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An Update From Bodman PLC

Bodman PLC | COVID-19 Response Team Website

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401(k) Loan Requests

As participants attempt to deal with the COVID-19 crisis, many will consider borrowing from their 401(k) plans. While not required, most 401(k) plans offer loans to participants. Sponsors of 401(k) plans should be prepared to address issues as they arise with respect to loan requests. Sponsors should coordinate with their record keepers to ensure that loans can be processed in a timely and orderly manner. While each 401(k) plan is different and the terms of the plan and the loan policy and procedure should be consulted, the following highlights some of the considerations.

What are the procedures for requesting loans? Are loan requests processed using paper or an electronic medium? Can participants access the necessary means for applying for loans? Should alternative access to loans be made available? If the sponsor's staff is working remotely, will they have access to necessary information to approve loan requests? If spousal consent is required, how will the consent requirement be satisfied? Who is eligible for a loan? The first issue to consider will be whether the individual is eligible to borrow from the plan. Eligibility is often based on the status of the individual requesting the loan. If eligibility is based on whether the individual is a "participant" or "beneficiary" (i.e., someone who is or may become eligible to receive a benefit from an employee benefit plan) they may be eligible to apply for a loan even if they have separated from service. The eligibility rules might limit the availability of loans to former employees and beneficiaries.

Are there limitations on the number of loans outstanding? Is there a limit on the number of loans that a participant can have outstanding at one time? If multiple loans are permitted, the dollar and percentage limits applicable to loans must be applied on an aggregate basis.

How will the loans be repaid? Typically, loans are repaid via payroll withholding. While payroll withholding minimizes loan defaults and the adverse tax consequences that result from a default, loans can be repaid via other means. Should the loan provisions permit alternative payments? Will the sponsor or record keeper be able to process alternative payments?

What are the loan default provisions? Loans must define when a default occurs (e.g., non-payment). Typically, loans provide for a cure period during which missed payments can be made up. What is the cure period under the plan? The maximum cure period is the end of the calendar quarter following the calendar quarter in which the default occurs.

Are there acceleration requirements? Are there any events which trigger the acceleration of the outstanding loan balance? It is not uncommon for plan loans to accelerate the remaining loan balance due at the end of the cure period when an active employee terminates employment with the employer (either voluntarily or involuntary). Acceleration eliminates the administrative complexities of processing loan payments other than through payroll withholding. However, acceleration may create a financial burden for the participant.

If you have questions, please contact Bodman attorney **Dave Walters** at (248) 743-6052 or dwalters@bodmanlaw.com