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CORRESPONDENCE MEMORANDUM

DATE: May 14, 2012

TO: Wisconsin Deferred Compensation Board

FROM: Shelly Schueller, Deferred Compensation Director

SUBJECT: Financial Emergency Hardship Withdrawal Scenarios

Staff requests Deferred Compensation Board (Board) input/decisions regarding certain financial emergency hardship withdrawal scenarios.

The Wisconsin Deferred Compensation Program (WDC) is required to follow the Internal Revenue Code (IRC) and Wisconsin Administrative Code Chapter ETF 70.10 (attached) when granting a financial emergency hardship withdrawal (also called an unforeseeable emergency). Regulations under Section 457(b) of the IRC define an unforeseeable emergency as follows:

> **IRC Section 1.457-6 (c)**
> (2) Requirements – (i) Unforeseeable emergency defined. An unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse or the participant's or beneficiary's dependent (as defined in Section 152(a)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, e.g., as a result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary. For example, the imminent foreclosure of or eviction from the participant's or beneficiary's primary residence may constitute an unforeseeable emergency. In addition, the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication, may constitute an unforeseeable emergency. Finally, the need to pay for the funeral expenses of a spouse or dependent (as defined in Section 152(a)) may also constitute an unforeseeable emergency. Except as otherwise specifically provided in this paragraph (c)(2)(i), the purchase of a home and the payment of college tuition are not unforeseeable emergencies under this paragraph (c)(2)(i).

Reviewed and approved by Matt Stohr, Administrator
Division of Retirement Services

Matt Stohr — 5/18/12
Signature — Date

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> (ii) Unforeseeable emergency distribution standard. Whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution under this paragraph (c) is to be determined based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not by itself cause severe financial hardship, or by cessation of deferrals under the plan.
>
> (iii) Distribution necessary to satisfy emergency need. Distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include any amounts necessary to pay any federal, state or local income taxes or penalties reasonably anticipated to result from the distribution).

To date, there has been very limited additional federal guidance regarding what constitutes an unforeseen financial emergency. In particular, no substantial guidance exists to define what is meant by the terms "severe" or "unforeseeable". Revenue Ruling 2010-27 from the Internal Revenue Service (IRS) lists just three examples of participant requests for unforeseen financial emergency distributions and the IRS' decision on each:

1. **"[To] repair significant water damage to the participant's principal residence not covered by insurance** - the distribution is allowable because the damage to the participant's primary residence is an extraordinary and unforeseeable circumstance and is substantially similar to the need to pay for damage to a home from a natural disaster.
2. **[To] pay funeral expenses of the participant's non-dependent adult son** - the distribution is allowable because it is for an extraordinary and unforeseeable circumstance and is substantially similar to the need to pay for funeral expenses of a dependent.
3. **[To] pay credit card debt** - the distribution is **not allowable** because it is not due to an extraordinary and unforeseeable circumstance or the result of events beyond the participant's control."[1]

As noted in the attached National Association of Government Defined Contribution Administrators (NAGDCA) documents on financial emergency hardship distribution requests, because there is no definitive list, plan administrators "have been left with what amounts to a subjective facts and circumstances test for adjudicating unforeseeable emergency withdrawal requests".

[1] http://www.irs.gov/retirement/article/0,,id=232436,00.html last accessed on March 3, 2012

The decision to either allow or deny an unforeseeable financial emergency hardship withdrawal application is subject to each Section 457 plan provider's interpretations of the rules and how they apply to individual situations. Each participant's financial emergency hardship withdrawal application must be carefully evaluated, based on the unique facts and circumstances of that participant's particular situation. The key to administering financial emergency hardships is to apply the rules and procedures for these distributions to all participants consistently.

The Department of Employee Trust Funds (ETF) respectfully requests guidance from the Board regarding which of the following situations should be considered for a possible loss of income distribution under the WDC financial emergency hardship withdrawal provision. ETF management and staff discussed these situations and the table reflects ETF's current interpretation for each of the situations listed. Note that this list is not meant to be all inclusive; rather, it is a sampling of situations that have been presented as financial emergencies in the past.

Selected WDC Financial Emergency Hardship Situations

Situation	Appropriate for a Hardship Withdrawal?	Decision Notes
Furloughs	Yes	Distributions may be allowed depending on each individual's circumstances.
Partner/spouse loss of income due to involuntary termination	Yes	A distribution may be allowed if the participant can document that the job loss was the result of an involuntary termination (layoff, etc.) and it was within the last twelve months.
Loss of income due to abandonment	Yes	A distribution may be allowed if a participant can document the loss of income from the abandonment via a copy of an income tax form or paycheck stub.
Loss of income due to increase in employee-paid share of Wisconsin Retirement System (WRS) pension contributions	No	A distribution is not allowable because WRS pension contributions are not truly "lost" income; the income is invested for the participant's future retirement via the WRS.
Loss of income due to	No	A distribution is not allowable because

Selected WDC Financial Emergency Hardship Situations		
Situation	**Appropriate for a Hardship Withdrawal?**	**Decision Notes**
increase in employee-paid share of group health insurance premiums		insurance premium increases are not due to extraordinary and unforeseeable circumstances.
Loss of income due to a divorce	No	A distribution is not allowable; divorce is neither extraordinary nor unforeseeable.
Loss of business income due to economic changes	No	The distribution is not allowable because typically this is not the participant's primary source of income, and business income losses may be relieved through other means (e.g. commercial sources).

Please review the list of situations prior to the June 2012 Board meeting. ETF staff will discuss these scenarios with you for your guidance at the meeting and will include your decisions in the Board's Governance Manual for future reference and guidance regarding financial emergency hardship situations.

Attachments

1. Ch. ETF 70.10: http://legis.wisconsin.gov/rsb/code/etf/etf070.pdf
2. National Association of Government Defined Contribution Administrators (NAGDCA):
    a. http://www.nagdca.org/content.cfm/id/nagdcanote20091118 (2009)
    b. http://www.nagdca.org/content.cfm/id/content.cfm/id/hardship_distributions (2008)
    c. http://www.nagdca.org/content.cfm/id/unforeseeable_emergency_withdrawals (2007)

Chapter ETF 70

DEFERRED COMPENSATION PLANS

Subchapter I — General Provisions

ETF 70.01 Statement of purpose. The purpose of this chapter is to establish a procedure for administration of a deferred compensation program as provided by s. 40.80, Stats. The procedure includes requirements and regulations for the primary deferred compensation plan and any alternate deferred compensation plan. All plans shall be monitored, evaluated and approved by the deferred compensation board. However, only the primary plan shall be supported by the board as the official state of Wisconsin deferred compensation plan.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.02 Definitions. (1) In this chapter, words and phrases shall have the following meanings:

(2) "Administrator" means any company with which the board contracts to provide administrative services for deferred compensation plans authorized under s. 40.80, Stats.

(3) "Alternate administrator" means any company with which the board contracts to provide administrative services for an alternate deferred compensation plan authorized under s. 40.80 (2m), Stats.

(4) "Alternate plan" means any deferred compensation plan authorized under s. 40.80 (2m), Stats., and offered by an alternate administrator.

(4m) "Beneficiary" has the meaning given in s. 40.02 (8), Stats.

(5) The "board" means the deferred compensation board.

(6) The "department" means the department of employee trust funds.

(7) "Employee" means any person who receives earnings as payment for personal services rendered for the benefit of any employer including officers of the employer and is eligible to participate in the deferred compensation program.

(8) "Investment product" means any insurance or annuity contract, bank or credit union account, mutual or money market fund or other type of investment vehicle.

(9) "Investment provider" means any company that manages and offers investments products.

(10) "Member" means any employee electing to participate in the deferred compensation program.

(11) "Plan document" means the document developed by the department and approved by the board to describe in detail the regulations of the program and ensure program compliance with section 457 of the internal revenue code which requires the availability of this document to members.

(12) "Primary administrator" means the company contracted to provide administrative services for the primary deferred compensation plan authorized under s. 40.80 (1), Stats.

(13) "Primary plan" means the deferred compensation plan authorized under s. 40.80 (1), Stats., and offered by the primary administrator.

(14) "Program" includes the primary plan and any alternate plan authorized under s. 40.80, Stats., and approved by the board for offering to eligible employees.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92; **CR 08−016: cr. (4m) Register August 2008 No. 632, eff. 9−1−08.**

ETF 70.03 Board responsibilities. (1) The board shall have the following responsibilities in regard to the program:

(2) Act, at all times, in a manner consistent with that of a trustee with a fiduciary duty to the program and members.

(3) Determine and implement the most efficient and cost effective method for administration of the program consistent with high quality services to members.

(4) Establish standards by which the primary administrator shall be evaluated for initial and continued participation in the primary plan.

(5) Evaluate the performance of the primary administrator, annually, to determine contractual compliance and compliance with standards as established under sub. (4).

(6) Declare the board's official support of the primary plan to participating employers and members in the publication prepared by the department as required in s. ETF 70.04 (6) (c).

(7) Determine the initial eligibility of any potential alternate administrator that petitions the board to offer an alternate plan based on criteria established in s. ETF 70.06.

(8) Evaluate alternate administrators, annually, based on criteria established in s. ETF 70.06 to determine their continued eligibility.

(9) Define general categories of investment products to be offered under the primary plan and any alternate plan.

(10) Establish criteria by which specific investment products shall be evaluated for initial and continued participation in the primary plan or any alternate plan.

(11) Evaluate investment products offered by the administrator, annually, based on criteria established in sub. (10) to determine if the investment product continues to be acceptable for offering by the primary plan or alternate plan.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.04 Department responsibilities. (1) The department shall be responsible for the following:

(2) Negotiate and implement contracts with administrators and investment companies.

(3) Monitor plan administration and ensure contract compliance.

(4) Develop and maintain a plan document that defines rules and requirements of the program regarding member enrollment in the program, member deferral amounts, distribution of account balances, and administration of the program that will be distributed, by the administrator, to new and current members by request.

(5) Provide information and recommendations to the board and its committees that shall be necessary to complete the evaluation of the primary and alternate administrator as required in s. ETF 70.03 (5) and (8) and the investment products as required in s. ETF 70.03 (11).

(6) Prepare and distribute to members an annual publication that presents a balanced and impartial overview of the primary plan and any alternate plan that includes the following:

(a) Description of investment products and corresponding investment risks.

(b) Full disclosure of all direct and indirect costs to members.

(c) Announcement of the board's official support of the primary plan as required in s. ETF 70.03 (6).

(d) General information about deferred compensation plans including the maximum deferral amount allowed under internal revenue code section 457.

(7) Review and approve all material prepared by the primary administrator and alternate administrator to describe the primary plan and alternate plan and investment products to eligible employers, employees and members.

(8) Review and issue a determination on all requests for emergency withdrawals as defined in s. ETF 70.10.

(9) Provide reports to the board at each board meeting that detail emergency withdrawals, enrollment statistics, plan assets and any other information that may be requested by the board.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.05 Primary plan administration. (1) Based upon a request for proposal process, the board shall contract with one primary administrator to offer the primary plan that is approved and officially supported by the board. The administrator awarded the contract for the primary plan shall have:

(a) At least 5 years experience administering other section 457 deferred compensation programs. The administrator's experience shall include administering at least one program that meets each of the following:

1. Participation level of 5,000 members or more.

2. Program involves multiple payroll reporting agencies.

3. Record keeping includes consolidated record keeping for all investment products that are offered.

(b) Marketing and enrollment services that include the following:

1. A staffed office located in Madison and field representatives to provide services to all areas of the state.

2. Contacts to each eligible employee at least annually to describe the plan being offered by this administrator.

3. Frequent enrollment opportunities at intervals established by the board.

4. Presentations to employees that include full disclosure of all direct and indirect costs to members as well as advantages and disadvantages of participating in the plan offered by this administrator.

5. Literature and forms regarding the plan to be distributed to employees and payroll personnel that are in a form approved by the department.

(c) Member services that include the following:

1. Unlimited opportunities to increase or decrease deferral amounts.

2. Unlimited opportunities to redirect deferral amounts to any other investment product offered by the administrator.

(d) Accounting procedures and consolidated record keeping for member account transactions that maintains all individual member records and submits deferrals, transfers and withdrawals to the investment companies offering investment products to the primary plan.

(2) The potential administrator shall agree to return all interest earned on idle funds of the plan that are held by the administrator to the department to offset plan costs.

(3) The potential administrator shall provide the necessary financial disclosure for assurance of its financial soundness.

(4) The investment products offered by the primary administrator shall meet the criteria in s. ETF 70.03 (10) and be approved by the board.

(5) The primary administrator shall provide an annual report to the board illustrating the investment performance of all investment products offered by the primary plan, as measured by criteria established under s. ETF 70.03 (9).

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.06 Alternate plan administration. (1) At its discretion, the board may contract with an alternate administrator to offer an alternate plan. An alternate plan shall not be officially supported by the board. Any administrator that meets the criteria set forth in s. ETF 70.05 (1), (2) and (3) may be allowed to offer an alternate plan. The board shall not contract with more than one alternate administrator at any one time.

(2) Investment products offered by an alternate administrator shall meet the criteria as established in s. ETF 70.03 (10) and be approved by the board and shall not duplicate any of the specific investment products offered by the primary administrator.

(3) The alternate administrator shall provide an annual report to the board that describes the investment performance of all investment products offered by the alternate plan, as measured by the criteria in s. ETF 70.03 (10).

(4) Potential alternate administrators who meet the minimum requirements as defined in subs. (1), (2) and (3) may petition the board for approval to participate in the program within a 30 day period beginning the day after publication of these rules in the Wisconsin Administrative Code and then from May 1 through May 31 of every other year starting in 1994 for approval to participate in the program as of the next calendar year. The board shall limit the number of alternate administrators to one through a request for proposal process should there ever be a second, or more, potential administrator that petitions the board.

(5) If the evaluation of an alternate administrator as required in s. ETF 70.03 (8) results in the termination of the alternate administrator's participation in the program or if their contract is not renewed, members shall be instructed to redirect deferrals and transfer existing balances from investment products offered by the terminated administrator to other investment products offered by the primary administrator or any other alternate administrator within a six−month period or other time period designated by the board. At the end of the six−month period or the date designated by the board, the board shall instruct the terminated administrator to redirect any deferrals and transfer any remaining account balances with investment products offered by the terminated administrator to board designated alternative investment products offered by the primary administrator. Surrender charges that are normally assessed against funds transferred from investment products offered by one administrator to another, shall not be assessed for transactions under this subsection.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.07 Primary and alternate plan administration. (1) All contracts with administrators shall be approved by the board and signed by the board chair or designee. Any administrator who participates in the program shall sign a contract in which the administrator agrees to:

(a) Follow all requirements and regulations of the program as defined in the plan document.

(b) Share information, such as member's annual deferral amounts, with the department and any other administrator contracted by the board to ensure compliance with internal revenue code section 457.

(c) Provide full disclosure of all revenues received by the administrator from members and investment providers of their plan to the department at least annually.

(d) Provide monthly reports to the department to allow adequate monitoring of program administration and compliance with internal revenue code section 457 regulations.

(e) Provide an annual independently audited financial statement of the administrator and the plan to the department within 120 days from the end of the calendar year.

(f) Submit to the department an acceptable contingency plan to address both data processing systems failures and administrative services interruptions.

(g) Provide to members, upon enrollment, full disclosure of all fees and charges that are assessed, either directly or indirectly as an offset of earnings, by the administrator or the investment providers. A memorandum of understanding detailing key aspects and restrictions of the primary plan or any alternate plan shall be presented to and signed by employees enrolling in either the primary plan or any alternate plan.

(h) Provide to members, when requested, a copy of the fund prospectus and annual report for each investment product offered by the administrator and the ability to transfer account balances from investment products offered by one administrator to those offered by another.

(i) Provide statements to members, at least annually, detailing member's year to date annual deferral amounts, account balance information and disclosure of all fees and charges affecting member's interest earnings or account balances.

(j) Provide information and counseling to members at termination of employment or retirement, regarding the options offered by the administrator for distribution of their account and timely processing of payouts. The type of distribution options offered shall include lump sum and partial lump sum payments, installment payment options and annuity options.

(2) The primary plan and any alternate plan shall reimburse the department for their proportionate share of the department's costs associated with the program.

(3) The administrator, their agents and the investment products they offer shall meet all applicable state and federal regulations including section 457 of the internal revenue code, security and exchange commission regulations, and state and federal insurance laws and regulations.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.08 Investment providers. (1) Investment providers offering an investment product through the primary plan or an alternate plan shall be selected by the board based on the investment product categories and criteria established under s. ETF 70.03 (9) and (10). All contracts with investment providers of the primary plan or an alternate plan shall be approved by the board and signed by the board chair or designee.

(2) Investment providers shall not be allowed to assess any direct or indirect costs to members.

(3) Based on the board's review required under s. ETF 70.03 (11), the board may determine that an investment product offered by the primary plan or an alternate plan is no longer acceptable for inclusion in the program. If the board decides to remove an investment product from the plan as a result of the product's failure to meet the criteria as established under s. ETF 70.03 (10), the product shall be phased out of the primary or alternate plan in a 2−step process over a 12 month period that shall commence on the first business day of the sixth month following the board's decision, as follows:

(a) Phase 1 of the investment product termination process shall last for 6 months during which time current members and employees newly enrolling in the primary or alternate plan shall be informed in writing that the terminating investment product does not meet board's evaluation criteria and that this *investment product is not open to new enrollments.*

1. Any members already deferring to the terminating investment product shall be informed in writing that they need to redirect future deferrals from this product to an alternative investment product offered by the primary or alternate plan by notifying the administrator of their new investment choice.

2. At the end of the 6−month period, the board shall instruct the administrator to automatically redirect any member's deferrals that have not been redirected to an alternative investment product from the terminated product into a board designated alternative investment product offered by the primary or alternate plan.

3. Existing member account balances shall be allowed to remain in the terminating investment product during this period.

(b) Phase 2 of the investment product termination process immediately follows the first 6−month period and provides an additional 6−month period during which time members shall transfer existing balances from the terminating product to another investment product offered by the primary or alternate plan.

1. If at the end of the 6−month period, any member has failed to move a remaining account balance from the terminated fund, the board shall instruct the administrator to automatically move that member's account balance into a board designated alternative investment product offered by the primary or alternate plan.

2. During the phase out process and at any time prior to the end of the second phase, the board may re−examine the performance of the terminating investment product to determine if continued plan participation is justified.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92; **CR 08−016: am. (3) (intro.) Register August 2008 No. 632, eff. 9−1−08.**

ETF 70.09 Member responsibilities. (1) Employees electing to become a member of the primary or an alternate plan shall sign a memorandum of understanding prior to enrolling to certify that all program requirements and regulations have been clearly explained.

(2) A member shall select one administrator for his or her deferrals. A member may not simultaneously defer earnings to the primary plan and an alternate plan.

(3) Each member shall review information provided by the administrator and the department about the investment type and performance of the investment products offered to determine which investment products best meet the member's individual needs and financial objectives.

(4) Each member shall monitor his or her own annual deferral amounts to ensure the amount does not exceed the maximum deferral amount allowed under internal revenue code section 457.

(5) Upon termination of employment or retirement, a member shall notify the administrator of his or her termination date within the time period designated in the plan document, to establish when distribution of the member's account shall begin.

History: Cr. Register, June, 1992, No. 438, eff. 7−1−92.

ETF 70.10 Emergency withdrawals. (1) A participant or beneficiary may make emergency withdrawals in the event of an unforeseeable emergency under the following conditions and limitations:

(a) As defined in 26 USC 457 (b) (5) and 26 CFR 1.457−2 (h) (4), an unforeseeable emergency is one which causes severe financial hardship to the participant or beneficiary as a result of a sudden and unexpected illness or accident of the participant or beneficiary or of a dependent of the participant or beneficiary, loss of the participant's or beneficiary's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary.

Note: "A dependent of the participant" as used here is defined by the secretary of the treasury as one specified in 26 USC 152 (a).

(b) The need to send a participant's or beneficiary's child to college or the desire to purchase a home are examples of what are not unforeseeable emergencies.

(c) The facts of each case shall be ascertained to determine if the circumstances constitute an unforeseeable emergency.

(d) Withdrawal payment may not be made to the extent that the hardship is or may be relieved:

1. Through reimbursement or compensation by insurance or otherwise,

2. By liquidation of the participant's or beneficiary's assets to the extent the liquidation of these assets would not itself cause severe financial hardship, or

3. By cessation of deferrals under the plan.

(e) The withdrawal, because of an unforeseeable emergency, shall be limited to an amount reasonably needed to satisfy the emergency need.

(2) The administrative plan provider as defined in s. 40.02 (18s), Stats., which is selected by the board under s. 40.80, Stats., and which administers the deferrals which are the subject of the withdrawal request shall:

(a) Receive requests from participants or beneficiaries for unforeseeable emergency withdrawals,

(b) Investigate and document the facts on a form prescribed by the department,

(c) Exchange relevant information with the employer's designated agent, and

(d) Within 5 working days after the receipt of the information required in sub. (3) make a recommendation to the department on a form prescribed by the department.

(3) The employer shall within one week of the receipt of the administrative plan provider's written request for information provide to the administrative plan provider any relevant information required to process an individual participant's request for an unforeseeable emergency withdrawal on a form prescribed by the department.

(4) The employer shall acknowledge, on the form prescribed by the department, that relevant unforeseeable emergency information concerning each emergency withdrawal request has been given to the administrative plan provider and has been received by the employer from the administrative plan provider.

(5) The department, within 5 working days of receipt and on the basis of the administrative plan provider's recommendation required in sub. (2) (d) and any additional information the department may receive, shall approve or deny the emergency withdrawal.

(6) The department shall prepare a report on unforeseeable emergency withdrawal activity since the last meeting of the board for presentation at the following meeting of the board.

History: Cr. Register, June, 1985, No. 354, eff. 7−1−85; renum. from ETF 10.01, Register, June, 1992, No. 438, eff. 7−1−92; **CR 08−016: am. (intro.), (1) (a), (b), (d) 2. and (2) (a) Register August 2008 No. 632, eff. 9−1−08.**

Subchapter II — State Deferred Compensation Plan for Local Employees

ETF 70.11 Participation in the deferred compensation plan. The governing body of any employer as defined under s. 40.02 (28), Stats., other than the state, may provide the state's deferred compensation plan for its employees by the adoption of a resolution in the form approved by the department. The employer shall forward a certified copy of the resolution to the department and the then current administrative plan provider as defined in s. 40.02 (18s), Stats.

History: Cr. Register, June, 1985, No. 354, eff. 7−1−85; renum. from ETF 70.10, Register, June, 1992, no. 438, eff. 7−1−92.

ETF 70.12 Effective date. Local implementation of the deferred compensation plan and enrollment of eligible employees may begin immediately upon acceptance, by the department, of the resolution under s. ETF 70.10.

History: Cr. Register, June, 1985, No. 354, eff. 7−1−85.

ETF 70.15 Terminating participation in the deferred compensation plan. The governing body of an employer, other than the state, may terminate participation in the state deferred compensation plan after a minimum of one year from the date the certified copy of the resolution required under s. ETF 70.10 was accepted by the department, by adopting a resolution in the form approved by the department and forwarding a copy of the resolution to the department and the then current administrative plan provider as defined in s. 40.02 (18s), Stats. Enrollment and payroll deferral activities shall cease 90 days after receipt by the department of the certified copy of a resolution to terminate participation in the state's deferred compensation plan. Treatment of previous individual deferral investment specifications, accounts and benefits shall continue to be governed by the plan and investment plan provider contracts, unless the employer exercises its right of ownership under 26 CFR 1.457−2 (j) to provide for different treatment.

Note: Chapter ETF 70 requires several forms which are available at no charge by contacting either the department of employee trust funds or the current administrative plan provider.

History: Cr. Register, June, 1985, No. 354, eff. 7−1−85.

Unforeseeable Emergencies and Hardship Withdrawals: What Every Plan Administrator Needs to Know

In today's economy an emergency or hardship withdrawal may be a last resort for a participant facing a tough financial situation. As a plan administrator, if your plan offers in-service withdrawals, it is important to remember that a withdrawal for an unforeseeable emergency under a section 457(b) plan has narrower circumstances than a hardship withdrawal under a 401(k) or 403(b) plan.

The circumstances that constitute an unforeseeable emergency (UE) should be based on facts and made on a case by case basis. The IRS has not provided guidance on what is adequate documentation to validate the UE request and this has created some uncertainty among administrators about whether they are requiring enough documentation from plan participants who are applying for a UE. NAGDCA recently spoke with Cheryl Press, a Senior Counsel for Tax Exempt and Government Entities at Chief Counsel IRS, regarding the feasibility of using self-certification to satisfy the regulations regarding distributions from a section 457 plan for unforeseeable emergencies.

Press said that the regulations do not discuss self-certification, and that there is no guidance that has been issued on this topic. She said that, nevertheless, Section 457 does appear to set a higher standard for emergency distributions than exists in 401(k) and 403(b) plans. Therefore, the Service would be looking for practices and procedures to be in place to demonstrate that the emergency was indeed unforeseeable; as well as some paperwork with regard to the granting of an UE in a section 457 plan.

For example, she indicated that merely relying on the statement of a participant (a self-certification) that they were going into foreclosure was insufficient. The Plan should at least have a foreclosure notice from the participant. She pointed out that under the regulations the UE must be limited to the amount needed to relieve the emergency, pointing out that without documentation this amount cannot be verified.

She also stated that while the Service is not looking for an overabundance of documentation (e.g., 10 years of prior tax returns), enough documentation must be available to show that the 457 plan is complying with the requirements of the 457 regulations, in accordance with its section 457 plan provision, and its own administrative practices and procedures.

Overview

457(b) Plan Unforeseeable Emergency Withdrawals

Under a 457(b) plan, a hardship distribution can only occur when the participant is faced with an unforeseeable emergency. An unforeseeable emergency is defined in the Internal Revenue

Service Code 457 as a severe financial hardship resulting from a sudden and unexpected accident or illness of the participant or of a dependent of the participant. It may be the loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances. The loss must be as a result of events beyond the control of the participant. According to the IRS, foreclosure or eviction, medical expenses, and funeral expenses for a family member may be, but are not necessarily always, unforeseeable emergencies. The IRS has stated that the purchase of a home and the payment of college tuition are not unforeseeable emergencies.

The participant cannot make a withdrawal if their emergency condition can be relieved by any of the following:

- Reimbursement or compensation by insurance
- Liquidation of the participant's assets as long as liquidation of these assets would not itself cause severe financial hardship
- Stopping elective contributions or employee contributions under the plan
- Other currently available distributions (such as plan loans) under plans maintained by the employer or by any other employer, or
- Borrowing from commercial sources

The IRS requires that the determination be based on relevant facts and circumstances and be made on a case by case basis and cannot exceed the amount necessary to satisfy the emergency.

<u>401(k) and 403(b) Plan Hardship Withdrawals</u>

IRS rules provide safe harbors for determining if a hardship distribution is due to (or caused by) an immediate and heavy financial need:

- Certain medical expenses previously incurred by the employee, the employee's spouse, dependents or beneficiary
- Costs directly related to the purchase of a principal residence (excluding mortgage payments)
- Tuition, related educational fees and expenses
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or mortgage foreclosure
- Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary of the employee
- Certain damage repair expenses for the employee's principal residence.

A written statement from the participant can be sufficient proof that the financial need cannot be met any other way, except in cases where the administrator has actual knowledge that the needs can be relieved by any of the following:

- Reimbursement or compensation by insurance
- Liquidation of the participant's assets as long as liquidation of these assets would not itself cause severe financial hardship
- Stopping elective contributions or employee contributions under the plan

- Other currently available distributions (such as plan loans) under plans maintained by the employer or by any other employer, or
- Borrowing from commercial sources

Under IRS rules, distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if all of the following requirements are satisfied:

- The distribution is not larger than the amount of the employee's financial need (this amount can be increased to include any federal, state or local income taxes or penalties that are anticipated).
- The employee has taken all nontaxable loans (if available) and obtained all distributions, other than hardship distributions, that are currently available.

Employees who take a hardship distribution cannot repay it back to the plan and in most cases are not permitted to contribute to the plan for six months after the withdrawal. Hardship withdrawals are subject to income taxes and a 10% additional tax.

Additional information can be found on the NAGDCA website at:
http://www.nagdca.org/content.cfm/id/content.cfm/id/hardship_distributions
http://www.nagdca.org/content.cfm/id/unforeseeable_emergency_withdrawals

Resources:
Retirement Plans FAQs regarding Hardship Distributions
http://www.irs.gov/retirement/article/0,,id=162416,00.html

Section 457 Deferred Compensation Plans of State and Local Government and Tax– Exempt Employers http://www.qai.irs.gov/pub/irs-utl/topic-m.pdf

457 Final Regulations http://www.irs.gov/pub/irs-regs/td9075.pdf

Neither NAGDCA, nor its employees or agents, nor members of its Executive Board, provide tax, financial, accounting or legal advice. This memorandum should not be construed as tax, financial, accounting or legal advice; it is provided solely for informational purposes. NAGDCA members, both government and industry, are urged to consult with their own attorneys and/or tax advisors about the issues addressed herein.

Similarities and Differences of Hardship Distributions Among Defined Contribution Plans

By Joann Albrecht, CPC, QPA, Technical Consultant, Nationwide® Retirement Solutions

Introduction
Section 401(k), 403(b) and 457 plans may permit participants to take in-service withdrawals because of situations that result in a financial hardship. Although the requirements for distributions for financial hardship differ between 457 and 401(k)/403(b) plans, any plan that permits financial hardship distributions must apply a two-part test to the participant's request before making this distribution:

1. The Unforeseeable Emergency or hardship must create a heavy and immediate financial need that cannot be relieved or met from other sources, and
2. The amount of the distribution will not exceed the amount of the financial need.

457 Unforeseeable Emergencies
Section 457 permits distribution to a participant or beneficiary because of financial need as a result of an Unforeseeable Emergency (UE). The conditions for what qualifies as an UE must be defined in the Plan Document as a severe financial hardship for the participant or beneficiary resulting from:

- Illness or accident of the participant, beneficiary or the participant's or beneficiary's spouse, or dependents.
- Loss of property due to casualty - including the need to rebuild a home after damage such as a natural disaster that is not covered by insurance.
- Events beyond the participant's or beneficiary's control which may include:
    - Eviction or foreclosure on primary residence.
    - Need to pay medical expenses - including prescription drug costs and non-refundable deductibles.
    - Need for participant or beneficiary to pay funeral expenses of a family member.

Situations that may qualify as an UE are not as broad as those permitted for 401(k) and 403(b) hardship distributions. For example, the final 457 regulations state that payment of college tuition or purchase of a home - although considered eligible for hardship distributions from 401(k) and 403(b) plans - would not generally qualify as an UE distribution from a 457 plan.

Determination for what qualifies as an UE distribution is based on the relevant facts of each case. Unlike 401(k and 403(b) plans, there are no safe harbor standards that may be used in making these determinations. UE distributions may be made only for those amounts not already covered by:

- Reimbursement or compensation from insurance,
- Liquidation of participant's assets provided such liquidation will not cause a financial hardship, or
- Cessation of deferrals under the plan.

Instead of requesting documentation from an employee about his/her available resources etc. and then evaluating this information, the employer/administrator may rely on a written statement from the employee that the employee's financial need cannot be relieved except by a distribution from the plan. The employer may not rely on an employee's written statement if the employer has actual knowledge that the employee representations made in the statement are not true.

The distribution to satisfy the financial hardship caused by the UE is limited to the amount needed to satisfy the financial hardship but can be increased to cover federal, state, or local income taxes or penalties that are expected to result from this distribution. Unlike 401(k)/403(b) using the safe harbor distribution standard, 457 plans are not required to suspend deferrals for a period of time after an UE distribution as long as the plan document provides for the this flexibility. **Where the money comes from is important.** The IRS final regulations permit 457 plans to establish two accounts for rollover contributions into the plan: one for 457 rollovers and one for non-457 rollovers. Depending on plan provisions, the 457 contribution account and the 457 rollover accounts could be used first to make UE distributions before using a non-457 rollover account that may be subject to an early distribution tax. (Beneficiaries are not subject to this tax.)

UE distributions from 457 plans are generally not subject to the 10% early distribution tax that applies to qualified and 403(b) plan participants who have not reached age 59½. However, any funds that are rolled into the 457 plan from a qualified 401(k) or 403(b) plan, or IRA may be subject to the 10% early distribution tax - unless an exception that applies to qualified plans would be applicable.

403(b) and 401(k) Hardship Distributions
The criteria for financial hardships are the same for both 401(k) and 403(b) plans. Unlike 457 plans, financial hardship from these plans can result from foreseeable events and voluntary choices. These plans must still apply the same two-part test as 457 plans by determining if:

1. There is a need that causes a severe and immediate financial hardship, and
2. The financial hardship can be relieved with a distribution from the plan.

The methodology in making the hardship determination for these plans can be more complex because both parts of the test can be met using a facts-and-circumstance determination, a deemed Safe Harbor standard, or a combination of the two. The plan does not have to use the same methodology for both parts of the test.

For example, the financial-needs test could use the safe harbor deemed standard (most do) and either a safe harbor or facts-and-circumstance evaluation to determine if a plan distribution will satisfy the financial hardship.

Safe Harbors
The Safe Harbor method deems a financial hardship as "an immediate and heavy financial need" for any or all of the following:

- Expenses for medical care of employee, spouse, or employee’s dependents
- Costs related to the purchase of a principal residence, but not the mortgage payments
- Cost of tuition payments related to educational fees and room-and-board expenses for the next 12 months of post-secondary education for the employee, spouse, children or dependents
- Payments necessary to prevent eviction from the employee’s principal residence or to prevent foreclosure on the mortgage on the employee’s principal residence.

The Safe Harbor deems a plan distribution will satisfy the financial need, if all the following requirements are met:

- Distribution cannot exceed financial need but may be increased for anticipated federal, state, local taxes and penalties.
- All non-taxable loans and other available plan distributions must be taken first before taking a hardship distribution from all qualified and non-qualified plans of the employer.
    - Plans are not required to have loan programs.
    - Even if the plan does have a loan program, participants are not required to take plan loans if these loans will increase financial need.
- Participants must suspend deferrals <u>to all plans of the employer</u> for at least 6 months after receiving a hardship distribution. Participants are not required to cease mandatory employee contributions to defined benefit or health and welfare plans.

Facts-and-Circumstance Determinations
If a facts-and-circumstance determination is used instead of the safe harbor definition of financial hardship, the plan must contain the objective requirements used to determine the financial hardship.

For example, the need to pay funeral expenses of a family member would generally constitute an immediate and heavy financial need. On the other hand, a distribution to pay for a boat or television would not generally constitute an immediate and heavy financial need that would be eligible for a hardship distribution.

Prior to making a distribution from the plan, all assets of the employee, the employee’s spouse, and minor children that are available to the employee to meet the financial need may have to be considered depending on all relevant facts-and-circumstances of a particular case. An employee’s resources could include a vacation home and/or jointly held property. Property held for the employee’s child under an irrevocable trust, or under the Uniform Gift to Minors Act would not be considered a resource of the employee.

The employer/administrator may rely on the written statement of the employee that the financial need cannot be relieved by other means - unless the employer has knowledge to the contrary that the need cannot be reasonably relieved by:

- Reimbursement or compensation from insurance.
- Liquidation of employee’s assets.
- Cessation of elective deferral or employee after tax contributions under the plan.
- Other distributions or non-taxable loans from any of the employer’s plans.
- Borrowing from commercial source at reasonable commercial rates.

Employees need not take counter-productive actions that would increase financial need. For example, the employee would not be required to take a plan loan to purchase a home if the plan loan would prevent the employee from obtaining the necessary financing to purchase the home.

What Can Be Distributed?
All elective deferrals, but not the earnings on those deferrals, may be distributed for financial hardship. Depending on the type of plan and the terms of the plan, employer contributions and earnings may also be available for hardship distributions.

As opposed to Section 457 UE distributions, Section 401(k)/403(b) hardship distributions prior to age 59½ are subject to a 10% early distribution tax. Of course, federal and other applicable income taxes and penalties also apply. Hardship distributions are not eligible for rollover.

Putting It All Together

The following examples use a Safe Harbors approach to determining financial need and demonstrate how facts-and-circumstance and safe harbor are then used to determine if a plan hardship distribution will satisfy the financial need.

Example 1

Employer Q maintains a 401(k) and no other plans. The plan does not have a loan provision but does permit in service distribution of elective deferrals for hardship using the Safe harbor deemed and heavy financial need standard. A facts-and-circumstance evaluation is used to determine if the financial need can be satisfied by a distribution from the plan.

Allen has a 401(k) account balance of $50,000 attributable to elective deferrals and earnings. His total elective deferral contributions are $20,000. He has requested a hardship distribution of his elective deferrals of $15,000 to pay for the 6 months of his daughter's college tuition and room and board expenses. At the time of this request, the only other asset he has is a $10,000 savings account.

Facts-and-Circumstance Determination Without Written Statement From Employee

The plan will need to consider Allen's situation and resources to determine if a plan distribution and how much of a plan hardship distribution can be made. The employer does not rely on a written statement from Allen that his need cannot be relieved by other sources and the plan will have to evaluate his other resources.

Since his $10,000 savings account is a resource that is reasonably available to him, it must be considered when determining the amount necessary to be distributed from the plan to satisfy his financial need. After evaluating Allen's situation the plan administrator determines that he may receive a distribution of only $5,000 from the plan plus any amount to pay anticipated taxes and penalties.

Example 2

Burt is in the same plan as Allen and has an account balance of $25,000 attributed to his elective deferrals and earnings. He has made total elective deferral contributions of $15,000 and has not received any other distributions from the plan. He needs $10,000 to pay for 6 months of college tuition and room and board for his son.

Facts-and-Circumstance Determination With Written Statement From Employee The employer now accepts written representation from employees about their other resources instead of requiring this detailed information about these resources. Burt provides his employer with a written statement that his need for a hardship distribution cannot be met by:

- Reimbursement or compensation from insurance.
- Liquidation of assets available to him.
- Cessation deferrals to the plan.
- Other distributions from plans maintained by the employer or any other employer.
- Borrowing from commercial sources on reasonable commercial terms in an amount sufficient to satisfy the need.

Since Burt's employer has no actual knowledge that Burt's written statement is not true, his employer can rely on the representations in Burt's written statement. The plan may therefore give Burt a $10,000 hardship distribution of his elective contributions plus any amount necessary to pay reasonably anticipated taxes and penalties.

Safe Harbor/Safe Harbor

Same as Example 1, except Allen's employer applies safe harbors to meet both parts of the test for making hardship distributions. Since Allen is not eligible for a plan loan or any other distribution from the plan and the plan suspends Allen's elective contributions for 6 months after making the hardship distribution, this distribution is deemed necessary to satisfy Allen's immediate and heavy financial need. He will not have to liquidate his savings account and may receive a $15,000 hardship distribution from the plan plus any anticipated taxes and penalties.

Sources used for this article:

457 Final Regulations
401(k) Proposed Regulations
Final 414(v) Catch-up Regulations
ERISA Outline Book 2003 Edition, Sal A. Tripodi, J.D. LL.M

About the author:

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Joann has extensive experience with both the private and public sector retirement plans including qualified plans, 403(b), and 457 plans. She is a credentialed member of the American Society of Pension Actuaries (ASPA), and serves on several ASPA committees including its Tax Exempt and Government Plans Committee and has been a speaker at several ASPA benefit conferences.

Section 457(b) Plan Administrator's Guide
To Unforeseeable Emergency Withdrawals

By: Gay Lynn Bath, Deferred Compensation Manger of the Oregon Savings Growth Plan and Roderick Crane, Director of Institutional Business Development for TIAA-CREF Individual & Institutional Services, LLC

Section 457(b) Plans may (but are not required to) offer participants the ability to take an in-service withdrawal in the event of an "unforeseeable emergency." While 457(b) plans typically offer an unforeseeable emergency withdrawal option, most plan sponsors would agree that this feature is one of the most difficult to administer.

Why is unforeseeable emergency administration so difficult?

The source of the difficulty in administering 457(b) unforeseeable emergency provisions lies primarily with the law and related regulations. Unforeseeable emergency withdrawal provisions are difficult to administer because so many of the legal requirements are not well defined.

Regulations under Section 457(b) of the Code define an unforeseeable emergency as a severe financial hardship resulting from:

- an illness or accident,
- the loss of property due to casualty loss (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, *e.g.*, as a result of a natural disaster), or
- any other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the individual's control.

The IRS has not provided much guidance on the key parts of this definition. In particular, no substantial guidance on what is meant by the terms "severe" or "unforeseeable" has been issued. Plan administrators have been left with what amounts to a subjective facts and circumstances test for adjudicating unforeseeable emergency withdrawal requests.

Many plan administrators have tried to streamline and simplify administration by creating lists of events and expenses that are eligible or ineligible. While helpful, it is also clear that making such lists is an endless proposition because of the myriad of circumstances and situations the participants present when making withdrawal requests.

This Guide is intended to help plan sponsors understand the basic requirements and some best practices for the design and sound administration of this common but difficult to administer 457(b) plan feature.

Does the unforeseeable emergency withdrawal option need to be part of the plan document?

Yes. The 457(b) regulations make it clear that the unforeseeable emergency option must be a written provision in the plan document before it can be offered.

What are some common best practices for designing and administering 457(b) unforeseeable emergency withdrawal provisions?

As with other aspects of plan administration, consistency is important. Realize that plan sponsors set a precedent of sorts with each granted request, and that participants will expect similar treatment from their perspective for their situation. While consistency of administration is not a guarantee that each and every decision will satisfy IRS scrutiny, it is evidence of good faith compliance that may be helpful.

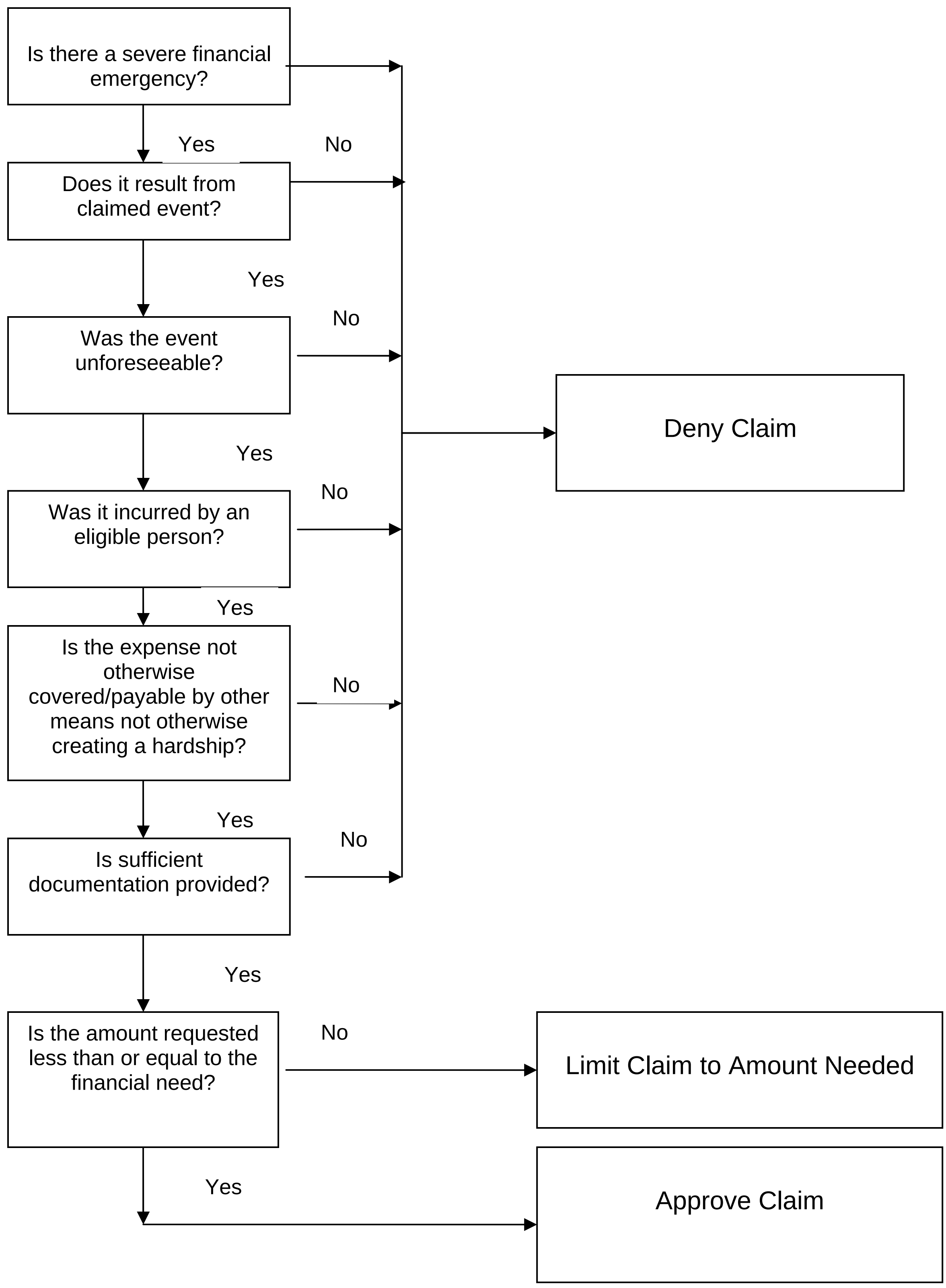
A written policy detailing the established procedures and objective standards for administering unforeseeable emergency withdrawal features is also advisable. Written policies need not (nor could such be expected to) address all the possible circumstances that may arise. However, a written policy that 1) identifies the process to be followed, 2) the standards to be applied and 3) circumstances that clearly qualify or do not qualify as eligible unforeseeable emergencies can help streamline administration.

Having a written unforeseeable emergency withdrawal policy also helps demonstrate good faith compliance to the IRS.

The written policy should be adopted by the plan fiduciaries and should clearly identify responsibilities that have been delegated to committees, staff or to third-party service providers and appeal procedures.

What are the requirements for reviewing unforeseeable emergency requests?

There are seven basic requirements that an individual must meet in order to be eligible for an unforeseeable emergency withdrawal under 457(b). The accompanying flow chart identifies each of these requirements and provides a process that administrators may wish to consider for reviewing unforeseeable emergency requests.


Is there a severe financial emergency?
Yes
No
Does it result from claimed event?
Yes
No
Was the event unforeseeable?
Yes
No
Was it incurred by an eligible person?
Yes
No
Is the expense not otherwise covered/payable by other means not otherwise creating a hardship?
Yes
No
Is sufficient documentation provided?
Yes
Is the amount requested less than or equal to the financial need?
No
Yes
Deny Claim
Limit Claim to Amount Needed
Approve Claim

What does severe financial hardship mean?
The 457(b) regulations do not define what constitutes a "severe financial hardship". Because IRS guidance has been limited in this area, administrative practices vary rather widely. Some practices have evolved that may be helpful to plan administrators. One of the clearer and more understandable approaches is to adopt something similar to the "immediate and heavy" standard used for administering the hardship distribution provisions under 401(k) and 403(b) plans. Under this standard, a 457(b) plan participant would have to show that the financial hardship is

- Immediate – The requested withdrawal is needed currently and not at some later date, and
- Heavy – The size of the resulting financial burden must be large enough to create a hardship to the individual. This is a subjective test and will depend on the facts and circumstances of each case. For example, a $1,000 uninsured medical bill for a person with family income of $15,000 per year is more likely be judged to be a heavy financial burden, while it may not be for an individual with family income of $150,000.

Some plan sponsors have used other standards, including requiring the financial hardship to be "catastrophic", "sudden, or "unexpected". These are all permitted under federal law. Regardless of what standard a plan uses to define what a "severe" financial hardship is, it will mean applying a facts and circumstances test.

Does the severe financial hardship have to be directly caused by the unforeseen event?

The 457(b) regulations state that the financial hardship must be the result of the events in question. There has been no further IRS guidance as to how connected the event has to be to the claimed financial hardship. Plan administrators should require, however, that the individual identify the emergency event and explain how the event contributed to the financial hardship. Some causal connection between the event and the financial hardship must be shown.

What does "unforeseeable" mean?
The regulations identify the following as events that will be considered unforeseeable:

- Illness
- Accident
- Casualty loss

Illness and accidents are generally understandable and recognizable events. Casualty is not further explained by the IRS, but is commonly understood to include other sudden, unexpected or unusual events, such as fires, storms, lightning, earthquakes and other natural or weather related disasters.

Unfortunately, except for the three events noted above, there really is no easy test or clear standard to determine the existence of an unforeseeable emergency. The 457 regulations state that the existence of an unforeseeable emergency is "to be determined based on the relevant facts and circumstances of each case" – in other words by your interpretation and best judgment. Some questions to ask in every case include:

- Were events beyond the individual's control?
- Could the situation have been anticipated, avoided or budgeted?

While applicable federal law and related regulations do not identify any formal "reasonableness" standard for determining whether an emergency was unforeseeable, it is clear that the IRS expects unforeseeable emergency withdrawal provisions to be administered under objective standards that are consistently applied. Plan sponsors should establish policies that determine unforeseeability from the perspective of a reasonable and prudent person.

Whose emergency does it have to be?

The illness, loss, or other unforeseeable emergency can be that of:

- the participant
- the participant's spouse
- the participant's dependent for Code Section 152 tax purposes (e.g. a minor child, relative or other individual who lives with the participant full time and receives over half of his or her support from the participant) or
- the participant's beneficiary under the Plan. (The Pension Protection Act of 2006 added this optional category.)

Has the IRS provided any other guidance or examples of what is or may be an unforeseeable emergency?

The IRS has specifically ruled out the elective purchase of a home or college tuition as unforeseeable emergencies. (Note that these two events are probably eligible as "financial hardship" in-service distribution events for a 401(k) or 403(b) plan.)

The IRS has also said that foreclosure or eviction, medical expenses, and funeral payments **may** be, but are not necessarily always, unforeseeable emergencies.

What are some examples of events that are generally considered not to be unforeseeable emergencies?

The following are examples of expenses that, standing on their own, ordinarily would not qualify as a severe financial hardship because there is no unforeseeable emergency involved. These are situations where the individual 1) had significant control or 2) could have reasonably and prudently anticipated, avoided or budgeted for the event.

- Cost of education/tuition
- Normal monthly expenses – e.g., utility bills, mortgage or rent payments
- Payment on credit cards or loans
- Payment of federal, state, local or property taxes

- Elective purchase, maintenance or remodeling of a home or other real estate
- Costs associated with divorce or separation
- Purchase of automobile other transportation expenses
- Automobile or appliance maintenance
- Elective or cosmetic surgery
- Routine medical, dental or orthodontic services
- Bankruptcy
- Legal judgments and legal fees
- Investment losses
- Gambling losses
- Wage garnishment
- Costs of adoption
- Child support payments

It is important to note, however, that where there is a demonstrated unforeseeable emergency, some of these expenses may be considered as a severe financial hardship. For example, if a natural disaster strikes an area and an individual loses their house and their job, they could ask for an unforeseeable emergency distribution. The basis for this unforeseeable emergency distribution would be a loss of income that the participant could use to cover ordinary expenses, including credit card payments. The unforeseeable emergency distribution could not exceed the participant's income loss. An unforeseeable emergency distribution could also be granted in this example to buy a new primary residence. However, the unforeseeable emergency distribution would have to be reduced by any insurance and other benefits the participant receives from other sources related to the housing loss. This illustrates why it is so difficult to develop comprehensive lists of situations and expenses that will be eligible under the unforeseeable emergency rules and why it is so important to develop clear and consistent standards and processes for making decisions in this area.

Does an individual need to use other financial resources first before seeking an unforeseeable emergency withdrawal?

Yes, the regulations provide that the individual should only withdraw assets intended as retirement savings in the Plan as a last resort. To that end, the following requirements must typically be met:

- Insurance coverage is either not available or is insufficient to cover the financial need caused by the unforeseeable emergency.
- The need cannot be satisfied by taking a loan from the Plan, from other plans of the employer, or from commercial lenders.
- The need cannot be met by stopping contributions under the Plan and/or any other plan of the employer with elective deferrals.
- The need wouldn't be satisfied through the liquidation of the participant's assets, as long as the liquidation itself doesn't impose further unreasonable hardship.

What kind of documentation is generally required with an unforeseeable emergency withdrawal request?

The decision to grant or deny an unforeseeable emergency withdrawal request must be based on sufficient evidence indicating the emergency is extraordinary and unforeseeable. The participant must file a written request and provide all necessary and requested supporting proof and documentation. (On their website listing of top 403(b)/457(b) compliance issues, the IRS lists inadequate documentation, lack of proper internal controls, and distributions that exceed the amount needed as common violations in unforeseeable emergency withdrawal administration.)

While the IRS has not provided guidance as to how much evidence is necessary, it is relatively clear that the mere statement by an applicant without an offer of proof is likely insufficient. Some examples of commonly required documentation include:

- A written explanation of the circumstances giving rise to the withdrawal request
- Explanation of Benefits (EOB) for medical bills.
- Written notice of eviction/foreclosure
- Pay stubs
- Worker's compensation or disability payments
- Bills, receipts, or statements for funeral, repairs to home, attorneys' fees, etc.
- Personal financial statements
- Loan denial letters from commercial lenders
- Foreclosure or eviction notices/documents

Other documentation or proof may be necessary depending on the nature of the emergency event and the financial hardship.

Can adding a plan loan feature decrease the burdens of administering an unforeseeable emergency feature?

Yes. Plan loans can be offered by 457(b) plans and are being increasingly considered as an alternative way for participants to gain access to their accounts when needed. Federal law and regulations allow loan features to be offered without requiring participants to meet the "extraordinary and unforeseeable emergency" standard that is so difficult to administer.

Plan sponsors concerned about making participant retirement savings too available can impose limitations on the availability of plan loans. For example, a plan sponsor could require that plan loans can be made available only for "hardships" permitted for 401(k) and 403(b) plans.

Adding a plan loan feature may lessen the time and effort spent administering unforeseeable emergency withdrawal requests. However, plan loans add their own complexities that should be assessed carefully before being added, including administering loan repayments and defaults.

What taxation and reporting rules apply to unforeseeable emergency distributions?

Unforeseeable emergency withdrawals are taxable to the participant as ordinary income. Under IRS Notice 2003-20, unforeseeable emergency withdrawals are non-periodic payments that are reported on Form 1099R for federal and state income tax purposes. Unforeseeable emergency distributions are not eligible rollover distributions and are subject to withholding under § 3405(b) at a 10-percent rate, unless the recipient elects not to have withholding apply.

Can an unforeseeable emergency withdrawal be paid back?

No. An unforeseeable emergency withdrawal is not a loan. Further, because the participant may not be allowed to contribute for up to 12 months, the participant will likely miss out on the opportunity to make even regular contributions until the plan allows contributions to begin again. However, subject to the regular annual deferral limits, once the participant is again eligible to contribute, additional contributions could be made at that time to make up for the amounts withdrawn.

Does an unforeseeable emergency withdrawal affect the amount that can be deferred in the year of the hardship?

No. A participant may still contribute up to the regular deferral limit for that year. Again, however, because the plan may prohibit participant to make contributions for up to 12 months, the participant most likely will not reach the limit for that year.

Does an unforeseeable emergency withdrawal affect the amount a participant can contribute under the Age 50 or 3-year catch up feature?

No. The unforeseeable emergency withdrawal does not reduce the amount of a participant's Age 50 or 3-year catch-up calculation.

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