As defined contribution (DC) plan sponsors prepare for annual nondiscrimination testing, they may need to consider the potentially adverse effects that coronavirus-related employer actions could have on their test results and how they can best respond to those possible effects.

The tests at issue—the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests—must be passed each year, unless the plan satisfies one of the 401(k) safe harbors. Intended to ensure that 401(k) plans don’t unfairly benefit highly compensated employees (HCEs), the tests compare HCE with non-HCE contribution percentages to determine whether HCEs have exceeded certain thresholds.

Furloughs, employer match suspensions, salary reductions, and other employer actions taken in response to the financial crisis prompted by the coronavirus may negatively impact ADP and ACP testing, in addition to any changes plan participants may make to their deferral rates.

**Stick with plan design best practices**

While coronavirus-related employer actions may be necessary for some companies, we encourage plan sponsors to continue using plan design best practices such as automatic enrollment, reenrollment sweeps, and targeted participant communications in an effort to ensure all participants continue to benefit from the plan.

We believe the best approach is to keep current plan features in place for this singular event year and make corrections as needed after year-end. Projection testing may provide some insight into the expected plan-year test results in a more typical plan year. However, it will be exceptionally challenging to adequately assess corporate actions’ impact on employee saving behaviors in time to implement effective HCE savings limitations that avert a testing failure in this economically uncertain environment. For this reason, we generally do not feel that midyear projection testing will add much value at this time.

Some plan sponsors may want to consider limiting the amount HCEs can contribute for the remainder of the year to avoid a failed test, which would result in refunds to HCEs. However, implementing HCE caps risks overly restricting savings opportunities for employees who need to save maximally and often results in HCEs, especially lower-paid HCEs, saving less than they could.

**Consult and discuss**

Vanguard recommends contacting your retirement plan consultant to discuss the likely outcomes for compliance testing, review the plan document to ensure maximum flexibility in resolving testing issues, explore options to mitigate test failures, and develop a plan to complete the 2020 plan year ADP and ACP tests in a timely manner (typically by March 15 of the following year) to minimize any employer costs related to late refunds.

In the meantime, we have compiled the following list of employer actions taken in response to the coronavirus pandemic and the potential impact on ADP and ACP nondiscrimination testing, including possible mitigation steps. If you have any questions, please contact your Vanguard representative.
<table>
<thead>
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<th>Employer action</th>
<th>Potential impact on ADP and ACP nondiscrimination testing</th>
<th>Potential options for consideration</th>
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| Furloughs       | • Because contributions end when compensation stops, ADP and ACP percentages are not reduced as a result of this action, and any impact on ADP and ACP testing should be minimal.  
• If furloughed employees return to work later in the year and do not elect to resume making salary deferral contributions, the ADP and ACP test results could be negatively impacted. | • Automatically enroll furloughed employees upon return to work, if possible.  
• Use targeted participant communications to encourage plan enrollment if automatic enrollment is not an option.  
• If plan sponsors are concerned that tests will fail, they could consider the following:  
  o Impose a cap on HCE deferrals for the balance of the year, or  
  o Keep the current plan features in place and make refunds to HCEs if necessary. This will allow HCEs to maximize their contributions within the limits of the ADP and ACP testing. It is important to communicate the possibility of refunds to HCEs early so that they understand and expect this possible result.  
  o In limited circumstances, where practicable, consider midyear projection testing after employee saving behavior changes can be determined. |
| Layoffs         | • Because contributions end when employment stops, ADP and ACP percentages are not reduced as a result of this action, and any impact on ADP and ACP testing should be minimal. | • No action needed. |
| Salary reductions | • Affected non-HCEs may intentionally reduce or eliminate their contributions in an effort to close the gap in their take-home pay. This could negatively impact ADP and ACP test results.  
• If salary reductions apply to HCEs and they do not reduce their salary deferrals, the result could be an increase in the HCE ADP and ACP, which could negatively impact the test results.  
• If participants generally accept the salary reductions without changing their salary deferral percentages, the ADP and ACP tests would be unaffected.  
• If any participants were considered HCEs because their prior-year compensation was just over the HCE compensation limit, and this pay cut would cause them to drop below the HCE compensation limit for the current year, this could cause them to be considered non-HCEs for the following plan year. This could have either a negative or positive effect on the test results depending upon the level of contributions these individuals were making. | • Implement an undersaver or nonsaver sweep to improve savings rates if salaries are fully restored later in the year.  
• If sweeping this population is not possible, use targeted participant communications to encourage reenrollment.  
• If plan sponsors are concerned that tests will fail, they could consider the following:  
  o Impose a cap on HCE deferrals for the balance of the year, or  
  o Keep the current plan features in place and make refunds to HCEs if necessary. This will allow HCEs to maximize their contributions within the limits of the ADP and ACP testing. It is important to communicate the possibility of refunds to HCEs early so that they understand and expect this possible result.  
  o In limited circumstances, where practicable, consider midyear projection testing after employee saving behavior changes can be determined. |
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| Reduction or elimination of company match | • If non-HCEs reduce or eliminate their salary deferral contributions, the ADP and ACP test results could be negatively impacted.  
• If the plan is a 401(k) safe harbor plan, reducing or eliminating the match may only be done if certain timing, notice, and amendment requirements are satisfied. This would also require that the plan perform ADP and ACP testing. | • If plan sponsors are concerned that tests will fail, they could consider the following:  
  o Impose a cap on HCE deferrals for the balance of the year, or  
  o Keep the current plan features in place and make refunds to HCEs if necessary. This will allow HCEs to maximize their contributions within the limits of the ADP and ACP testing. It is important to communicate the possibility of refunds to the HCEs early so that they understand and expect this possible result.  
  o In limited circumstances, where practicable, consider midyear projection testing after employee saving behavior changes can be determined.  
• If the match is restored later, implement an undersaver or nonsaver sweep to restore savings rates for participants who elected to reduce or stop salary deferrals in response to the reduction in the match.  
• If sweeping this population is not possible, use targeted participant communication to encourage reenrollment. |
| Elimination of nonelective employer contribution | • If the plan is a 401(k) safe harbor plan, and the plan was satisfying the safe harbor contribution requirements by making the 3% nonelective contribution, reducing or eliminating this contribution may only be done if certain timing, notice, and amendment requirements are met. This would also require that the plan perform ADP and ACP testing.  
  o While it is not as likely that participants will reduce their salary deferral rates in reaction to this change, it is possible that the ADP and ACP tests will not pass if difficulty passing these tests was part of the motivation for adopting the safe harbor. | • If plan sponsors are concerned that tests will fail, they could consider the following:  
  o Impose a cap on HCE deferrals for the balance of the year, or  
  o Keep the current plan features in place and make refunds to HCEs if necessary. This will allow HCEs to maximize their contributions within the limits of the ADP and ACP testing. It is important to communicate the possibility of refunds to the HCEs early so that they understand and expect this possible result.  
  o In limited circumstances, where practicable, consider midyear projection testing after employee saving behavior changes can be determined. |