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Is Your Nonprofit Slashing Benefits to Offset Federal Funding Cuts?

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Use Caution When Responding to the Recent Executive Orders

On February 6, 2025, the Trump administration (the Administration) issued an executive order (the Review Order) directing the heads of Federal executive departments and agencies (Agencies) to review all funding the Agencies provide to "Nongovernmental Organizations."[1] The Agencies were further ordered to align all future funding decisions with the interests of the United States and the Administration's goals and priorities.

The Administration's issuance of the Review Order, when coupled with an earlier executive order (the Funding Order) freezing federal spending on grants, loans, and other initiatives,[2] has shaken the nonprofit community by threatening the funding of nonprofit organizations both in the United States and around the world. Nonprofit organizations are now weighing their options for managing the potential impact the Funding Order and the Review Order may have on their operations and finances.

While some nonprofit organizations may turn to layoffs or furloughs as a means of cost-cutting,[3] others may consider reducing employer contributions to their employee benefit plans to stay afloat while the funding fight plays out. Like for-profit employers, nonprofit employers recognize the important role generous benefits play in hiring and retaining talented employees, and understand that reducing benefits mid-year is not a decision to be taken lightly. This article discusses some of the compliance challenges nonprofits may face if they elect to do so.

Health Care Plans

Nonprofit employers (like other employers) typically set the employee contribution levels for their health and welfare plans for the full plan year and don't adjust those levels until the next year. As a result, if an employer wants to increase employee contributions during the plan year, it must make such changes carefully.

Plan Amendments and Employee Notifications:

A nonprofit employer should work with its third-party administrator and/or legal counsel to amend the terms of its health plan documents to implement any planned increase in employee contributions. In

determining the effective date of any changes, the employer should consider both when it must notify its employees of the change and how best to do so.

SPDs and SMMs. Under ERISA, employers must provide retirement and welfare benefit plan participants[4] with a "summary plan description" (SPD) describing the terms of their plans in a way that is straightforward and understandable to participants. If an employer amends an ERISA benefit plan in a way that materially modifies the SPD, it must provide plan participants with a "summary of material modifications" (SMM) describing the change. Generally, an SMM must be provided to plan participants within 210 days after the end of the plan year in which the employer adopted the change.

Different timing rules apply, however, if the employer amends a health or welfare plan to materially reduce the plan's "covered services or benefits." A material reduction in covered services or benefits may occur due to increases in "premiums, deductibles, coinsurance, copayments, or other amounts to be paid by a participant or beneficiary."[5] When an employer amends a health or welfare plan to materially reduce the plan's covered services or benefits, it must provide plan participants with an SMM describing the change within 60 days after adopting that change.

SBCs. Sometimes, an employer may also be required to provide participants and beneficiaries with advance notice of a change to the employer's health plan. Under the Patient Protection and Affordable Care Act (the ACA), an employer must provide its employees with a "Summary of Benefits and Coverage" (an SBC), an easy-to-understand summary of each coverage offered under the employer's health plan. If a material modification to a health plan affects the content of the plan's SBC, the employer must provide participants and beneficiaries with advance notice of the change – at least 60 days before the date on which the change becomes effective.

Cafeteria Plan Elections:

Even if an increase in employee premium contributions doesn't affect a health plan's SBC, from a practical standpoint, an employer will likely want to give plan participants advance notice of any premium increase. This will allow the employer to provide context for the increase, and if permitted under the employer's Code §125 or "cafeteria" plan, to communicate to employees their ability to make new benefit elections under that plan.

A cafeteria plan allows employees to purchase (or pay the cost of) certain welfare benefits (such as premiums for group health benefits, group life and AD&D coverage, dependent care assistance, etc.) on a pre-tax basis. To receive that benefit, however, employee elections must be made during open enrollment (before the beginning of the applicable plan year) and are generally irrevocable for the entire year.

Employees may be permitted to change their elections, however, if they experience certain "change in status" events, such as marriage, birth/adoption of a child, etc. They may also be permitted to change prior elections because of a "significant" change in cost or coverage.[6] Whether a change in cost or coverage is significant is based on the relevant facts and circumstances, including the relative impact on the employee population, prior cost increases, etc. If increasing employee health care premium contributions is deemed "significant," employees must be given the opportunity to change their prior health care elections.

Potential ACA Penalties:

If employees are permitted to change their health care elections due to an increase in their health

care premium contributions, they may elect to drop a nonprofit employer's health care coverage entirely. This could lead to unintended consequences for the employer. For instance, if after dropping the employer's health care coverage, the employee then obtains alternate coverage on a state ACA marketplace and qualifies for a premium subsidy (because the employer's coverage is now deemed to be unaffordable), the employer could be subject to ACA penalties.

Tax-Qualified Retirement Plans

Code §401(k) and §403(b) Plans:

A nonprofit employer may elect to offer its employees access to a Code §401(k) plan, a §403(b) plan, or (in some cases) both, to allow them to save for their retirements.[7] Nonprofits may provide employer nonelective or matching contributions as an additional benefit to their employees. If, as a cost-cutting measure, a nonprofit wishes to reduce its employer contributions to such a plan, it should look first to the plan's terms.

Discretionary Contributions. If the plan grants the employer discretion to determine whether nonelective/matching contributions will be made each year, a plan amendment won't be needed. The employer can simply reduce – or suspend entirely – its contributions going forward. (Note that any such change would need to be made prospectively.)

Because no plan amendment is required, *technically*, the employer would not be obligated to notify employees of the change. However, open communication with employees about the reduction/suspension is probably the better option, as it will allow the employer to explain the rationale for the change. Employees, for their parts, may want to adjust their own elective deferrals because of the reduction/suspension of employer contributions.

Fixed Rate of Contributions. If the plan specifies the rate of employer nonelective or matching contributions, the employer will need to amend the plan to implement a reduction/suspension of those contributions.

Advance notice of the amendment isn't required in this case, but the employer will be obligated to provide plan participants with an SMM. While the SMM isn't due until 210 days after the end of the plan year in which the amendment is adopted, again, a nonprofit employer should consider whether communicating the change sooner rather than later (by providing the SMM to participants as soon as possible or by other means) makes sense under the circumstances.

"Safe Harbor" Plans. A "safe harbor" §401(k) or §403(b) plan will be deemed to pass certain nondiscrimination testing requirements, if the sponsoring employer satisfies various contribution and participant notice requirements.

If an employer makes "safe harbor" *matching* contributions on behalf of participants, it may amend its plan to reduce/suspend those contributions mid-year if:

- The employer is "operating at an economic loss" during the plan year; or
- For any reason, if the "safe harbor" notice provided annually to plan participants includes a statement allowing the employer to reduce or suspend the "safe harbor" matching contributions during the year.

The plan amendment may take effect no earlier than 30 days after the employer provides employees

with a supplemental "safe harbor" notice describing the reduction/suspension of employer contributions.

Employers that use a pre-approved plan format should contact their plan vendors for help in preparing the needed amendment (working with their legal counsel as needed) and in coordinating the amendment's effective date with the distribution of the supplemental "safe harbor" notice.

An employer that makes "safe harbor" *nonelective* contributions on behalf of plan participants may also amend its plan to reduce or suspend those contributions. While such employers are generally no longer required to provide an annual safe harbor notice (per the Setting Every Community Up for Retirement Enhancement (SECURE) Act), employers should still consider providing employees with timely notice of the change.

SMMs Required. Even if an employer must notify plan participants in advance of the reduction/suspension of employer "safe harbor" contributions (through the provision of a supplemental "safe harbor" notice), the employer will also need to provide participants with an SMM describing the change within the timeframe discussed above.

Non-Qualified Deferred Compensation Plans

Code §457(b) and §457(f) Plans:

A tax-exempt nongovernmental nonprofit[8] may establish a Code §457(b) plan to permit a select group of its highly-compensated or management employees to set aside additional funds towards their retirement (in excess of the amounts contributed to a Code §401(k) or §403(b) plan). Nonprofit employers may also make contributions on behalf of Code §457(b) plan participants.

In order to defer immediate taxes on those employer and employee contributions, a Code §457(b) plan must meet certain requirements, such as limits on annual contributions (combined between employee and employer contributions), timing of distributions, etc. Nonqualified deferred compensation plans that do not meet the requirements of Code §457(b) (typically because total contributions to the plan exceeds the annual contribution limit) are classified as Code §457(f) plans. (Together, this article refers to such plans as "457 Plans.")

Amendment Needed? Like §401(k) and §403(b) plans, whether a 457 Plan must be amended to reduce/suspend the employer's rate of contributions (if any) will depend on whether the plan documents give the employer discretion to determine its contributions each year, or whether such language is baked into the plan document. If a 457 Plan grants the employer total discretion to make contributions, no amendment will be needed. If the 457 Plan contains language describing the employer's level of contributions, however, the 457 Plan will need to be amended if the employer wishes to reduce/suspend employer contributions.

No SMM Needed. Even if an amendment is needed (because the 457 Plan document specifies that the nonprofit employer will make a particular level of employer contributions), the employer is not required to provide 457 Plan participants with an SMM. Because participation in 457 Plans is limited to a small group of (at least presumably) financially-sophisticated employees, 457 Plans are considered "top-hat" plans. Top-hat plans are not subject to ERISA's disclosure rules,[9] including its requirement to provide an SPD to participants or to update that SPD with an SMM any time the plan is materially modified.

Even so, given that participants in the 457 Plan will likely include the nonprofit's senior executives and staff, a nonprofit amending its 457 Plans to reduce/suspend employer contributions will likely wish to be open with participants about the changes to its contributions and the rationale behind those changes.

Benefits in Employment Agreements. A nonprofit employer's ability to amend a 457 Plan may be limited if the grant of benefits under the 457 Plan is only documented in an eligible participant's employment agreement.[10] In that case, any amendment to the employer's obligation to contribute to the arrangement will be subject to the terms of the employment agreement, and, as a result, may be subject to the employee's approval.

Code §409A Issues. Code §457(b) plans are exempt from the requirements of Code §409A, while Code §457(f) plans) are not. Code §409A imposes stringent rules on both the timing of payment and changes to the timing of payment under nonqualified deferred compensation arrangements.[11] Failure to meet Code §409A's requirements can result in significant penalties to the employee (and result in information reporting failures for the employer). While the reduction/suspension of employer contributions to a Code §457(f) plan *probably* won't implicate Code §409A, a nonprofit employer should consult with its tax advisor or legal counsel before making any changes to such plans.

FOOTNOTES

[1] The Review Order doesn't specifically define what a "Nongovernmental Organization" is. However, given the broad scope of the Review Order, it seems reasonable to assume the term includes any nonprofit organization accepting federal funds.

[2] The Funding Order was challenged in Federal court by Democratic Attorneys General in 22 states and the District of Columbia. Although the District Court hearing that challenge found that a "broad categorical and sweeping freeze of federal funds" was "likely unconstitutional," the fight to force the Administration to resume payments for federal programs is ongoing.

[3] Nonprofits considering layoffs or furloughs as a means of saving funds should review our prior article about the impact of employer furloughs on employee benefits. While written at the beginning of the COVID-19 pandemic, the article provides helpful guidance to nonprofits navigating the potential effects a furlough or layoff may have on their workforce's benefits. Be aware, however, that the COVID-19 relief programs mentioned in that article no longer apply.

[4] Beneficiaries receiving benefits under the plan are also entitled to receive an SPD.

[5] *See* 29 CFR §2520.104b-3(d)(3).

[6] *See* 26 CFR §1.125-4(f).

[7] While some nonprofits may offer defined benefit pension plans to their employees, this is not as common as in the past. As a result, we have not discussed changes to such plans in this article. However, additional information about such changes can be found here.

[8] For clarity, this article discusses the rules applicable to Code §457(b) and §457(f) plans maintained by non-governmental, tax-exempt nonprofit organizations. Different rules may apply to Code §457(b) plans maintained by governmental entities.

[9] They are, however, subject to certain other provisions of ERISA, such as ERISA's claims and appeals procedures.

[10] This happens occasionally, especially where only a single employee is receiving a 457 Plan benefit. The better practice is to mention the 457 Plan in the employee's employment agreement, while documenting the 457 Plan arrangement separately.

[11] A discussion of the parameters of Code §409A is outside the scope of this article. Consider yourself lucky.

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