circuit affirmed the trial court in an ongoing Merrill Lynch dispute concerning its WealthChoice Award program, which examined the same issues with respect to "top hat" plans described under Sections 201(2), 301(a)(3) and 401(a)(1) of ERISA (see, e.g.,:https://www.boutwellfay.com/post/top-hat-plan-basics) as in the Morgan Stanley case and concluded that the program was a "bonus plan" exempt from the compliance requirements of the Employee Retirement Income Security Act of 1974 ("ERISA").

The Fourth Circuit established a non-exhaustive list of six factors to be considered when determining whether an incentive compensation program is an ERISA-exempt bonus plan.

The list of factors includes:

(1) Whether the plan contemplates universal employee participation or imposes heightened eligibility requirements (such as the generation of a particular amount of revenue for the employer);
(2) whether the plan is funded with money that would otherwise be immediately payable to the employee, e.g., a retirement plan funded with bonus proceeds that the participant elects to defer versus a bonus plan that is unfunded;
(3) whether the plan is actually funded or involves phantom investments;
(4) whether employees can unilaterally postpone payments until termination or beyond;
(5) whether the plan is presented as a vehicle for obtaining retirement income; and
(6) whether firm performance impacts plan payments.

Addressing each factor in turn, the Court found as follows:

(1) The Merrill Lynch program has heightened eligibility requirements and is not broadly available to all employees.
(2) The program is unfunded and is, in any event, not funded with money that employees would otherwise be immediately entitled to receive (they are required to remain in continuous service through the vesting date).
(3) For this program, participants' potential payout is measured through an unfunded notional account indexing value to a reference investment. The notional account is an "unsecured contingent promise" to pay the hypothetical value if and when other requirements are satisfied. The court notes that this is not a scheme for the deferral of income but instead a scheme "carefully devised to further two management objectives: increasing employee retention and maximizing employee productivity."
(4) Mandatory payments under the plan are triggered automatically by vesting. Participants have no ability to determine when to receive the payment (i.e., at termination or during retirement).
(5) Communications and documentation regarding the program describe it to participants as an incentive bonus program and not as a pension plan or a plan designed to provide retirement income.
(6) Finally, the program exhibits a common feature of bonus plans (but not pension plans) in that the amount of a participant's award is measured in part by the contribution of the employee to the company's overall revenue.

This is not a red-line test, not every factor will or must be present for a plan to be ERISA-exempt, other factors may be considered, and no single factor is determinative as to the

plan's status and each compensatory plan or arrangement should be evaluated based upon the particular context.

If you have any questions about how the Fourth Circuit's decision may affect your incentive or bonus plans, compensation planning or existing programs, please contact your Boutwell Fay attorney.