Features That 401(k) Plan Sponsors Shouldn't Volunteer For

By Ary Rosenbaum, Esq.

The older I get, the more I become like Larry David in "Curb Your Enthusiasm." As a curmudgeon in my 50s, I hate my time being wasted and I hate being volunteered for things. So when it comes to my 401(k) plan sponsor clients, the last thing I'm going to do is volunteer them to do things that they don't need to do. I'm not going to foist duties onto a 401(k) plan sponsor that aren't required and might increase their liability. This article is all about things a 401(k) plan sponsor like you, shouldn't volunteer them to do.

Certifying Hardship requests

401(k) plans can offer hardship distributions to participants. Since it's participant money, I have always advocated that 401(k) plans offer it. Hardship distributions are for important reasons like burial expenses, medical expenses, educational expenses, to prevent a foreclo¬sure/eviction, or other life-important events. While many believe that participants shouldn't tap their accounts in these instances, we should allow participants to have the free will to make those choices when they need to. Up until recently, plan sponsors had to certify a participant's request for a hardship had a bonafide reason, according to regulations. As an ERISA attorney, I have had to approve these requests for clients and I had to tell the participant in jail that being in jail isn't a hardship for purposes of a hardship distribution (it's just a hardship in life). Thanks to a law change by SECURE 2.0, plan sponsors can now establish policies and procedures allowing participants to self-certify that the hardship distribution is being made on account of a deemed immediate and heavy financial need. You're no longer required to collect documentation when approving hardship distributions, which should help streamline the hardship distribution process. However, participants should retain documentation of the need for the distribution, especially if the Internal Revenue Service audits the plan and reviews the hardship distributions made by the plan. I understand why plan sponsors still want to certify hardship requests, but doing that puts the burden on you to make sure they're legitimate. If a participant certifies it, the burden is on them. If they're lying about their hardship request and you have no knowledge of that lie, they will have to deal with any ramifications.

Allowing annuities within the plan

Styles change and then come back, except for leisure suits. Even in the 401(k) world, we have options that fall out of favor and then return. One idea is offering annuities within 401(k) plans and it's something I don't think you should voluntarily offer. Retirement plans such as defined benefit plans and money purchase plans have a requirement to offer annuities as the designated payment option because they are pension plans that require minimum funding. A 401(k) plan doesn't require an annuity payment. Most 401(k) plans that had them, were allowed to remove them a few years back and it wasn't considered a cutback in benefits if they offered a lump sum in cash. A 401(k) plan that had assets from an old money purchase plan would still require annuities as an option for those assets. With the Federal government being concerned about retire-

ment plan accounts and whether they will last over people's retirement, there has been a renewed push by the Department of Labor (DOL) to offer annuities, which they now call a "lifetime income option." Until the government mandates that 401(k) plans have one, there is no need for you to offer it. Offering annuities is more work for you. So I'm not going to volunteer you to offer it. Once an employee needs to receive their benefit, pay them in cash and let them go. You don't have time to go through the whole process of finding an annuity provider for your plan. Do you have time to vet the annuity product or the licensed insurance salesman who will sell it? I don't think so. An annuity is an insurance product, making nice commissions for those who sell it, and I'm not convinced they are the best bet for most retiring participants, especially those terminated participants who aren't retiring. Again, annuities are an option and an option that should be turned down.

Offering In-kind distributions and any option other than lump sum

When it comes to drafting plan documents and payment options for new 401(k) plans, I offer a lump sum in cash. That's it. As a plan sponsor, you can also offer installments and partial withdrawals. You can also offer an in-kind distribution which means paying participants in property, mainly the assets within their account balance such as mutual funds. Making in-kind transfers of plan assets to a former participant's IRA or brokerage account is a lot of work that you don't need to volunteer for. You're not a brokerage firm. You're also not a bank. You should pay former participants in cash and a lump sum, and be done with them. Keep it Simple, Stupid, and pay people in cash in one lump sum.

The student loan match

I graduated school in 1998 and my student loan was finally extinguished in 2023. Student loan debt is a big deal and a hamper for people to save for retirement. There is about $1.6 trillion in student loan debt. So while I would love to help out participants, I don't like to volunteer plan sponsors to offer things. SECURE 2.0 gives 401(k) plans the option to make matching contributions to participant accounts that are tied to the participant's student loan program. A matching contribution is usually made to participants who defer, so now you could make a matching contribution to participants who make student loan payments. While participants have the burden to certify they're making the student loan payments to get the matching contribution, it still requires you to create a process for making these contributions. A new process is more work and will force you to make additional 401(k) matching contributions for people not deferring into the plan. As someone who had considerable student loan debt, I have empathy for people who had to finance their higher education through loans, but it's an extra burden for 401(k) plan sponsors in both work and contributions.

After-Tax, Roth Employer Contributions

Another provision in SECURE 2.0 allows plan participants to elect to have any employer contributions funded to their 401(k) plan made as a Roth contribution. Like with Roth salary deferrals, participants making such an election will owe income tax on the contributions but will avoid tax on qualified distributions of both principal and income. This is an optional provision that I won't volunteer you to get. I think it will be a lot of work for you to implement for the one or two employees who can afford it and want to do it. The biggest problem with this provision is that any Roth employer contribution would have to be fully vested. If you have a vesting schedule because you use it to entice employees to stay, then you have to treat these participants who elect after-tax employer contributions, as extra special and vest them at 100%. In addition, there is a headache of recordkeeping. Since it's an employer contribution and the participant will have to pay tax on it, there is the issue of tax reporting. If a participant elects to receive matching or profit-sharing contributions as Roth contributions, the Roth contributions are treated as an in-plan Roth rollover and must be reported on Form 1099-R (and not a Form W-2) for the year in which the contributions are allocated to the employee's account (even if the contributions are designated for a prior year). Roth contributions will not be subject to FICA taxes, and federal income tax withholding does not apply. So, the participant would need to adjust their tax withholding to avoid owing additional income tax at the end of the year. I think it's Roth employer contributions are too much work for you to implement and I don't believe that they will be very popular.

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