Impact of Economic Downturn on Retirement Plans
Part I – Defined Contribution Plans (Including 403(b) Plans)

Presented by

Jon C. Schultze
99 Summer Street, 13th FL
Boston, MA 02110
JSchultze@wagnerlawgroup.com

Stephen P. Wilkes
315 Montgomery Street
Suite 900
San Francisco, CA 92037
SWilkes@wagnerlawgroup.com

www.wagnerlawgroup.com

Agenda

- Plan Operations
- Plan Administration
- Fiduciary Matters

Plan Operations – General Issues

- Suspension of employment – furlough, leave of absence or layoff of a temporary nature is not a severance of employment
  - Impacts eligibility to participate, employer contributions, and vesting
    - Elapsed time plans
    - Hours of service plans
  - Contributions
    - Unpaid leave – unable to make contributions; no compensation-based employer contributions

Plan Operations – General Issues

  - Compensation definition – certain payments may or may not be included
- Permanent termination of employment – layoffs and reductions in force
  - Distribution requests must be processed
  - Partial plan terminations - one or a series of layoffs affects 20% or more of the workforce; full vesting of terminated participants

Plan Operations – Plan Provisions

- In-service withdrawals
  - Hardship withdrawals (most plans are safe harbor)
    - "Federally declared disaster" hardship standard – participants who live and work in some states may not be eligible unless/until FEMA provides individual assistance
    - Other basis – to prevent foreclosure, for medical care and expenses (for the participant, spouse, dependents or primary beneficiary); to pay tuition, etc.

Plan Operations – Plan Provisions

- Other withdrawal types - age 59-1/2, rollover accounts, employer contributions under certain designs, etc.
  - Note that plans can be amended to add or modify in-service withdrawal types subject to certain conditions.
- May be subject to federal income taxes and a 10% early distribution penalty tax

Plan Operations – Plan Provisions

- CARES Act provides that a coronavirus-related distribution may be taken at any time during 2020 by a "qualified individual":
  - "Qualified individual" is an individual
    - who is diagnosed with COVID-19,
    - whose spouse or dependent is diagnosed with COVID-19,
    - who "experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to" COVID-19,
    - who is unable to work due to COVID-19 child care issues,
    - who has closed or reduced hours in a business owned or operated by the individual, due to COVID-19, or
    - who has experienced other factors as determined by the Secretary of the Treasury

Plan Operations – Plan Provisions

  - The administrator of the plan may rely on the individual's certification
- Federal income tax withholding is not required on a coronavirus-related distribution, and 10% early distribution penalty tax will not apply to such distributions up to $100,000
- Distribution may be re-contributed to that plan or another plan within 3 years after the date the distribution is received. If not re-contributed, taxation on the distribution may be spread over a 3-year period
- A direct rollover does not need to be offered
- Safe harbor plans might need to distribute updated annual notices describing the new type of withdrawal available under the plan.

Plan Operations – Plan Provisions

- Loans – Existing loans
  - Participants may continue to make repayments from personal accounts if the plan and loan policy so permit and the trustee will accept such payments
  - Participants may suspend loan repayments if the unpaid leave does not exceed one year and the participant makes up the missed loan repayments
    - Lump sum payment upon returning to work
    - Lump sum payment at the end of the term
    - Increasing repayments for the remainder of the term

Plan Operations – Plan Provisions

- New loans - Participants might not recognize negative implications
  - Initial issuance and annual fees
  - Missed growth through tax-deferred earnings
  - Selling investments at bottom of market
  - Repayments are made from after-tax amounts
  - Potential taxes and penalties if default or miss repayments

Plan Operations – Plan Provisions

- CARES Act makes changes to the loan rules:
  - The loan limit is increased from 50% of vested account balance up to $50,000 to 100% of vested account balance up to $100,000 for loans from qualified plans to "qualified individuals" made during the 180-day period from the date of enactment
  - "Qualified individual" - one who could meet the same coronavirus-related tests discussed above for coronavirus-related distributions
  - The due date for any repayment of any outstanding loan is delayed for up to one year. Later repayments are adjusted to reflect the delayed due date and any interest accruing during such delay. The delay period is ignored in determining the 5-year maximum period for such loan

Plan Operations – Plan Provisions

  - Plan document or loan policy can be amended to add flexibility within limits (e.g., allowing additional loans or additional money types)
- Impact on nondiscrimination testing
  - NCHE's suspension of deferrals and not receiving matching contributions could result in nondiscrimination test failures at end of year
  - Monitor HCE behavior and impose limits or prepare them for possible refunds early

Plan Operations – Plan Provisions

- Service requirements
  - Depending on length of suspensions, participants might miss out on employer contributions or vesting service
- Employer Contributions
  - If discretionary formula, consider suspending or deferring
  - If predetermined formula, consider amending to be discretionary or suspend

Plan Operations – Plan Provisions

- Safe harbor designs require contributions as long as compensation is paid (SH QNEC) or participants make contributions (SH match or QACA).
  - Amend to suspend or reduce SH contributions with at least 30 days advance notice if the annual notice so provided or the company is facing financial hardship

- Required minimum distributions
  - CARES Act suspends RMDs that are otherwise required in 2020 from defined contribution plans
    - Initial distributions for 2019 payable by April 1, 2020 and distributions for 2020 payable by December 31, 2020

Plan Operations – Congressional Action

- The IRS and DOL have authority and have previously declared emergencies that permit greater latitude in issuing hardship withdrawals and making larger amounts available for loans, which may help participants who are not "qualified individuals" under the CARES Act

Plan Operations – Plan Amendments

- Plan amendments will be required to reflect plan operations.
  - If modifying existing plan provisions, amendments are generally required by the last day of the plan year.
  - In some cases the timing to adopt amendments may be extended; for example, the deadline to adopt amendments for the CARES Act changes will be the last day of the first plan year beginning on or after January 1, 2022.

Plan Administration

- Treasury Dept, IRS and Labor Dept have authority under Code Section 7508A and the disaster relief provisions in Rev. Proc. 2018-58 and can extend deadlines for required administrative filings, including:
  - Form 5500, Annual Return/Report, automatically extend deadline without filing Form 5558
  - For distributing excess deferrals and correcting a failed ADP or ACP test and distributing excess contributions and excess aggregate contributions without incurring a 10% penalty tax

Plan Administration

- Extend Form 1099-R e-filing deadline for employers (was March 31, 2020)
- Provide relief from notices required to be provided to plan participants under Title I of ERISA
- Note: the deadline to amend and restate 403(b) plans has been extended 3 months from March 31, 2020 to June 30, 2020

Plan Administration - Investments

- Participant-directed investments
  - Investment advisors generally suggest “stay the course,” but many participants panic
  - Sponsors and their service providers should provide information and guidance to plan participants and make sure they have the tools they need to avoid emotional responses that wreak havoc with their accounts and to allow them instead to make informed decisions

Plan Administration - Investments

- Trustee-directed investments
  - Trustees assume the fiduciary risk of their choices. This risk can be passed on to participants by satisfying investment option requirements under of ERISA section 404(c).
- Account reviews
  - Plan administrators should ask investment advisers to review the plan's assets, whether individual 401(k) line ups, or pooled accounts
    - Short and long term risks
    - IPS review
    - Valuations and impact on NAV, performance

Plan Administration - Investments

- Liquidity Needs – lack of market liquidity, investor redemption
- Adviser conflicts – how is adviser handling proprietary product and affiliated investment advisors
- Review any new adviser disclosures or information carefully
- Share class and fee considerations
- Update any 404(c) information about the investment options to enable informed decision making

Fiduciary Matters – Plan Investments

- Critically important: Continue to monitor investment performance and seek advice regarding prudent actions to take
  - Properly document steps taken by fiduciaries to monitor the situation and to determine whether and what actions should be taken, if any
  - Educate participants so they understand how the retirement plan works and can respond to their own individual risk tolerances and exposure based on their investment options, and long term goals and needs

THE WAGNER LAW GROUP

Fiduciary Matters – Plan Investments

- Carefully prepare and review employee communications to avoid affirmative misrepresentation or failures to properly disclose
- Review default investment options, like target date funds, so that participants will be more inclined to stay the course

Fiduciary Matters – Plan Investments

- Understand investments in employer stock, e.g., as a voluntary option or as the plan's main investment, such as in an employee stock ownership plan, may see greater valuation fluctuations than the general market or investment fund
  - Publicly traded employer stock may receive relief from the courts
  - Closely held companies generally do not have a market to buy and sell shares, so harder to make investment changes
  - Consider freeze of offering on interim basis, use of Independent Fiduciary

Fiduciary Matters – Plan Administration

- Important: Maintain a mechanism for plan administration, especially through remote working conditions
  - Administrative committees, boards of directors still need to be able to act and respond to immediate needs
  - Signature authority needs to be vested in more than one individual for flexibility
  - Systems access, procedures and methodologies need to be maintained

Fiduciary Matters – Plan Administration

- Service providers should be monitored to ensure they offer appropriate guidance and advice
- HR department should be instructed to follow policies and procedures when answering participant questions to stay within contours of “education” and to not give investment advice

Fiduciary Matters – Who Are the Fiduciaries?

- Confirm how fiduciary responsibility is allocated, monitored and supervised among the three broad fiduciary categories of
  - investment advice,
  - investment / plan management, and
  - administration
- Beware of becoming a functional fiduciary
- Review ERISA bond and fiduciary insurance

Conclusion

We don't know what the long term prospects are for the economy. Certainly the current and expected degradation in economic growth will impact defined contribution retirement plans and their participants in the short term, but the severity of the virus and how effectively it can be contained will have a significant bearing on the timing of any recovery.

Important Information

This presentation is intended for general informational purposes only, and it does not constitute legal, tax or investment advice from The Wagner Law Group. Consult with legal counsel to understand the nature and scope of the responsibilities under ERISA and other applicable law.

www.wagnerlawgroup.com

Jon C. Schultze
99 Summer Street, 13th FL
Boston, MA 02110
JSchultze@wagnerlawgroup.com

Stephen P. Wilkes
315 Montgomery Street
Suite 900
San Francisco, CA 92037
SWilkes@wagnerlawgroup.com

THE WAGNER LAW GROUP