

Unforeseeable emergencies

A resource guide for nonqualified plans

This resource guide is designed for administrative committees of plan sponsors who have participants applying for unforeseeable emergency relief in nonqualified deferred compensation plans. You should consult with appropriate counsel or other advisors on all matters pertaining to legal, tax, or accounting obligations and requirements.



Recent changes in qualified plan rules in response to COVID-19 may make distributions from a qualified plan more appealing.

For more information, please see “CARES Act of 2020: Individual provisions”, especially “Tax-favored retirement distributions” and “Qualified plan loan restrictions loosened.”

An “unforeseeable emergency” is defined as a **severe financial hardship to the participant** resulting from an illness or accident of the participant, his or her spouse, beneficiary, or dependent (generally using the same requirements as a dependency exemption), the loss of the participant’s property due to casualty, or other similar extraordinary and unforeseeable circumstances arising because of events beyond the participant’s control.

If a plan design allows, a participant may petition the employer to stop his or her deferrals only, or to stop the deferrals and make a distribution from the plan upon the occurrence of an unforeseeable emergency.

For more information, see the Applied Knowledge document “Unforeseeable emergency and IRC Section 409A”.

Please check your plan document for all unforeseeable emergency provisions. The plan document may:

- Limit the amount of money available for distribution to vested amounts under the plan.
- Limit unforeseeable emergency applicants to active plan participants.
- Limit the distribution to certain money types—for example, employee deferrals only.
- Be amended to add an unforeseeable emergency provision (applicable to plans governed by IRC Section 409A), effective upon proper documentation.

The participant seeking the distribution must apply to the plan sponsor for a distribution, show the emergency expenses are not covered by insurance, and cannot be met through liquidation of assets, or cessation of deferrals under the plan.

For more information, see cancellation of deferrals in a nonqualified deferred compensation plan.

A distribution can be made of all or part of the participant’s account(s) up to the amount needed to satisfy the emergency, plus amounts necessary to pay any taxes on it. If a participant has multiple accounts, the administrative committee should decide which account(s) the distribution should come from without input from the participant.

Scenarios

In 2010, the Internal Revenue Service issued Revenue Ruling 2010-27, which addresses the availability of an unforeseeable emergency distribution under three scenarios:

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.

The following are additional examples of items that probably do not qualify as an unforeseeable emergency distribution:

- Purchase of a vehicle
- Cost of divorce or separation
- Cost of child support
- Cost of bankruptcy
- Cost of education
- Normal monthly expenses
- Payment of Federal, state, or local property taxes
- Legal judgments or fees
- Investment losses
- Gambling losses
- Elective or cosmetic surgery

Except in extraordinary circumstances, the purchase of a home or the payment of college tuition are not unforeseeable emergencies.

The following suggests documentation that you may want to require:

Eviction. Foreclosure or eviction notice

Medical. Doctors or hospital bill, plus evidence that insurance does not cover

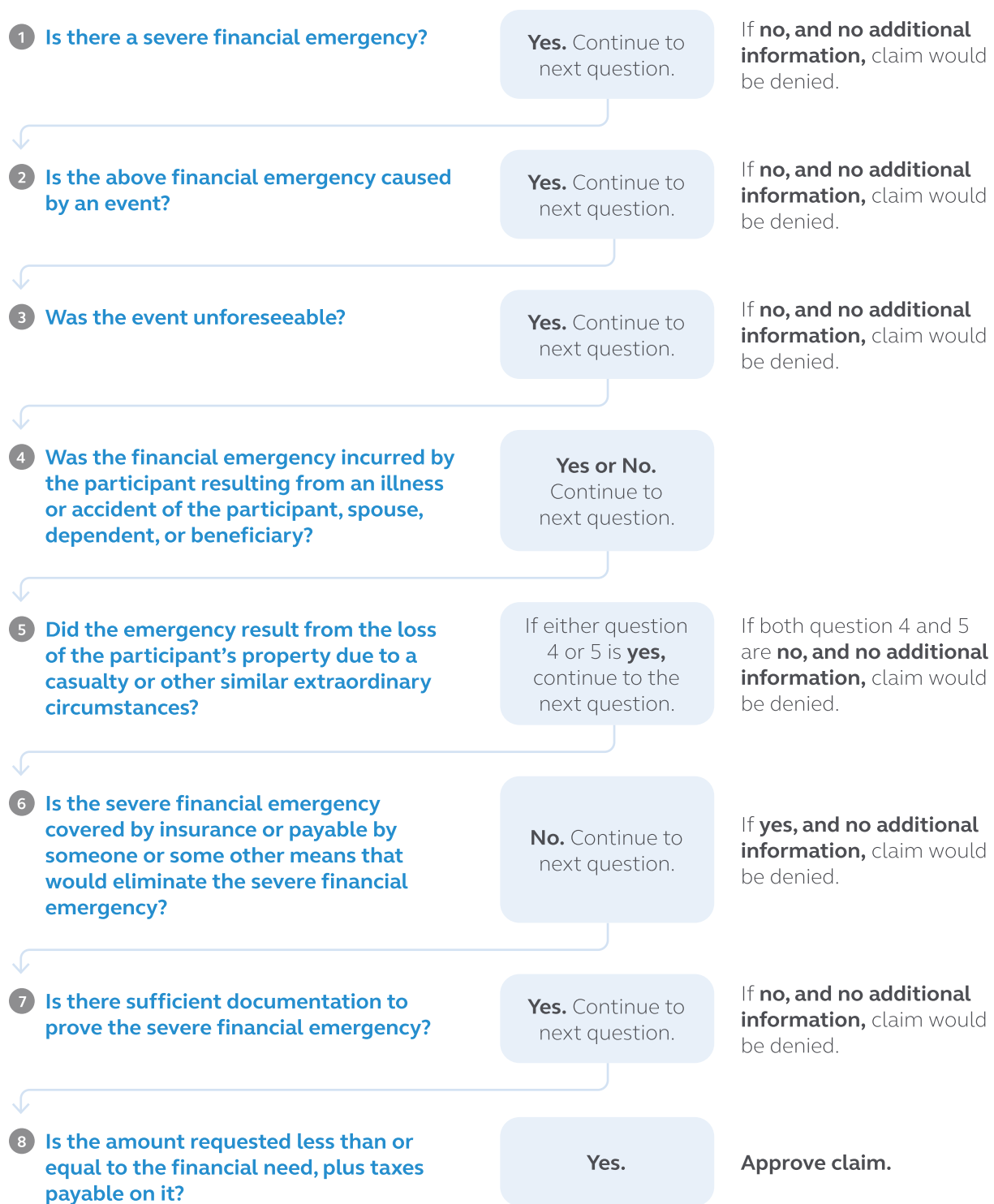
Funeral. Funeral bill

Loss of property due to casualty. Repair bills, plus evidence that insurance does not cover

National financial emergency. Proof of reduction in income or increase in expenses due to emergency

If expenses are for anyone other than the participant, the individual should provide documentation of the relationship, such as a birth certificate, marriage license, tax return, insurance coverage documentation, or any other relevant documents.

You might want to implement the following **basic steps in reviewing a request** for an application for an unforeseeable emergency by a participant for plans that allow unforeseeable emergencies:



Cancellation of deferrals following an unforeseeable emergency. A plan may provide for a cancellation of a service provider’s deferral election, or such cancellation may be made, due to an unforeseeable emergency. The deferral election must be cancelled, not merely postponed or otherwise delayed. Accordingly, any later deferral election will be subject to the provisions governing initial deferral elections.

Upon a “hardship” distribution for 401(k) purposes (note that a “hardship” has a different definition than unforeseeable emergency), some deferred comp plans require or allow participant deferrals to be cancelled. Check your plan document to see if this is allowed under your plan design.

You may want to develop a form for the participant to use to request an unforeseeable emergency distribution. The sample form included is provided by Principal® to help in completing an unforeseeable emergency distribution request. This sample was prepared based on the understanding of the relevant statute and/or regulations by Principal. It may not fit your situation. **You should consult with your legal counsel or financial professional on any legal implication of an unforeseeable emergency distribution or cancellation of deferrals.** Neither Principal nor its employees or agents can be responsible for the legal or tax aspects of the form, nor its appropriateness for your situation. Principal is not responsible for anything you decide to include, add, delete, or modify with regards to the form. Use or modification of the sample form should be reviewed by your legal counsel before providing to your participants.



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Request for Cancellation of Employee Deferrals and/or Unscheduled Plan Distribution as a result of an Unforeseeable Emergency

Submission of this form initiates the review process. The Plan Administrator has established uniform, nondiscriminatory guidelines to use in determining if an unforeseeable emergency exists. The Plan Administrator's determination shall be final. The Participant has no legal or equitable right to a plan distribution.

Additional forms may be required by the plan service provider if the cancellation of employee deferrals and/or unscheduled plan distribution is approved.

Participant (Employee) Name _____

The plan permits cancellation of employee deferrals and/or unscheduled distributions under unforeseeable emergency guidelines. You (the Participant) must demonstrate that the reason for the distribution is in compliance with the requirements of the plan document and the Internal Revenue Code. You must demonstrate that you have a severe financial emergency that was unforeseeable and cannot be remedied by certain other methods.

Taxation

An unscheduled distribution, if allowed, will be taxable. You may withdraw enough to cover the need, plus any taxes you expect to pay on it.

Description of the Unforeseeable Emergency

In the area below, describe the unforeseeable emergency. You may attach additional pages if more space is needed. Please attach any documents you feel would help demonstrate that you have a severe financial emergency.

___ I hereby request to cancel my nonqualified plan deferrals as of ____/____/_____.
(date)

___ I hereby request to cancel my nonqualified plan deferrals as of ____/____/_____.
and request a distribution in the amount of \$_____.
(date)

I hereby certify that I have an unforeseeable emergency as outlined above and do not have any other resources to use to meet the needs of this unforeseeable emergency.

Participant (Employee) Signature _____ Date _____