



## Nondiscrimination Testing

# POTENTIAL EFFECTS OF THE CORONAVIRUS

### How will coronavirus-related business decisions affect nondiscrimination testing?

The coronavirus disrupted business across the world, leading some employers to lay off or furlough staff or make other decisions to deal with the financial challenges caused by the pandemic.

While these changes are usually unavoidable, they could come with an unexpected side effect: potential failure of the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) nondiscrimination testing required for non-safe harbor defined contribution plans.

#### Key Insights:

- Changes to plan design or employee population as a result of the coronavirus could impact nondiscrimination testing
- If you stop or make changes to safe harbor contributions, please contact T. Rowe Price to discuss potential considerations in advance of the date of the changes
- Depending on the circumstances, you may want to consider allowing highly compensated employees (HCEs) to maximize their deferral contributions for the year and prepare to distribute excesses if failure of ADP/ACP testing seems likely

### THREE STEPS TO TAKE NOW

T. Rowe Price recommends plan sponsors begin thinking now about how the pandemic may negatively affect testing:

#### Contact your analyst and plan compliance consultant.

1

We suggest that you review your plan document with a plan compliance consultant and testing analyst to determine any steps you can take now to mitigate the risk of testing failures for the 2020 plan year and to complete ADP/ACP testing in a timely fashion (generally by March 15 of the following year for calendar year plans).

#### Consider your options with testing in mind.

2

Retaining your existing plan design features, such as auto-enrollment and reenrollment, could help you avoid potential ADP/ACP failures. You can consider allowing HCEs to maximize their contributions within ADP/ACP testing limits and prepare to distribute excesses to HCEs if failure is likely.

#### Identify action steps.

3

If your organization experienced changes to staffing or employee benefits as a result of the pandemic, work with your testing analyst and plan compliance consultant to identify the action steps you can take now to prepare for 2020 ADP/ACP testing.

If ADP/ACP testing is required for the 2020 plan year, testing must be completed by 2½ months following the end of the plan year (March 15 for a calendar year plan) to avoid a 10% excise tax on distribution of excesses. In order for T. Rowe Price to complete testing by March 15, testing data will be due January 29, 2021.

## ADP/ACP PREPAREDNESS

In this section, we explain how actions taken during the coronavirus pandemic could affect nondiscrimination testing for the 2020 plan year.

### Plan changes

#### Reducing or suspending company match

Note: Safe harbor plans that reduce or suspend company safe harbor matching contributions mid-year will be required to complete ADP/ACP testing using the current year method for the 2020 plan year.

RISK TO TESTING:	CONSIDERATIONS:	WATCH FOR:
<b>Medium/high risk</b> Changing the match could influence lower-paid employees to reduce or stop contributions, which could affect ADP/ACP testing if HCEs contribute at a disproportionately higher rate	<ul style="list-style-type: none"><li>Consider limiting HCE contributions for the rest of 2020</li><li>Allow HCEs to maximize their contributions within ADP/ACP testing limits, and prepare to distribute excesses to HCEs if failure is likely</li><li>Be proactive in communicating to HCEs about the possibility of a testing failure and distribution of excesses</li></ul>	<ul style="list-style-type: none"><li>Non-savers and undersavers may not reinstate contributions once the match is restored. Use plan design and education to encourage these employees to save</li><li>Using the current year testing method for ADP/ACP testing may be beneficial when making changes to matching contributions<sup>1</sup></li></ul>

#### Nonelective safe harbor employer contribution suspension/elimination

RISK TO TESTING:	CONSIDERATIONS:	WATCH FOR:
<b>Medium/high risk</b> Safe harbor plans have to follow specific timing, notice, and amendment requirements when stopping nonelective contributions, <sup>2</sup> and doing so would trigger ADP testing	<ul style="list-style-type: none"><li>Consider limiting HCE contributions for the rest of 2020</li><li>Allow HCEs to maximize their contributions within ADP/ACP testing limits, and prepare to distribute excesses to HCEs if failure is likely</li><li>Be proactive in communicating to HCEs about the possibility of a testing failure and distribution of excesses</li></ul>	<ul style="list-style-type: none"><li>Safe harbor plans that reduce or suspend the company safe harbor nonelective contribution will be required to complete ADP testing using the current year method for the 2020 plan year</li></ul>

### Staffing changes

#### Furloughs or Layoffs

RISK TO TESTING:	CONSIDERATIONS:	WATCH FOR:
<b>Low risk</b> <ul style="list-style-type: none"><li>Furloughs may not reduce ADP/ACP percentages because both contributions and compensation for furloughed employees generally stop</li><li>Layoffs do not reduce ADP/ACP percentages because contributions and compensation for these employees stop</li></ul>	<ul style="list-style-type: none"><li>Reenroll automatically any employees who return to work or encourage reenrollment</li><li>Review how specific population volatility may affect testing</li></ul>	<ul style="list-style-type: none"><li>Potential ADP/ACP failures if employees who return to work do not restart contributions to the plan.</li><li>Potential for partial plan termination<sup>3</sup></li></ul>

## General benefit changes

### Salary reductions

RISK TO TESTING:	CONSIDERATIONS:	WATCH FOR:
<b>Medium/high risk</b> Lower-paid employees may reduce or stop contributions to the plan because of a salary reduction, which could affect ADP/ACP testing if HCEs contribute at a disproportionately higher rate.	<ul style="list-style-type: none"><li>▪ Encourage employees to save more through plan design or education, including through the addition or enhancement of auto-services</li><li>▪ Consider limiting HCE contributions for the rest of 2020</li><li>▪ Allow HCEs to maximize their contributions within ADP/ACP testing limits, and prepare to distribute excesses to HCEs if failure is likely</li><li>▪ Be proactive in communicating to HCEs about the possibility of a testing failure and distribution of excesses</li></ul>	<ul style="list-style-type: none"><li>▪ Salary reductions could switch HCEs to non-HCEs in 2021, leading to positive or negative effects on testing</li><li>▪ Consider the potential costs related to plan design changes intended to increase participation</li></ul>

### Employer Contribution Allocation Changes

RISK TO TESTING:	CONSIDERATIONS:	WATCH FOR:
<b>Medium/high risk</b> Introducing changes to the employer contribution allocation period and last day requirements could negatively affect ACP tests. <sup>4</sup>	<ul style="list-style-type: none"><li>▪ Determine if this change would allow the plan to defer or reduce costs of employer contributions</li><li>▪ Be proactive in communicating the changes to participants</li></ul>	<ul style="list-style-type: none"><li>▪ Changes may be required to be made on a prospective basis.</li><li>▪ A true-up contribution may be required when changing the allocation period</li></ul>

<sup>1</sup>Note: In order to change from the current year ADP/ACP testing method to the prior year ADP/ACP testing method, the current year method must be used for each of the five plan years preceding the year of the change.

<sup>2</sup>IRS Notice 2020-52 relaxes the conditions for mid-year reductions or suspensions, including notice requirements, for amendments adopted between March 13 and August 31, 2020.

<sup>3</sup>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.

<sup>4</sup>Please consult with your assigned plan compliance consultant before making a change to add a last day requirement to employer contributions. Such changes must generally be made on a prospective basis to prevent an impermissible cut-back in accrued benefits. Also note that changes to allocation requirements could negatively impact coverage testing.

#### Ask T. Rowe Price

Please contact your assigned testing analyst and assigned plan compliance consultant if you have questions about ADP/ACP testing for the 2020 plan year. If you do not have an assigned plan compliance consultant, please contact your T. Rowe Price representative for next steps.