CARES Act Relief for Retirement Plan Loans is Ending, Now What?

Facts

Earlier this year, we implemented the coronavirus relief provisions that allowed our participants to suspend loan payments for the remainder of 2020. As a result of reduced hours and other financial hardships, we had a number of plan participants take advantage of this relief.

Question

We know that participants must resume regularly scheduled loan payments starting in January 2021. Is there anything we have to do to account for the postponed payments and, if so, when do we have to do it?

Answer

Let's start with a quick review of what the CARES Act said with regard to the suspension of participant loan payments. It allowed participants who were impacted by the coronavirus to delay loan payments due between March 27th and December 31, 2020 for up to one year. In addition, it permitted the 5-year maximum repayment period to also be extended by a year to avoid a sudden increase in the amount of ongoing payments once they resume.

So how does one put this into practice?

- First, barring any extensions to the CARES Act or subsequent legislation, participant loan payments must restart as of January 1, 2021. If this date made you nervously glance at your calendar, we get it, just keep reading.
- Second, the loan must be reamortized to reflect the interest which accrued during the payment delays in 2020.
- Third, as part of the reamortization, the loan maturity date may be extended up to one year to account for the permitted suspension of payments.

Great! That provides participants with a reprieve in 2020 but leaves a lot to be desired for plan sponsors trying to figure out how and when to restart loan payments in 2021. Luckily, the IRS published Notice 2020-50 which provides guidance and a safe harbor approach to reinstating loan payments after the December 31st sunset.

What does this look like for plan participants? The safe harbor method provided in Notice 2020-50 states the participant loan should be amortized with the new payment amount effective January 2021. This means the principal amount of the loan and the interest which accrued since the payment delays began will need to be amortized over the remaining life of the loan, albeit with an option to extend the maturity date by up to one year to avoid a particularly large increase in the new loan payment amounts.

The IRS has recognized that there are other reasonable methods for reinstituting loan payments although, admittedly, these other options may be more difficult to administer. For example, it may be deemed reasonable to have loan payments begin in January 2021 according to the original amortization schedule and then reamortize the balance and accrued interest as of the anniversary of the date of the first postponed loan payment. That is, the reamortization of the payments takes place one year after the delay in payments took place rather than as of January 1, 2021. This option means you aren't dealing with it at the same time you are attending to so many other year-end close-out items, but it also means you potentially have a different reamortization date for each affected loan.

The conservative, and arguably easier, approach is to follow the IRS safe harbor, reamortizing the loans and starting the new payments effective January 2021. Following this interpretation conforms with the parameters of the IRS guidance while also making administration and communication to participants easier (win, win, win). If instead, you prefer an alternative method like the one described above, it is important to document the decision along with the methods of calculation in the event the plan is selected for audit at a later date.

There is another recommendation as you get ready to resume January loan payments, regardless of your chosen method; make sure you provide plan participants with an updated amortization schedule and communicate the new loan payment terms. While there is not a strict requirement to obtain their approval before withholding the new payment amounts, doing so lessens the likelihood of any future complaints or related issues down the road. Documentation of decisions, communication with participants, and records of execution are important items to maintain with your permanent plan records.

Last but not least, you may encounter a situation in which a participant asks that loan payments continue to be suspended beyond the end of 2020. Unless Congress passes new legislation that extends this relief, it is generally not an option to voluntarily suspend payments any longer for active participants, particularly if the plan requires payments to be made by payroll deduction. We won't go too far into the details, but as a plan fiduciary, there is an obligation to collect amounts that are due to the plan. When a participant takes out a loan, they sign an enforceable agreement to make periodic payments (usually each pay period). That means those periodic payments are "due to the plan." Connecting the dots, that also means plan fiduciaries have an obligation to collect those payments.

A number of recordkeepers have indicated that their systems will be ready to reamortize the loans, as necessary, come next year. That's good news. Nevertheless, if you need a helping hand as you work through reamortization calculations and coordinate with the plan's recordkeeper, your friendly pension geeks at DWC are happy to assist!