Executive Compensation, Employee Benefits and ERISA Alert

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Employee Benefits and Executive Compensation Aspects of the CARES Act

April 10, 2020

In response to the coronavirus pandemic, Congress recently passed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). President Donald Trump signed the CARES Act into law on March 27, 2020. Below is a summary of the key employee benefits and executive compensation-related provisions of the CARES Act.

Retirement Plan Distributions

The CARES Act permits participants in eligible retirement plans (including 401(k) plans and individual retirement accounts (IRAs)) who are affected by the coronavirus to take Coronavirus-Related Distributions of up to $100,000 if the plan permits such distributions, without some of the potential negative consequences as noted below.

- "Coronavirus-Related Distributions" are plan distributions made on or after January 1, 2020, and before December 31, 2020, to a qualified individual ("Qualified Individual"):
  - Who is diagnosed with the virus SARS-CoV-2 or the coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention or
  - Whose spouse or dependent is so diagnosed by such a test or
  - Who experiences adverse financial consequences due to certain coronavirus-related events, including quarantine, being furloughed or laid off or having work hours reduced, being unable to work due to lack of child care, closing or reducing hours of a business owned or operated by the individual, or other factors as determined by the Secretary of the Treasury (or the Secretary's delegate).
- In determining whether a distribution is a Coronavirus-Related Distribution, plan administrators may rely on an employee's certification that the employee satisfies these conditions.
- The $100,000 cap on Coronavirus-Related Distributions to a Qualified Individual applies to the total amount of such distributions from all eligible retirement plans in the plan sponsor's controlled group.

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- Currently there is no guidance as to whether reductions in bonuses or other incentive compensation impacted by reduced operations will be treated as "adverse financial consequences" that will allow an individual to be treated as a Qualified Individual.
- Coronavirus-Related Distributions made to Qualified Individuals will not be subject to the 10 percent early distribution penalty under Internal Revenue Code (IRC) Section 72(t) for distributions prior to age 59-1/2, regardless of whether such funds are rolled over to another qualified plan or an IRA.
- Coronavirus-Related Distributions may be repaid at any time during the three-year period beginning on the day after a Qualified Individual receives the distribution by making one or more contributions in an aggregate amount not to exceed the amount of such distribution and such distribution repayment(s) will be treated as a qualifying rollover. Coronavirus-Related Distributions may be repaid to any eligible retirement plan (including a 401(k) plan or IRA) in which the Qualified Individual is a beneficiary. To date, there is no guidance on how to reverse any income tax previously paid on such amounts.
- Coronavirus-Related Distributions that are required to be included in gross income will be included ratably over a three-taxable-year period beginning with the taxable year in which the distribution was made, unless the Qualified Individual elects otherwise.
- Coronavirus-Related Distributions are not treated as eligible rollover distributions and, accordingly, will not be subject to mandatory 20 percent federal income tax withholding.
- If the Coronavirus-Related Distribution feature is desired, a plan amendment must be adopted by the last day of the first plan year beginning on or after January 1, 2022 (December 31, 2022, for calendar year plans) or January 1, 2024, for governmental plans (December 31, 2024, for calendar year governmental plans).

Retirement Plan Loans

The CARES Act permits Qualified Individuals to take out larger loans from qualified employer plans (such as a 401(k) plan) that offer such loans during the 180-day period after the enactment of the CARES Act, or until September 23, 2020. The limit on such loans is increased from $50,000 to $100,000, and the vested account balance limit is increased from 50 percent to 100 percent of the vested account balance for defined contribution plans. Thus, with respect to qualified employer plans that offer such expanded loans, Qualified Individuals may borrow the lesser of $100,000 or 100 percent of their vested account balance during such 180-day period.

It is important to note that, as of this writing, the Department of Labor (DOL) has not issued relief under the adequate security requirements of the Employee Retirement Income Security Act (ERISA). Under these rules, plan loans must be secured by something supporting the promise to pay, which may include no more than 50 percent of the participant's vested account balance. Based on past disaster relief actions, we anticipate that the DOL will issue temporary relief under these rules to conform to the tax-related changes under the CARES Act at some point, but plan sponsors and administrators should exercise caution and avoid exceeding the 50 percent limit on loans until the DOL clarifies this point.

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The CARES Act also provides relief to Qualified Individuals for repayment of outstanding retirement plan loans. Loan payments that are due between March 27, 2020, and December 31, 2020 (on existing retirement plan loans and, seemingly, new loans taken between March 27, 2020, and December 31, 2020) must be delayed for one year. It is not clear if the delay includes payments "due" prior to March 27, 2020 that are within the grace period before they are included in income. Subsequent payments, including interest that accrues during the delay period, must be reamortized over the extended repayment period. The delay period is disregarded for purposes of determining the maximum five-year repayment term that generally applies to most plan loans.

As with the Coronavirus-Related Distribution feature described above, expanded plan loans are optional. Conversely, the one-year delay of loan repayments is mandatory and must be implemented immediately. A plan amendment to add the one-year delay provision, and, if desired, the expanded plan loan provision, must be adopted by the last day of the first plan year beginning on or after January 1, 2022 (December 31, 2022, for calendar year plans) or January 1, 2024, for governmental plans (December 31, 2024, for calendar year governmental plans).

Required Minimum Distributions

The CARES Act allows eligible retirement plans, such as a defined contribution retirement plan, to waive required minimum distributions for calendar year 2020 (including any initial required beginning date distributions attributable to 2019 that have not yet been paid), regardless of whether the distribution is with respect to an individual affected by the coronavirus. In the case of a defined contribution plan, an amendment to add this provision must be adopted by the last day of the first plan year beginning on or after January 1, 2022 (December 31, 2022, for calendar year plans) or January 1, 2024, for governmental plans (December 31, 2024, for calendar year governmental plans).

Minimum Required Contributions

The CARES Act extends the deadline for any minimum required contributions to a single-employer defined benefit pension plan that would otherwise be due during calendar year 2020 (including quarterly contributions due in 2020 and any final contribution due for 2019), to January 1, 2021. Such contributions will accrue interest for the period between the original due date and the payment date at the effective rate of interest for the plan for the plan year which includes such payment date, but will not be subject to late payment penalties.

Use of Pre-2020 AFTAP

With respect to single-employer defined benefit pension plans, the CARES Act permits a plan sponsor to elect to treat the plan's adjusted funding target attainment percentage (AFTAP) for the last plan year ending before January 1, 2020, as the AFTAP for plan years that include any portion of calendar year 2020. As a result of the coronavirus pandemic, a pension plan's funding status has likely declined. Absent the AFTAP relief provided by the CARES Act, the decline in funding status could have triggered certain funding-based benefit restrictions under the pension plan, including the prohibition on lump sum distributions.

Postponement of ERISA Deadlines

The CARES Act amends Section 518 of ERISA by adding "a public health emergency declared by the Secretary of Health and Human Services" to the list of events under which the DOL may postpone deadlines imposed by ERISA for a period of up to one year. Although the CARES Act does not specifically extend the deadline for filing Forms 5500 (or any other ERISA deadlines), since the deadline for making minimum required contributions was extended (as discussed above), and such contributions are reportable on a Form 5500, it would appear that DOL guidance regarding extension of the Form 5500 filing deadline may be forthcoming.

COVID-19 Diagnostic Testing

The Families First Coronavirus Response Act, which was signed into law on March 18, 2020, requires group health plans (and health insurance issuers offering group or individual health insurance coverage) to provide coverage for COVID-19 diagnostic testing without imposing cost-sharing (including deductibles, copayments and coinsurance), prior authorization or other medical management requirements.

The CARES Act expands the COVID-19 diagnostic tests that must be covered and generally includes the following:

- Tests that are approved under the Federal Food, Drug, and Cosmetic Act.
- Tests for which the developer has requested or intends to request, emergency use authorization under the Federal Food, Drug, and Cosmetic Act, unless and until the request has been denied or the developer of such test does not submit a request within a reasonable timeframe.
- Tests that are developed in and authorized by a state that has notified the Secretary of Health and Human Services of its intention to review tests intended to diagnose COVID-19.
- Any other tests that the Secretary of Health and Human Services determines appropriate in guidance.

In addition, the CARES Act requires that a group health plan (or health insurance issuer) must reimburse the provider of the diagnostic testing as follows:

- If the health plan or issuer has a negotiated rate with the provider in effect before the public health emergency was declared, the negotiated rate will apply or
- If the health plan or issuer does not have a negotiated rate with the provider, the plan or issuer must reimburse the provider at the cash price for such service as listed by the provider on a public internet website, or the plan or issuer may negotiate a reduced rate with the provider.

During the public health emergency, providers must disclose the cash price of the COVID-19 diagnostic tests on a public internet website (or, if they fail to do so, they may be subject to civil monetary penalties imposed by the Secretary of Health and Human Services).

Rapid Coverage of Preventive Services and Vaccines for Coronavirus

The CARES Act requires group health plans (and health insurance issuers offering group or individual health insurance) to cover, without cost-sharing, qualifying coronavirus preventive services within 15 business days after a recommendation is made relating to the qualifying coronavirus preventive service. A "qualifying

coronavirus preventive service" is an item, service or immunization that is intended to prevent or mitigate COVID-19 and that is either an evidence-based item or service that has in effect a rating of "A" or "B" in the current recommendations of the United States Preventive Services Task Force, or an immunization that has in effect a recommendation from the Advisory Committee on Immunization Practices of the Centers for Disease Control and Prevention with respect to the individual involved.

Telehealth Services Exemption

The CARES Act creates a safe harbor for "telehealth and other remote care services" provided under a high deductible health plan (HDHP). Under the safe harbor, such services may be provided under an HDHP before the plan's deductible is satisfied without jeopardizing a participant's eligibility to contribute to a health savings account. By allowing HDHPs to cover all telehealth services, the CARES Act expands upon the Internal Revenue Service's guidance in Notice 2020-15, which limited this telehealth exception to COVID-19 testing and treatment. This provision is effective for plan years beginning on or before December 31, 2021.

Over-the-Counter Products

The CARES Act eliminates provisions in the IRC that prohibited health savings accounts, Archer MSAs, health flexible spending accounts and health reimbursement arrangements from reimbursing expenses for over-the-counter drugs without a prescription. As such, individuals do not need a prescription in order to be reimbursed for over-the-counter medicines and drugs under such arrangements. The CARES Act also amends applicable provisions of the IRC to provide that expenses incurred and amounts paid under such arrangements for menstrual care products are treated as incurred and paid for medical care. These provisions are effective for amounts paid or expenses incurred, as applicable, after December 31, 2019.

Employer Payments of Student Loans

The CARES Act permits employers to make payments of principal or interest on any qualified education loan of an employee on a tax-free basis (up to $5,250). Payments may be made to the employee or to a lender and will not be included in the employee's gross income. In order to qualify for tax-free treatment, payments must be made under an educational assistance program that meets the requirements of IRC Section 127, such as not discriminating in favor of highly compensated employees. The $5,250 limit applies to both the new student loan repayment benefit and payments made under an educational assistance program. This provision applies to payments made after March 27, 2020, and before January 1, 2021.

Limits on Certain Employee Compensation

In addition to certain other requirements and restrictions, including certain workforce maintenance requirements, employers who are recipients of loans, loan guarantees or other investments in support of eligible businesses under Title IV of the CARES Act[1] are prohibited from increasing the compensation and offering certain severance pay and benefits to any officer or employee of the eligible business whose total compensation exceeded $425,000 in calendar year 2019 (other than an employee whose compensation is determined through an existing collective bargaining agreement entered into before March 1, 2020) (a "Qualifying Employee"). Specifically, a Qualifying Employee cannot receive from the eligible business:

- Total compensation during any consecutive 12-month period while the restrictions are in place that exceeds the total compensation that the Qualifying Employee received from the eligible business in calendar year 2019 or
- Any severance pay or other benefits on termination of employment with the eligible business that exceeds twice the maximum total compensation received by such Qualifying Employee from the eligible business in calendar year 2019.

In addition, a Qualifying Employee whose total compensation exceeded $3 million in calendar year 2019 cannot receive during any 12 consecutive months of such period more than the sum of $3 million plus 50 percent of the excess over $3 million of the total compensation received by the Qualifying Employee from the eligible business in calendar year 2019. These restrictions remain in place from the date the loan or guarantee is executed until the date that is one year after the date the loan or loan guarantee is no longer outstanding.[2] "Total compensation" includes salary, bonuses, awards of stock and other financial benefits provided by an eligible business to the Qualifying Employee.

Additional guidance will be needed to fully understand and implement the foregoing restrictions to address the following issues, among others. The CARES Act makes reference to compensation being received from an "eligible business." Accordingly, it is unclear as to whether the compensation restrictions apply to officers and employees of other entities that are not the legal borrower or whether compensation received from other entities that are not the legal borrower is impacted. In addition, the CARES Act refers to amounts being "received," so it is unclear as to how deferred compensation or compensation that is subject to vesting would be treated. The CARES Act also does not provide how "total compensation" will be calculated, including what constitutes "other financial benefits" or "awards of stock" and how such items will be valued. It is not clear how these limitations will apply to Qualifying Employees who were hired during or after 2019.

Employers subject to these restrictions will need to carefully consider the treatment of existing compensation and benefits plans, programs, policies, agreements and arrangements that provide for payments and benefits that will or may cause a Qualifying Employee to exceed these limitations, as well as the interplay between the rigorous rules regarding the timing of payment of deferred compensation under IRC Section 409A and the compensation limitations imposed under Section 4004 of the CARES Act. We expect there to be detailed guidance or regulations in the coming months that attempts to address these issues and others. In the interim, it is important that an employer who seeks to participate in a program under Title IV of the CARES Act review, and consider the statute's impact on, its compensation arrangements.

[1] See Section 4004 of the CARES Act. We note that the programs available under Title IV of the CARES Act are separate from the loans offered by the Small Business Administration under Title I of the CARES Act (including the Paycheck Protection Program and the Economic Injury Disaster Loan Program), which have their own requirements. The programs under Title IV (Section 4003) of the CARES Act are summarized in a prior Akin Gump alert and can be accessed via this link. The Paycheck Protection Program and the Economic Injury Disaster Loan Program under Title I (Sections 1102 and 1110, respectively) of the CARES Act are also summarized in a prior Akin Gump alert and can be accessed via this link. An Akin Gump Q&A summary of the Paycheck Protection Program can also be accessed via this link. The compensation limitations described in Section 4004 of the CARES Act apply to air carriers and certain related businesses, cargo air carriers, businesses critical to maintaining national security, and other eligible businesses who accept a direct loan under Section 4003(b)(4) of the CARES Act, including medium-sized U.S. businesses with between 500 and 10,000 employees.

[2] There are similar compensation limitations that apply to air carriers and related contractors who receive financial assistance under Subtitle B of Title IV of the CARES Act that apply from March 24, 2020 through March 24, 2022. See Section 4116 of the CARES Act.