COVID-19 EMPLOYEE BENEFIT AND EXECUTIVE COMPENSATION QUESTIONS

In light of the recent economic developments stemming from the COVID-19 pandemic, many employers are evaluating their employee benefit plans and how employee and employer costs will be impacted. The following summary provides a list of questions we have been receiving from clients over the past week, along with action items to help employers address these issues.

Health and Welfare Plans and Fringe Benefits

1. *Should benefits coverage continue while an employee is on an unpaid furlough? If so, how would the employee pay the employee's portion of the premium? Could the employee elect to drop coverage due to the reduction in hours of active service? Could the employer pay for coverage for some or all of its furloughed employees?*

    - Continued eligibility for benefits will depend on whether the employer treats the furlough as a termination of employment or as an unpaid leave of absence.

    - The terms of the plan, including any insurance policies, will determine whether the employee remains eligible; however, the employer may be able to amend these to revise eligibility to extend coverage if desired. Employers should discuss possible amendments with benefits counsel as well as their insurers and stop-loss carriers, as applicable.

    - If an employee loses eligibility due to the furlough, COBRA may need to be offered. An employer may be able to subsidize COBRA premiums on a nondiscriminatory basis.

    - If an employee maintains eligibility during the furlough, the employee will need to submit premiums on an after-tax basis or the employer can waive or subsidize premiums on a nondiscriminatory basis.

    - Generally, if an employee maintains eligibility, there would not have been a change in status event that permits the employee to drop coverage. One exception to this would be the Affordable Care Act ("***ACA***") change in status event that permits dropping group health plan coverage when the employee enrolls in other coverage.

2. *Does the employer's group health plan cover medical expenses related to COVID-19?*

    - The Families First Coronavirus Response Act requires an employer-sponsored group health plan (including a grandfathered plan under the ACA) to provide coverage for COVID-19 diagnostic testing and services related to the diagnostic testing without any cost sharing (including deductibles, copayments, and coinsurance), prior authorization, or other medical management requirements.

    - Future legislation could address coverage for treatment of COVID-19, including relief from high deductibles or balance billing.

    - Employers may need to amend their plans to provide such coverage and should contact their third-party administrators to ensure continued compliance as individuals start to submit claims.

3. *If an employee is off work because he or she has been quarantined due to potential exposure to COVID-19, does this qualify as a disability for purposes of an employer's short-term disability ("**STD**") and long-term disability ("**LTD**") plans?*

    - Whether or not such a situation constitutes a "disability" under the employer's STD and LTD plans would be based on the "disability" definition set forth in the plans' terms.

    - Employers should review their plan documents and summary plan descriptions to determine whether amendments to the "disability" definition are needed to meet the employer's intended interpretation.

    - To the extent that the STD and/or LTD plan coverage is fully-insured, any desired amendments must be made in collaboration with the insurance carrier.

4. *Can an employer stop or suspend pre-tax HSA contributions to its employees' accounts?*

    - An employer's funding of pre-tax HSA contributions to its employees' accounts ("***HSA Funding Benefit***") should be described in the employer's cafeteria plan under Section 125 of the Internal Revenue Code of 1986, as amended (the "***Code***"). Provided that the employer has reserved the right to amend the plan at any time, the employer should be able to amend the plan to terminate or suspend the HSA Funding Benefit.

    - The circumstances under which mid-year election changes would be allowed for the HSA Funding Benefit should be addressed in the cafeteria plan document and in participant communications. Employers should review their plan documents to determine whether any circumstances related to COVID-19 would permit such a change.

    - As a general rule, pre-tax HSA contribution election changes must be allowed at least monthly—a time period that correlates with the HSA monthly eligibility rules—and upon a loss of HSA eligibility.

    - If an employer provides a matching HSA contribution for any salary-reduction HSA contributions made by employees under the HSA Funding Benefit, the employer should consider whether to allow employees to also terminate or suspend their contributions in the event the employer terminates or suspends the matching contribution; a plan amendment may be required in that circumstance.

5. *What tax-free payments can an employer make to its employees as "qualified disaster relief"?*

    - In areas that have been declared a qualified disaster under the Stafford Act, the COVID-19 outbreak will fall into the category of disasters that permit certain tax-free reimbursements by employers of disaster-related expenses as "Qualified Disaster Payments."

    - Such payments could include an employee's expenses, that are not otherwise reimbursed by insurance, for medical expenses, health-related expenses that are not

medical expenses (e.g., over-the-counter medications, hand sanitizers), child care expenses due to school closings, increased home expenses due to telecommuting, (e.g., home office set-up, Internet, printer), and transportation expenses due to work relocation.

- Employers should consult with their benefits counsel to determine whether the employers are eligible to pay such reimbursements to employees on a tax-free basis.

Executive Compensation and Stock Options

1. *If an employer sponsors a nonqualified deferred compensation plan, could the employer suspend, reduce, or eliminate the employer's contribution to, or terminate, the plan during the year?*

    - As long as the nonqualified deferred compensation plan gives the employer the discretion to modify contributions mid-year, and the reduction or elimination of the employer portion of the contributions under the nonqualified deferred compensation plan does not impact the timing of payments under the plan (either by accelerating or delaying payments), the employer should be able to reduce or eliminate the employer portion of the contributions.

    - The employer should use care if it wants to suspend contributions, as merely delaying the contributions and promising that they will be made in a future tax year could cause problems under Code Section 409A and the regulations issued thereunder ("***Section 409A***").

    - If the employer wants to terminate the nonqualified deferred compensation plan, it should discuss such termination with its benefits counsel. Section 409A does not permit an employer to terminate a nonqualified deferred compensation plan if the termination and liquidation would occur proximate to a downturn in the financial health of the employer.

2. *Can employees' contributions to a nonqualified deferred compensation plan be suspended during the year, or can they take hardship withdrawals from the plan?*

    - Generally, an employee cannot suspend or modify his or her deferral elections mid-year. However, Section 409A does permit a plan to allow a plan participant to cancel a deferral election due to an "unforeseeable emergency" or a hardship distribution under a qualified plan pursuant to Treasury Regulation §1.401(k)-1(d)(3). The deferral election cannot be suspended or otherwise delayed.

    - Employers should review their nonqualified deferred compensation plans to determine whether such plans allow for distributions upon an unforeseeable emergency. The guidance issued under Section 409A permits certain expenses relating to an illness of the participant, the participant's beneficiary, or the participant's or beneficiary's spouse or dependents to constitute an unforeseeable emergency. In addition, the need to pay certain medical expenses or funeral expenses may constitute an unforeseeable emergency.

    - However, the requirements under Section 409A for an event to qualify as an unforeseeable emergency are more stringent than the requirements to receive a hardship distribution under a qualified plan (discussed below). Employers should consult with their benefits counsel before approving either a cancellation of deferrals or a distribution under a nonqualified deferred compensation plan relating to an unforeseeable emergency.

- In the event the employer decides to approve a distribution or cessation of deferrals due to an unforeseeable emergency, the employer should retain documentation in its files to demonstrate why the expenses met the requirements under Section 409A.

3. *If an employer's stock price has dropped, and the employer's stock options are underwater, can the employer reprice those options?*

    - The employer should first review its plan's terms to determine whether the plan document expressly prohibits repricing of stock options without stockholder approval.

    - If the plan does not expressly permit an employer to unilaterally reprice options (which most do not), or the plan is silent with respect to a repricing, the rules of the exchange on which the employer's stock is listed may require the employer to obtain stockholder approval before conducting the repricing.[1]

    - In the event stockholder approval of a repricing is required, the employer should consider whether the repricing can be structured to receive support from ISS and Glass Lewis. ISS considers repricing proposals on a case-by-case basis, and Glass Lewis generally recommends a vote against repricing proposals. However, both ISS and Glass Lewis have indicated that repricing proposals may be appropriate when a decline in the employer's stock price is due to macroeconomic trends beyond the employer's control. Other factors that could influence a positive voting recommendation include, among other things, prohibiting officers and board members from participating in the repricing, extending the vesting requirements of the exchanged options and initiating the repricing at least a year after the decline in the stock price.

    - Depending on whether a repricing involves an investment decision on the part of the option holder, such as an exchange of options for another security or a reduction in the exercise price of incentive stock options, the repricing may constitute a tender offer under SEC rules. If the repricing is a tender offer, SEC rules require, among other things, the repricing offer to be held open for a minimum of 20 business days and a disclosure document to be distributed to option holders.

    - Employers should also consider alternatives to repricing existing awards, including making new grants to employees under the plan, or making grants of cash-based stock appreciation rights or restricted stock units.

    - If an employer is considering repricing its options, it should consult with both securities and executive compensation counsel to determine what would be required to conduct a repricing.

401(k)/Profit-Sharing Plans

1. *Would expenses incurred by employees qualify as "financial hardships" eligible for hardship withdrawals under a qualified retirement plan?*

[1] See NYSE Listed Company Manual Section 303A.08, Nasdaq Stock Market Listing Rule 5635(c) and Interpretive Material IM-5635-1, and NYSE American Company Guide Section 711.

- Under current law, hardship distributions are likely not permitted solely due to the COVID-19 outbreak, except in areas that have been declared federal disasters, unless the expenses are one of the other "immediate and heavy financial needs" that would otherwise give rise to a permissible hardship distribution under the plan (e.g., medical or funeral expenses of the employee or the employee's spouse, dependent, or beneficiary, payment to prevent an eviction). Federal disasters have already been declared in some states, and similar declarations may be made with respect to other states in the coming days.

- Pending federal legislation would change the hardship distribution rules to permit additional distributions in connection with the COVID-19 outbreak in certain circumstances.

- Employers should review their plan documents and consult with their benefits counsel to determine whether their plan permits hardship distributions in connection with a federally declared disaster or a plan amendment to permit such distributions is needed.

2. *Can a plan sponsor suspend, reduce, or eliminate matching and other contributions under qualified retirement plans (including safe harbor plans) mid-year?*

    - The plan sponsor should review their plan documents and participant communications, including safe harbor notices, if applicable, to determine whether the plan sponsor has the discretion to change contributions mid-year.

    - If the employer contributions under the plan are discretionary contributions, generally, the plan sponsor can suspend, reduce or eliminate contributions at any time until the contributions are made. However, if employers have sent employee communications promising that a specific contribution will be made for a specific period, then the employer should consult with their benefits counsel before deciding to eliminate the contribution.

    - If the employer contribution is a profit sharing contribution, then subject to the plan's terms, the employer should be able to suspend, reduce, or eliminate the contribution. However, if there are multiple years when the contribution is not made, the suspension of the contribution may be treated as a plan termination requiring 100% vesting of participants in their accounts.

    - If the employer contributions are safe harbor contributions, then the employer may not be able to suspend, reduce, or eliminate the contributions mid-year. Specifically, if the retirement plan is a safe harbor plan, it can only be amended if either:

        - The plan sponsor is operating at a qualifying economic loss for the applicable plan year, or

        - The plan's annual safe harbor notice included a statement that the plan could be amended during the plan year to reduce or suspend safe harbor matching contributions.

- If the plan is amended to suspend or reduce safe harbor contributions, plan participants must be provided with an updated safe harbor notice and given an opportunity to change their deferral elections before the change or suspension takes effect.

3. *If the employer furloughs some of its employees, would that action result in a "partial termination" of the employer's qualified retirement plan?*

    - Whether a partial plan termination occurs is a facts and circumstances determination.

    - Under current guidance, if a significant percentage (generally, at least 20%) of the employees participating in the plan permanently cease to accrue future benefits in the plan, it is likely that a partial plan termination has occurred.

    - If a furlough of employees is temporary and the furloughed employees resume participation in the plan after the furlough ends, those employees should not count toward determining whether a partial plan termination has occurred.

Defined Benefit/Cash Balance Plans

1. *Can a plan sponsor freeze or terminate its defined benefit or cash balance plan?*

    - Possibly, but the process for freezing or terminating a defined benefit or cash balance plan is complicated and requires careful consideration and planning.

    - If a plan sponsor is considering freezing or terminating its defined benefit or cash balance plan, the plan sponsor should consider when benefits are accruing under the plan (e.g., monthly, after 1,000 hours, end of the plan year). When benefits accrue affects what the plan sponsor can freeze or terminate.

    - The plan sponsor should carefully consider the funding status of the plan and the consequences of freezing or terminating the plan during a financial downturn. Any discussions regarding freezing or terminating the plan should include the plan's actuaries and benefits counsel.

    - Freezing or terminating a defined benefit or cash balance plan requires advance notice to participants, so plan sponsors should carefully develop a timeline relating to the termination or freeze to ensure that all required notice time periods can be met.

2. *What is the effect of the current market and interest rate down turn on the funded status of defined benefit pension plans?*

    - According to October Three Consulting, as stated in the article "Markets 2020 - Effect on ERISA minimum funding" Markets 2020 - Effect on ERISA Minimum Funding Requirements:

        - "To begin with a (very brief) bottom line: Funding requirements for 2020 for a calendar year plan were locked in as of January 1, 2020. 2020 asset declines may affect minimum funding as early as 2021. Interest rate declines won't show up in minimum funding numbers until 2023. If they persist."

- Plan sponsors should consult with the plan's actuaries to discuss the impact of the current financial downturn on their plans.