State of Wisconsin
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

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

1-877-533-5020 (toll free)
Fax 608-267-4549
etf.wi.gov

Correspondence Memorandum

DATE: October 3, 2016

TO: Deferred Compensation Board

FROM: Shelly Schueller, Director, Wisconsin Deferred Compensation Program
David Nispel, Chief Legal Counsel

SUBJECT: Unforeseeable Financial Emergency Hardship Withdrawals
1) Language and Location Options for 12 Month Lookback Provision
2) Proposed Unforeseeable Financial Emergency Hardship Withdrawal Policy Revisions

Staff requests the Board:

1. **Determine where language related to a 12-month lookback provision for hardships should be placed and approve language for this location; and**
2. **Clarify and remove a certain situation from its unforeseeable financial emergency hardship withdrawal policy and clarify another example.**

Background
Under s**.** 40.80 of the Wisconsin Statutes, the Deferred Compensation Board (Board) is charged with administering the Wisconsin Deferred Compensation Program (WDC) on behalf of plan participants. The Board has included a provision permitting unforeseeable financial emergency hardship withdrawals (hardships) in the Plan and Trust since this document was created. In 2012, the Board created a hardship policy that clarifies the hardship process and provides examples of financial hardship situations presented by participants.

The Board has also discussed adding an optional loan provision to the Plan and Trust several times, but has not opted to do so because the existing hardship withdrawal provision permits financial emergency withdrawals.

At the June 14, 2016 meeting, the Board discussed hardships and the 12-month lookback provision. The Board's legal counsel from the Department of Justice, Assistant

Reviewed and approved by Robert J. Conlin, Secretary

Electronically Signed 10/13/16

Board	Mtg Date	Item #
DC	11.1.16	8

Attorney General Charlotte Gibson, advised the Board that a 12-month lookback should be placed in either Wis. Admin. Code ETF s. 70.10 or in the Plan and Trust Document.

The Board has a choice to make: If the Board desires flexibility regarding hardships, then the 12-month lookback provision should be included in the Plan and Trust document. If the Board wants a firm hardship rule with no exceptions, then the 12-month lookback provision should be in the administrative code.

After some discussion, the Board requested that ETF staff provide potential language illustrating both the administrative code and the Plan and Trust document language options, and a recommendation on placement. The Board also asked that Ms. Gibson review and approve the language prior to ETF staff submitting the options to the Board. Pursuant to this request, ETF provided the options to Ms. Gibson, who responded that the language was acceptable. The proposed language for both options is as follows and in the attached documents.

<u>Language and Location Options for 12 Month Lookback Provision</u>

a. Plan and Trust Document
   In March 2016, the Board approved updates to Section 10.03 of the Plan and Trust Document that included specific language regarding a 12 month lookback period. Keeping the lookback language in the Plan and Trust permits flexibility. In the event of a documented extraordinary hardship with events extending beyond 12 months, the Board could make an exception and approve a hardship distribution. This is essentially what the Board did with the two appeals it heard during 2015. The Department recommends the addition of the <u>underlined</u> sentence below, which is also shown in attachment 1, the WDC Plan and Trust document. This explanatory sentence is intended to clarify for participants that they may need to submit additional information if events that occurred longer ago than in the last 12 months are included in the participant's financial emergency application.

   Excerpt from Article 10.03 of the Plan and Trust document
   …"Expenses from events exceeding twelve (12) months prior to the date of a hardship application may not *by themselves* be considered appropriate for a hardship withdrawal 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. <u>Participants with situations created by events exceeding twelve months prior to the date of an emergency withdrawal application must be prepared to submit additional documentation explaining how their situation may qualify as a financial emergency."</u>

b. Administrative Code
   If the Board desires to place the 12 month lookback language in the administrative code, the Department suggests the <u>underlined</u> language as

shown below, which is also included in attachment 2, Wis. Admin. Code ETF s. 70.10 with proposed language. Placing the 12 month lookback language in the administrative code creates less flexibility for the Board. There would be no opportunity, other than amending the administrative code, to make exceptions for hardship applications exceeding the 12 month timeframe, as was done when the Board recently heard two appeals in 2015 and reversed decisions made by the WDC administrator and the Department.

Wis. Admin. Code. ETF s. 70.10(1)(e)
Expenses from events exceeding twelve (12) months prior to the date of an unforeseeable emergency application shall not be considered for an emergency withdrawal.

Proposed Unforeseeable Financial Emergency Hardship Withdrawal Policy Revisions
Since 2012, the Board has had a formal Unforeseeable Financial Emergency Hardship Withdrawal Policy. This policy was last updated by the Board in March 2016. As a result of Ms. Gibson's comments at the June 14, 2016 Board meeting, ETF staff has also reviewed the language in the Board's existing Unforeseeable Financial Emergency Hardship Withdrawal policy and is proposing the changes outlined below and shown in attachment 3, the Board's hardship policy document:

a. Spousal Abandonment
ETF staff recommends the Board remove the example situation related to loss of income due to spousal/partner abandonment. Loss of income due to spousal/partner abandonment was originally included in the 2012 policy as an example of a situation that may be appropriate for a hardship withdrawal. However, permitting a release due to spousal/partner abandonment is not permitted by many other plan sponsors. For example, of the 360+ plans administered by Empower Retirement, the WDC is the only plan that has permitted consideration of spouse/partner abandonment as a situation potentially qualifying for a hardship withdrawal.

b. Divorce
ETF staff recommends the Board consider adding a note to the "loss of income due to divorce" example. The note would clarify that participants going through a divorce may split a WDC account via a Domestic Relations Order and may help direct participants to an alternative method to help settle martial property issues, by allocating all or part of their WDC account to their ex-spouse.

Recommendations
ETF staff recommend the Board consider leaving the 12-month lookback language in the Plan and Trust document and add the explanatory sentence as shown in attachment 1. ETF staff further recommends the Board approve the revisions to the Unforeseeable Financial Emergency Hardship Withdrawal Policy as shown in attachment 3.

Staff will be available at the Board meeting to discuss the contents of this memo and answer questions.

Attachments

A. Potential language and location of 12 month lookback language in WDC Plan and Trust document
B. Potential language and location of 12 month lookback language in Wis. Admin. Code ETF s. 70.10
C. Potential Revisions to the Board's Unforeseeable Financial Emergency Hardship Withdrawal Policy

Attachment A: Wisconsin Plan and Trust Document
Proposed Changes to Hardship Withdrawal Section
Draft as of August 9, 2016

10.03 Hardship Withdrawal: Notwithstanding any other provisions herein, in the event of an UNFORESEEABLE EMERGENCY, a PARTICIPANT or BENEFICIARY may request that benefits be paid to him or her at any time. Such request shall be filed in accordance with procedures established pursuant to this PLAN. If the application for payment is approved by the TRUSTEE or its designee, payments shall be effected within ten (10) working days of receipt of such approval. The decision whether a PARTICIPANT or BENEFICIARY is faced with an UNFORSEEABLE EMERGENCY will be based upon the relevant facts and circumstances of each case and in accordance with the terms of the PLAN and 26 CFR §1.457-6(c)(2). Benefits to be paid shall be limited strictly to the amount necessary to meet the UNFORESEEABLE EMERGENCY constituting financial hardship, and may include any amounts necessary to pay for any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution, to the extent such UNFORESEEABLE EMERGENCY is not relieved:

a. by reimbursement or compensation from insurance or otherwise;
b. by liquidation of the PARTICIPANT'S assets, to the extent the liquidation of such assets would not itself cause financial hardship; or
c. by cessation of deferrals under the PLAN.

A PARTICIPANT'S deferrals will automatically be terminated upon approval of a hardship application and the PARTICIPANT cannot re-enroll in the PLAN for 180 days from the date of approval of the hardship withdrawal. The ADMINISTRATOR may require such medical, financial or other evidence deemed appropriate for a determination to be made concerning the PARTICIPANT'S or BENEFICIARY'S withdrawal request.

The Board has determined that, in general, ~~E~~expenses from events exceeding twelve (12) months prior to the date of a hardship application may not *by themselves* be considered appropriate for a hardship withdrawal 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. Participants with situations created by events extending twelve months prior to the date of an emergency withdrawal application must be prepared to submit additional documentation explaining how their situation may qualify as a financial emergency.

Foreseeable personal expenditures normally budgetable, such as a down payment on a home, the purchase of an automobile, college or other educational expenses, etc., may not necessarily constitute an UNFORESEEABLE EMERGENCY. The decision of the TRUSTEE or its designee concerning the payment of benefits under this Section shall be appealable under Wisconsin Statutes Sections 40.80(2g) and 40.08 (12).

Attachment B: Chapter ETF 70 Proposed Language

DEFERRED COMPENSATION PLANS

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) Expenses from events exceeding twelve (12) months prior to the date of an unforeseeable emergency application shall not be considered for an emergency withdrawal.

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

(2) The administrator 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, and

(d) Within 5 working days after the receipt of the information requested from the employer or other parties, either render a decision or make a recommendation to the department on a form prescribed by the department.

(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; **CR 14-055: am. (2) (intro.), r. (2) (c), am. (2) (d), r. (3) to (5) Register May 2015 No. 713, eff. 6-1-15; correction in (2) (b) made under s. 35.17, Stats., Register May 2015 No. 713.**

Attachment C: Potential Revisions to the Board's Unforeseeable Financial Emergency Hardship Withdrawal Policy

Adopted: November 6, 2012

Last Revised: ~~March 8, 2016~~draft as of August 9, 2016 for November 2016

The Deferred Compensation Board's Unforeseen Financial Emergency Hardship Withdrawal Policy recognizes that each Wisconsin Deferred Compensation Program (WDC) participant's unforeseeable financial emergency hardship withdrawal reflects a participant's unique situation and must be evaluated accordingly. However, 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.

Background: The Wisconsin Deferred Compensation Program (WDC) is required to follow the Internal Revenue Code (IRC) and Wisconsin Administrative Code Chapter ETF 70.10 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).
>
> (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 [or daughter]** - 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 by the 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”.

The Board has determined that, *in general,* expenses from events exceeding twelve (12) months prior to the date of a hardship application may not *by themselves* be considered appropriate for a hardship withdrawal 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. Participants with situations created by events extending twelve months prior to the date of an emergency withdrawal application must be prepared to submit additional documentation explaining how their situation qualifies as a financial emergency.

The following list of hardship situations is not meant to be all inclusive; rather, it is a sampling of situations that have been presented as financial emergencies in the past.

[1] http://www.irs.gov/irb/2010-45_IRB/ar09.html last accessed on November 5, 2012

Selected WDC Financial Emergency Hardship Situations		
Situation	**Appropriate for a Hardship Withdrawal?**	**Decision Notes**
Furloughs	Yes, depending on the duration	Distributions may be allowed for furloughs experienced within the last twelve months, depending on each individual's circumstances. Applications for distributions citing furlough as the only reason for a request where the furlough has occurred for more than twenty four months will not be considered appropriate for a hardship withdrawal.
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 spousal/partner abandonment~~	~~Yes~~	~~A distribution may be allowed if a participant can document the loss of income from the abandonment within the last twelve months 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 increase in employee-paid share of group health insurance premiums	No	A distribution is not allowable because 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. Note: WDC participants may divide their WDC accounts via an Order to Divide WDC Program Account, ET-2367. This document is available on both the ETF website, etf.wi.gov, and the WDC website, www.wdc457.org.

Selected WDC Financial Emergency Hardship Situations		
Situation	**Appropriate for a Hardship Withdrawal?**	**Decision Notes**
Loss of business income due to economic changes	No	A 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).

References

1. Wis. Admin. Code~~Ch.~~ ETF s. 70.10: http://legis.wisconsin.gov/rsb/code/etf/etf070.pdf
2. National Association of Government Defined Contribution Administrators (NAGDCA):
   a. NAGDCA Note: Unforeseeable Emergencies and Hardship Withdrawals: What Every Plan Administrator Needs to Know (2009) accessible at http://nagdca.org/Publications/NAGDCA-Notes/ArtMID/5428/ArticleID/212/NAGDCA-Note-Unforeseeable-Emergencies-and-Hardship-Withdrawals--What-Every-Plan-Administrator-Needs-to-Know
   b. Section 457(b) Plan Administrator's Guide to Unforeseeable Emergency Withdrawals (2007) accessible at http://nagdca.org/dnn/Portals/45/Publications/Issues/unforeseeableEmergency.pdf