Thinking about suspending employer contributions?

The coronavirus could prompt plan sponsors to reduce benefits.

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KEY POINTS

- The impact of the novel coronavirus on the economy has caused some employers to focus on cost reductions, including contributions to their employees' retirement plans.
- Employers considering reductions or suspensions in employer contributions need to think about the timing of plan amendments and (in some cases) participant notifications.
- Safe harbor plans especially should proceed carefully given these plans' unique requirements.

The novel coronavirus outbreak has caused a number of employers across the U.S. to consider or even take steps toward reducing or suspending employer contributions. This is especially true for businesses in the hospitality industry, whose success is inherently connected to market cycles and face-to-face interaction with its customers.

With the increasing need for social distancing to combat the spread of COVID-19, the disease caused by the coronavirus, a number of states and countries have required non-essential businesses to close or limit their operations. As a result, the pandemic has had a dramatic effect on the global economy and threatens the bottom line for many employers.

As these companies explore options for limiting costs, some are considering contributions to their defined contribution retirement plan(s) as a "lever" for avoiding other measures—such as layoffs, reductions in force, and furloughs.[1]

[1] At a certain point, layoffs and reductions in force trigger 100% vesting in affected participant accounts. In general, IRS Revenue Ruling 2007-48 provides that when employer actions result in 20% or more of the plan's eligible participants being terminated, a "partial plan termination" has occurred (triggering the need to immediately vest these accounts). Guidance may be needed from the IRS as to whether and when furloughs may count towards the 20% threshold.

What steps are required?

There are a number of considerations—in particular, considerations relating to the timing of plan amendments and participant notices—that employers must take into account in order to ensure that regulatory requirements are satisfied. In addition to meeting these requirements, employers will likely want to devise a communications strategy to frame the purpose for these changes to their participants.

In order to reduce or suspend nondiscretionary contributions—such as employer matching contributions or fixed company contributions—a plan amendment will be required prior to the effective date of the change. For example, if a plan suspends its contribution effective May 1, 2020, a plan document amendment reflecting the change will need to be adopted by that date. Similarly, it would not be permissible to retroactively eliminate an accrued benefit, such as when an employee has already satisfied conditions for receiving employer contributions for a given time period.

It will also be necessary to provide participants with a Summary of Material Modifications (SMM) to the plan's Summary Plan description (SPD). Because an SMM does not need to be provided until up to 210 days following the end of the plan year in which the change was made, employers will likely want to communicate these changes much sooner—ideally, in advance of the effective date in order to provide employees with the opportunity to make changes to their deferral and/or contribution elections.

Are there any special considerations for safe harbor plans?

As is usually the case, there are special considerations for design-based safe harbor plans (in addition to those specified earlier). As a reminder, safe harbor plans must provide certain levels of employer matching or nonelective contributions and meet other requirements (including the requirement to provide notice regarding the safe harbor plan design and other features) to be exempt from nondiscrimination testing.

In order to even consider a mid-year reduction or suspension of safe harbor contributions, the employer must either:

- Be operating at an economic loss (defined by reference to Internal Revenue Code section 412(c)(2)(A)) for the plan year; or
- Have included in their safe harbor notice a provision indicating their ability to reduce or suspend safe harbor contributions with 30 days advance notice to eligible participants.

Assuming the plan meets the requirements outlined, the plan must provide 30 days advance notice (referred to as a "supplemental" notice) to participants and adopt an amendment prior to the effective date of the reduction or suspension. The supplemental notice must describe:

- The consequences of the amendment that reduces or suspends future safe harbor contributions;
- The procedures for changing their cash or deferred elections and, if applicable, their employee contribution elections; and
- The effective date of the amendment.

In addition to these requirements, the plan must be amended to provide that the ADP test will be satisfied for the entire plan year in which the reduction or suspension occurs using the current year testing method (it would be most efficient to include this amendment with the reduction/suspension amendment).

The conclusion: Keep regulatory requirements in sight

Employers faced with adverse economic circumstances may focus on their retirement plans as part of a broader effort to reduce costs. To the extent an employer moves forward with reducing or eliminating employer contributions, it needs to be cognizant of regulatory requirements—especially the unique requirements for safe harbor plans.

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