Retirement Alert

Retirement Plan Issues Related to Workforce Reductions

In the upcoming weeks, some employers may find themselves in the difficult position of reducing their workforces through layoffs or temporary reductions as a result of the regulatory and economic issues related to the coronavirus outbreak. If this occurs, plan sponsors need to understand the impact these actions can have on their retirement plans, notably the potential need to vest participants.

Reductions may result in a partial plan termination

The IRS notes that where a significant reduction in plan participation occurs, affected participants must become 100% vested in their accrued account balance. This is deemed to be a partial plan termination (PPT). The most common scenario causing a PPT occurs when an employer initiates a reduction in force causing a significant number of participants to be involuntarily terminated and, therefore, unable to participate in the plan. The IRS notes that turnover of 20% or more of plan participants is significant to cause a PPT. When this occurs, employees affected must become 100% vested in their employer contributions.

Determining turnover rate

A plan sponsor can determine the turnover rate by (1) dividing the number of participants who undergo an employer-initiated termination during the applicable period by (2) the sum of all participants as of the start of the applicable period plus those who became participants during the applicable period. The applicable period is generally the plan year, but can be longer if there is a series of related terminations. It is important to note that "participants" refers to all eligible employees, not just those actively contributing to the plan, for purposes of this calculation.

An employer-initiated termination is any involuntary termination other than death, disability or retirement on or after normal retirement age, even if it is caused by reasons outside of the employer's control (e.g., depressed economic conditions). No exception is provided for terminations due to good cause.

Vesting affected employees

When a PPT occurs, all affected employees become 100% vested, including all participants who had any severance from employment during the PPT period. It is important to note that this means even employees who voluntarily sever employment during the applicable period (again, typically the plan year) must benefit from the partial termination's accelerated vesting. The vesting schedule continues to apply to other participants not affected by the workforce reduction.

Action steps

Employers should understand the potential impact a workforce reduction may have on their retirement plans, especially if they have vesting schedules tied to employer contributions. For example, many plans use forfeiture accounts to pay plan expenses and reduce employer contributions. Required 100% vesting under a partial plan termination could reduce future forfeiture dollars available for these purposes.

Your Lockton team is ready to help you if you have questions about retirement plan implications that may result from difficult business decisions you must make in the upcoming weeks. Should circumstances require a workforce reduction, we are here to assist you every step of the way.

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