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COVID-19: MID-YEAR CHANGES TO 401(K) PLANS

Mar 26, 2020

U.S. employers looking to reduce operating costs in the short term in response to the disruption caused by the COVID-19 pandemic may seek to reduce or suspend their matching or nonelective contributions in their 401(k) plan. The following summarizes the key issues facing employers in making the determination to suspend or reduce safe-harbor contributions.

Suspending or Reducing Employer Contributions in Non-Safe-harbor Plans

Discretionary employer matching and nonelective contributions generally may be immediately suspended or reduced through appropriate corporation action. Employers should consider the following in connection with a suspension or reduction of employer contributions:

- Does the Plan have Discretionary Employer Contributions?

  If the plan does not include provisions setting out a formula or specific amount of employer contributions, the board simply needs to take action to change the amount of the employer matching contribution, which could include suspending the contribution until the board takes further action.

- Does The Plan have a Set Formula for Determining Matching or Nonelective Contributions?

  If the retirement plan or related documents set out a formula for determining the employer contributions (that is, the amount of the contributions are “hard-wired” into the plan), the plan will need to be amended to change the formula. Companies may also consider removing specific formulas entirely and replacing them with provisions stating that the amount of the employer nonelective or matching contributions is discretionary and will be determining by the board from time to time.

- When may the Reduction or Suspension of Employer Contributions be Effective?

  For plans with discretionary employer contribution provisions, the amendment to the amount of the contributions may be effective for contributions which have not yet been made. For example, discretionary nonelective contributions made at the end of the plan year may be reduced or suspended at any time.

For plans that set the amount of the contribution either through a formula or specific amount, the corporate action and any amendment to the Plan must be effective prospectively for contributions for which the employees have satisfied the conditions to receive the contribution in order to comply with the anti-cutback provisions of Internal Revenue Code Section 411(d)(6). For example, if a plan states that employer matching contributions on the first 4% of employee elective deferrals will be made each payroll period, any change in the amount of the employer matching contribution would need to apply to future pay dates and therefore elective deferrals contributed after the date of the amendment.

- Does a change in the amount of the employer contributions need to be coordinated with payroll vendors and recordkeepers?

  Yes. If you are contemplating amending the plan to reduce or suspend employer contributions, reach out to your payroll vendor and plan recordkeeper immediately to determine how much lead-time they will need to implement the change. At this point, some record-keepers are already saying they cannot implement a suspension or reduction of employer matching contributions until May 1. The sooner you are in the que, the better.

- How will the change be communicated to employees?

  While there is no requirement that employees receive advance notice of a change in the amount of the employer matching contribution to be made to a 401(k) plan (as there is for safe-harbor plans, described below), the best practice from an employee-relations perspective is to provide employees with as much advance notice of the change in the employer matching contribution as possible so employees have an opportunity to change their elective deferrals.

Suspending or Reducing Employer Contributions to Safe-Harbor Plans

The ability to suspend or reduce employer matching or nonelective contributions to a safe-harbor plan is more limited and depends on whether the employer meets either of the following conditions:

1. The Safe-Harbor Notice Included a Statement that Safe-Harbor Contributions Could be Suspended or Reduced: If the safe-harbor notice preserved the Plan Sponsor's right to make a mid-year change by including a statement that the plan could be amended during the plan year to suspend or reduce the safe-harbor contributions, the Plan Sponsor can amend the plan to change the safe-harbor contributions in the middle of the year.

   The mid-year change must comply with the following

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     - Effective Date – The amendment cannot take effect earlier than the later of a) the date the plan is amended, or b) 30 days after the date the supplemental notice described below is provided to all eligible employees.

- Supplemental Notice – Eligible employees must receive a notice that includes the following information:
  - An explanation of the consequence of reducing or suspending the future safe-harbor contribution;
  - A procedure for employees to change their deferral election;
  - The effective date of the amendment.
- Opportunity to Change Elections – Employees must be given a reasonable opportunity to change their deferral election, including a period after they receive the supplemental notice.

For plans with safe-harbor nonelective contributions, the SECURE Act enacted at the end of 2019 removed the requirement that the employer provide an annual safe-harbor notice for plan years beginning after December 31, 2019. It is expected that the Internal Revenue Service will provide guidance on how the SECURE Act change affects the ability of employers to reduce or suspend safe-harbor nonelective contributions.

2. The Employer is Operating at an "Economic Loss": If the employer is operating at an "economic loss" within the meaning of Internal Revenue Code Section 412(c)(2)(A), the plan can be amended mid-year to reduce the amount of or suspend the safe-harbor employer contribution, regardless of the content of the safe-harbor notice. Whether an employer is operating at an economic loss is a facts-and-circumstances test.

If an employer satisfies the conditions for suspending or reducing employer contributions, there are additional considerations that should be taken into account in connection with a mid-year change, including:

- When an employer amends a safe-harbor plan mid-year to reduce or suspend the employer contributions, the plan will lose its safe-harbor status for the entire plan year. The amendment to the plan must, therefore, provide that the plan will be subject to nondiscrimination testing for the plan year and include applicable testing provisions for the plan.
- Plans relying on the exemption from the top-heavy rules for safe-harbor plans will also lose their exemption because the plan will no longer be considered a safe-harbor plan for the plan year.
- The plan will be required to prorate the compensation limit under Internal Revenue Code Section 401(a)(17).

- The plan must continue to satisfy the safe-harbor requirements for the safe-harbor compensation paid through the effective date of the amendment (in the case of nonelective contributions) or the elective deferrals made through the effective date of the amendment (in the case of matching contributions).

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