Non-Qualified Plans: How to Balance Current Participant Needs with a Secure Retirement

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How Non-Qualified (NQ) Plans Factor into Employers' Near-Term Strategies

- **Cash flow is king**, balance sheet and P&L are secondary (for now)
- **NQ cash benefits and demands:**
  - **Employer perspective**: NQ deferrals and delayed payments enhance cash flow
  - **Participant perspective**: demands for cash following reduction in family income (pay restructuring, loss of second income)

Result: suspensions of deferrals/withdrawals counteract to some degree the freed-up cash to be obtained from restructuring compensation

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How NQ Plans Factor into Participant Long-Term Strategies

- Like qualified plans, **non-qualified plans are capital accumulation plans designed for long-term needs**
- Underlying financial assumption is **dollar-cost averaging** into the capital markets over the deferral period, followed by **planned distributions** with continued compounded returns during the payout phase

How NQ Plans Factor into Participant Short-Term Strategies

- **Plans may provide for accelerated payment for events beyond the participant's control:**
  - death
  - disability
  - unforeseeable emergency affecting the participant, a dependent or beneficiary
  - "haircut" withdrawals from/terminations of pre-409A "grandfathered" plans
- Except for these events, in order to provide the tax advantage, **payments from an NQ plan must be made when agreed between the employer and participant**

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Emergency Relief

- **CARES Act does not contain COVID19-specific relief for NQ plans**
- **NQ plans can provide or be amended to provide for cancelation of deferrals or payments upon the participant demonstrating an unforeseeable emergency**
  - Cash needs cannot be met from insurance, loans or discretionary assets.
  - Determined case by case.
  - Hardship withdrawal requirements will not be met if the employers assumes that a national emergency or employer emergency affects all participants the same way.
  - The payment is limited to the specific amount of the need, if the need cannot be addressed by canceling deferrals.

Emergency Relief – Qualified Plans

- **CARES Act provides relief to qualified plan participants**
  - COVID19-impacted participants may request withdrawals or a loan up to $100,000 from a 401(k) account without penalty
  - Withdrawals may be repaid over three years, pre-tax, as if rolled over. If not repaid, tax can be spread over three years.
  - Relief is similar to prior disaster relief

Newport will be holding a webinar on
The CARES Act Effect on Retirement Plans
on Wednesday, April 8 at 4 p.m. ET/1 p.m. PT

Use this link to register: https://hubs.ly/H0pdmXJ0

Steps Employers Can Take to Address Cash Flow and Participant Concerns

- **Include NQ deferrals when evaluating pay reductions** Evaluate whether NQ deferrals can be included in the reduction percentage, leaving the participant's take-home pay at the target level (the "50% deferral" problem) **Helps employer and participant**

- **Postpone NQ payments scheduled for April-August, 2020** (for example) treated as timely under 409A if payment is made by December 31, 2020. **Helps employer**

- **NQ payments scheduled for 2020 are timely when paid in 2021** if payment in 2020 would jeopardize the employer's ability to continue as a going concern. **Helps employer**

Steps Employers Can Take to Address Cash Flow and Participant Concerns *(continued)*

How will "make up" payments be made?

- **If a 2020 reduction includes a commitment to make up payments in 2021 based on 2020 services:**
  - the 2021 commitment, if a "legally binding" commitment, may constitute deferred compensation under 409A if the make-up payment is made after March 15, 2021
  - if paid after March 15, 2021, the election timing requirements under 409A may not be met since the commitment is being made mid-2020

- **Changes in pay rates, based on current year services only, generally would not result in deferred compensation, as long as there is no shifting of compensation earned in 2020 to a subsequent year.**

Managing the Plan

Reductions in Pay—Impact on Eligibility:

- deferrals must continue (409A preamble)
  - includes "fixed dollar" deferrals
- discretionary company contributions may, but need not continue

Company (matching) contributions – suspensions/reductions do not materially impact cash flow unless there is a contractual commitment to fund the rabbi trust

Enrolling Performance-Based Pay Earned in 2020:

- if the earnings criteria change after March 31 (calendar fiscal year) the bonus may no longer be performance-based
- a change in bonus potential (not the earnings metrics) generally would not change the performance-based nature of the bonus
- deferment of portion of bonus earned in 2020 may result in deferred compensation apart from the plan

Managing the Plan *(continued)*

Separation from Service:

- <u>situation</u>: unpaid furlough, leave, unpaid while continuing to work
- “facts and circumstances”
  - 409A does not recognize “furlough” or “layoff”; the test is based primarily on whether the employer and employee anticipate that service levels will decline permanently as of a certain date to 20% or less of the prior 36 month average

<u>In general</u>:

If the parties anticipate re-employment
a separation will not occur

Communicating with Participants

If retirement plans are tapped as the first source in response to COVID-19, participants may do long-term and possibly irretrievable damage to their retirement security:

- forced liquidations at the bottom of the market
- if deferrals are suspended, dollar cost averaging stops
- no participation in the expected recovery

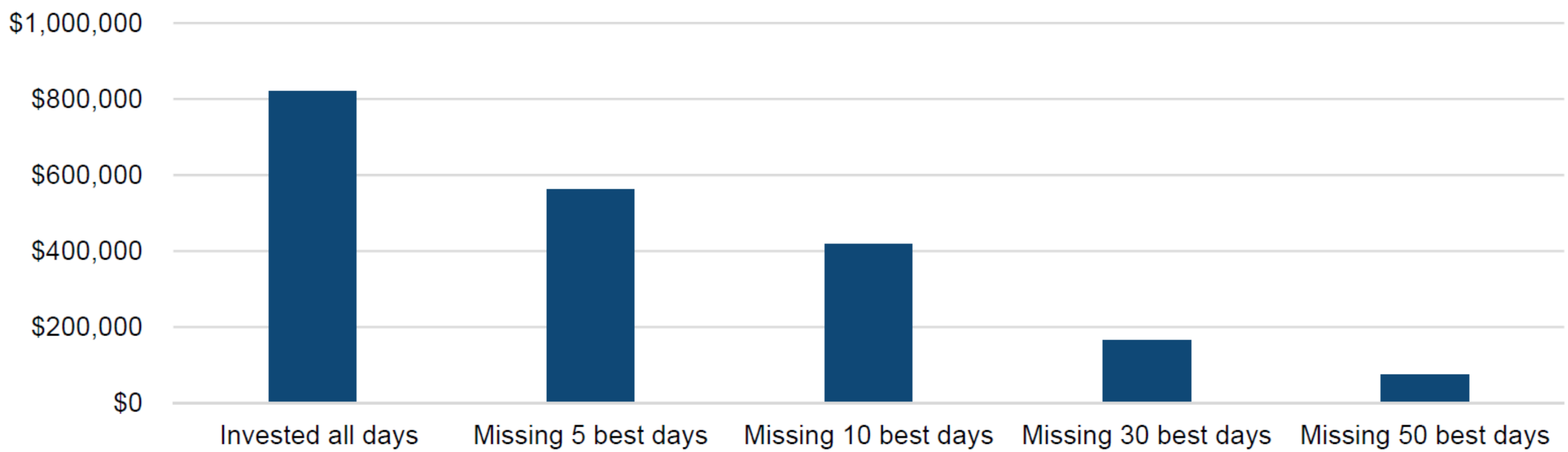
Communicating with Participants

- **Example:**
- 401(k) $100,000 balance on February 1, 2020
- reduced to $70,000 due to market declines,
- then withdrawn for COVID-19 reasons leaving a post-tax payment of approximately $56,000.
- participant must repay $70,000 within 3 years,
- then obtain a 42% total return to recover the February 1 balance.

Importance of Staying the Course

IMPACT OF MISSING THE BEST RETURN DAYS

Growth of $10,000 invested in the S&P 500



Source: Bloomberg. Data is historical. Past Performance is not a guarantee of future results
Footnote: Growth of $10,000 invested in the S&P 500 (01/01/1980 – 12/31/2019)

Communicating with Participants *(continued)*

Other forms of relief are being offered to those impacted by COVID-19:

- Mortgage relief
  - FHA backed mortgages may be deferred to a later date.
  - Non FHA mortgages-bank policy to permit deferrals.
    – may be reported on credit reports with a COVID-19 designation
- Utilities
- Unemployment benefits even if furloughed employee is technically employed by the employer (States vary on this)
  - CARES Act adds $600 per week up to four months.
- $1,200/$2,400 “stimulus” check
- Deadline for filing income tax returns extended to July 15

Communicating with Participants *(continued)*

These are extraordinary circumstances; participants should seek qualified personal financial advice before making any financial decisions

- Participants should be educated about their options under The CARES Act
- Qualified retirement funds should be tapped only as a last resort and only what is needed
- Creditors cannot reach participants' 401(k) accounts
- NQ plan accounts may not be pledged or assigned to creditors
- Newport is available to assist plan sponsors and participants in evaluating and processing unforeseeable emergency requests

Questions and Answers

And don’t miss our next webinar:

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Wednesday, April 8

4 p.m. ET (1 p.m. PT)

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Or look for the link in the chat box

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