

To be or not to be.... LOANS



Proposed 457 Regulations

- Only eligible governmental 457 plans can adopt
- Must comply with IRC Section 72(p)
- Must be bona fide and for the exclusive purpose of benefiting participant/ beneficiary

Loan will be considered a distribution unless...

- Safeguards are adopted to require repayment as any other prudent lender
 - enforceable agreement with repayment schedule
- Fixed repayment schedule
 - repaid within 5 years except for a home (principal residence)
 - loan repayments at least quarterly

Additional Requirements

- Loan cannot exceed the lesser of \$50,000 (in total outstanding loans) or 50% of account balance
- Reasonable interest rate must be assessed
 - typically prime plus 1%
- Loans in default (e.g., at termination) are treated as a distribution and included in gross income

Rationale “For” Loans

- Encourages employees to participate at a younger age
 - employee can access money if needed, e.g., for purchase of home, child’s education, etc.
- Encourages participants to defer greater income because they know they can access in the future for unforeseen needs

Rationale “For” Loans

- Older participants may find this desirable to help plan for retirement before terminating employment
 - such as to supplement income during a bridge job or to help purchase a retirement home
- Participants that fail to qualify for a financial hardship may qualify for a loan to meet current financial need

Rationale “Against” Loans

- This is a retirement benefit, not a bank account and participants will not have the money when they need it...at retirement
- More paperwork and complications for plan administration, which could result in additional cost

Rationale “Against” Loans

- Communicating drawbacks of loans is complicated
 - the cost of the lost investment opportunity
 - loan payments are made with after-tax income
 - outstanding loan balance taxed at termination

How would they work?

- All costs for administering the loan to be paid by those who use it
- Participants “borrow” assets from their WDC account and establish a repayment schedule with after-tax income
- Payments include interest at prime + 1% and are deposited back into their WDC account

Participant Loan Costs

- Current participant costs identified in NRS contract / bid document
 - \$50 application fee
 - \$2 per deduction for payroll repayment
 - \$5 per payment if made by check (plus any bank assessed NSF charges if checks returned)

Loan Features

- All participants would be eligible
- Must apply through a loan application, pay the application fee and acknowledge receiving a Truth in Lending document
- Must demonstrate ability to repay loan

Loan Features

- Minimum loan is \$1,000
- Maximum loan is 50% of account balance up to \$50,000 (*any other outstanding loans through an employer sponsored plan must be considered when determining this maximum*)
- Five year term for general purpose loans only

Loan Features

- Interest rate to be based on prime rate plus 1%
- Limited to one outstanding loan from the plan
- Loan payments made with after-tax dollars -- quarterly, monthly or by pay period
 - made by check, ACH wire transfers or payroll deduction

Loans In Default

- Failure to make scheduled payment could result in loan default
 - if payment and interest owed not paid within 30 days, loan will be in default
- Outstanding loan balance will be a deemed distribution and subject to federal and state tax
- Participant ineligible for future loans

Outstanding Loans at Termination

- Participants allowed a set period of time (e.g., 90 days) to repay outstanding balance and interest to their account
- If payment not received, outstanding loan balance considered in default and reported as a taxable distribution

Steps Necessary to Implement Loans in WDC

- Amendments to the Wisconsin Plan and Trust Document necessary to identify loan requirements
- Possible amendments to NRS administrative services contract
- Develop participant communication plan
 - Explain how “borrowing” from account will affect retirement income

Loan Administration - NRS

- Provide participants with information about loan feature
 - written material, one-on-one contacts and group presentations
- Approve or deny loan applications
- Administer repayment activities
- Determine loan defaults and issue necessary tax forms