How Does the CARES Act Expand the Availability of Plan Loan Loans?

Facts

Our 401(k) plan allows participants access to their accounts via hardship distributions and, for those at least age 59 ½, via in-service withdrawals. But with the economic uncertainty of the current environment, participants are now asking about taking loans from their plan accounts.

Question

It has been difficult to keep up with all the changes coming out of Washington, DC in response to this pandemic. Did I hear correctly that one of the changes expands the availability of participant loans from 401(k) plans?

Answer

Yes! The CARES Act doubled the maximum amount a participant can take as a loan from the plan. As a refresher, the "regular" rules limit participant loans to no more than the lesser of $50,000 or 50% of the participant's vested balance. Under the CARES Act, that limit is doubled to the lesser of $100,000 or 100% of a participant's vested balance. But there are a few additional points to keep in mind about this relief.

Optional Provision

Plans are not required to implement these increased limits, so the first order of business is to decide whether your company wants to offer this expanded access in the plan. Once the plan decides to offer the increased limits, a participant must be self-certify to meeting one of the following requirements:

- S/he has been diagnosed with COVID-19;
- His/her spouse and/or a dependent has been diagnosed with COVID-19;
- S/he is experiencing adverse financial consequences as a result of being quarantined, furloughed, or laid off or having work hours reduced due to the coronavirus; or
- S/he is unable to work due to loss of childcare due to the coronavirus.

If you choose to offer this relief, the good news is that you can do so now and don't have to formally amend your plan until the end of the 2022 plan year. With that said, we are strongly encouraging our clients to document their elections in writing now (preferably through a resolution of some other "official" action by the company) to minimize any surprise questions down the road. Having documentation in place now will also help ensure the amendment is prepared correctly come 2022.

Plan Must Otherwise Allow Loans

In order to take advantage of the new limits, the plan must otherwise allow for loans. If your plan doesn't already permit participants to take loans and you wish to add that option, it is necessary for you to amend your plan to reflect that by the end of 2020 even though the amendment to reflect the increased limits isn't due for several years.

The date to adopt that amendment is the last day of the 2020 plan year (December 31, 2020 for calendar year plans), so you are still able to provide relatively immediate plan loan access to your participants and adopt the amendment after the fact. What if you only want to make loans available temporarily to help participants through this challenging time? That is also an option. Since participant loans are not considered a "protected benefit", it is possible to amend the plan document to allow for loans temporarily (say through December 31, 2020) and then remove the provision effective January 1, 2021.

Other Loan Provisions Still Apply

If your plan already allows loans, you should have a separate policy that spells out additional parameters such as the applicable interest rate and other items. There are two parameters in particular that may warrant a second look. It is not uncommon for a plan to limit a participant to only one loan outstanding at a time and/or to prohibit a participant from refinancing an existing loan in order to take out additional funds. The CARES Act does not change those types of provisions. For example, if your plan limits a participant to only one loan outstanding a time, that still applies even though the maximum dollar amount has doubled. That means a participant with an existing loan would not be able to take advantage of the new limits unless/until he or she pays off that loan or you amend the plan to remove the "one loan at a time" limitation. The same goes for refinancing. Similar to an amendment to add a loan provision, the company would have to adopt an amendment to change any of these other parameters no later than the last day of the 2020 plan year.

Maximum Repayment Period

Although the loan limits have doubled, the maximum repayment period is still limited to no more than five (5) years unless the loan is used to purchase a principal residence. The CARES Act does provide some relief that allows certain participants to postpone loan repayment on new or existing loans for up to a year. Participants whose payments are postponed under that provision can extend their repayment period by the length of the postponement. We have included some additional commentary on the payment suspension here and will be exploring it further in next week's Question of the Week.

Participant Communication

The CARES Act does not include any specific participant communication requirements related to the increased loan limits. However, in order to make the change effectively available, participants need to know about it. So, even though you might not be strictly required to provide formal communication of these changes, we strongly suggest that you notify participants of the new loan limits as well as any other changes you might be making to your plan to accommodate expanded loan access.

Recordkeeper Availability

It is important to remember that this increase in loan limits is likely to require that recordkeepers reprogram their systems, modify loan applications and paperwork (both hard copy and online), and train their staff to ensure they can properly accommodate the new limits while also maintaining important checks and balances. For this reason, it's possible there may be some lag time between the enactment of CARES and the availability of these larger loans from participant accounts. Speaking directly with your plan's recordkeeper is the best way to navigate any new processes in place to help facilitate these participant requests.

As you explore the option of adding loans, utilizing the increased limits, or communicating this information to plan participants, know that your DWC team is here to assist. For those curious about the details of suspending participant loan payments, we'll be addressing that topic in our very next Question of the Week; stay tuned!

For additional information about participant loans, please visit our Knowledge Center here. Please also visit our FAQ on the Coronavirus and its impact on retirement plans.

Related Resources

- Coronavirus: The Impact on Retirement Plans