

STATE OF WISCONSIN  
Department of Employee Trust Funds  
David A. Stella  
SECRETARY

801 W Badger Road  
PO Box 7931  
Madison WI 53707-7931

1-877-533-5020 (toll free)  
Fax (608) 267-4549  
<http://etf.wi.gov>

**CORRESPONDENCE MEMORANDUM**

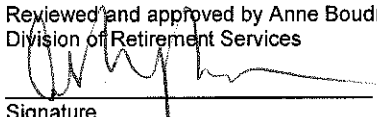
**DATE:** February 15, 2011  
**TO:** Deferred Compensation Board  
**FROM:** Shelly Schueller, Director  
Deferred Compensation Program  
**SUBJECT:** Financial Emergency Hardship Application Trends

**This memo is for informational purposes only. No Board action is required at this time.**

Under § ETF 70.10(6), Wis. Admin. Code, the Department is required to prepare and present to the Board a report on financial emergency hardship applications since the last meeting. Since 2008, hardship data has been included in the "Operational Updates" materials in a Board report, "Selected Quarterly Statistics." The data on this report includes total applications received, returned for more information, and submitted to ETF for review. This report provides a running percentage of applications approved and denied. The Board also receives a narrative report that includes the date the hardship application was initially submitted to GWRS, the specific situation creating the need for a distribution, and the date and decision made by ETF. (See Item 12 for the current reports.)

**Background**

The guidelines for approving financial emergency hardship withdrawals from deferred compensation retirement savings accounts are defined in Section 457 of the Internal Revenue Code. Examples of permissible financial emergencies include loss of income, foreclosure, eviction, legal expenses, medical bills beyond what insurance covers and funeral expenses. Examples of situations that are not considered unforeseeable emergencies include college tuition and purchase of a home. In November 2010, the Internal Revenue Service published Rev. Rul. 2010-27, considering three claims for financial emergency hardship withdrawals not explicitly covered in prior guidance and approved two of them. A copy of this guidance is attached. The key for determining approval appears to whether the situation results in a severe financial hardship due to circumstances "beyond the control of the participant or beneficiary."

Reviewed and approved by Anne Boudreau, Deputy Administrator,  
Division of Retirement Services  
  
Signature \_\_\_\_\_ Date 02-16-2011

Board	Mtg Date	Item #
DC	03.01.11	11

In an effort to help participants understand what documentation is necessary to support a successful hardship withdrawal, in late 2009 the WDC created an informational article, "WDC Emergency Hardship Withdrawal Information," and posted it on the WDC website. A copy of this article is attached for your reference.

Participants who experience financial hardships may file a financial emergency hardship withdrawal application with the Wisconsin Deferred Compensation (WDC) Program by contacting the Great-West Retirement Services (GWRS) call center or the local Madison staff. GWRS staff usually assists participants completing *Emergency Withdrawal Applications*. GWRS also provides information on the types of additional documentation (paycheck statements, foreclosure or eviction notices, etc.) that may help justify the request.

On average, GWRS staff spends 30-45 minutes processing each hardship application. This time includes reviewing the application, speaking with the participant, making recommendations regarding additional documentation that may support the participant's application and forwarding the completed hardship application package to the Department of Employee Trust Funds (ETF) for a determination. ETF staff spends approximately 30 minutes per application reviewing documentation in order to determine whether to approve or deny an application. If a denial is appealed to the Board, several more hours of work by ETF staff is usually required. The number of hardship applications reviewed by ETF differs from the number submitted to GWRS. When an application is received, GWRS staff reviews it and frequently contacts the participant to obtain additional information documenting the participant's financial emergency. In approximately 45% of these cases, the participant does not respond and the application is not processed. The charts in this memo pertain only to completed applications reviewed by ETF.

After completing its review, GWRS forwards the application and supporting documentation to ETF for review and a decision. By law, ETF must process these requests within five days of receipt. Once a determination on a hardship application has been completed, GWRS has ten days to issue a payment to the participant or provide rationale for the denial. A participant receiving a denial from the WDC may request a Department determination letter. This determination letter provides the participant with the reasons for the denial and notifies them of their right to appeal the decision to the Board.

### **Trends**

The table below summarizes the outcomes for all WDC hardship applications that were submitted to ETF for a decision between 2004 and January 31, 2011. In the last few years, between the uncertain economy and the number of participants utilizing the WDC, hardships applications have increased dramatically. Overall, ninety percent of hardship applications are approved. Just two percent of participants who have their applications denied request a Department determination letter. One participant has appealed the Department's decision.



Until the economic outlook improves for the State of Wisconsin, the Department anticipates the number of hardship applications will continue rise and that furlough loss of income will continue to be a justification for many applicants.

Staff will be available at the March 1, 2011, meeting to discuss the contents of this memo with the Board.

Attachments:

- 1) GWRS summary of Internal Revenue Service Rev. Rul. 2010-27
- 2) WDC Emergency Hardship Withdrawal Information from WDC website

# FOCUS on 457<sup>SM</sup>

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Edited by

Gregory E. Sellar, Senior Vice President  
Government Markets (800) 933-9808

Marilyn R. Collister, Senior Director  
Legislative and Regulatory Affairs (303) 737-7712

## IRS Guidance on Unforeseeable Emergency Distributions

**Background.** As in the past, an eligible 457(b) deferred compensation plan may allow unforeseeable emergency distributions if the plan document specifically defines an unforeseeable emergency as a severe financial hardship of the participant resulting from any of the following developments:

- (1) An illness or accident of the participant, the participant's spouse, or the participant's dependent;
- (2) The loss of the participant's property due to casualty, including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance (such as a natural disaster); or
- (3) Similar extraordinary and unforeseeable circumstances arising as a result of events beyond the participant's or beneficiary's control.

In addition to the definition in the final regulations, the IRS previously published a "Model Amendment" for 457(b) plans that authorizes unforeseeable emergency distributions under other similar circumstances arising beyond the control of the participant or beneficiary. This prior guidance specifically provides that casualty loss (e.g., from a natural disaster, foreclosure, eviction, medical expenses, prescription drug costs, and funeral expenses of a spouse or dependent may constitute unforeseeable emergencies. On the other hand, the purchase of a home or payment of college tuition is not an unforeseeable emergency.

Whether the participant or beneficiary has incurred an unforeseeable emergency is generally determined based on the relevant facts and circumstances. The participant must provide documentation to substantiate the facts and circumstances surrounding the need for the emergency distribution. He or she must also be able to show that he or she has no assets that could be liquidated to relieve the hardship, to the extent that such liquidation would not itself constitute a severe hardship, and that the costs are not otherwise covered by insurance.

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These materials do not constitute tax or legal advice. Each situation is dependent upon its own complete set of facts. The reader should consult with an attorney or tax advisor and not rely upon these materials or attempt to apply them to specific situations.

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Rev Rul 2010-27. On November 8, the IRS published Rev. Rul. 2010-27 considering three claims for unforeseeable emergency distributions not explicitly covered in prior guidance and approved two of them. The three fact situations addressed in Rev. Rul. 2010-27 do not fit within any of the examples used in Reg. Sec. 1.457-6(c)(2)(i) nor those used by the plan. As you will see from the three scenarios discussed below, the key is whether the situation results in a severe financial hardship due to circumstances beyond the control of the participant or beneficiary.

Home Repair. In the first situation, an emergency distribution was requested to repair the participant's principal residence because of significant water damage that is not covered by insurance but is substantially similar to the need to pay for damage to a home as a result of a natural disaster. The participant provided written estimates of the repair cost. The IRS determined that this is a permissible emergency distribution because it is the result of events beyond the control of the participant, even though the participant's situation is not identical to any of the specific examples listed in the regulations or Model Amendment. Since the expenses arise "as a result of events beyond the control of the participant or beneficiary" and are substantially similar to expenses that would result in the wake of a natural disaster.

Funeral Expenses. In the second situation, a 457(b) plan participant requests an unforeseeable emergency distribution to pay for the funeral expenses of an adult son who is not a dependent. An itemized bill from the funeral home was submitted. The IRS held that this was a permissible unforeseeable emergency distribution because "the need to pay for the funeral expenses of a non-dependent adult son is an extraordinary and unforeseeable circumstance that arises as a result of events beyond the control of the participant and that is substantially similar to the need to pay for funeral expenses of a dependent."

Credit Card Debt. The facts in the third situation involve a 457(b) participant who requests an unforeseeable emergency distribution to pay for accumulated credit card debt. The IRS disallowed this distribution request because it did not arise "due to any events that are extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant." It neither fits within any of the specified examples nor results from circumstances arising beyond the participant's control.

Application to Code Sec. 409A. The IRS said that the principles and rulings set out in Rev Rul 2010-27 in the context of §457(b) plans, also apply to § 409A(a) plans, as long as the distributions may be paid under the terms of the plan upon the occurrence of an event constituting an unforeseeable emergency that complies with §409A(a) and Reg. §1.409A-3(i)(3).

If you have any questions, please contact your representative at the address below.



J. Chris Luttges, VP Field Ops/Plan Management 800-537-2033 ext. 71856	Julie Klassen, Regional Director, Govt. Market Development 800-933-9808	Kent Morris, Vice President, Western Region, 800-382-8924	Theresa Cruz Myers, Vice President, Central Region 800-947-4409	Brent Neese, Vice President, Eastern Region 978-407-9000	Robert Dwyer, Manager, Market & Strategic Development 800-537-2033 ext 72408
Perry Christie, Vice President 800-537-2033 ext 73724	John Steggell, Regional Director, Irvine, CA 800-933-9808	Linda Ulrich, Regional Director, Pacific Northwest 800-462-9277	Michelle Williams, Director, National Accounts 800-537-2033 ext 74648	Darryl Collier, Asst. Vice President 800-537-2033 ext 73291	Lisa Tilley, Director, National Accounts 800-537-2033 ext 75159
Trampus Bright Regional Director, Denver, CO 303-737-7706	Denise Fortune, Regional Director, Maryland/DC 301-627-7579	Cathy Matusiewicz, Regional Director, Irvine, CA 800-933-9808	Brion Beetz, Regional Director, San Ramon, CA 800-274-8491	Jim Condon, Regional Director, NY/NJ Region 718-238-2731	Keith Anderson, Regional Director, Pittsburgh 610-716-3129
Nancy Ornduff Regional Director, South Carolina 803.754.7997	Marianne Franco, Regional Director, Glendale, CA 800-382-8924	Usha Archer, Regional Director, Los Angeles, CA 800-382-8924	Vanessa Coakley, Regional Director, Michigan 269-823-4020	Gary Robison, Regional Director, City of Los Angeles 800-382-8924	Jaimie Biesel, Regional Director, Indiana 877-728-6738
Nancy Roth, Regional Director, Florida 904.652.3595	Sue Oelke, Regional Director, Wisconsin 608-241-6604	Gary Wilkins, Regional Director, Houston 713-426-5588	Kris Morton, Regional Director Ohio 614-493-6185	Karl Kroner, Regional Director, New England 800-596-3384	Jim Rohlinger, Regional Director, Pennsylvania 717-901-3590
Javier Obando, Regional Director, San Francisco 877-457-9321	Connie Rettig, Regional Director, St. Louis 314-241-1334 ext. 105	Connie Stevens, CRCP, Regional Director, Louisiana 255-926-8082 ext. 35501	Donald Erwin Regional Director, Alabama 334.240.0057	Alice Tajeron Regional Director, Guam/Micronesia 671-475-8945	Gary Robison Regional Director City of Los Angeles (888) 466-0381

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## Wisconsin Deferred Compensation Program EMERGENCY HARDSHIP WITHDRAWAL

The Wisconsin Deferred Compensation Program (WDC) allows participants to withdraw funds in the event of an “unforeseeable financial emergency” that causes a severe financial hardship as defined in Section 457 of the Internal Revenue Code (IRC). However, you must meet certain conditions. In addition, the WDC also has to follow IRC rules and regulations. Please read this document carefully. The requirements are very strict.

### WHAT IS A FINANCIAL EMERGENCY?

According to the Internal Revenue Service (IRS) and its *Treasury Regulation 1.457-6(c)*, an unforeseeable emergency is a “**severe financial hardship**” to the participant or beneficiary resulting from a sudden and unexpected illness or accident of the participant, or beneficiary, the spouse of the participant or beneficiary, or of a dependent<sup>1</sup> (as defined in Section 152(a)) of the participant or beneficiary; loss of a 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 and certain dependents.

Examples include:

- imminent foreclosure on, or eviction from, the participant’s primary residence
- loss of regular income due to circumstances beyond the participant’s control
- medical expenses, including nonrefundable deductibles and medications
- funeral expenses of a participant’s spouse, beneficiary or dependent

The unforeseeable emergency must be based on a financial hardship actually *experienced*, not one that is *expected to* or *may* happen. You must prove that you are experiencing a severe financial emergency and provide evidence that you have exhausted all other sources of income. Other sources may include:

- reimbursement or compensation from insurance
- liquidation of assets to the extent that this would not cause a severe hardship
- cessation of deferrals

### WHAT IS NOT CONSIDERED A FINANCIAL EMERGENCY?

Under IRS regulations, the following examples are not typically considered financial emergencies:

- the purchase of a house or other real estate
- school tuition or other educational expenses
- normal, ordinary living expenses such as: mortgage, auto payments or repair costs, home remodeling, utility bills, loans, delinquent taxes, overdue credit card bills, the

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<sup>1</sup> As defined by Section 152(a) of the IRC, the term “dependent” means any of certain individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer [participant].



purchase of major appliances, losses or cash flow problems on properties held for investment, and marital separation or divorce.

### **HOW TO APPLY FOR A WDC FINANCIAL EMERGENCY WITHDRAWAL**

If you feel your situation meets the IRC requirements for a financial emergency, and your WDC account is the only choice you have, contact the local WDC office in Madison at (608) 241-6604 or toll-free (877) 457-9327, option 2 and request a *WDC Financial Emergency Hardship Withdrawal Application*. Complete and submit it with your documentation to the WDC. You must provide everything listed on the application form. Please keep a copy of your application for your records.

*Documentation to support your emergency claim is also required. Your personal financial information will be used solely to determine eligibility to withdraw funds under the financial emergency hardship withdrawal provision and remain confidential.*

Types of documentation that may be required include:

- unpaid medical bills not covered by insurance
- doctor's statement for unpaid medical leave
- police or fire accident report for loss of property not reimbursed by insurance
- copy of most recent earnings statement (check stub) for income loss
- other legal or administrative reports that document your situation

The amount you request cannot exceed what is needed to pay your debt. The amount requested may include funds needed to pay federal and state income taxes as a result of the distribution. Emergency withdrawals are subject to federal taxes.

### **THE REVIEW PROCESS**

You must provide adequate documentation for your application to be evaluated. The Department of Employee Trust Funds (ETF) will review your materials to determine if you meet the requirements for an emergency withdrawal. It takes between four to seven weeks to completely review your withdrawal application and materials. If more documentation is required at any step in the process, your application will be delayed and may be denied.

If your application is approved:

- You will receive a confirmation and your withdrawal will be processed within seven to ten days of the approval date
- All funds will be withdrawn from your WDC account on a pro-rated basis according to your allocation percentages
- A 10% federal income tax will be withheld and sent to the IRS
- The amount distributed will be reported on an IRS Form 1099-R and will be included in your gross income for both federal and state income tax purposes in the year the distribution is made
- Your deferrals into the WDC will be suspended for six months after a hardship withdrawal application is granted

### **NEED HELP?**

If you have any questions, or need assistance in completing your application, contact the local WDC office in Madison between 8:00 a.m. and 4:30 p.m. at (608) 241-6604 or toll-free (877) 457-9327, option 2.\*

\* Access to the voice response unit may be limited or unavailable during periods of peak demand, market volatility, systems upgrades/maintenance or other reasons.

## WDC Hardship Documentation Checklist

Use this checklist to ensure that you've included copies of all necessary documentation in your *WDC Financial Emergency Hardship Withdrawal Application*. Documentation will be reviewed and, in some cases, more information may be requested. Submitting documentation does not guarantee approval of your request.

Hardship	Examples of Documentation
Loss of Income	<ul style="list-style-type: none"> <li><input type="checkbox"/> Pay stubs or tax forms illustrating the lost income.</li> <li><input type="checkbox"/> Letter from payroll office stating leave is uncompensated, including date of last employment, wage/salary, hours/weeks missed and total lost income.</li> <li><input type="checkbox"/> If the loss of income is your spouse's income, include copies of tax forms* or other documents proving their relationship to you.</li> </ul>
Medical/Dental Expenses	<ul style="list-style-type: none"> <li><input type="checkbox"/> Copies of bills or Explanation of Benefit (EOB) statements that show the portion of the procedure(s) covered by insurance.</li> <li><input type="checkbox"/> If no portion was covered by insurance, a letter from your insurance company explaining the procedure was not covered.</li> <li><input type="checkbox"/> If the bill is for your spouse, dependents, or beneficiaries, include copies of tax forms* or other documents proving their relationship to you.</li> <li><input type="checkbox"/> Loan denial letter from a commercial source. Credit card and lines-of-credit are not acceptable.</li> </ul>
Foreclosure/Eviction	<ul style="list-style-type: none"> <li><input type="checkbox"/> Notice of foreclosure or eviction on letterhead stating the date of impending foreclosure or eviction and the dollar amount needed to prevent such action. Foreclosures can be for a primary residence only.</li> <li><input type="checkbox"/> If you rent from a private landlord and not a rental company, a copy of your original lease agreement.</li> <li><input type="checkbox"/> If the foreclosure or eviction is in your spouse's or beneficiary's name, copies of tax forms* or other documents proving their relationship to you.</li> <li><input type="checkbox"/> Loan denial letter from a commercial source. Credit card and lines-of-credit are not acceptable.</li> </ul>
Funeral Expenses	<ul style="list-style-type: none"> <li><input type="checkbox"/> Proof of relationship to the deceased.</li> <li><input type="checkbox"/> Copies of bills or invoices in your name. If the bill is in your spouse's or beneficiary's name, copies of tax forms* or other documents proving their relationship to you.</li> <li><input type="checkbox"/> Loan denial letter from a commercial source. Credit card and lines-of-credit are not acceptable.</li> </ul>
Loss of Property or Damage due to Casualty Not Covered by Insurance	<ul style="list-style-type: none"> <li><input type="checkbox"/> Copy of the accident or police report, if available.</li> <li><input type="checkbox"/> Copy of estimated cost of repairs.</li> <li><input type="checkbox"/> If repairs are not covered by insurance, letter of denial of coverage from the insurance company.</li> <li><input type="checkbox"/> Loan denial letter from a commercial source. Credit card and lines-of-credit are not acceptable.</li> </ul>
Other Reasons	<ul style="list-style-type: none"> <li><input type="checkbox"/> Copies of letters from banking institutions, bills, etc. that demonstrate your financial hardship.</li> </ul>

Please attach your documentation to your completed *WDC Financial Emergency Hardship Withdrawal Application* and send to: WDC Program, 5325 Wall Street, Suite 2755, Madison, WI 53718. You may also fax your information to the WDC at (608) 241-6045.

If you have any questions, or need assistance in completing your application, contact the local WDC office in Madison at (608) 241-6604 or toll-free (877) 457-9327, option 2.

\* only first page of tax forms showing gross and net income is necessary

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