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Sponsors face quandary in how to help participants

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Will Hansen said it was 'an unprecedented time' and agreed that hardship withdrawals should be available for those who need it. | Photo: Jennifer Bishop

New law opens difficult choice between savers' present, future needs

Desperate times call for drastic measures. Such are the retirement plan provisions in the $2 trillion stimulus bill President Donald Trump signed March 27 to help Americans cope with the financial consequences of COVID-19.

Bucking conventional wisdom, the provisions in the Coronavirus Aid, Relief and Economic Security Act make it much easier for plan participants to tap their retirement savings — a break from norms that encouraged them to leave the funds untouched.

If plan sponsors choose to implement the emergency measures, participants will be able to take hardship distributions of up to $100,000 from their retirement accounts without the 10% early withdrawal penalty if they are under age 59½ and without having to pay taxes on the distributions all at once but rather over three years.

Participants will also be able to borrow the lesser of $100,000 or 100% of their vested balances from their accounts, or twice as much as they could before.

Industry experts say there's no easy answer to the question of whether plan sponsors should adopt the new rules, adding that any change would require communication and analysis of participant demographics. And they acknowledge that the loosening of restrictions, which comes amid a calamitous market decline will make it virtually impossible for participants who withdraw funds to recover their losses.

Still, experts say they cannot ignore the immediate needs of millions of out-of-work Americans.

"This is an unprecedented time in our country right now," said Will Hansen, chief government affairs officer at the American Retirement Association and executive director of the Plan Sponsor Council of America in Washington. "I think we all as a country have to agree that these are necessary moves that we have to make at this time."

It's a sentiment that is widely shared by industry leaders. "People are desperately in need of cash for food, shelter and debts," said Lynn Dudley, senior vice president of global retirement and compensation policy at the American Benefits Council in Washington.

Alison Borland, executive vice president of wealth solutions and strategy at Alight Solutions in San Francisco, put it more directly. If choosing between "eviction and eroding their retirement benefit," participants are likely to choose the longer-term evil of jeopardizing retirement security, she said.

While worried about the impact of withdrawing money during a severe market downturn, industry leaders defend the measures as a last resort to be used only after participants have exhausted emergency savings and explored borrowing money from family, friends and banks.

"We are not encouraging participants to use these options but rather see these as the last option for participants who are facing economic challenges," said Aliya Robinson, senior vice president of retirement and compensation policy at the ERISA Industry Committee in Washington.

Facilitating repayment

Industry leaders also point to provisions that will facilitate the repayment of hardship withdrawals and loans. The legislation, for example, provides a mechanism by which participants can repay or "recontribute" their hardship distributions to the plan over three years without those contributions counting toward the limit on annual contributions allowed by law.

Still, the provisions don't erase the concerns. "I really fear that the people who are forced to take out their money are not going to be the people who are going to be able to recontribute," said Alicia Munnell, director for the Center for Retirement Research at Boston College, who nevertheless supports the measures.

Gregg Levinson, senior director of retirement at Willis Towers Watson PLC in Philadelphia, also has conflicting views. While he believes easier loans and hardship distributions are a "great backstop for people who really need them," he worries the legislation may have been a "knee-jerk reaction" to the crisis.

"Short term it's an easy fix to things but long term it does a ton of damage to your retirement savings," Mr. Levinson said.

Mr. Levinson also sees the $100,000 cap on hardship withdrawals and loans as too high. "We don't want to see people jump at $100,000 if they don't need it," he said, adding that a $50,000 limit probably would have been enough for most people.

Rather than plunder their retirement savings accounts, Mr. Levinson recommends that participants consider stopping their contributions and putting those deferrals into an emergency savings account.

"It's better to redirect future contributions to current needs than to dig into retirement accounts if it can be avoided," Mr. Levinson said, adding that when the crisis subsides, people can begin their savings again. "These times call for serious, previously unthinkable actions, but we should try not to damage our futures if we truly don't have to."

Michael Francis, president and chief investment officer at Francis Investment LLC in Brookfield, Wis., is also thinking beyond the crisis, noting that the slowdown is expected to be short-lived. "Taking $100,000 from retirement plan assets to cover short-term liquidity concerns may not be in participants' best long-term interests," Mr. Francis said.

Difficult question

For plan sponsors, the legislation poses a difficult question: Should or shouldn't they adopt the retirement plan measures? Sponsors are not required to implement them, but if they do, they should try to limit the scope of what they make available to employees to avoid confusion, according to Alight's Ms. Borland. They might want to make either the hardship distributions or the plan loans easier, but not both, based on the demographics of their workforces, she said.

"We're a little bit concerned about the potential confusion if plan sponsors try to implement too much," she said.

Ms. Borland believes that plan sponsors are more likely to ease up on hardship withdrawals rather than plan loans because the withdrawals "apply to everyone" regardless of whether they still have jobs. Loans, unlike hardship withdrawals, are only available to individuals who are still employed by the sponsoring employer.

The new hardship withdrawal option also behaves almost like a loan since distributions can be repaid over three years.

In addition, hardship distributions under the legislation are available for all of 2020, unlike the stepped up plan loans, which are available through Sept. 23.

"I think that's the provision that we're really expecting will have the most traction within the plan sponsor community," Ms. Borland said, referring to hardship withdrawals.

For plan sponsors that do adopt the measures, it's important that they provide participants with "careful communications" about the potential short- and long-term impact of taking hardship withdrawals or loans, she said.

With retirement account balances down an average of 20%, participants should be aware that they're not going to "get that 20% back if they take their money out of the market," Ms. Borland said. They should realize that if they're unable to repay the loans or withdrawals, the impact on their overall retirement security will be significant given the compound interest lost and the time value of money.

For now, plan sponsors are considering their strategies. Some, for example, are thinking about providing participants with access to financial counselors to help participants think through their options based on their financial situation. Others are considering offering employees short-term loans that they can repay via payroll deductions, Ms. Borland said.

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