EVALUATING A MIDYEAR REDUCTION OR SUSPENSION OF EMPLOYER MATCHING AND SAFE HARBOR CONTRIBUTIONS

With the current unprecedented circumstances and financial challenges resulting from the coronavirus (COVID-19), some plan sponsors may find themselves forced to consider the difficult decision of temporarily suspending or reducing their employer 401(k) contributions. While the decision to do so must not be taken lightly and should only be a last resort, plan sponsors should understand the compliance considerations.

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Rules surrounding reducing or suspending employer matching contributions midyear

The decision to offer employer matching contributions is a business decision and not subject to ERISA fiduciary considerations. Plan sponsors wishing to reduce or suspend their plans' employer contributions may generally do so at any time on a **prospective** basis. For example, a 401(k) plan could be amended on April 1, 2020, to provide that employer matching contributions will be reduced or suspended effective on or after that date. Such a change would require the plan to issue all eligible participants an updated summary plan description (SPD) or a summary of material modification (SMM). Although not required, a thoughtful communication strategy to participants is strongly suggested.

Many plans do not specifically state the amount of the employer matching contribution, rather the plan document and SPD reference **discretionary** matching contributions. Employers with discretionary contributions should consult with their plan document providers to determine what, if any, plan document or SPD changes may be necessary. Again, a thoughtful communication strategy to participants is strongly suggested.

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Rules surrounding suspending or reducing safe harbor contributions midyear

A plan sponsor must meet one of two circumstances to amend the plan midyear to reduce or suspend safe harbor contributions. If the plan's annual safe harbor notice included language describing the employer's option to reduce or suspend contributions midyear, the plan sponsor can amend the plan to do this. If this language was not in the annual notice, the employer must be operating at an economic loss to halt safe harbor contributions midyear.

If a plan meets one of the two circumstances described above, the plan sponsor can stop safe harbor contributions midyear after providing participants with a supplemental 30-day notice. The supplemental notice must explain:

- The consequences of the reduced or suspended safe harbor contribution.
- The procedures to change deferral/contribution elections.
- The amendment's effective date.

The employer must fund the safe harbor contributions through the effective date of the plan amendment or 30 days after notice is provided to participants, if later. When a plan reduces or suspends safe harbor contributions midyear, annual ADP/ACP testing must be performed. Testing will be based upon the entire plan year using the current-year testing method. An updated SPD or SMM also would need to be distributed to all eligible participants.

Action steps

Employer contributions play an essential role in the retirement readiness of the workforce, providing a highly desirable tax benefit for both employers and employees. The decision to reduce or suspend these contributions can have a significant impact on employee morale and retention, and thus careful thought should be given before taking this step. Knowing the rules and potential impact of midyear changes may help with other benefits decisions you may be considering over the coming weeks.

Your Lockton team stands ready to help you and your committee evaluate options as appropriate for your business. Should circumstances require a midyear change, we are here to assist every step of the way.

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