ERIC The ERISA Industry Committee
Driven By and For Large Employers
701 8th Street NW, Suite 610, Washington, DC 20001 • (202) 789-1400 • ***www.eric.org***
Annette Guarisco Fildes, President & CEO

January 14, 2019

The Honorable Charles P. Rettig
Commissioner
CC:PA:LPD:PR (REG-107813-18)
Internal Revenue Service
Courier's Desk
1111 Constitution Avenue, NW
Washington DC 20224

RE: REG-107813-18 – *Proposed Amendment to Regulations Relating to Hardship Distributions*

Dear Commissioner Rettig:

The ERISA Industry Committee ("ERIC") appreciates the opportunity to provide the United States Internal Revenue Service (the "Service") comments on the proposed regulations relating to the Bipartisan Budget Act of 2018[1] (the "Act"), particularly with regard to guidance addressing the simplification of the hardship distribution provisions for 401(k) plans. ERIC supports the Service's efforts in providing clarification and simplification surrounding the hardship distribution provisions and appreciates the opportunity to provide its input.

ERIC's member companies are uniquely positioned to provide valuable insight that could strengthen and expand the final regulations pertaining to hardship distributions. ERIC is the only national association that advocates exclusively for large employers on health, retirement, and compensation public policies at the federal, state, and local levels. ERIC's members provide comprehensive retirement benefits to tens of millions of active and retired workers and their families across the country. ERIC has a strong interest in policies that impact the ability of employers to provide cost-effective retirement programs and the ability of employees to receive such benefits and plan for a secure retirement.

ERIC's members care greatly about the participants and beneficiaries of their employer-sponsored plans. These member employers put tremendous resources into these retirement plans, and they want each participant to benefit fully from them. This forthcoming guidance is welcomed in order

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[1] Pub.L. No. 115-123, 132 Stat. 161.

to guide plan sponsors in ensuring that 401(k) plan participants receive their benefits but continue to have an opportunity to access their benefits in the event of a hardship circumstance.

ERIC respectfully requests that the Service consider its suggestions to provide for even greater flexibility such that employers can voluntarily design certain requirements regarding hardship distributions to reflect their particular workforces and to provide for even greater clarity regarding the administration of hardship distributions.

- First, ERIC proposes that employers should be able to elect whether to require participants to cease contributions of all forms for a period of up to (and including) six months following the receipt of a hardship distribution from a 401(k) plan. ERIC believes that the proposed prohibition on such a suspension period is neither required by the Act, nor does it further the public interest as it will likely increase "leakage" from retirement savings and unreasonably restricts plan sponsor discretion in tailoring 401(k) plans to the specific workforce.

- Second, ERIC also requests that the Service provide additional direction regarding the circumstances under which a federally declared emergency (or other similar disaster) justifies loosening the procedural requirements normally imposed on participants to qualify for hardship distributions.

- Third, with regard to these admirable efforts to simplify the hardship distribution provisions, ERIC encourages the Service to remove the mandatory requirement that participants take distributions of all employee stock ownership plan ("ESOP") dividends before receiving a hardship distribution. ERIC believes that this requirement results in a disproportionally large burden placed on plan administrators that far outweighs the often-negligible effect that such a distribution would have on participants' financial situation.

<u>ERIC Believes the Act Prohibits the Internal Revenue Service from Requiring Six-Month Suspensions, But the Act Does Not Prevent Plan Sponsors from Voluntarily Instituting Suspensions</u>

Section 41113 of the Act directs the Secretary of the Treasury to "delete the 6-month prohibition on contributions imposed by paragraph (2) thereof [of Section 1.401(k)-1(d)(3)(iv)(E) of the Treasury Regulations]." Presumably in response to this statutory direction, the proposed regulation[2] provides that "a plan may not provide for a suspension of an employee's elective contributions or employee contributions as a condition of obtaining a hardship distribution." However, this exceeds the requirement of the statute. Specifically, the statute merely directs that a suspension period not be a necessary element for satisfying the current *regulatory* safe harbor

[2] 83 Fed. Reg 5673 (Nov. 14, 2018).

for a distribution that is "deemed necessary to satisfy an immediate and heavy financial need,"[3] a term which is an element of the safe harbor circumstances that are deemed to constitute the occurrence of a "hardship of the employee" (the statutory provision that originally gave rise to the concept of a hardship distribution).[4] This is illustrated in the official summary of the Act provided by the Congressional Research Service which states that section 41113 requires the Secretary of the Treasury to modify the rules regarding "distribution[s] . . . *deemed* necessary to satisfy an immediate and heavy financial need."[5]

In short, the Act prevents the Service from requiring plan sponsors to impose a six-month suspension period in order to substantiate that a plan participant is experiencing a hardship. However, it does not preclude a plan sponsor from implementing such a requirement of its own volition. As a result, the provision of the proposed regulation that a "plan may not provide for a suspension of an employee's elective contributions or employee contributions as a condition for obtaining a hardship distribution"[6] and the related conforming amendments are neither mandatory, nor within the scope of the legislative intent.

Furthermore, the Act does not define what is meant by "contributions." Historically, plan sponsors have had difficulty in ensuring that their employees who receive hardship distributions suspend their contributions "to all other plans maintained by the employer."[7] By eliminating the mandatory nature of requiring the suspension, it provides flexibility for employers to determine an appropriate suspension period of up to (and including) six months, as well as to specify the types of contributions that will be suspended during such suspension period (if any).

Accordingly, ERIC asks that the Service not prohibit plan provisions that require a suspension of elective or employee contributions after a hardship distribution, but rather provide plan sponsors with greater flexibility to design hardship procedures best suited to each of their 401(k) plan participant populations.

ERIC Stresses That the Ability to Impose a Suspension Period Provides a Critical Tool to Plan Sponsors to Prevent Leakage

By now the persistent gap between retirement needs and retirement readiness is well established. This shortfall is made worse by the "leakage" of retirement savings through pre-retirement

[3] Treasury Regulation section 1.401(k)-1(d)(3)(iv)(E)(2).

[4] 26 United States Code section 401(k)(2)(b)(IV).

[5] Available at *https://www.congress.gov/bill/115th-congress/house-bill/1892* (emphasis added).

[6] Proposed Treasury Regulation section 1.401(k)-1(d)(3)(iii)(C).

[7] Treasury Regulation section 1.401(k)-1(d)(3)(iv)(E)(2).

distributions from qualified retirement plans.[8] As twenty percent of distributions are hardship distributions, and because hardship distributions are never paid back to the plan and are almost always taken prior to a participant turning 59½ (depriving the participant of years of compounding returns),[9] the impact of the proposed regulations on national retirement preparedness will be drastic.

Employers should be provided with appropriate tools to discourage employees from taking hardship distributions other than as an absolute last resort. The suspension period is the best such tool, as it imparts onto employees the seriousness of taking hardship distributions, as well as provides them with opportunities during the suspension period to rebuild their taxable savings and, thus, reducing the need for additional hardship distributions in the future.

Absent the suspension period, employees are encouraged and tax-incentivized to treat their retirement accounts as an additional emergency fund to be tapped whenever a need arises, as the effects of foregone pre-tax investment growth are not as evident to the average investor as the sting of foregoing tax deferral (and possible matching contributions) in the current year. Similarly, because employers could no longer automatically suspend elective deferrals and, due to the nondiscrimination rules, would not be incentivized to encourage employees to voluntarily decrease their deferral elections, only extremely attentive and knowledgeable participants will discontinue 401(k) plan contributions at precisely the time they should be focusing on their non-retirement financial wellness.

In addition, it seems counterintuitive that the availability of hardship distributions is a voluntary feature but should plan sponsors choose to provide for such distributions, they may not institute a common safeguard to prevent leakage. In absence of such authority, the only option for plan sponsors who want to prevent one of the most common sources of leakage—other than requiring participants to first obtain plan loans, a plan provision that the Act seeks to deemphasize[10] or to distribute ESOP dividends (as discussed below)—would be to not provide for any hardship distributions under their 401(k) plans which, in turn, could discourage employees from electing to make contributions in the first case. In short, by no longer allowing plan sponsors to implement a suspension period (for a period of up (and including) to six months for some or all forms of contributions), the Service is forcing employers to choose between making hardship distributions unavailable to participants and making them appear so innocuous to participants as to make it the preferred investment vehicle for emergency funds.

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[8] See, e.g., Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income, Aon Hewitt (2011); Plug the Drain: 401(k) Leakage and the Impact on Retirement, Lori Lucas, Callan Associates, Defined Contribution Institutional Investment Association (2011).

[9] See 26 United States Code section 401(k)(2)(b)(III)(providing for distributions to participants after the attainment of age 59 ½, even in the absence of a hardship).

[10] Section 4114 of the Act.

Large employers, including many of ERIC's members, have a multitude of opinions as to the best way to ensure that their employees are able to balance their present-day financial needs with their needs to save for retirement. As a result, ERIC requests that plan sponsors be provided with additional discretion to not only remove the suspension requirement, but also to impose one for any length of time they deem appropriate, up to and including six months.

ERIC Requests More Guidance Regarding Justifiable Delays in Processing Hardships

ERIC applauds the Service's decision to provide more global and concrete guidance relating to federally-declared emergencies that will hopefully preclude the type of well-meaning, but *ad hoc*, guidance that previously made it difficult for plan sponsors to provide information regarding distribution options at the precise moment the information is most needed. However, one recurring situation has not been addressed: recognizing that federally declared disasters are likely to impact the ability of employees/participants to provide substantiating documentation (as well as the ability of affected employers or service providers to receive such documentation), the Service has previously allowed victims of certain large-scale emergencies to receive hardship distributions prior to submitting documentation, but no guidance has been provided in the proposed regulation to clarify the appropriate time period for such delay. This is especially problematic because those participants who are the most delinquent in providing the documentation are likely to be suffering the type of personal turmoil that makes employers especially reticent to threaten adverse tax consequences. In order to rectify this emotionally-charged situation, ERIC requests that the Service provide illustrative guidance on the time period that an employer may permit delay of receipt of substantiation documentation, as well as appropriate corrective action.

ERIC Requests Removal of the Proposed Requirement That Participants Must Take a Distribution of All ESOP Dividends

Currently under the hardship regulations, in order to satisfy the "no alternative means reasonably available" requirement to receive a hardship qualifying under the safe harbor provision, a participant must have "obtained all other currently available distributions (including distributions of ESOP dividends under section 404(k))."[11] Under the proposed regulations, this requirement would be functionally unaltered.[12]

However, the requirement that participants receive a distribution of ESOP dividends has long been a burdensome obligation that, in the experience of our members, does not generate sufficient liquidity to alleviate the financial hardship being experienced by the participant,[13] and merely

[11] Treasury Regulation section 1.401(k)–1(d)(3)(iv)(E).

[12] Proposed Treasury Regulation section 1.401(k)-1(3)(iii)(B).

[13] In fact, a survey performed by Aon reveals that over 50% of hardship distributions are requested in order to prevent an eviction, a situation that often requires participants to obtain cash within a few days or risk immediate

serves to increase retirement leakage and decrease employee investment. In fact, in most cases, cumulative yearly ESOP dividends are less than the required minimums for hardships and, therefore, will almost always be taken in conjunction with, rather than in lieu of, a hardship distribution.

At the same time, the continuation of the requirement to take ESOP dividends increases the administrative burden of the plan, which must then check the dividend election status of participants and, if set to reinvest, modify the election to cash prior to making a hardship distribution. The end result is that a number of participants then begin to receive small dollar dividend checks that may go uncashed, resulting in affected participants foregoing tax-free growth of retirement savings with no offsetting present benefit to them. ERIC's members report that often times ESOP dividend checks are never cashed, resulting in participants being denied both the present and future value of their plan earnings.

ERIC members also report hundreds of hardship requests and ESOP dividend elections each quarter. Accordingly, this results in a massive operational challenge that is unnecessarily burdensome and does not serve any purpose in preventing participants from meeting the availability requirements for taking hardship distributions, but rather merely delays such distributions, which could greatly exacerbate such participants' hardships.

Further, by removing otherwise reinvested dividends from particular funds that could otherwise grow within the plan and offer long-term tax and retirement savings to ensure a more secure financial future for participants, continuing the requirement that participants take the dividend pass-through is detrimental to the longer-term financial security of the participants. Of course, this rationale applies to other types of early distributions, but the ESOP dividend requirement is a unique harm because it interferes with the ability of the participants to direct particular investments of plan assets, a key attribute of most defined contribution plans.

Finally, as the regulations are moving to a more streamlined standard for hardship distributions, where it is up to the affected participants, and not plan fiduciaries, to determine that the participants are unable to meet a financial need through other sources, it is not consistent to continue to deny participants the ability to determine for themselves whether pass-through ESOP dividends are sufficient in nature and timing as to alleviate some or all of the hardship.

As a result, in the interest of greatly simplifying the hardship procedures applicable to ESOPs, ERIC respectfully recommends that the final regulations no longer require that participants take distributions of all ESOP dividends prior to taking hardships.

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homelessness. The time it takes to process dividends, or even just to confirm that there are no ESOP distributions outstanding, could render the distribution too late to prevent or cure the hardship. See Note 8.

Alternatively, ERIC suggests that the Service consider imposing a minimum dollar threshold for payment of dividend pass-through checks to participants in order to reduce the number of small-dollar uncashed checks that plans must issue at added expense to all participants without a corresponding benefit to their long- or short-term financial and retirement wellness. ERIC suggests that, in the case that the latter approach is adopted, participants retain the option of electing dividend re-investment or cash distributions. However, if distributions were to be elected, the plan could provide that any dividend would only be distributed if the total amount exceeded a small-dollar threshold linked to an amount reasonably likely to alleviate a financial hardship.

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ERIC is ready to work with the Department of the Treasury and the Service as guidance is developed to implement the various retirement-plan provisions of the Act and the Tax Cuts and Jobs Act of 2017 and seeks to update the Treasury Regulations and subregulatory guidance that impact employer-provided benefits. In this respect, ERIC continues to fully offer its services and knowledge to the Department of the Treasury and the Service.

If you have any questions concerning our comments, or if ERIC can be of further assistance, please do not hesitate to contact me at 202-789-1400.

Sincerely,