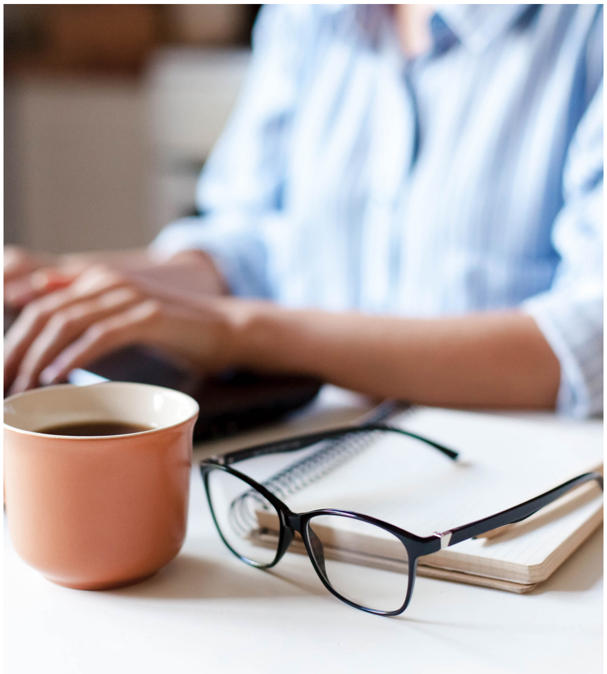
EGPS ECONOMIC GROUP PENSION SERVICES

TAKING A PARTICIPANT LOAN

What you need to know



The Department of Labor (DOL) has established strict guidelines for participant loans, should a qualified retirement plan allow for them. Plans that permit loans must have a written Participant Loan Procedure, sometimes called a Participant Loan Policy, which describes the requirements for participant loans from the plan.

Advantages of a participant loan

- Plan loans usually are easier and quicker to obtain than other loans.
- If the plan provides individual participant accounts, the interest paid on the loan will usually go to the participant's account.
- Typically, the only collateral that is required is the participant's vested account balance in the plan.

Disadvantages of a participant loan

- Other plan investments may pay a greater return than the loan interest.
- Should employment terminate, many plans require that the loan be paid in full.
- If the loan goes into default, the outstanding balance becomes taxable income to the participant. If the participant is younger than age 59½, an "early withdrawal" penalty will apply. Additionally, the loan will remain in force until it is fully repaid or the participant is eligible for a plan distribution.
- Loan payments are paid with after-tax income. When the participant terminates and takes a distribution, the money that went into the plan as after-tax loan payments will be taxed a second time.

In general, the following are the requirements on plan loans to participants. The Participant Loan Procedure will provide requirements specific to the plan.

Eligibility

Loans must be available to all active participants on a reasonably equivalent basis and must not discriminate in favor of highly compensated employees. Some plans allow loans only for reasons of immediate financial hardships.

Loan amount

The loan, plus all other loans outstanding to the participant from the plan, may not exceed the lesser of one-half of the participant's vested account in the plan or $50,000. The $50,000 limit is further reduced if the participant has had a loan from the plan at any time during the past 12 months. The loan procedure may also require that a loan be at least a minimum amount.

Maximum loan term

The loan must be repaid within 5 years. This period may be longer if the loan is used to purchase the participant's principal residence.

Payments

The loan must be repaid with level amortized payments of principal and interest, made at least quarterly. The employer may require that loan payments be made through payroll withholding.

Interest deductibility

Interest on loans secured by 401(k) contributions is not deductible. In other types of plans, interest on loans to key employees is not deductible, and interest on loans to non-key employees is subject to the general limits on deductibility. A participant should consult with their tax advisor on tax deductibility on a participant loan.

Interest rate

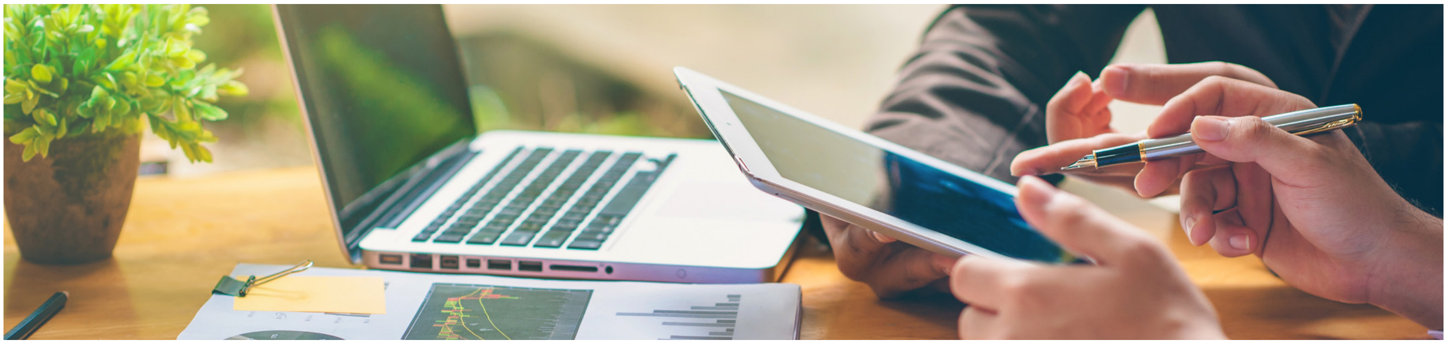
Loans must bear a reasonable rate of interest. The DOL requires a rate equal to the rate a commercial lender would charge for a similar loan, under similar circumstances, in the local area of the plan sponsor. The loan interest rate is fixed for the term of the loan.

Collateral

The loan must be secured. Up to 50% of the participant's vested account may be used as security. If the plan permits, other property may be used as security if it is of sufficient value and liquidity to protect the plan from losses of principal and interest in the event of default.

Default

The loan will be in default if a scheduled payment becomes overdue under the terms of the plan's loan program. Upon default, the outstanding loan balance will become taxable income to the participant. Even though a participant is taxed on the defaulted loan, the loan is still active until it is paid off or the participant is eligible for a plan distribution. As a result of a loan default, the participant may not be eligible for another loan until the defaulted loan is repaid.



Fees

Typically, a loan documentation/origination fee is charged when a loan is taken. Additionally, there may be annual loan maintenance fees. These fees are sometimes paid for by the plan sponsor, but the fees are typically charged to the participant directly or deducted from the participant's account in the plan.

Termination of employment

The loan program will describe what happens when the employment of the participant with an outstanding loan terminates. Some plans will allow the terminated participant to make arrangements to continue making loan payments. Many plans, however, state that the loan will be due in full 30 days after employment terminates, and if not paid off within the 30 days, the outstanding balance will become taxable income to the participant.