The CARES Act

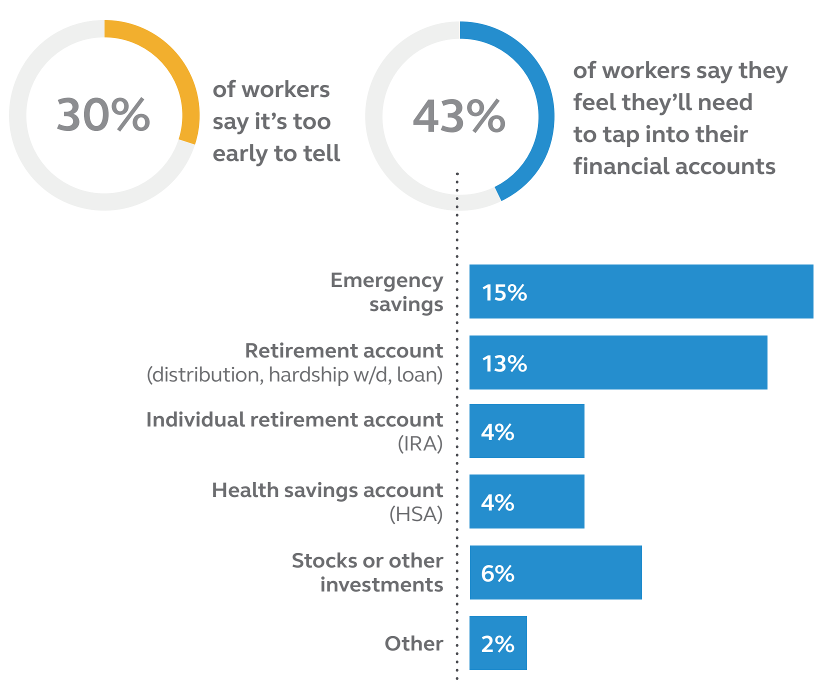
Loans and withdrawals

In times of crisis—such as a global pandemic—accessing the money in a retirement account is a reality that many begin to consider. Understanding that people are experiencing tremendous financial burdens caused by COVID-19, Congress quickly passed the CARES Act, parts of which make it easier for eligible individuals to borrow or take a coronavirus-related distribution (CRD) from a retirement account if meeting eligibility requirements. As some individuals look to this source for financial relief, it's important to offer education so they can make the most informed choice for their situation.

Could more people tap into their retirement funds?

Data before the coronavirus pandemic shows that over 70% of defined contribution plans allow loans.[1] Of these, we see that nearly 14% of participants have at least one loan.[1] In a survey conducted after COVID-19 mandates, **we asked employees[2]:**

Do you feel you will need to tap into any of the following financial accounts, if available, due to the effects of COVID-19 and market volatility?



[1] Data and metrics analysis of plan sponsors and participants with services provided by Principal, May 2020.

[2] Principal Financial Group, Consumer Pulse Survey, March 2020.

What you should know about CARES Act loans or CRDs

If the plan allows, the CARES Act allows individuals to borrow or "withdraw" 100% of their vested account balance, up to $100,000. That's a lot more than is typically allowed. The increased loan amounts are available through Sept. 22, 2020, and CRDs available through Dec. 30, 2020. It's important to calculate how much is needed to get through the crisis by reviewing additional income options and ways to reduce monthly expenses.

Fees may apply

Fees will most likely be charged for both a CARES Act loan or CRD. Loans typically have an origination fee and quarterly maintenance fees. Withdrawals usually come with a distribution processing fee. Ask the provider for more details and amounts.

Principal is waiving both loan origination and distribution processing fees through Sept. 30, 2020.

No tax penalty for the CRD

A benefit under the CARES Act is that there is no 10% early withdrawal tax penalty for a CRD.

Changes to taxes

To get more money into the hands of those impacted by the pandemic, a CRD only withholds 10% for federal tax at distribution (typically 20%). But the participant can choose to opt-out of this withholding altogether at distribution. But beware—taxes are still due! To help with the potential tax burden of the distribution, the CARES Act allows:

1. The entire distribution amount be included in their taxable income in the year of the distribution, or
2. The tax burden to be spread equally over three tax years (2020, 2021, and 2022).

Repayment is allowed for both

Loans: The benefit of a loan is that the principal and interest are paid back to the retirement account. The CARES Act is delaying loan payments due from March 27 - Dec. 31, 2020, for one year, and the delay period doesn't count against the loan's maximum term. However, interest begins accruing from the loan's origination date.

CRDs: The CARES Act allows all or part of a CRD to be paid back within three years. This is a unique way to take a withdrawal and still make up some of the lost savings. The individual may be able to file amended tax returns and claim a refund for the tax years in which amounts were paid back to the CRD.

Plan sponsors to decide what's best for their plan

Under the CARES Act, plan sponsors must decide if they will allow revised loan provisions and CRDs and have their plan amended. Just because the plan normally permits loans and withdrawals doesn't mean they automatically will under the CARES Act.

Eligible plans – 401(a), which includes 401(k), 403(b); or eligible deferred compensation plans under governmental 457(b).

Eligibility for CARES Act loans and CRDs – Account owners must self-certify that they:

- Themselves, have been diagnosed with virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention,
- Have a spouse or dependent (as defined in Section 152 of the Internal Revenue Code of 1986) diagnosed with the virus or disease by such a test,
- Themselves (not a spouse or partner), have experienced adverse financial consequences resulting from a reduction in work hours, layoff, quarantine, furlough, or are unable to work due to lack of childcare or business closing, all on account of the virus or disease; or based on other factors determined by the Treasury Secretary.

Have an existing loan? If eligible under the CARES Act, account holders are allowed to delay their payments due from March 27 - Dec. 31, 2020. Interest will continue to accrue during this time and payments will be adjusted beginning with the 2021 payments.

How a loan or withdrawal can impact future retirement savings

When looking to take a CARES Act loan or CRD, there's a lot more than just the amount that hits future retirement savings. One is typically taking money when the market values are lower, which could mean losing out on potential market rebounds. The account also loses the potential for compound interest growth on the amount taken and any deferrals that may have been paused during the loan period. This distribution of savings can be a substantial setback to your goals.

How taking $10,000 could turn into a $171,000 shortfall at retirement

Here we see a 35-year-old with a current retirement account balance of $16,000. If they leave their account alone, the account balance at age 65 could be as much as $628,000.

Taking a $10,000 CARES Act loan and pausing deferrals for four years could result in an overall reduced account of 18% or -$113,000.

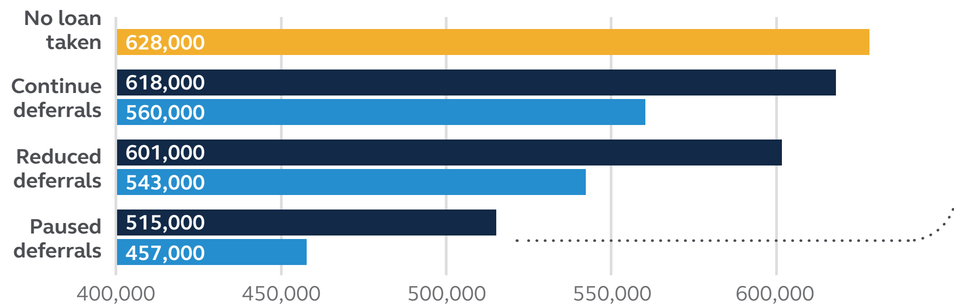
Taking a CRD of $10,000 and pausing deferrals for four years could hit the 35-year-old even harder with a potential reduction of

27.2% or -$171,000 to their retirement account balance by age 65.

$10k loan/CRD estimated impact to balance at age 65*

● Loan ● CRD

Retirement cost of loan analysis, Principal 2020



A loan or withdrawal closer to retirement can hit hard*

The chart below shows the potential impact of taking $15,000 with either a CARES Act loan or CRD to the retirement balance of a 50-year-old whose current balance is $34,000.

The older person doesn't have as much time to make up the reductions from taking out $15,000. If they take a loan and pause deferrals for four years during repayment they could be down 22.7%, or -$58,000.

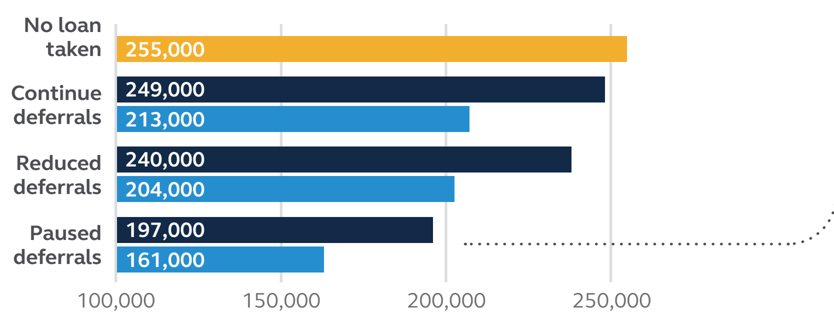
Taking a $15,000 CRD and pausing deferrals for four years as they get back on good financial footing could results in

36.9% less, or -$94,000 at age 65.

$15k loan/CRD estimated impact to balance at age 65*

● Loan ● CRD

Retirement cost of loan analysis, Principal 2020



Deferrals

Both scenarios show the importance of maintaining deferrals during a loan repayment or after taking a CRD.

One should ask:

1. Can I afford to make regular contributions to the retirement account while making the required loan payments? Or, after the CRD?
2. If I can't afford to maintain the current level of deferral, can I reduce the deferral rate? At a minimum, keep the deferral rate at the level necessary to get all the employer match so not to miss out on what many consider "free money" from the plan sponsor.

*See appendix section for more information related to these charts. All amounts rounded.

Next steps

Taking money from a retirement account is not a decision to take lightly. There are a few things to consider first.

Create a budget

Now's the time to develop a budget to determine how much may be needed to borrow or withdraw. Three months? Six months? Maybe 12 months? Come as close to the actual amount needed to get through the impact created by COVID-19.

Exhaust other options

Because of the COVID-19 pandemic, there may be other help available for those looking to get through this crisis.

Find additional income:

- **Determine** if eligible to receive stimulus money.
- **Factor** in any severance or bonus payments from the employer, if laid off.
- **File** for unemployment.
- **Look** into a personal loan from a bank or credit union.
- **College savings.** Temporarily stop contributing to a college savings account. Or, see if there's a way to access the balance without penalty. It may be easier to fund college for your children through other means than sacrificing your retirement savings.
- **Home owners:** Look into a home equity line of credit (HELOC). Again, with interest rates so low, this may be the time to tap into your home's equity.

Look for ways to reduce monthly expenses:

- **Reach out to creditors –** (e.g., auto loan holder, credit cards)—many are willing to make different arrangements such as waiving fees, lowering interest rates or making payment adjustments.
- **Renters –** reach out to the landlord and ask for leniency or a payment plan.
- **Utilities –** Call utility providers. There may be assistance programs for customers who cannot pay due to a loss of income due to COVID-19.
- **Student loans –** The CARES Act temporarily suspends principal and interest payments on federally held student loans through Sept. 30, 2020. If the student loan is privately held, it may not qualify for the CARES Act relief. If this is the case, reach out to the servicer to see if they are offering any options to help those impacted by COVID-19.
- **Home owners:**
  - **Many companies have halted foreclosures and evictions.** The CARES Act mandates that all borrowers with government-backed mortgages be allowed to delay at least 90 days—or possibly a year.
  - **See if the mortgage can be refinanced –** interest rates are at historic lows, which could lower your mortgage. Ask if there are any fees for refinancing.

Speak to a financial professional

As we've said before, it's a big decision to take money out of a retirement account. Even though the CARES Act provides some relief, it still needs careful consideration and thought. Financial professionals have the expertise to work through various scenarios with individuals to help them meet their financial burdens due to COVID-19 and keep their retirement goals in focus.

Appendix

Retirement cost of a loan analysis summary

Analysis has been completed to estimate the potential impact on a participant's estimated retirement account balance from taking a loan and CRD from their retirement account. The analysis looks at two sample participants and measures the impact of multiple scenarios on a given sample participant.

Assumptions

The analysis uses the standard assumptions with the following changes related to the COVID-19/CARES Act situation.

Annual rate of return – This analysis uses two annual rates of return to account for the heightened rate of return following an economic downturn. Principal Global Investors identified a 12.7% annual rate of return for the first three years following the Great Recession using a 60/40 asset allocation, based on 60% S&P 500 index and 40% Bloomberg Barclays US Aggregate. For these reasons, we use a 12% annual rate of return for the first three years of these estimated projections. The analysis then uses an annual rate of return of 6% for the remaining years until retirement. The assumed rates of return in this analysis are hypothetical and do not guarantee any future returns nor represent the returns of any particular investment. Amounts shown do not reflect the impact of taxes on pre-tax distributions. Individual taxpayer circumstances may vary. This is for illustrative purposes only.

Loan details – The loan's interest rate is the default assumption of 4.5% which aligns with the common Prime +1% rate used in practice. A loan repayment period of three years (78 bi-weekly payments) is used which aligns with the three-year period allowed for a coronavirus related distribution to be paid back into the retirement account. The analysis also includes a one-year delay for loan repayment allowed by the CARES Act which means the loan taken in the analysis is fully paid back after a total loan length of four years.

Sample participant inputs

We use a 6% deferral rate and a 50% up to 6% match for both sample participants. The goal was to get two sample demographics, one being earlier in their career and one later in their career. Once the ages were identified, the distribution of salaries and account balances were analyzed for participants with loans to identify the inputs used in the estimated projections. A 3% annual salary increase was assumed. Due to the increased maximums available from the CARES Act, loan amounts were increased from median to the top of the third quartile in Principal data to assume a need for larger loan amounts. The loan amounts align with three months of average expenditures by quintile provided in the 2019 Consumer Expenditure Survey from the U.S. Bureau of Labor Statistics. For this analysis, loan amounts can exceed 50% of the participant's account balance allowed by the CARES Act.

Appendix

Scenarios

The analysis uses the defined assumptions and sample participant inputs to project the account balance and future employee/employer contributions forward to get an estimated retirement account balance at age 65 under each scenario. Estimated account balances are varied for each sample participant to reflect typical balances for the sample ages. The following scenarios were projected:

No loan taken – This scenario is used as the baseline scenario. The participant does not take a loan or distribution and continues their path until retirement. We measure the potential loan/distribution's impact by measuring the difference in estimated retirement account balances for the various scenarios to compare to the baseline scenario's estimated balance.

Takes loan and pays it back (still deferring) – assumes the participant takes a loan and pays it back to the retirement account following the loan repayment schedule. The loan repayment amount includes the interest accrued during the CARES Act repayment delay period. No interruption to deferrals is assumed.

Takes loan and pays it back (reduced deferrals) – assumes the participant takes a loan and pays it back to the retirement account following the loan repayment schedule. The loan repayment amount includes the interest accrued during the CARES Act repayment delay period. This scenario assumes the participant reduces their deferral rate by 1% and therefore reduces the employer match which is in line with analysis of Principal data.

Takes loan and pauses deferrals in repayment – assumes the participant takes a loan and pays it back to the retirement account following the loan repayment schedule. The loan repayment amount includes the interest accrued during the CARES Act repayment delay period. This scenario assumes the participant stops deferring in the first four years and then resumes deferrals once the loan is fully repaid.

Coronavirus-related distribution – assumes the participant takes a distribution from the retirement account of the same amount as the assumed loan amounts for comparison purposes. This scenario assumes the distribution does not get paid back to the retirement account and assumes there is no change to the participant's deferrals.

Coronavirus-related distribution reduced deferrals – assumes the participant takes a distribution from the retirement account of the same amount as the assumed loan amounts for comparison purposes. This scenario assumes the distribution does not get paid back to the retirement account and assumes the participant reduces their deferral rate by 1% and therefore reduces the employer match which is in line with analysts of Principal data.

Coronavirus-related distribution pauses deferrals – assumes the participant takes a distribution from the retirement account of the same amount as the assumed loan amounts for comparison purposes. This scenario assumes the distribution does not get paid back to the retirement account and assumes the participant stops deferring in the first four years and then resumes deferrals.

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