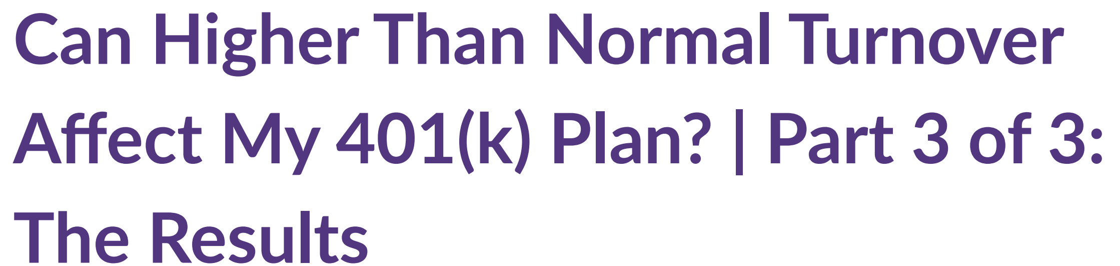


Can Higher Than Normal Turnover Affect My 401(k) Plan? | Part 3 of 3: The Results

Facts

In last week's QOTW, you provided some tools we could use to identify which participants were affected by our decision to close one of our locations, and to calculate our actual turnover rate for purposes of determining whether a partial plan termination has occurred.

We've performed the review, and our minimum turnover rate will exceed 20%. Depending on which employees accept our relocation offer, we may have even more folks who terminate during this timeframe.

Question

Since it looks like a clear-cut partial termination, the only real question we have is what happens now?

Answer

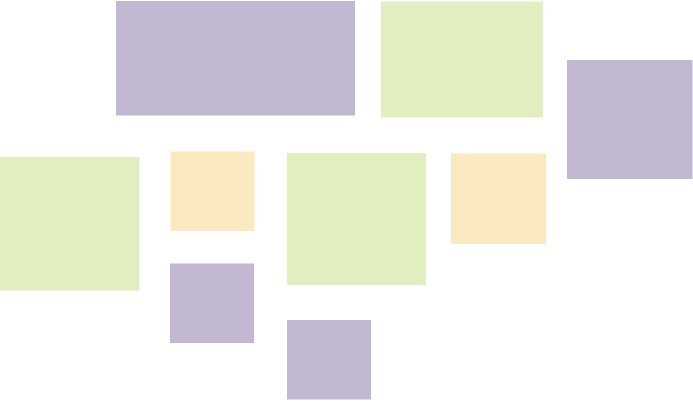
For all the work it took to get to this point, there is really only one repercussion when dealing with a partial plan termination – vesting. Any employee who is affected must immediately have their vested percentage accelerated to 100%, regardless of how long they have worked for the company.

In this situation, you have identified your affected employee group and determined that a partial plan termination will occur. This makes the first part of the process pretty simple; those in the affected group who are not already fully vested must be adjusted to 100%.

But you know that if we've been talking about this for three weeks, there must be more to the story! It can't be this short and simple!

In your case, this is a planned event and you can see the turnover coming. Thus, you are able to plan for it and address the vesting requirements for the affected participants. This isn't always the case though. What if the writing isn't on the wall and an event that significantly impacts your turnover sneaks up on you? Or, more likely, what if a seemingly benign event turns out to be more significant than expected? Since the measurement period can span several years, it could have a subtle beginning without anyone realizing it. How can you possibly be expected to predict the future?

An example of this conundrum was the recession of almost a decade ago. The official dates of that recession are from December 2007 through June 2009; however, many companies started feeling the effects earlier and/or continued experiencing them longer. The duration may be obvious in retrospect, but it was difficult to predict the end date while in the midst of it. As a result, a company could have experienced a partial termination, not known about it, and paid out affected participants at something less than full vesting.



The forfeitures that result from those pay-outs present a bit of a Catch 22. The rules require plan sponsors to use up forfeitures relatively quickly, usually not later than the end of the year after they occur. But, if it is later determined that a partial termination occurred, those forfeitures might not have truly been forfeitures in the first place since those participants should have had their vesting accelerated.
One potential solution is that if you think a partial plan termination may occur, delay using forfeitures for other purposes for as long as possible. That will leave those amounts available to reinstate accounts that end up having to be vested. Otherwise, the company will need to come up with the dollars to make the affected participants whole.

Another approach you can take if you suspect, but are not sure, that a partial termination is in the cards is to proactively amend your plan to fully vest the affected participants. Of course, that means you would be voluntarily foregoing the ability to use amounts that could become forfeitures, but it also takes away any uncertainty about whether participant distributions are paid properly.

If you think you might have experienced a partial plan termination, please give us a call. We are happy to review your situation and help you come up with a game plan.

Related Resources

- Can Higher Than Normal Turnover Affect My 401(k) Plan? | Parts 1 and 2 of 3: Doing the Math
- Which 401(k) Fees can be Paid Out of Plan Assets?

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