



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

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The current volatility in the economy due to the coronavirus pandemic has created various issues for retirement plans that need to be addressed in an expedited and efficient manner. The impacts on defined contribution plans, including 401(k) plans, profit sharing plans, money purchase plans and 403(b) plans, can be categorized into three broad areas: day-to-day plan operations, plan administration and fiduciary matters. Each of these categories has a range of considerations which are outlined below.

1. Plan operations.
  - a. General Issues:
    - i. Suspension of employment – A furlough, leave of absence or layoff of a temporary nature generally would not be considered a severance from employment permitting distributions.
      - A. Impacts on eligibility to participate and to receive employer contributions, and vesting.
        - I. In elapsed time plans, an employee is credited with periods of service, which generally means the employee must be employed at the beginning and end of a specified period (not more than 12 months) or for a specified period of time.
        - II. In hours of service plans, an employee generally must be credited with a specified number of hours of service during a measurement period. Hours of service are credited for actual hours for which the employee is paid or entitled to payment.
      - B. Contributions
        - I. Participants can make contributions from compensation they receive; if leave is unpaid, they will be unable to make contributions.
        - II. An employer’s obligation to make plan contributions is usually based on participants’ compensation or hours worked; unpaid leave means no contributions for that period.
      - C. Compensation is a defined term in a plan, and certain payments to employees may or may not be included.
    - ii. Permanent termination of employment – Layoffs and reductions in force.

- A. Distribution requests from participants will have to be processed.
  - B. Partial plan terminations may occur if one or a series of layoffs affects 20% or more of the workforce, in which case terminated participants will have to be made fully vested.
- b. Plan Provisions
- i. In-service withdrawals
    - A. Hardship withdrawals (most plans use IRS safe harbor provision)
      - I. Plan participants who live and work in some states may not be eligible under the “federally declared disaster” hardship standard. FEMA has declared coronavirus a major disaster for most states, the District of Columbia and several territories, but at this time, its website states no assistance is available to individuals and families affected by the coronavirus. Crisis counseling is listed as “individual assistance” in FEMA’s Individual Assistance Program and Policy Guide, and is available in its declarations to at least 10 states, but this assistance appears to be grants to states to provide such services locally.
      - II. Other basis for hardship might apply: to prevent foreclosure, for medical care and expenses (for the participant, participant’s spouse, participant’s dependents or primary beneficiary), to pay tuition, etc.
    - B. 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 and restrictions.
    - C. In service distributions may be subject to federal income taxes and a 10% early distribution penalty tax.
    - D. The CARES Act provides that a coronavirus-related distribution may be taken at any time in calendar year 2020 by a “qualified individual.”
      - I. A “qualified individual” is an individual (i) who is diagnosed with COVID-19 by a CDC-approved test, (ii) whose spouse or dependent is diagnosed with COVID-19 by a CDC-approved test, (iii) 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, (iv) who is unable to work due to COVID-19 child care issues, (v) who has closed or reduced hours in a business owned or operated by the individual, due to COVID-19, or (vi) who has experienced other factors as determined by the Secretary of the Treasury. The administrator of the plan may rely on the individual’s certification that the individual qualifies for a coronavirus-related distribution under these categories.

- II. Federal income tax withholding is not required on a coronavirus-related distribution, and the 10% early distribution penalty tax will not apply to such distributions up to \$100,000.
  - III. The amount distributed may be re-contributed to that plan or another plan within three years after the date the distribution is received. If the individual does not re-contribute the distribution within that time period, taxation on the distribution may be spread over a 3-year period.
  - IV. A direct rollover does not need to be offered.
- ii. Loans
- A. Existing loans
    - I. Participants may continue to make repayments from their personal accounts, provided the plan and loan policy so permit, the trustee will accept direct checks or electronic transfers and the participant has the funds.
    - II. Participants may forego making loan payments during the leave of absence without triggering taxation of the loan, provided the unpaid leave does not exceed one year and the participant repays the loan by the end of the original term by making up missed loan repayments upon returning to work, resuming the original repayments with a lump sum payment at the end of the term, or increasing the amount of each repayment for the remainder of the repayment period upon returning to work.
    - III. If participants are already making repayments from their personal accounts, the plan administrator can confirm whether the plan’s loan policy permits suspension of repayments and notify affected participants accordingly.
  - B. New loans - Participants might not recognize negative implications of taking a loan:
    - I. Initial issuance and annual fees;
    - II. Missed growth through tax-deferred earnings;
    - III. Selling investments at bottom of market;
    - IV. Repayments are made from after-tax amounts; and
    - V. Potential taxes and penalties if default or miss repayments.
  - C. The CARES Act makes changes to the loan rules.
    - I. 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.
    - II. A “qualified individual” is one who could meet the same coronavirus-related tests discussed above for coronavirus-related distributions.

- III. The due date for any repayment by a “qualified individual” of a participant loan that would occur from the date of enactment through December 31, 2020, is delayed for up to one year. Later repayments for such loan 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.
        - D. An employer can amend its plan document or loan policy to add flexibility to its loan program within limits, such as allowing additional loans or additional money types that might otherwise be restricted.
      - iii. Impact on nondiscrimination testing – Suspension of deferrals by NHCEs 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.
      - iv. Service requirements – Depending on length of suspensions, participants might miss out on employer contributions or vesting service.
      - v. Employer contributions:
        - A. If plan has a discretionary formula, consider suspending or deferring making such contributions.
        - B. If plan has a predetermined formula, consider amending the employer contribution to be discretionary or to suspend it.
        - C. Safe harbor designs require contributions to be made to accounts based on a participant’s compensation (SH QNEC) or contributions (SH match or QACA). Plans can be amended during a plan year to suspend or reduce safe harbor contributions with at least 30 days advance notice if the annual notice so provided or the company is facing financial hardship.
      - vi. Required minimum distributions: The CARES Act suspends minimum distributions that are otherwise required in 2020 from defined contribution plans. This applies to both initial distributions for 2019 payable by April 1, 2020 and distributions for 2020 payable by December 31, 2020.
    - c. 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.
    - d. 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.

2. Plan administration.
  - a. Treasury Department, IRS and Labor Department have regulatory authority under Code Section 7508A and the disaster relief provisions in Rev. Proc. 2018-58 and can extend deadlines for required administrative filings, including:
    - i. Form 5500, Annual Return/Report, automatically extend deadline without filing Form 5558.
    - ii. Extend deadline for distributing excess deferrals and for correcting a failed ADP or ACP test and distributing excess contributions and excess aggregate contributions without incurring a 10% penalty tax under Code Section 4979 for distributions after the statutory deadline.
    - iii. Extend Form 1099-R e-filing deadline for employers (was March 31, 2020).
    - iv. Provide relief from notices required to be provided to plan participants under Title I of ERISA.
    - v. Note: the deadline to amend and restate 403(b) plans has been extended three months, from March 31, 2020 to June 30, 2020.
  - b. Investments – investment performance has sagged.
    - i. 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.
    - ii. Trustee-directed investments – When trustees direct investments in a defined contribution plan, they assume the fiduciary risk of their choices. This risk can be passed on to participants by satisfying investment option requirements under ERISA.
    - iii. Account reviews – Plan administrators should ask the investment advisers to review the plan’s assets, whether individual 401(k) line ups, or pooled accounts.
      - A. Short and long term risks
      - B. IPS Review
      - C. Valuations and impact on NAV, performance
      - D. Liquidity Needs – lack of market liquidity, investor redemption
      - E. Adviser conflicts – adviser handling of proprietary product and affiliated investment advisers
      - F. Review any new adviser disclosures or information carefully
      - G. Share class and fee considerations
      - H. Update any 404(c) information about the investment options to enable informed decision making
3. Fiduciary matters.
  - a. Plan administration – It is important to maintain a mechanism for plan administration, especially through remote working conditions.

- i. Administrative committees, boards of directors still need to be able to act and respond to immediate needs.
  - ii. Signature authority needs to be vested in more than one individual for flexibility.
  - iii. Systems access, procedures and methodologies need to be maintained.
  - iv. Service providers should be monitored to ensure they offer appropriate guidance and advice.
  - v. 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.
- b. Plan investments – It is critical to continue to monitor investment performance and seek advice regarding prudent actions to take.
- i. Properly document steps taken by fiduciaries to monitor the situation and to determine whether and what actions should be taken, if any.
  - ii. 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 depth and duration of average market downturns can provide opportunities because contributions made to a plan will be invested in more shares while the market is cheaper.
  - iii. Carefully prepare and review employee communications to avoid affirmative misrepresentations or failures to properly disclose.
  - iii. Review default investment options, like target date funds, so that participants will be more inclined to stay the course.
  - iv. 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.
    - A. Publicly traded employer stock may receive relief from the SEC.
    - B. Closely held companies generally do not have a market to buy and sell shares, so it can be harder to make investment changes.
    - C. Consider freeze of offering on interim basis, use of Independent Fiduciary
- c. Who are the fiduciaries?
- i. Confirm how fiduciary responsibility is allocated, monitored and supervised among the three broad fiduciary categories of (A) investment advice, (B) investment / plan management, and (C) administration
  - ii. Beware becoming a functional fiduciary
  - iii. Review ERISA bond and fiduciary insurance to ensure appropriate coverage

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.