JOURNAL of PENSION BENEFITS

Issues in Administration, Design, Funding, and Compliance
Volume 28 • Number 1 • Autumn 2020

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Plan Distributions

Administering Retirement Plans Through a Disaster

The United States has experienced many relatively recent disasters—from hurricanes, wildfires, and the financial crisis, to the COVID-19 pandemic. A pattern of guidance has emerged surrounding access to retirement plan distributions following a disaster. Plan administrators should develop a disaster response administrative checklist to navigate plan distribution and related issues.

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The COVID-19 pandemic creeped into our lives in early 2020 and brought the entire world to a halt. As with any disaster, US employers had to act quickly to determine how to continue their businesses and manage their workforces. For employers that sponsor employee benefit plans, ensuring proper management of those plans added another layer of responsibility. As laws were enacted to address the economic fallout that ensued, many retirement plan sponsors and fiduciaries found themselves in the position of having to make decisions in short time frames in response to service provider deadlines regarding new plan distribution options under the Coronavirus Aid, Relief, and Economic Security Act

(CARES Act). Many implementation decisions had to be made even before Department of Labor (DOL) and Internal Revenue Service (IRS) guidance was issued. As guidance was released, however, reference was made to interpretations and approaches set forth in previous guidelines issued for qualified Hurricane Katrina distributions under the Katrina Emergency Tax Relief Act of 2005 (KETRA). Notably, similar guidance was issued in connection with other disasters.

Despite the past pattern of disaster laws and related guidance, the absence of guidance at the time when quick decisions needed to be made by plan sponsors and administrators (often a retirement committee) caused debate as the CARES Act retirement provisions were reviewed on their face and interpretations of the provisions varied. In light of the similarity of rules and interpretations set forth in past disaster distribution guidance, it would be prudent for retirement plan administrators to prepare a disaster response administrative checklist (DRAC) to use as a guidepost for future decisionmaking and administration should another disaster impacting the workplace occur.

Review of Distributions and Loans Under the CARES Act and Prior Disaster Guidance

The CARES Act permits Section 401(k) plans, Section 403(b) plans, and governmental Section 457(b) plans to be amended to allow qualified individuals to request certain distributions or loans. Qualified individuals are defined to include those: (1) who are diagnosed with SARS-CoV-2 or COVID-19 (hereinafter COVID-19); (2) whose spouse or dependent is diagnosed with COVID-19; or (3) who experience adverse financial consequences due to certain novel coronavirus-related events including quarantine, furlough, or layoff, having hours reduced, or losing child care. Guidance provides that a plan administrator may rely on reasonable representations from plan participants that they are a qualified individual unless they have actual knowledge to the contrary. The definition of qualified individual was augmented by the IRS in Notice 2020-50, to include individuals having a reduction in pay (or self-employment income) or having a job offer rescinded or start date for a job delayed due to COVID-19 as well as those whose spouses or household members suffered the adverse financial consequences reflected above or experienced reduction in pay or the delay in start date or subsequent rescission of a job offer due to COVID-19.

The special distributions and loans under the CARES Act include:

a. Coronavirus-related plan distributions up to $100,000 in the aggregate (determined on a controlled-group basis by the employer maintaining the plan, not including any individual retirement account distributions) on or after January 1, 2020, and before December 31, 2020 (COVID-19 Distribution). In addition, COVID-19 Distributions can be included in income ratably over a three-year period, and are not subject to (i) the additional 10-percent tax under Section 72(t) of the Internal Revenue Code of 1986, as amended (Code); (ii) 20-percent mandatory withholding; or (iii) the Code Section 402(f) notice requirement. These distributions can be recontributed to an eligible retirement plan within three years from the date of the distribution in a direct rollover if the plan accepts eligible rollover contributions [CARES Section 2202(a)]; and
b. Plan loans up to the lesser of $100,000 or 100 percent of their vested account balance during a 180-day period beginning on March 27, 2020 (the date of the CARES Act enactment) to no later than September 22, 2020. {CARES Section 2202(b)} While the prohibited-transaction exemption for plan loans requires that plans cannot use more than 50 percent of the present value of a participant's vested accrued benefit to secure all outstanding plan loans made to the participant to ensure adequate security, later DOL guidance under the CARES Act provided that this rule would not be enforced for these loans. {EBSA Disaster Relief Notice 2020-01}

In addition, qualified individuals with an existing plan loan were permitted to suspend for one year any loan repayments due between March 27, 2020 and December 31, 2020. {CARES Section 2202(b)(2)} The loan would be appropriately adjusted to reflect the delay and any interest accruing for such delay, and the period of delay would be disregarded in determining the five-year period and the term of the loan. Although the terminology in the CARES Act provided that these loan repayments "shall be delayed," subsequent IRS guidance posited that this was an optional provision for a plan to adopt. This was further complicated by IRS Notice 2020-23, which allowed for the suspension of loan payments for any individual with a plan loan for payments due April 1, 2020, through July 15, 2020.

The CARES Act also temporarily waives required minimum distributions (RMDs) from qualified defined contribution plans and individual retirement accounts (IRAs) for the calendar year 2020 and to distributions for 2019 that were due by a required beginning date in 2020 (and not paid in 2019). Guidance regarding this waiver was issued in IRS Notice 2020-51. This waiver followed changes already made under the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which passed at the end of 2019, and increased the required beginning date for RMDs to April 1 of the calendar year following the calendar year in which the individual attains age 72 (as opposed to age 70½), effective for distributions required to be made after December 31, 2019 (with respect to individuals who will reach age 70½ after that date).

On May 4, 2020, after many plan sponsors had made their plan adoption decisions regarding the CARES Act provisions, the IRS issued coronavirus-related relief for retirement plans and IRAs Questions and Answers (Q&As), which noted that the US Department of the Treasury (Treasury) and the IRS anticipated releasing guidance on the coronavirus-related distributions and loan provisions of the CARES Act applying the principles of IRS Notice 2005-92 that was issued following KETRA to the extent that the provisions of Section 2202 of the CARES Act were substantially similar to the provisions of KETRA addressed in that Notice. The clarifying guidance was issued on June 19, 2020, in IRS Notice 2020-50.

Similar Past Disaster Guidance

Hurricane Katrina

As a result of Hurricane Katrina, access to plan distributions and loans was permitted under KETRA and IRS Notice 2005-92 for qualified Katrina distributions occurring between August 25, 2005, and December 31, 2006. Plan administrators could also rely on participant representations that they qualified for these features. KETRA allowed:

1. Qualified Katrina distributions in the amount of $100,000 without incurring the 10-percent penalty tax on early distributions and permitted eligible individuals to pay the income tax over three years with income tax relief on the withdrawal if it was repaid within three years;
2. Loans to qualified individuals made between September 23, 2005, and December 31, 2006, where the maximum loan amount was increased to the lesser of 100 percent of the participant's account balance or $100,000 despite the rule that a plan may only allow loans equal to the lesser of $50,000 or 50 percent of a participant's account balance; and
3. Loan repayments due during the suspension period could also be delayed, with the applicable adjustments to reflect the delay and any interest, and the period of delay was to be disregarded in determining the five-year period and the term of the loan. In IRS Notice 2005-92, it was noted that the DOL advised the Treasury and the IRS that it would not treat any person as having violated the provisions of Title I of the Employee Retirement Income Security Act (ERISA), including the adequate security and reasonably equivalent basis requirements in Section 408(b)(1) of ERISA, solely because the person made a plan loan to a qualified individual in compliance with Section 103 of KETRA, Code Section 72(p), and the provisions of IRS Notice 2005-92.

Other Disaster Legislation and Guidance

More recently than KETRA, however, similar distribution provisions were also permitted under the Disaster Tax Relief and Airport and Airway Extension Act of 2017 for qualified individuals affected by Hurricanes Harvey, Irma, and Maria (during the applicable dates) (2017 Hurricanes), and The Tax Cuts and Jobs Act provided some relief to plan participants living in 2016 federally declared disaster areas who received plan distributions in 2016 or 2017. The Bipartisan Budget Act of 2018 also provided relief for individuals impacted by the California wildfires (as well as amendments related to the flooding, mudslides, and debris flow directly related to the wildfires) (Wildfires).

The Taxpayer Certainty and Disaster Tax Relief Act of 2019 Act (Disaster Act), signed into law on December 20, 2019, as part of the larger Further Consolidated Appropriations Act of 2020, also includes provisions that permit employees to take qualified disaster distributions (if losses were suffered in a qualified disaster area, not including the California wildfire area, beginning after 2017 and ending 60 days after the enactment of the Act) up to an aggregate amount of $100,000, which are not subject to the 10-percent early distribution tax penalty. Qualified disaster distributions are conditioned on an individual taking a distribution on or after the first day of the disaster and before June 17, 2020 (*i.e.*, 180 days after the Disaster Act was enacted); having a principal place of abode in a presidentially-declared disaster area during the relevant disaster; and sustaining an economic loss by reason of the disaster. Again, for these distributions, employees can pay the tax on the distribution ratably over three years.

Additionally, these employees generally will have up to three years to make one or more contributions to the eligible retirement plan in which the employee participates to repay the distribution. Further, an employee who lived in a qualified disaster area and sustained an economic loss could be eligible to take a loan of up to the lesser of $100,000 or 100 percent of the present value of the employee's vested account balance. Additionally, the Disaster Act permits an employee to delay loan repayments that were due during the applicable disaster incident period until the later of one year and 180 days after the enactment of the Disaster Act, extends the maximum loan term beyond five years for general purpose loans by that extension period, with interest accruing during the period, and permits the repayment of hardship distributions for certain cancelled home purchases due to a qualified disaster.

The similarities in the past disaster guidance is striking. Under all of these laws, qualified disaster distributions (as applicable) to retirement plan participants could be taken in an amount up to $100,000, they were exempt from the 10-percent additional tax on early distributions that may apply to participants under age 59½, could be included in income in equal amounts over three years, and could be repaid within three years of receiving a distribution by making one or more contributions to an eligible retirement plan. Victims of the 2017 Hurricanes and the Wildfires and other qualified disasters (*e.g.*, under the SECURE Act, CARES Act) could also have been allowed to take plan loans to the lesser of $100,000 or 100 percent of their account balance, and have an extra year to make payments due on current loans. The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), which was passed as a result of the financial crisis, also waived the calendar-year 2009 RMD requirement under Code Section 401(a)(9) for qualified defined contribution plans, 403(b) plans, governmental 457(b) plans, and IRAs.

It also is worth noting that, under the IRS hardship distribution final regulations, employers were also permitted to add a new safe harbor hardship category that would allow an employee to take a hardship withdrawal to cover expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by FEMA under the Stafford Act. To qualify, either the employee's principal residence or place of employment must be in a disaster area designated by FEMA for individual assistance with respect to the disaster. Expenses and losses incurred by family members do not count for this purpose. If the employer's 401(k) plan incorporates the IRS safe harbor definition of hardship, employees whose principal place of residence or principal place of employment at the time of the disaster is in an eligible area may take a hardship withdrawal from their 401(k) accounts for expenses and losses (including loss of income) incurred on account of the COVID-19 outbreak.

Considerations for a DRAC

Given the pattern of past rules allowing access to retirement plan distributions and loans following a disaster, it would be prudent for plan administrators to have a designated checklist of issues to confirm regarding potential plan design changes and implementation of such changes in the event of another untimely disaster, well in advance of the next crisis. As businesses must be prepared for many types of events with emergency response protocols, a DRAC can serve as a benefit plan's administrative emergency response policy. Further, the DRAC can well extend beyond plan distribution issues. Creation of a DRAC now may also serve to assist plan administrators in a self-audit of their implementation efforts regarding recent plan changes to ensure compliance. Thus, plan administrators may wish to consider the following decisionmaking guideposts for adoption of a DRAC:

- *Settlor Position*. With regard to a potential future crisis, it should be determined as a threshold matter whether the plan sponsor desires to open the retirement plans to disaster-related distributions and/or loans, especially if they have already allowed participants to access these monies in relation to the COVID-19 pandemic and prior disasters. Analyze the impact to the plan and participants of potential future $100,000 disaster distributions, increased loans and/or hardship distributions. If it is determined as a threshold matter that access will be allowed whenever the law permits, then this type of business decision can serve to inform plan administrators how to proceed if faced with such options in the future and hasten adoption of all options. Also, define a process to obtain necessary approvals so it is readily available.

- *New Laws and Plan Amendments.* Plan sponsors and fiduciaries must stay abreast of changes in the law and related benefit plan guidance even in a time of crisis, especially with regard to plan contribution and distribution options. Work with plan service providers to identify and discuss available options for benefit plans and document time frames for plan amendments. Confirm which rules are required or optional, any plan amendments that may be needed, and confirm an action plan. Calendar applicable plan amendment due dates and monitor additional guidance that may be issued to confirm interpretations and procedures, as it can become confusing. For example, plan amendments for the 2017 Hurricanes and the Wildfires disasters were due just recently in 2019 (the 2016 disaster amendments were due in 2018). The plan amendments for the CARES Act distribution and loan provisions will not be due until the last day of the first plan year beginning on or after January 1, 2022 (with government plans provided an additional two years to amend plans). Plan amendments to reflect adoption of the Disaster Act relief provisions must generally be adopted by the last day of the first plan year beginning on or after January 1, 2020, for nongovernmental plans.
- *Operational Compliance.* It is also important to ensure operational compliance from the effective date of the intended plan amendments. It will be important to review procedures for processes that may be affected by recent changes to avoid errors, including with regard to loans, hardship requests, required minimum distributions, payroll deductions, and any other changes made to the plan. Coordinate changes with service providers and update service agreements as needed. Confirm whether any guidance is issued to delay compliance deadlines impacting any benefit plan administration and update procedures accordingly.
- *Participant Communications.* Plan fiduciaries will be tasked with implementing plan changes. Having a well-defined communications approach in place will be helpful. Determine whether service providers will be able to distribute communications and educational materials to active participants and terminated vested participants. Consider whether supplemental materials will be created to explain new plan options and their pros and cons to the participants, as well as any changes to plan administrative deadlines. Ensure required plan disclosures and notices are timely updated to reflect any new features, including summary plan descriptions. Confirm whether participants will have access to representatives or consultants to discuss their accounts, as well as any webinars or related services, and disseminate information regarding same.
- *Payroll coordination and reporting.* Ensure that the payroll department or payroll provider is implementing any necessary changes to reflect plan amendments and tax reporting. Document reporting procedures set forth in past guidance, update any Form W-2 and/or Form 1099-R procedures as applicable, and confirm any other tax reporting requirements for distributions and repayments. Address payroll changes related to loan administration and loan suspensions, as well as any contribution-level changes. Calendar important dates to resume applicable payroll contributions and any related reports that must be reviewed in order to do so.
- *Loan Programs.* Update any loan administration procedures, forms, and loan policy documents to reflect any changes in plan loan limits and amounts, re-amortizations, and payment terms. Review loan default, deemed distribution, and offset files to confirm they are properly updated to reflect any loan suspensions or permissible delays in payment. Ensure loan repayments timely resume as applicable. Determine procedures for employees who terminate employment and any plan amendments related to same, especially if they were in the midst of loan repayment suspension at time of termination.
- *Hardship Distributions.* Determine whether hardship approvals are being made by the service provider or plan administrator. Update procedures for any disaster distribution processes, including any permissible repayment procedures as applicable.
- *Committee Meetings.* Ensure plan fiduciaries have an action plan for staying connected during a crisis. Schedule interim meetings. Meet virtually with plan service providers and investment managers. Review plan investments and plan administrative issues and maintain meeting minutes.
- *Cybersecurity*. Confirm that any new processes conform to the plan's cybersecurity best practices, including usage of apps and participant self-certifying procedures. The security of distribution requests has been the subject of recent litigation. Review of cybersecurity issues should be part of

ongoing plan administration including selection and monitoring of service providers, service agreement terms, management of plan data, education and training of employees and plan participants, and insurance.

- *Self-Audit and Correct.* Take time to review plan year changes and confirm proper implementation. Confirm any additional guidance that has been issued since plan changes were implemented and update administration accordingly. Also consider and review the impact that any furloughs, layoffs, reductions-in-force had on plan eligibility, vesting, and service crediting. Identify any plan errors. Make an action plan to correct any errors as soon as possible under applicable government programs.
- *Contact Information.* List names and contact information for key decisionmakers, committee members, and service providers so that it is readily available, especially in a time of crisis.

The foregoing DRAC outline can be tailored to specific plan needs and cover additional administrative procedures, as well as expanded to address considerations related to all types of ERISA plans including pensions and health and welfare programs, which have also been the subject of disaster-related legislation. The DRAC can be maintained along with other plan administration manuals and guidelines so that it can be easily retrieved for review when needed. Most of all, a well-thought-out DRAC can serve to guide plan administrators regarding the issues that will most likely need to be addressed in a time of crisis, refer to past guidance on similar issues, and perhaps alleviate some stress along the way. ■