

Coronavirus Check-Up for Retirement Plans

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The last two weeks have seen dramatic changes for communities and businesses as COVID-19 has spread to all parts of the world. Significant disruptions for businesses and individuals have become necessary as we work together to slow the spread of COVID-19. As a result, businesses are adapting to changing customer demand, taking actions to protect their employees, and reacting to increased volatility in financial markets. Employers have already started reviewing the impact of COVID-19 on health and welfare programs as well as other fringe benefits, and they should also consider the potential impacts on retirement plans.

As 401(k) plan and other retirement benefits represent significant assets for most employees and retirees, they may look to their retirement plans for assistance. We have included some considerations for retirement plan sponsors and fiduciaries as they navigate the process of reacting to the changes in the business environment and helping participants. And stay tuned for additional specific Congress, IRS, DOL, PBGC, and Treasury relief specifically focused on COVID-19 that may be coming as this situation continues to evolve.

401(k) and Profit Sharing Plans

- **Participant Withdrawals** – We expect many participants will want to tap their 401(k) plan for resources if they experience a loss of income. For participants who remain employees, the ability to get in-service distributions from their 401(k) plan may be limited other than through hardship withdrawals. Plan sponsors should review their plans to understand the available in-service withdrawals.
 - Most plans that allow hardship withdrawals follow the IRS safe harbor for deemed and immediate financial need. The safe harbor reasons do not generally cover COVID-19. One of those safe harbors added by the new hardship regulations could be helpful in the future – the case of a “disaster” eligible for individual assistance declared by FEMA. Although the President has declared a state of emergency for COVID-19, FEMA (to date) has not declared such a “disaster”, and is not clear that the state of the emergency would be considered the same as a “disaster”. As a result, many requests may fall outside the safe harbor reasons. While additional relief may well be provided in the future, in the meantime, plan

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sponsors could consider amending their plan to go beyond the safe harbor reasons and apply a facts and circumstances test to allow for withdrawals due to COVID-19 that result in an immediate and heavy financial need. Congress is also considering providing relief similar to the qualified disaster payments provided for natural disasters that will provide welcome relief as well for withdrawals and loans, with more favorable tax consequences.

- Plans may consider adding other permitted in-service withdrawals to provide more flexibility to participants (e.g., allowing participants to withdraw employer contributions that have been in the plan for at least 2 years, or after the individual has been a participant for at least 5 years). Once added, those withdrawal rights are generally protected benefits, so plan sponsors may want to carefully consider the expansion of withdrawal rights.
- **Plan Loans** – Work schedules are changing in response to COVID-19, including some employees being placed on leaves without pay. Plans will want to review their plan loan policies on addressing loan payments during leaves, including leaves without pay. Moreover, if the loan policy otherwise limits loans (e.g., 1 loan outstanding), additional loosening of the policy could be considered, but will still be subject to the IRS limits (generally the loans cannot exceed the lesser of 50% of the account balance or \$50,000).
- **Changing Benefit Formulas** – As the business environment for employers rapidly changes, companies will be looking at all expenses and alternatives, including reducing employer contributions. For plans that do not have a 401(k) or 401(m) safe harbor formula, there may be significant flexibility to reduce or eliminate the employer contributions (such as a match or non-elective contribution). Plan sponsors should look at their plan documents as well as communications to determine if there are restrictions on amending the benefit or if participants have already met the conditions to receive such benefit. In the case of a 401(k) or 401(m) safe harbor plan, the ability to reduce or stop contributions mid-year may be restricted, and special rules apply. Safe harbor plans can reduce or suspend employer contributions if the safe harbor notice previously distributed indicated that such contributions could be reduced or suspended, or the employer is operating at an economic loss for the plan year. Moreover, reducing or stopping employer contributions will require a 30 day notice period, during which time employer contributions must continue. Finally, plans that reduce or stop safe harbor contributions must satisfy applicable nondiscrimination testing for the plan year. Plan sponsors should discuss with counsel the methods and consequences of stopping contributions that apply to their plan.
- **Compensation Definition** – As employers revise certain fringe benefits to address the issues related to COVID-19, especially adding taxable (or nontaxable) fringes, they should also review the compensation definition used in their 401(k) plan. For example, if the 401(k) plan generally allows deferrals and provides benefits on W-2 compensation, increases in taxable fringe benefit could result in additional deferrals and employer contributions being due under the 401(k) plan (and other retirement programs).

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- **Vesting** – Plan sponsors will want to review how they are tracking the service of participants on leave and review their plan to determine how leave related to the virus will be considered for vesting purposes. In other situations, such as a complete discontinuance of contributions or lay-offs that would result in a partial termination, impacted participants may need to be fully vested in their benefit.
- **Investment Education** – Financial markets are currently experiencing significant volatility. Some plan fiduciaries are considering additional investment education resources for participants to help them understand and navigate these markets.
- **Investment Fees and Fund Structure** – Plan fiduciaries have shown increased attention in managing plan investment fees by using the lowest fee available share class for funds, or establishing collective investment trusts (CITs) and separately managed accounts to reduce investment costs. Institutional funds, CITs, and separately managed accounts frequently require a minimum level of assets from a plan. It may be worth reviewing the fund agreements to understand if the drop in the market may trigger movement to a higher fee share class or a failure to meet a minimum asset level. Some agreements may include exceptions from the minimum asset levels for extraordinary circumstances for limited periods of time, and plan fiduciaries may want to take advantage of such exceptions, or negotiate similar exceptions if not already present.

Defined Benefit Pension Plans

- **Earlier Distribution Options** – After the passage of the SECURE Act earlier this year, a defined benefit plan is now permitted to offer participants the option to elect commencement of their benefit as early as age 59 ½ while still working. A plan sponsor could consider amending their pension plan to allow active participants who are at least age 59 ½ to commence their pension benefits. For terminated vested participants, plan sponsors could consider allowing benefits to commence at ages younger than the plan's current early or normal retirement age rules. There is no age limit for the time at which pension distributions can start for terminated vested participants.
- **Cash Balance Plans** – The drop in interest rates will impact the interest crediting rate for many cash balance plans. The interest crediting rate for 2020 is likely set for many calendar year plans, however, for non-calendar year plans, and in 2021 for calendar year plans, the interest crediting rate may be substantially lower than expected. Plan sponsors will want to discuss with the plan actuary whether the low interest rate environment will trigger a minimum interest crediting rate to avoid backloading and forfeiture issues. And, for plans with a market-based interest credit, losses in the market may trigger the minimum, lifetime capital preservation rule for some participants.
- **Plan Investments and Funding** – Investment fiduciaries for defined benefit plans will want to review their investment strategies given the volatile financial markets. Further, based on initial

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investment returns in 2020, plan sponsors may want to review expected funding levels and contributions required for their defined benefit plans.

- **Freezing Plan Benefits** – If a plan sponsor of a defined benefit plan wishes to freeze or otherwise reduce future benefit accruals, it is important to remember that the plan must provide advance notice to participants at least 45 days (in most cases) before it becomes effective. Plan sponsors should consider and plan for compliance with the detailed content and delivery requirements of these notices.

Executive Compensation

- **Withdrawals from Deferred Compensation Plans** – While Code Section 409A has very stringent rules regarding the time and form of payment, one permissible payment event is upon an unforeseeable emergency, and such payment event may be added to amounts already deferred under a plan as a potentially earlier payment event. To qualify as an unforeseeable emergency, based on the facts and circumstances, it must be a severe financial hardship of the participant resulting from an illness or accident of the participant (or the participant's spouse, beneficiary or dependent) or other similar extraordinary and unforeseeable circumstances arising from events beyond the participant's control that cannot be met by other financial means. Although meeting these requirements is generally uncommon, the current situation with COVID-19 may provide a situation allowing for such a withdrawal.
- **Deferral Changes** – Likewise, Code Section 409A also requires deferral elections for nonqualified deferred compensation plans to remain in place except in limited situations. An unforeseeable emergency would be a situation where a deferral election could be cancelled by an employer for the remainder of the year.
- **Excess Plans and SERPs** – Plan sponsors that modify or freeze qualified retirement plan benefits should consider how those changes may impact any nonqualified plans, such as excess benefit plans or Supplemental Executive Retirement Plans (SERPs). In some cases, excess plans and SERPs may refer to the benefit formulas in the underlying qualified plan and therefore are amended with the change in the qualified retirement plan. Other excess plans and SERPs, however, may include their own benefit formula that would require a separate amendment to reduce the respective benefit.
- **Nonqualified Retirement Plan Terminations** – Some employees may ask if the nonqualified retirement plans, such as deferred compensation plans, can be terminated so they can receive a distribution of their benefit. While Code Section 409A allows nonqualified plans to be terminated by the sponsoring company if specific rules are met, unfortunately, those rules do not allow a termination that occurs near a financial downturn of the company. Also, voluntary terminations on nonqualified plans generally require the termination of all similar nonqualified arrangements, does not allow payments for 12 months after the plan termination, and the company cannot adopt a new nonqualified plan of the same kind within 3 years after the action to terminate the plan(s).

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- **Equity Grants** – COVID-19 could not have hit at a worse time for equity grants. For grants that have already been made, the drop in financial markets have significantly reduced the value of the awards. Option awards may now be significantly underwater. For awards yet to be granted, companies are left with a choice of providing an award with significantly lower value or granting more shares. Companies will want to balance the impact of the stock market conditions on the near-term value of the grants versus the share usage that would result from increasing the awards.

Other Considerations for Retirement Programs

- **Collectively Bargained Plans** – Changes to benefit levels of collectively bargained plans will likely need approval by applicable union representatives. Companies will want to consult with labor counsel on any changes to these plans.
- **Updating Plan Data** – Plans will want to make sure that participant information, including addresses and beneficiary elections, are up to date. With the potential for many changes in the near future, contacting participants will be important.
- **Communications** – Plans sponsors and plan fiduciaries will want to keep participants fully advised of developments, including the ability to access accounts and benefits as well as other potential changes.
- **Data Security** – As social distancing takes hold, and financial markets exhibit volatility, it is likely that more participants will be electronically accessing their retirement plan accounts to understand their benefits. Unauthorized users will likely want to try an access participant accounts too. Plan sponsors should review their data security measures with recordkeepers and participants to make sure that accounts remain protected.

Retirement plans can be a great tool for plan sponsors to differentiate their company and assist participants in a time of need. Your Groom attorneys can help you understand the risks for your retirement plans in the current business environment as well as maximize its potential to help your employees. Please contact your Groom attorney to discuss how we can help.

If you have any questions, please do not hesitate to contact your regular Groom attorney or the authors listed below:

David Ashner, John Barlow, Kimberly Boberg, Stacey Bradford, Mark Carolan, Michael Cook, Elizabeth Dold, William Fogleman, Kelly Geloneck, Daniel Hogans, Jeffrey Kroh, David Levine, Mark Lofgren, Louis Mazaway, David Powell, Malcolm Slee, Allison Ullman, Jeff Witt, Rosie Zaklad

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