

Plan Loans

Issue Date 06/17/2008

A. Background

Ongoing pension plans may allow participants to take loans (generally, of up to \$50,000) secured by the value of their benefits. Under Internal Revenue Service rules, money a participant receives from a pension plan generally is considered a distribution of his or her benefit and taxed accordingly. However, an amount received by a participant as a loan from an ongoing pension plan is not treated as an actual distribution of a benefit if specified conditions are met. These conditions include rules covering the terms of repayment, restrictions on the amount of the loan, and a requirement that there be an enforceable written loan agreement.

IRS rules also require spousal consent for a loan to a married participant. If spousal consent is not obtained at the time the loan is made, and if the participant is married to the same spouse when the benefit starts, the IRS rules require that the spousal benefit relating to the loan amount be protected.

This PBGC internal guidance describes the conditions that must be met for PBGC to consider a plan loan properly documented and the rules for handling such loans, in addition to those that are not properly documented. It also establishes rules for PBGC treatment of such loans, including repayment options, treatment of the loan in the plan valuation, and reporting the loan as income.

B. Scope and Effective Date

This PBGC internal guidance applies to participants and beneficiaries in PBGC-trusted plans. It is effective upon issuance.

C. Internal Guidance

1. General Rule

PBGC generally treats as loans all loans that met the IRS rules (see section C.3), as well as certain loans that failed to meet those rules in the ways described in section C.4. Other payments that may resemble loans but that departed from the IRS rules in major ways will be treated as pre-DOPT distributions under the guidance on Assignment or Alienation of Benefits (see section C.4.e, below).

PBGC will not make new plan loans after it becomes trustee of a plan, and it generally will not accept periodic repayments on prior loans after PBGC trusteeship. Thus, all plan loans taken before trusteeship but not fully repaid will be treated as due and payable as of DOPT. Borrowers will be given the opportunity to repay the unpaid loan balance at DOPT, including accrued interest, in a single payment. If the borrower does not repay the full amount (see section C.2), PBGC will offset the participant's benefit by the annuity equivalent of the unpaid loan balance at DOPT (see section C.3 and see section C.4). Section D of this guidance contains rules for calculating the "unpaid loan balance at DOPT" and for offsetting benefits by the unpaid loan balance at DOPT.

2. Repayment Option

As soon as practicable after the date of trusteeship (DoTR), PBGC will notify the borrower of the amount of the unpaid loan balance at DOPT and that his or her benefit will be offset by the annuity equivalent of that amount as of DOPT unless he or she repays the entire unpaid loan balance at DOPT within a reasonable time (generally 60 days from the date of the letter). If spousal consent was needed but not obtained at the time of the loan, this notice will also describe the spousal consent rules in section C.4.d.(3), below.

3. Offset of properly documented loans

A properly documented loan is one that was consistent with plan provisions and/or IRS rules, including loans that were:

- documented by a written loan agreement;
- made at the interest rate provided in the plan;
- made in an amount that did not exceed the maximum loan amount allowed by the plan;
- made with a repayment period that did not exceed the maximum allowable repayment period allowed by the plan; and
- if made to a participant married at the time the loan was made and the participant's accrued benefit was not *de minimis*, made with proper spousal consent. Generally, if the proper consent was obtained at the time the loan was made, or consent was not required to be obtained, the benefit may be offset regardless of the participant's marital status at any later date.

"Proper documentation" does not depend on whether payments have been made as required by the loan agreement (i.e., the loan may be in default).

If a loan is properly documented and not fully repaid under section C.2, the borrower's benefit will be offset by the unpaid loan balance at DOPT.

4. Offset of loans that are not properly documented

A loan is considered improperly documented if it was inconsistent with plan provisions and/or IRS rules. This includes, but is not limited to, loans that were:

- not evidenced by a written loan agreement but there is a clear indication that a loan was made;
- made at an interest rate below the plan rate;
- made in an amount in excess of the maximum loan amount permitted under the plan;
- made with a repayment period that exceeded the maximum allowable repayment period under the plan;
- made under a plan that did not provide for loans; and
- made to a married participant without required written spousal consent.

If a loan is not properly documented and not fully repaid under section C.2, the borrower's benefit will be treated as described below.

- a. No written loan agreement.** If a participant alleges that he or she took a loan under a plan that allows participant loans, but there is no written loan agreement, PBGC will treat the loan as if it were properly documented if the participant attests that there was

a written loan agreement **and** there are other indications that a debtor relationship exists, e.g., repayments made or correspondence indicating a debtor relationship. Otherwise, the amount distributed to the participant will be treated as a pre-DOPT distribution under section D.7 of PBGC Internal Guidance Assignment and Alienation of Benefits.

- b. **Improper interest rate, amount or term of loan.** If a participant took a documented loan under a plan that allows participant loans, but the loan was not at the interest rate or for the term specified in the plan or was more than the maximum amount allowed, PBGC will calculate the unpaid loan balance at DOPT, using the loan terms (interest rate and payment due dates) specified in the plan document and offset the benefit.
- c. **No plan loan provision.** If a participant alleges that he or she took a loan under a plan that does not allow participant loans, but there is a written loan agreement, PBGC will calculate the unpaid loan balance at DOPT using the loan terms specified in the loan agreement and offset the benefit. If the plan does not allow plan loans and there is no written loan agreement, the unpaid amount will be treated as a pre-DOPT distribution under section D.7 of PBGC Internal Guidance Assignment and Alienation of Benefits.
- d. **Spousal consent**

Generally, if the proper consent was obtained at the time the loan was made, or was not required to be obtained because the borrower was not married at that time, all necessary consent has been obtained for the loan. No consent will be needed at a later date, regardless of the participant's marital status. Of course, normal rules regarding benefit forms will apply to the participant's remaining benefit at retirement.

If required consent was not obtained at the time of the loan and the participant is married to the same spouse at DOPT, PBGC will seek consent when it becomes trustee. If the spouse does not consent, his or her survivor benefit with respect to the loan amount must be protected. See below for specific rules. An example of how a benefit will be calculated and paid under these rules is provided in Attachment 1.

- 1) Consent not required.** If a borrower was not married at the time the loan was made, or if at the time of the loan the participant's accrued plan benefit was less than the amount of the plan's *de minimis* cashout limit, no spousal consent is required for PBGC to offset the benefit, even if the borrower is married either at DOPT or annuity starting date.
- 2) Consent required and obtained.** If a participant was married at the time the loan was made and his or her spouse consented to the loan, no further spousal consent is required at a later date for PBGC to offset the benefit, even if, at DOPT or annuity starting date, the borrower is married to a person other than the spouse who consented at the time the loan was made.
- 3) Consent required but not obtained.** If a borrower was married at the time the loan was made, there is no evidence that the borrower's spouse consented to the loan, and the borrower is married to the same spouse at DOPT, PBGC will ask the spouse for consent as soon as practicable after DoTR as described in Section C.1, above.

Note: an alternate payee who is being treated as a spouse under a QDRO will be considered a spouse for this guidance only if he or she was married to the participant at the time the loan was made or the QDRO was in effect at the time the loan was made.

- If the spouse consents, PBGC will offset the benefit.
- If the spouse does not provide written consent to the loan, PBGC will still offset the benefit but will provide the spouse a survivor annuity. This "protected" survivor annuity is equal to the plan's automatic QJSA for the annuity equivalent of the unpaid loan balance at DOPT at the death of the borrower, providing the spouse was still married to the borrower at his or her annuity starting date.

Any remaining benefit payable to the borrower will be reduced by the cost of providing this "protected" survivor annuity. The remaining benefit will be paid in such form as the borrower elects at retirement under normal rules regarding benefit form. If there is no remaining benefit payable to the borrower, the annuity starting date for calculating this protected survivor annuity is the borrower's normal retirement date, or date of death, if earlier.

If, at his or her annuity starting date, the borrower is not married to the person to whom he or she was married at DOPT, no survivor annuity will be paid as a result of the preceding paragraph. As a result, PBGC will increase the borrower's benefit to the amount he or she would have received if the DOPT spouse had consented. (If the participant is married to a different person at retirement, the benefit will be paid following PBGC's joint-and-survivor annuity rules.)

Spousal consent required or obtained under this guidance must meet the requirements of Internal Guidance Spousal Consent (Qualified Joint-and-Survivor Annuities.)

- e. **Other Improprieties.** If there was an express or tacit understanding that the loan would not be repaid or an amount taken was not otherwise a bona fide loan, the unpaid amount will generally be treated as a pre-DOPT distribution under section D.7 of Internal Guidance Assignment and Alienation of Benefits. If plan assets are paid directly to someone who is not a participant in the plan (including any corporate entity), the transferred amount is not a loan. The transfer may, however, be a fiduciary breach.

D. Calculations and Valuation

1. **Determination of unpaid loan balance at DOPT.** PBGC will calculate the unpaid loan balance at DOPT, including accrued interest, generally using the terms specified in the loan document and/or the plan document. Any payments made after DOPT will be discounted back to DOPT at the interest rate specified for the loan. If the loan document and the plan do not specify an interest rate, the rate at which PBGC credits underpayments in PACS will be used. This rate is the

"applicable federal mid-term rate" and it is described in PBGC's recoupment regulation (29 CFR § 4022.81(c)(3)(i)).

2. **Plan asset and liability valuations.** The full amount of the unpaid loan balance at DOPT is a plan asset and is valued as fully collectible. The full amount of the borrower's accrued benefit (*i.e.*, as if no loan had been made) is included in the plan's benefit liabilities. If the borrower's termination benefit is later determined to be less than the annuity equivalent of the unpaid loan balance at DOPT, PBGC reserves the right to attempt to collect the difference from the borrower.
3. **Benefit offset.** PBGC will calculate the borrower's termination benefit as of DOPT without regard to the loan, and then reduce it by the annuity equivalent of the unpaid loan balance at DOPT, determined using the rates PBGC uses to value immediate and deferred annuities.

E. Benefit Administration

The rules in this PBGC Internal Guidance regarding benefit administration are described in Attachment 2.

F. Effect of Personal Bankruptcy

Personal bankruptcy proceedings do not preclude PBGC from offsetting a benefit by the amount of an unpaid loan balance at DOPT.

G. Taxation

Generally, the offset of a benefit for a plan loan that is not repaid within the 60-day period described in section C.2., above, is treated as a distribution for purposes of federal income taxation. The total amount of the unpaid loan balance at DOPT will be reported to the IRS for the year in which the offset is communicated to the borrower.

Attachment 1

Spousal Consent Example

Assumptions:

- Unpaid loan balance at DOPT is \$100,000
- Unpaid loan balance at DOPT is equivalent to \$1,000 per month as an SLA
- Participant's termination benefit is \$5,000 per month
- Plan's automatic form for married participants is a J&50%S
- Plan's automatic form for unmarried participants is an SLA
- All calculations are made as of NRA; participant and spouse are the same age
- Participant elects a J&100%S benefit at retirement, with spousal consent
- J&S factors are: .9 for J&50%S (plan factor) and .93 for J&100%S (PBGC factor for converting a plan J&50%S to a PBGC J&100%S)

Scenario 1: Participant is unmarried, either at time of loan or at retirement

- Participant's benefit is reduced by \$1,000 per month for the loan; participant gets \$4,000 per month as an SLA (PBGC optional forms are available)

Scenario 2: Participant is married and proper consent was obtained

Participant's benefit is reduced by \$1,000 per month for the loan; participant's \$4,000 per month SLA benefit, converted to the plan's automatic form, a J&50%S, is \$3,600 ($4,000 \times .9$). PBGC optional forms are available with spousal consent.

- Participant & spouse elect a J&100S. Participant gets \$3,348 for life; spouse gets \$3,348 for life if she survives the participant. (Plan automatic form, J&50%S, is converted by PBGC (PACS) factor for J&100%S: $\$3,600 \times .93 = \$3,348$)

Scenario 3: Spousal consent required but not obtained

Part 1: Spouse's protected survivor annuity

Spouse is entitled to a 50% survivor annuity (the plan's automatic form) on the annuity equivalent of the unpaid loan balance at DOPT, \$1,000 benefit as an SLA.

- Spouse gets \$450 per month upon the participant's death (SLA benefit multiplied by plan J&50%S factor, then by 50%: $\$1,000 \times .9 \times .5 = \450)

Part 2: Remaining benefit

Participant's SLA benefit is reduced by \$1,000 per month for the loan and \$100 per month (an assumed amount) for the cost of the protected survivor annuity: $\$4,000 - \$100 = \$3,900$; This \$3,900 per month SLA benefit is \$3,510, paid as a J&50%S, the plan's automatic form. (SLA benefit multiplied by plan J&50%S factor: $\$3,900 \times .9 = \$3,510$). PBGC optional forms are available with spousal consent.

- Participant & spouse elect a J&100S ($\$3,510 \times .93 = \$3,264$). Participant gets \$3,264 for life; spouse gets \$3,264 for life if she survives the Participant.
- Spouse also gets the protected survivor annuity of \$450 per month for life for a total benefit of \$3,714 per month, payable only after the participant's death.

Attachment 2

Plan Loans and Benefit Administration

Time of Loan	DOPT				
Marital Status & Spousal Consent	Marital Status & Spousal Consent	DOPT Benefit Calculation & Offset	QPSA Payable	Marital Status at ASD²	Benefits Administration at ASD
Unmarried, consent not required	Does not matter	Benefit is offset by unpaid loan balance at DOPT	Plan QPSA using reduced benefit	Does not matter	Reduced benefit is paid. ³
Married & spouse consented	Does not matter	Benefit is offset by unpaid loan balance at DOPT	Plan QPSA using reduced benefit	Does not matter	Reduced benefit is paid. ³
Married & spouse did not consent	Unmarried or different spouse, consent not needed	Benefit is offset by unpaid loan balance at DOPT	Plan QPSA using reduced benefit	Does not matter	Reduced benefit is paid. ³
Married & spouse did not consent ¹	Same spouse & spouse consents to offset	Benefit is offset by unpaid loan balance at DOPT	Plan QPSA using reduced benefit	Does not matter	Reduced benefit is paid. ³
Married & spouse did not consent ¹	Same spouse & spouse does not consent to offset	A "protected 50% survivor annuity is carved out for the DOPT spouse & the remaining benefit is offset by unpaid loan balance at DOPT plus cost of the survivor annuity.	Plan QPSA based on the pre-offset benefit less the cost of protection ⁴	Same spouse	Benefit is paid in a form that provides the spouse a "protected" 50% survivor annuity equivalent of the unpaid loan balance at DOPT. The participant is paid a benefit reduced for the offset and the cost of the

					survivor annuity (see Scenario 3 in Attachment 1).
Married & spouse did not consent ¹	Same spouse & spouse does not consent to offset	A "protected" 50% survivor annuity is carved out for the DOPT spouse. The remaining benefit is offset by unpaid loan balance at DOPT plus cost of the survivor annuity.	Same spouse: Plan QPSA based on the pre-offset benefit less the cost of protection ⁴ Different Spouse: Plan QPSA using reduced benefit	Unmarried or different spouse	Protected benefit for DOPT spouse is disregarded. Reduced benefit is paid. ³

Note 1: If required, PBGC will ask for consent as soon as practicable after DoTR; see section C.1.

Note 2: If the participant has no remaining benefit after the offset of the benefit, the ASD is the first of the month following attainment of normal retirement age or, if earlier, the first of the month following the date of the participant's death to calculate the survivor benefit.

Note 3: The plan's automatic forms for unmarried and married participants are paid based on marital status at ASD; PBGC optional forms are available.

Note 4: The cost of protection is a reduction to the participant's monthly benefit to pay for the protected survivor annuity.