



Critical Factors To Consider Before Reducing or Eliminating Employer Contributions

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In the midst of rapidly changing risks posed by COVID-19, employers are looking for ways to reduce expenses. For 401(k), 403(b), and money purchase pension plan sponsors, a reduction or elimination of the employer contribution is one possible source of cost savings. This article explores the main considerations for employers looking to reduce costs associated with their defined contribution employer contribution obligations. Of course, each situation is different and plan sponsors should consult with legal counsel.

GETTING STARTED

For any defined contribution plan, the elimination of employer contributions will involve some common considerations:

- Reviewing plan documents to examine any restrictions and to determine what type of contribution is at issue. The discretion to make changes will depend upon the type of employer contribution your plan utilizes and the specific plan provisions.
- Considering if the elimination of employer contributions could constitute a “complete discontinuance of employer contributions,” which can cause full vesting (an issue for you and your counsel).
- Ensuring the elimination is appropriately documented in a plan amendment.

NON-SAFE HARBOR PLANS

For plans that do not have a 403(b) or 401(k) safe harbor formula, there may be significant flexibility to reduce or eliminate the employer contributions (such as a matching or non-elective contributions). However, review the plan document for provisions that may impose restrictions on the ability to amend the benefit. For example, you may have much less flexibility in eliminating a match provided to employees covered by collective bargaining.

In addition, keep in mind that participants may have already met the conditions to receive a benefit at this point in the plan year. For example, if your plan has a fixed match on a payroll basis and does not have continuing eligibility requirements, you may not be able to reduce match retroactively to the beginning of 2020 but may be able to reduce or eliminate the match on a go-forward basis in 2020. Also, if a matching plan has a “true-up” feature, participants may be due a benefit up to the point of amendment.

To reduce non-safe harbor employer contributions:

- Step 1: Confirm how quickly payroll and administrative changes could be made.
- Step 2: Amend the plan document as appropriate.
- Step 3: Engage in communication with participants – in the case of matching contribution reduction or elimination, clearly explain what is changing and why, and consider encouraging participants to stay the course until match is reinstated.
- Step 4: For ERISA covered money purchase pension plans, sponsors must issue a 204(h) plan freeze notice at least 45 days prior to the effective date of the freeze. This statutory notification should not replace effective employee communication as described in Step 3. It is also important to carefully review a money purchase pension plan to determine at what point during the year are participants entitled to a benefit that cannot be reduced.



SAFE HARBOR 401(k) AND 403(b) PLANS

In the case of safe harbor plans, the ability to reduce or stop contributions mid-year is restricted and special rules apply. A safe harbor employer contribution can be reduced or suspended mid-year only:

- if the safe harbor notice previously distributed indicates that such contributions could be reduced or suspended, or, in the case of a safe harbor nonelective contribution, a “contingent” notice was provided; or
- the employer is operating at an “economic loss” for the plan year.

Additional requirements and considerations are further discussed below.

Unless your 2020 safe harbor notice included a statement that the employer was reserving the right to suspend or reduce safe harbor contributions, the economic loss exception is the only option.

WHAT IS ECONOMIC LOSS?

Economic loss is based on one of the same standards that the IRS considers when reviewing a request to waive minimum funding requirements for an ERISA covered defined benefit plan. However, economic loss is not defined. Presumably, it means that expenses exceed income on a plan sponsor's financial statements for the year to date, but it is not clear whether this would be sufficient to meet the standard. Additionally, the economic-loss test may need to be applied considering all related employers that would be required to be aggregated for coverage testing purposes (e.g., members of the control group). We recommend discussing with your plan counsel how to reasonably demonstrate economic loss.

Interestingly, for plan years beginning after Dec. 31, 2019, the SECURE Act eliminated the requirement that an employer who makes nonelective safe harbor contributions must disseminate an annual safe harbor notice. Guidance from the IRS will need to be forthcoming as to how this change impacts the ability of an employer to suspend or reduce nonelective safe harbor contributions going forward.

To reduce safe harbor employer contributions:

Step 1: Confirm how quickly payroll and administrative changes could be made.

Step 2: Evaluate non-discrimination testing impact:

- 401(k) plans will be subject to the Actual Deferral Percentage (ADP), Actual Contribution Percentage (ACP), and top-heavy tests for the full plan year. 403(b) plans are already exempt from ADP but are still subject to ACP testing requirement.
- Consider estimating these tests and communicating possible corrective action that may be forthcoming for certain Highly Compensated Employees (HCEs), as may be applicable.
- Review any other features to verify if participants may be due a benefit up to the amendment date.

Step 3: Issue the required supplemental safe harbor notice to participants **30 days prior** to the suspension effective date. A supplemental notice must:

- be provided to all eligible employees (not just those making deferrals); and
- explain the consequences of the amendment, the procedures by which participants can make changes to their deferral election and the effective date of the amendment.

Step 4: Amend the plan document – **note** that the **effective date** of the amendment cannot be earlier than the later of: (i) 30 days after the employees are provided the supplemental notice or (ii) the date the amendment is adopted.

For example, the employer maintains a calendar year 401(k) safe harbor plan. On April 15th, the employer provides the supplemental notice notifying employees that safe harbor contributions will be suspended. The earliest date that the amendment may be effective is May 15th, and only if the amendment is adopted by May 15th.



Step 5: Engage in communication with participants – in the case of matching contribution reduction or elimination, clearly explain what is changing and why, and consider encouraging participants to stay the course until match is reinstated.

A plan sponsor must fund the safe harbor contributions through the effective date of the amendment, in accordance with the terms of the plan.

ALTERNATIVES TO REDUCTION OR ELIMINATION OF EMPLOYER CONTRIBUTIONS

Before moving to a full employer contribution suspension, employers may want to consider alternative cost savings approaches such as:

Change the match or contribution formula.	Impose more stringent continuing eligibility requirements (e.g., 1,000 hours requirement and/or last day rule).	Limit the population eligible to receive the employer contribution without sacrificing non-discrimination testing satisfaction (e.g., limit participation to specific groups, such as lower-compensated employees).
If you currently have a safe harbor plan, consider moving to a discretionary employer contribution for more flexibility in the future.	Modify the frequency of the employer match contribution (e.g., contribute to employee plans on a quarterly or annual basis instead of monthly or weekly basis).	Note: be sure to assess the implications of a partial plan termination if groups will be excluded from plan participation.

Note that any of the above changes could be problematic or pose unique implications for safe harbor plans, thus each situation should be evaluated more extensively with counsel.

These are unprecedented times and many employers are dealing with significant financial uncertainty. The decision to reduce 401(k) benefits is not taken lightly by plan sponsors. In the event it is deemed necessary to reduce or suspend employer contributions, we hope this article provides some useful insights into the considerations for doing so.

FOR MORE INFORMATION

For more information on this topic, please contact your Fidelity Relationship Manager or contact us directly.

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