Loans Made under a Retirement Plan

The following are requirements for loans made under a 401(a)/(k), 403(b) or governmental 457(b) employer-sponsored retirement plan for loans made on or after January 1, 2004.

In General

An employer may offer loans to participants under a 401(a)/(k), 403(b) or governmental 457(b) plan. Participants are permitted to use a portion of their vested participant accounts to borrow from as loan proceeds and to repay those loan amounts, together with interest.

Depending on the product provisions issued to the retirement plan, a loan may be structured as either a “contract loan” or as a “trust loan”:

- A *contract loan* is structured as a loan between the insurer issuing the annuity contract and the participant. Amounts are loaned by the insurer (rather than from the participant’s account under the plan), with the participant’s account under the contract serving as security for the loan issued by the insurer.

- A *trust loan* is a loan taken from the plan rather than the underlying product. Amounts are loaned from the participant’s account under the plan and the plan holds a loan promissory note under a loan trust as an asset of the plan. Since the promissory note is a plan asset, it must be held in trust or similar custodial arrangement to comply with both the Internal Revenue Code (the “Code”) requirements and the terms of the applicable product.

Internal Revenue Code (the “Code”) and the Employee Retirement Income Security Act of 1974 (“ERISA”)

All loans made under retirement plans are subject to the Code. If a retirement plan is subject to ERISA, then ERISA imposes additional requirements on the loan program. The Code and the ERISA loan rules are discussed below.

Code Loan Rules

In General

- A loan cannot exceed the *lesser of* (a) $50,000 reduced by the participant’s highest outstanding loan balance during the last 12 months or (b) 50% of the vested account balance. In a nonERISA plan, if permitted by the plan and the underlying product from which the loan will be made, a participant may take a loan of up to $10,000, even if that amount is more than 50% of the vested account balance. The minimum $10,000 loan amount is not available for plans subject to ERISA.

  In calculating this limit, a participant’s account (including accrued interest on defaulted loans) under all retirement plans sponsored by the employer (together with employers under common control and affiliated service groups) must be taken into account.

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- Loans for nonresidential purposes must be repaid in level payments at least as frequently as quarterly within 5 years. However, if the loan is for the purpose of a participant's acquiring his principal residence within a reasonable period of time, the plan's loan program may permit a repayment period of more than 5 years.

- The loan must be set forth in a legally enforceable agreement specifying the amount and date of the loan and the loan terms, including the loan repayment schedule.

Loan Default, Deemed Distribution and Loan Offset

- The loan repayment schedule may provide for a grace period. The **grace period** or "cure period" is a period of time in which a participant is permitted to make a loan repayment after the due date of the scheduled repayment. Under the Code, this period cannot extend beyond the last day of the calendar quarter following the calendar quarter in which the payment was due. For example, if a loan repayment is due on March 31 of a calendar year, the loan program may give the participant until June 30 of that same calendar year to make a loan repayment.

- If a loan payment is not received by the last day of the "**grace period**," then the entire outstanding loan, including accrued interest to date, is in default. In addition, a plan may also provide that, notwithstanding the loan repayment schedule, if a participant terminates employment or the plan terminates and that participant has a plan loan outstanding, the participant's obligation to repay the loan is accelerated.

- Subject to the terms of the plan and the plan's loan program, as applicable, if a participant is entitled to receive a distribution (e.g., age 59½, severance from employment) at the time of default, the participant's accrued benefit may be reduced (or "**offset**") by the entire outstanding loan in order to repay the loan and such "**offset**" is reported via an IRS Form 1099-R as an actual distribution in the year of the default. That is, an "**offset**" is the amount by which a participant's account balance under the plan is reduced to repay the loan.

  A loan offset amount may be rolled over by a participant to another eligible retirement plan within 60 days from the date of the loan offset. Additionally, a participant whose loan offset is solely the result of plan termination or severance from employment may extend the 60 day rollover period to the due date (including extensions) for filing the participant's federal individual income tax return for the tax year in which the offset occurred. If the loan offset amount is rolled over to an employer-sponsored eligible retirement plan, the terms of that employer-sponsored plan must permit receipt of plan loan offset rollovers.

- If the participant is ***not*** entitled to receive a distribution under the terms of the plan at the time of default, the entire amount of the outstanding loan balance is considered a "**deemed distribution**", and is reported via IRS Form 1099-R as a deemed distribution in the year of default. Under this scenario, the defaulted loan remains outstanding until eventually paid or offset. A deemed distribution is not eligible for rollover.

Subsequent Loans Following a Deemed Distribution of a Loan

In accordance with the IRS loan regulations, interest continues to accrue on the entire defaulted loan balance until it is repaid post-default or offset with an actual distribution from a participant's account balances. Until an offset or post-default repayment occurs, the accrued interest is taken into account to determine the maximum amount available for a subsequent loan to the participant. However, interest that accrues post-default is not considered a deemed distribution and thus is not reported to the IRS for years following the year of the loan default.

If a participant requests another loan after his prior loan has defaulted and is considered a deemed distribution, the IRS regulations permit a loan under the following scenarios:

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- If a participant makes loan repayments after a deemed distribution has occurred but before an offset, the repayments (including repayments of interest) are treated as after-tax amounts or "tax basis." These after-tax payments are not considered after-tax contributions for purposes of nondiscrimination requirements and the Code Section 415(c) annual additions limit. Repaying a defaulted loan enables a participant to take a subsequent loan from the plan without any additional requirements outlined below.

- If the participant does not repay the outstanding loan post-default, a subsequent loan is permitted if either:
    - Repayments on the subsequent loan are made through payroll deductions, ***or***
    - The plan receives adequate security from the participant that is in addition to the participant's accrued benefit under the plan.

    Note: A participant's ability to take a subsequent loan is also dependent on there being both an available amount for a loan (taking into account the deemed distribution due to the loan default) and loan administration under the plan accommodating loan repayments and/or security in accordance with the IRS and ERISA regulations.

Loan Treatment When an Active Participant Goes on Leave of Absence

If a participant with an outstanding loan goes on bona fide leave of absence, the loan repayments may be made by check each month. Alternatively, loan repayments may be suspended during an approved leave of absence for a period of no more than 12 months for those circumstances where a participant on a leave of absence does not have sufficient wages during the leave (after reduction for income and employment tax withholding) to make the scheduled loan payments. Once the suspension period has ended, the loan may be reamortized to take into account the payments suspended during the leave of absence. However, the term of the loan cannot be extended beyond the original length of the loan.

Loan Treatment When a Participant's Leave of Absence Is Due to Military Service

Special rules apply if a plan participant with an outstanding loan goes on military leave.

- Interest rate: In accordance with the Servicemembers Civil Relief Act of 2003, the rate of interest accruing during the period of military leave cannot exceed 6% compounded annually. The participant must supply a copy of the military orders to the plan sponsor and request that this special interest rate limit be applied.

- Loan repayments: The plan may provide for loan repayments to be suspended (and thus will not be considered a deemed distribution) when the participant is performing military service, even if that suspension is greater than 12 months or results in an extension of the loan term. If loan repayments are suspended, they must resume when the participant's military service ends, and the repayment frequency and amount of each repayment upon return to employment must be at least equal to the repayment frequency and amount under the pre-military schedule.

- Loan term: If the nonresidential loan term initially was for a period of fewer than 5 years (or longer if a residential loan), the participant's loan term upon return from military leave may be extended to no more than the total of the maximum term for the original loan plus the military service period. In accordance with the terms of the loan and IRS regulations, the participant is obligated to repay the full loan amount (including interest accrued during the military service period) by the end of maximum term for the original loan plus the military service period.

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Refinancing Transactions

A refinancing transaction is defined as any situation in which one loan replaces another. A refinanced loan is treated as a new loan if it both replaces a prior loan and has a later repayment date. Thus, both loans are treated as outstanding on the date of the refinancing transaction and, as a result, must be taking into account in determining the maximum loan available to the participant. The refinancing rules permit the extension of a prior loan with an original term of less than five years to a term of five years from the date of the prior loan.

ERISA Loan Rules

If the plan is subject to ERISA, then the plan must also satisfy the following criteria when offering loans to participants:

- Loans must be made available to all participants on a reasonably equivalent basis including:
    - Making loans available to all participants without regard to race, color, religion, sex, age or national origin;
    - Considering only those factors that would be taken into account in a commercial setting by an entity in the business of making similar types of loans; and
    - Evaluating all reasonable facts and circumstances to indicate that, in actual practice, loans are not unreasonably withheld from any applicant.

- Loans cannot generally be made available to highly compensated employees in amount greater than the amount made available to other employees. This rule does **not** apply to participants who are former employees, retirees, beneficiaries or alternate payees under a qualified domestic relation order ("QDRO").

- Loans are made in accordance with the terms of the plan. A loan program may establish a minimum loan amount of up to $1,000.

- A loan must bear a reasonable rate of interest. The rate of interest on a loan must be "commensurate with the interest rates charged by persons in the business of lending money for loans which would be made under similar circumstances."

- A loan is required to be adequately secured. Up to 50% of the vested value of a participant's account balances can be used to secure a loan. The minimum $10,000 loan amount described under the Code is not available for ERISA plans.

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