Insights

UNRAVELING U.S. RETIREMENT SAVINGS - HOW A GLOBAL PANDEMIC THREATENS TO UNDO DECADES OF PLANNING

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With the economy in a free-fall and the U.S. government scrambling to create a financial safety net for citizens, giving access to tax-qualified retirement savings was a natural piece of Congress' plan to loosen the grip on needed funds. And yet, plan sponsors should pause before adopting the new in-service withdrawal and loan options wholesale. The options made available under the CARES Act are permissive, not required. Implementing a thoughtful, needs-based, COVID-19 withdrawal/loan policy could protect employees' financial security for decades to come.

Plan sponsors can adopt an incremental approach to COVID-19 in-service withdrawals or loans, and should consider doing so in the interest of helping participants not decimate hard-won savings in a panic.

What Options do Plan Sponsors Have?

COVID-Withdrawals. The CARES Act allows a new category of withdrawals, COVID-19 Distributions, which allows participants to take a withdrawal of the lesser of 100% of their vested account balance or $100K, anytime between January 1, 2020 – December 31, 2020, if they satisfy certain requirements. Here is a link to a prior blog which outlines the withdrawals allowed under the CARES Act..

Plan sponsors can design a COVID-19 withdrawal program within the parameters of the CARES Act without allowing the full $100K withdrawal at once – or at all. The statute does not require that a plan go from 0 to 100! Further, while the new law allows plan administrators to rely on the representation of participants that they qualify for the in-service withdrawals, plan sponsors can impose any reasonable substantiation requirements they wish.

For example, the plan could adopt a COVID-19 withdrawal program that limits withdrawals up to $10K a month, with a maximum limit for 2020 of $50K (or the full $100K).

For substantiation, in the event the COVID-19 qualification was not the result of the employee's status and, therefore, not part of the plan sponsor's records, the plan sponsor could require that the participant substantiate that the participant’s spouse’s employment is impacted by COVID-19, or related childcare burdens.

This approach to COVID-19 withdrawals imposes some discipline on participants, and meters out retirement savings plan leakage over time.

COVID-Loans. The CARES Act allows plan sponsors to liberalize existing loan programs to allow qualified participants to take a loan of up to the lesser of $100K or 100% of their vested account balance.

As with the COVID-19 in –service withdrawals, plan sponsors can design their COVID-19 loan program any way they wish within the parameters of the CARES Act.

For example, a plan sponsor could adopt a program that sets the limit of allowable loans for COVID-19 at some level between 50%-100% of a participant’s vested account balance. It is not a requirement of the statute that the plan sponsor adopt the fully permissive limit for COVID-19-justified loans.

As with COVID-19 in-service withdrawals, a plan sponsor could, though is not required to, impose a substantiation of need on plan participants.

Employers have spent untold hours and dollars educating employees on the importance of retirement savings and the serious deleterious impact mid-career withdrawals can have on their final retirement security.   If ever there was a time to impose some discipline in withdrawals from 401(k) plans, now is the time.

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