The COVID–19 crisis: Retirement plan sponsor, employee considerations

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The COVID–19 pandemic has made its impact felt throughout the United States. Not only has it had a significant effect on the economy, it has changed nearly every American’s way of life. COVID–19 has most likely made its mark on your company, which may present serious financial difficulties for your employees. Given the immediate financial impact that many individuals are facing, employers and retirement plan administrators should expect to receive inquiries from plan participants regarding access to retirement savings.

Some companies may need to take action in regard to employer retirement plan contributions and even personnel adjustments in the coming days, weeks and months. The following information is aimed at preparing you for inquiries, administration and decisions you might encounter, including:

- CARES Act legislation
- Required management distribution (RMD) temporary waiver
- Hardship distributions
- Loans
- Impact of furloughs
- Partial plan terminations
- Plan investments
- Employee compensation
- Employer contributions

CARES Act legislation

President Trump, signed into law the Coronavirus, Aid, Relief, and Economic Security (CARES) Act on March 27, 2020. The act is intended to loosen access to retirement plan funds for individuals affected by the COVID–19 pandemic.
Here are key elements of the act:

- Waiver of 10% penalty on early withdrawals for amounts up to $100,000 from a retirement plan or individual retirement act
  - For an individual who
    - Is diagnosed with COVID-19
    - Whose spouse is diagnosed with COVID-19
    - Who experiences adverse financial consequences due to furlough, quarantine, layoff, reduction in hours, inability to work due to lack of child care due to COVID-19, or closing of business/reduction of hours by individual due to COVID-19
    - Factors determined by the secretary of the treasury
  - Individuals are allowed to pay the tax on distributions ratably over a three-year period
  - Individuals are allowed to repay the distribution back to the plan, tax-free, over the next three years (not limited by plan limits)

- Plan loans are affected as follows
  - Amount available is doubled to the lesser
    - $100,000 or 100% of their vested account balance
  - Individuals with outstanding loans with a repayment due from the date of enactment of CARES through Dec. 31, 2020, may delay loan repayments for up to one year

Plans can adopt the new rules immediately. The plan will eventually need to be amended on or before the last day of the first plan year beginning on or after Jan. 1, 2022, or later if prescribed by the secretary of the treasury.

As legislation is quickly evolving, we will keep you informed of any and all pertinent information.

**RMD temporary waiver**

The act provides for a one-year waiver of the payment of required minimum distributions (RMDs) from defined contribution plans and IRAs. The waiver applies to both 2019 RMDs required by April 1, 2020, and RMDs that would have been otherwise required for 2020. Because the act waived RMD payments from IRAs and defined contribution plans for 2020, a taxpayer may roll over any such RMDs received in 2020 to an IRA or other qualified employer plan. The 60-day rollover rule will apply, however, subject to future IRS guidance.

**Hardship distributions**

COVID-19 could form the basis for a hardship distribution depending upon the terms of the employer-sponsored retirement plan. Most plans limit hardship distributions to the IRS “safe harbor” reasons. The safe harbor definition of permissible hardship expenses includes expenses for medical care (for the employee, employee’s spouse, employee’s dependents or employee’s primary beneficiary) to the extent the care would be deductible under Internal Revenue Code section 213(d). The safe harbor definition also includes expenses and losses incurred by the employee as a result of a FEMA declared disaster. You may also expect an uptick in needs for hardships under provisions for other permitted types of hardship expenses such as tuition or payments to prevent eviction from the participant’s principal residence.

At the time of publication, FEMA has not yet declared COVID-19 a disaster and historically has not declared a disaster for other virus outbreaks (such as Zika, H1N1 and SARS). Given the early impact of COVID-19, however, employers should monitor FEMA’s declarations for hardship distribution purposes. Note that President Trump’s recently declared national emergency does not constitute a FEMA disaster and thus, doesn’t qualify as a hardship under the safe harbor definition.

As of March 22, 2020, the president has approved major disaster declaration under FEMA for the states of California, New York and Washington. This means that participants whose principal residence or principal place of employment is in one of these states may request a hardship distribution for expenses and losses (including loss of income) incurred by the participant because of the COVID-19 pandemic.

Plan sponsors can consider amending their plan to open up hardship distributions for a broader array of reasons, however doing so will result in more IRS scrutiny upon investigation and would require much more administrative work on the part of the employer to determine what will and will not qualify. In addition, plan sponsors leveraging their service provider’s hardship distribution administrative services will likely not have this option available.
Loans

Plans might also find an uptick in participants requesting loans from their qualified plans. This will likely result in an additional administrative burden. Now is a good time to review whatever procedures the plan has in place in anticipation of such a loan. It is also worthwhile to take another look at whether your plan document even allows for loans. If it does not and you wish to provide loans, it would require a plan amendment. That said, Congress is currently considering bills that might allow greater access to retirement monies, so you may wish to wait to amend your plan for that eventuality (more on the potential legislation below).

Impact of furloughs

Many employers have already begun to furlough employees rather than terminating them. Under IRS regulations, employees with plan loans who are placed on unpaid leave of absence may forego making loan payments during the leave of absence without triggering taxation of the loan as long as the following requirements are met:

1. The furlough period must not exceed one year.
2. The loan must be repaid by the end of the original term of the loan. The loan payments missed during the furlough period may be repaid by either continuing the original rate of repayment, with a balloon payment of the missed installments at the end of the term, or by ratably increasing the installments during the remainder of the repayment period. This requirement poses potential practical problems in the case of an employee who is furloughed near the end of the original term of the loan.

Partial plan terminations

Companies in industries that will be particularly hard hit by the financial impact of COVID–19 should be mindful of the partial plan termination rules when considering layoffs. These rules require retirement plans to 100% vest all participants who are affected by a partial plan termination. The occurrence of a partial plan termination might occur as a result of one or a chain of group layoffs. The IRS has a presumptive threshold of 20% reduction in force as triggering a partial plan termination. But remember that ultimately this determination is based on facts and circumstances.

Employee compensation

Some employers are devising creative ways to design compensation structures for employees who may be partially furloughed, or part of a new unique scheme like bonusing, or attempting to create new fringe benefits. While it is 100% commendable that these employers are finding ways to help their employees, they also have to be mindful of how these new sources or designs of compensation fit into, or are excluded from, their plan’s definition of compensation. In some instances, it might be a simple case of determining if it is included or excluded. In other cases, it might require the assistance of a tax specialist to determine what category is appropriate for the new design.

Employer contributions

As was the case in the recession in the late 2000s, many employers are having to consider either lowering or ceasing employer contributions (matching or profit sharing) altogether in a time where every dollar may be crucial to keeping doors open. While many employees will understand the need to eliminate this benefit, there are some different elements that need be taken into account.

If a plan has a discretionary matching contribution or discretionary profit sharing or nonelective contribution the plan sponsor may elect to stop it. As a courtesy to employees, the employer may consider providing prior notice; however it’s not legally required.

If a plan has a stated matching contribution, or profit sharing or nonelective contribution, the plan sponsor should first amend the plan document to eliminate the contribution. In this instance, they would be required to provide a summary of material modifications to participants, and they should also consider providing prior notice to participants as well.

In both the case of discretionary and stated employer contributions, it is important to note that midyear changes will likely result in additional nondiscrimination testing under Internal Revenue Code section 401(a)(4). This testing will determine if the group of employees who were eligible for such employer contributions is nondiscriminatory when compared to the group of employees who were not yet eligible and later became eligible, plus individuals hired after the contribution cessation date.
Plans that utilize the safe harbor design to be deemed to meet annual nondiscrimination tests have different considerations. The IRS clarified that an employer may stop making safe harbor contributions (either matching or nonelective contributions) if they amend their plan document, but only if the employer is a) operating at an economic loss as defined in Internal Revenue Code section 412(c)(2)(A); or b) the safe harbor notice provided prior to the plan year included a statement that the plan sponsor may amend the plan during the plan year to reduce or eliminate the safe harbor contributions. The actual reduction cannot occur earlier than 30 days after all eligible employees are provided notice of the reduction/elimination. And the effective date of the reduction/elimination cannot be earlier than the date the plan was amended.

**Impact for participants**

These unprecedented times have created a great amount of volatility in the markets. In these challenging times it is important for all investors, including plan participants, to keep a long-term view on how to save for the future. Ten years from now, this may be a blip on the screen, but for now it is real and can be unnerving.

Global equity markets have weathered past viral outbreaks and may present a long-term opportunity as the following graph illustrates:

**Keys to communicate with participants:**

- If possible, avoid taking a loan or hardship distribution from your plan.
- Don't panic—volatile markets do not last forever
- Resist the urge to sell and don't try to time the market
- Remain diversified—consider appropriate risk-based models, managed options or target retirement date funds
- Don't stop contributing; consider a plan to eventually save 12%-17% of your pay in your plan.
- Seek help if you need it—contact your advisory team
Plan investments

The financial turmoil is also causing investment performance in retirement plans to sag. While experts may advise plan fiduciaries to “stay the course,” those fiduciaries should continue to monitor investment performance, ask experts questions as to prudent actions, and properly document the steps taken by the fiduciaries to monitor the situation. Fiduciaries should check their plan investment policies to determine whether any actions are required at this time, and consult with their plan financial advisors about proper actions, if any.

An attendant consideration is the timing of potential investment changes being made to a plan’s investment menu. In times of extreme volatility, the danger lies in potentially being out of the market during a blackout of a day or longer if assets are moved to cash, or in the participants’ individual inability to move their assets on a given day. If a plan is considering making a fund change, it is advisable to discuss the potential timing, length of blackout, and where assets are parked during blackout with the plan’s recordkeeper, and then make prudent decisions as are necessary. As with all things, document the decision and the reasons.

If you have questions on these directives and/or other employee benefit implications, please contact your plan advisor.