

Best Practices in Hardship Distributions

These days, many plans are experiencing an uptick in the number of participant request for hardship distributions. Much of this increased activity may be attributed to our prolonged and tepid economic recovery.

As these requests are considered, you want to be sure not to act to the detriment of your plan. Improper handling of a hardship request can ultimately result in plan disqualification. It is important to understand what the law, and your plan document, allow so your actions do not result in unintended but impermissible hardship distributions.

First, the law requires that any hardship distribution can only be made due to a participant's immediate and heavy financial need.

The law does not permit a distribution in excess of the amount necessary to satisfy the need, which cannot be met by other resources reasonably available to the participant. Unless the plan has knowledge to the contrary, the regulations allow a plan to rely on the participant's written representation that the need cannot be reasonably relieved by insurance, liquidation of other assets, cessation of contributions, distributions, or non-taxable loans from employer plans of commercially available loans.

Also, assets available for distributions are limited to the participant's accumulated elective contributions, exclusive of earnings but reduced by losses.

If the plan allows hardship distributions, the plan document must specifically state so.

A few safe harbor provisions have been granted. A safe harbor set of guidelines for what qualifies as an immediate and heavy financial need can be incorporated into the plan document. Also, regulations provide for the availability of safe harbor provisions to be included in the plan document to aid in determining if the distribution may be deemed necessary as long as any other loan or distribution available under the plan has been exhausted and the participant is suspended for making elective contributions for at least six months.

There is also a requirement for documentations of the hardship request activity. This includes maintaining a copy of the participant's application with appropriate representations, as well as your determinations regarding: immediate and heavy need; availability of other resources; and appropriateness of the amount of distribution.

Take this opportunity to review your plan's hardship provision to make certain you are following procedures correctly. Remember, inconsistent, sloppy, or overly liberal distributions may result in significant issues for the plan.