Safe Harbor 401(k) Plans: Changes in the Face of Financial Uncertainty | Fiduciary Focus Series

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This alert focuses on whether, in the throes of the COVID-19 pandemic, plan sponsors can amend their safe harbor plans mid-year to reduce or suspend employer safe harbor contributions if they determine that the safe harbor contribution is too expensive during this unparalleled time of financial uncertainty.

A safe harbor plan is a 401(k) plan which is not subject to nondiscrimination testing on employees and, in most cases, matching contributions because the plan design requires the employer to make a certain level of fully vested contributions, either as matching or as non-elective employer contributions. (Note: 403(b) plans can also be designed as safe harbors so that matching contributions are not subject to nondiscrimination testing.) Because the contributions are both required to be made and to be fully vested, safe harbor plans are often more expensive for employers even though they are less burdensome administratively. The safe harbor plan rules contain strict limits on when contributions can be reduced or stopped during a plan year.

An employer can provide that, in the safe harbor notice given to employees before the plan year begins, the plan may be amended mid-year to reduce or suspend safe harbor contributions with at least 30 days' notice to eligible employees, so long as the amendment and the plan satisfy certain other requirements. If a notice given before the current plan year reserved this right, an employer can, for any reason, eliminate the obligation to make the safe harbor contributions after the amendment is effective.

An additional notice explaining the consequences of the elimination or reduction of safe harbor contributions must be provided to eligible employees at least 30 days before the effective date of the plan amendment making the change, and the eligible employees must have the opportunity to change their contribution elections before the amendment becomes effective. Additionally, the

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amendment must provide that the plan will satisfy the IRS compliance tests (ADP and, if applicable, ACP) using the current year testing method, and the plan must satisfy the requirements of the ADP safe harbor with respect to amounts deferred through the effective date of the amendment.

Fortunately, for safe harbor plans that didn't reserve the right to make a mid-year change in a safe harbor notice given before the plan year, it may still be possible to change or stop contributions mid-year. The safe harbor rules also permit an employer that is "operating at an economic loss" for a plan year to amend the plan to reduce or suspend safe harbor contributions, subject to the same amendment, notice, and other requirements described above for plans that reserved the right in their annual safe harbor notice.

While the cost of amending a plan to reduce or suspend safe harbor contributions cannot be paid out of plan assets, the costs of drafting and issuing the supplemental notice to eligible employees is an administrative expense that can generally be paid out of plan assets.

We should also note that the SECURE Act made some changes to the rules that apply to safe harbor plans that use the non-elective employer contribution design, which provide additional flexibility for plan years beginning after December 31, 2019. For a non-elective contribution safe harbor plan, these new rules eliminate the requirement that a safe harbor notice be given to employees prior to the plan year (although notice is still needed if the plan also has matching contributions and wants to avoid the ACP test). Most plans would have already given the safe harbor notice for the 2020 plan year before the SECURE Act passed, and for non-elective contributions, often those notices include the right to discontinue contributions mid-year.

Having the ability to change contributions mid-year without having to determine the employer is operating at an economic loss may be one reason to continue giving a safe harbor notice to eligible employees before each plan year even if the notices are no longer required. For more information on this or other qualified retirement plan issues, contact Sarah Lowe or any member of the Frost Brown Todd's Employee Benefits & ERISA Practice.

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