Financial fitness for Life℠

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Qualified Plan Provisions in the CARES Act

On Friday, March 27, 2020, President Trump signed into law the "Coronavirus Aid, Relief, and Economic Security Act" or the "CARES Act". This summary addresses the CARES Act provisions relating to defined contribution plans and the urgent timeline on which plan sponsors must make some decisions.

Timeline – Immediate Attention Required!

Retirement plan recordkeepers and TPAs are working fast to get the CARES Act provisions into place. A plan sponsor's individual experience will depend on its particular recordkeeper (and TPA, if applicable), but we suggest that plan sponsors give these provisions *immediate attention*. Some of the CARES Act provisions are optional. Working under a sense of urgency, many recordkeepers are establishing default elections and providing little time to opt out. For example, one large recordkeeper has already alerted plan sponsors that they must opt out of any recordkeeper-determined default choices by March 31, 2020.

While the decisions must be swift, plan sponsors have plenty of time to adopt corresponding amendments, which are not required until the last day of the 2022 plan year (and even later for governmental plans).

Eligibility for Hardship Distribution and Loan Flexibility

Later sections of this Summary describe a new type of "coronavirus-related" hardship distribution option and flexibility for existing and new plan loans. Before considering those features, it is important to internalize that they will be available only to a "qualified individual", which includes an individual:

(i) who is diagnosed with COVID-19;

(ii) whose spouse or dependent is diagnosed with COVID-19; or

(iii) who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, subject to reduced hours, being unable to work due to lack of child care, closing or reducing hours of the individual's business, or other factors that may be added.

Commentary: The Act confirms that a plan administrator may rely on an employee's self-certification that he or she satisfies those conditions. But it is critical to recognize that the hardship distribution and loan features will not simply be available to *all* participants.

Existing Loans: Deferral of Repayments

Participants with outstanding plan loans may defer remaining 2020 repayments for one year. Those payments will later be increased for interest accruing during the time of deferral. The Act confirms that the deferral of repayments will not be considered to run afoul of any otherwise-applicable five-year limit for loan repayment.

Commentary: There may be two layers of optionality here. First, it is unclear whether plan sponsors must permit the repayment delay. We'll be closely watching recordkeepers' approach on that preliminary question. Second, we presume that a "qualified individual" has the option whether to delay repayment. This should work itself out because an individual desiring *not* to delay payments simply would not provide the "qualified individual" self-certification.

Access to Larger New Loans

For the 180-day period following enactment, the Act increases the ceiling on plan loans made to a "qualified individual". The limit increases to the lesser of $100,000 or 100% of the vested account balance (up from the lesser of $50,000 or 50%).

> **Commentary:** We'll also be closely watching recordkeepers' approach. Will they automatically increase the loan limit? Or will they make this the default decision and provide employers the option of retaining the lower limits otherwise in place? In either case, from a policy perspective it seems reasonable for most plan sponsors to offer the higher limits, provided that they have already made the threshold decision to offer plan loans. The higher limits apply only to "qualified individuals", which seeks to ensure the additional amounts are available only for those affected by the pandemic.

"Coronavirus-Related Distributions"

The CARES Act permits a plan sponsor to allow a special type of hardship distribution of up to $100,000 for one who meets the "qualified individual" definition. The associated tax liability can be spread over three years and the distribution is exempt from any otherwise-applicable 10% early withdrawal penalty (under Tax Code section 72(t)). The Act also permits a future repayment – likely to the same plan *or* to another plan or IRA that could have received the initial distribution as a rollover – over the three-year period following the distribution. The interaction between the three-year tax liability allocation and repayment provisions suggests that the IRS will need to provide helpful Form 1099 guidance. We hope so; this could be a bit messy.

> **Commentary:** Many recordkeepers will add this to plans through a default election. That may very well be the optimal outcome for many companies, but we recommend that each company carefully consider whether it wants to open up this distribution option, particularly if hardship distributions are not currently available.
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> That consideration should take into account: (1) whether it is in participants' best interests to sell their investments at depleted market values; (2) whether it is better policy to use the expanded loan provisions (described above) because loans better facilitate repayments to the plan; and (3) even if not added immediately, a plan sponsor may add this option later in the year if need arises.

"Required Minimum Distribution" or "RMD" Waiver

The Act provides a waiver of RMDs to be made in the 2020 calendar year. (This waiver closely tracks the 2009 RMD waiver implemented during the financial crisis.)

> **Commentary:** The waiver does not prohibit participants from receiving distributions. But it provides valuable flexibility, particularly to the degree that any minimum amounts would be calculated in reference to a December 31, 2019 account balance that has since decreased.

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