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The PensionActuary

ASPA
Dedicated to the Private Pension System

Employer/Employee Obligations and Rights for Our Military, National Guard, and Reserves

by Jeffery Mandell

In light of the anti-terrorism war, employers should be aware of their legal obligations to employees who are serving our country. Employees serving in this effort also should be aware of their rights.

Congress and the President passed the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), enacted on October 13, 1994, Title 38 US Code, Chapter 43, Sections 4301-4333, Public Law 103-353. USERRA significantly strengthens and expands the employment and reemployment rights of all uniformed service members. It provides, in general, that employees who perform service must be in the same position with respect to employment and benefits that they would have been in if they had not left to perform military service.

- When an employee returns from service, the employer must offer to such employee reemployment at the position the employee would have had if the employee had not gone on military leave.
- During the military leave, the employer generally must treat the employee as if he or she were on a leave of absence.
- The employer also generally must make up the retirement and other

WASHINGTON UPDATE

The 30-Year Treasury Bond Dilemma

by Brian H. Graff, Esq.

As many of you have already heard, in late October the US Department of Treasury announced that it would no longer be issuing 30-year Treasury bonds. Unfortunately, before making this announcement the Department of Treasury failed to consult with its own Office of Benefits Counsel and did not anticipate the significant impact the decision would have on funding and benefit calculations for defined benefit plans. Consequently, an unexpected retirement policy crisis has developed that both Congress and Treasury must address fairly soon. The ultimate decisions that are made will obviously have a dramatic effect on both small and large defined benefit plans.

Given the present state of the economy and the current

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benefits the employee would have received during the leave.

USERRA's provisions apply regardless of the number of employees employed by the employer and all types of employers. In these respects, it is different from many other employee protection laws, such as the Family and Medical Leave Act and COBRA (health continuation). Some aspects of USERRA are discussed below.

Who Does USERRA Protect?

USERRA protects persons who have been absent from employment because of "service in the uniformed services." "Service in the uniformed services" means the performance of duty on a voluntary or involuntary basis, including:

- Active duty
- Active duty for training
- Initial active duty for training
- Inactive duty training
- Full-time National Guard duty
- Absence from work for an examination to determine a person's fitness for any of the above types of duty, and
- Funeral honors duty performed by National Guard or reserve members.

The "uniformed services" that are covered consist of the following:

- Army, Navy, Marine Corps, Air Force, or Coast Guard
- Army Reserve, Naval Reserve, Marine Corps Reserve, Air Force Reserve, or Coast Guard Reserve
- Army National Guard or Air National Guard
- Commissioned Corps of the Public Health Service, and
- Any other category of persons designated by the President in time of war or emergency.

What Must Employees Do?

To be covered under USERRA, the employee's absence from the employer is limited to five years, with certain important exceptions.

Employees can also lose their rights to USERRA's protections if their service ends:

- With a dishonorable or bad conduct discharge
- On other than honorable conditions
- With dismissal as a commissioned officer in certain situations, or
- As a commissioned officer dropped from the rolls in certain situations.

Employees must give employers advance notice of the impending military leave in order to benefit from USERRA's provisions. The advance notification requirement is waived, however, if military necessity prevents the employee from being able to give advance notice. Notice to the employer may be either written or verbal.

With certain exceptions, the employee must return to employment within a prescribed time frame after

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Participant Loans: So, What's Still Bothering You?

by Ilene Ferenczy, CPC

Here we are, nearly 20 years after Congress enacted Code Section 72(p), and we still find that participant loans are one of the greatest challenges to effective and efficient plan operations. Why is that? One main reason is that the rules and regulations governing participants' borrowings from the plan continue to be out-of-sync with the realities of qualified plan operations, causing the individuals responsible for administering retirement plans to loathe participant loans with all the strength in their technical hearts. On the other hand, 401(k) plans have become the 2,000 pound gorilla of qualified plans, and they set the standard for the industry. For example, regardless of what administrators think, and notwithstanding that it may not be in participants' best financial interests, 401(k) participants want to have access to their deferrals in a non-taxable manner when they need the money. The disconnect between what participants want and what service providers want to provide continues to cause headaches throughout the industry.

The most recent IRS proposed regulations address some outstanding concerns and questions . However, they do not solve all our problems. Let's review what has changed in recent months to help us out. Where actual solutions under the current rules elude us, let's pretend that we are the ERISA Kings (or Queens) and see if we can fashion a positive alternative.

Parity Among Borrowing Rules

On a high note, thank you Congress for finally enacting loan rule parity among the different business entities. Under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) Section 612(a), owners of unincorporated entities may now borrow on the same terms as corporate owners. Having loan rule parity is a particular relief from the problems that arose when a C-corporation elected S-status, thereby converting its owners from shareholders to shareholder-employees and their plan loans into prohibited transactions. The new EGTRRA provision is effective for years beginning after December 31, 2001.

How Much Can the Participant Borrow? What About Now?

Under Code Section 72(p), a participant may not borrow in excess of fifty percent of his or her vested interest in the plan, up to a maximum of $50,000. The $50,000 maximum loan amount is reduced by the highest outstanding loan balance during the prior twelve months. [IRC §72(p)(2)(A)].

The formula for determining the maximum allowable loan seems simple enough, but in today's world of daily valuation, it is unworkable on a practical basis unless the $50,000 maximum applies. The value of the participant's account portfolio may change significantly between the time that the participant finds out how much he or she can borrow (and what the loan payment is) and the time that the loan is effected by the fundholder. The fluctuating valuation problem may be even worse when a participant is permitted unlimited discretion in investment choices, rather than being required to choose among mutual fund options. As a result, a permissible loan on one day may exceed permissible loan limits on the next. It's a moving target.

At the 2000 ASPA Annual Conference, practitioners asked IRS representatives if the maximum loan was judged on the date the loan was initiated or on the date the loan was actually funded. The IRS representatives responded that it was the date of

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Washington Update

circumstances requiring increased government spending, a number of economic analysts are suggesting that Treasury may need to reconsider its decision in the near future. Nevertheless, Congress and Treasury will need to deal with this issue assuming that Treasury's position will not change.

What Happens Before Congress Acts?

Although Congress is considering a short-term "fix" to this problem, as of this writing it appears likely that it will take until 2002 to sort through this issue. In the meantime, senior Treasury and IRS officials have informally indicated that they will be able to continue to issue a "30-year Treasury bond rate" for at least the next 12-24 months, based on Federal Reserve statistics and yields on existing bonds. However, this "rate" will likely be somewhat lower than the rate would have been if 30-year Treasury bonds were still being issued. As a result, funding and benefit obligations for many defined benefit plans will be higher, and in some cases much higher, than expected for the next few years.

What is the Impact of the Announcement?

The discontinuance of 30-year Treasury bonds will have a substantial and immediate impact on defined benefit plans. In general, the 30-year Treasury bond rate is used for four purposes with respect to defined benefit plans. First, it is used in calculating current liability for purposes of the deficit reduction contribution. The deficit reduction contribution may require an increased funding obligation for certain defined benefit plans that are not as adequately funded. Although plans may use up to 105 percent of a 4-year weighted average of 30-year Treasury bond rates for this purpose, a reduction in the current rate can have an enormous impact on funding obligations, particularly for larger plan sponsors.

For plans that offer a lump sum distribution option, the 30-year Treasury bond rate is also used for calculating the amount of the lump sum under Section 417(e). A reduction in the current rate will naturally increase the amount of any lump sum distribution. For many plan sponsors, particularly smaller plan sponsors, these increased lump sum payments can put significant pressure on the funded status of the plan. Many retirement policymakers have been concerned for some time that using of 30-year Treasury bond rates has resulted in artificially subsidized lump sums potentially to the detriment of participants who should more appropriately elect an annuity form of distribution. Changes resulting from the Treasury announcement will only exacerbate this problem.

The 30-year Treasury bond rate is also used for calculating the defined benefit plan limit under Section 415(b) in the case of a lump sum distribution. Although a reduction in the rate yields a higher limit, which is often a favorable result for the participant, this increase puts added funding pressure on plans, especially smaller plans that suddenly are required to make higher lump sum payments than anticipated to participants affected by the limit.

Finally, the 30-year Treasury bond rate is also used to determine whether a plan is required to pay a variable-rate PBGC premium. Using this rate, plans that are determined to be underfunded for PBGC premium purposes are required to pay an additional variable rate premium on top of a flat-rate per-participant premium. Thus, a lower rate can have the double effect of both increasing funding obligations plus increasing PBGC premiums.

Is There a Short-Term Solution?

Even before the Treasury announcement, larger plan sponsors have been raising concerns about depressed 30-year Treasury bond rates and their impact on defined benefit plans. These plan sponsors have been arguing that the decline in the rate over the last few years has artificially increased current liability and, accordingly, the funding obligation for many plans. Since the tragedy on September 11, they have been lobbying for an interim solution until Congress has time to completely consider the issue. Under this proposal, the Moody's AA Corporate Bond rate would be used as a substitute for the 30-year Treasury bond rate, but only for purposes of the deficit reduction contribution and variable-rate PBGC premiums. The 30-year Treasury bond rate would still be used for purposes of calculating lump sums and the Section 415(b) limit. Under the proposal, the change in the interest rate benchmark would last for only

two or three years until Congress decides on a permanent replacement.

The larger employer community argues that Moody's AA Corporate Bond rate is an appropriate interim benchmark since it more accurately reflects long-term rates of return for pension funds, but still is a conservative rate. Further, the Securities and Exchange Commission permits Moody's AA rate to be used for calculating corporate pension obligations for accounting purposes.

ASPA supports this proposal, provided that the proposal terms are optional, allowing plans to continue to use the 30-year Treasury bond rate for all purposes if desired. Otherwise, a mandatory change could create funding problems for some defined benefit plans that would be funding using Moody AA rates, but would still be paying lump sums at 30-year Treasury bond rates. Fortunately, the proposal has been changed to reflect ASPA's concerns.

Attempts are being made to add this short-term solution onto the economic stimulus package Congress is currently considering. Certainly, if enacted, the proposal would free up corporate capital to be used for other purposes. However, as noted earlier, given all that Congress has on its plate, it appears unlikely that Congress will be able to deal with this issue this year.

What are the Possible Long-Term Solutions?

Assuming Congress does not adopt an interim fix this year, they will need to deal with this issue comprehensively next year in earnest. Deciding on an appropriate benchmark will not be easy. Members of Congress may be uncomfortable using a benchmark that is not government issued. Further, participant rights groups will, no doubt, argue that a rate such as the Moody's rate is too high and will leave plans inadequately funded. Roughly estimating, Moody's AA rate right now is about 200 basis points higher than the 30-year Treasury bond rate. Further complicating matters, it is expected that the Society of Actuaries will issue a study that suggests that annuity rates be used as the benchmark.

The interest rate used for purposes of the deficit reduction contribution and the variable-rate PBGC premium is only part of the problem. Ultimately, there must be a link between that rate and the rate used for calculating lump sum distributions. Perhaps Congress may consider permitting a range of rates to prevent artificially subsidizing lump sums. Further, with the growth of cash balance plans, Congress needs to address the "whipsaw" problem that results from requiring that lump sums be calculated using an interest rate different from the rate for crediting interest under the cash balance plan.

Finally, funding uncertainties resulting from the impact of fluctuating interest rates on the Section 415(b) lump sum limit need to be addressed. Ideally, we should return to a fixed rate for this purpose, as it was prior to the 1994 Retirement Protection Act. In this way, smaller plans can avoid significant funding disparities due to short-term changes in interest rates and instead fund to a certain benefit.

As this debate begins, one thing is certain. ASPA's Government Affairs Committee will continue to be very actively involved protecting the interests of ASPA's members and ensuring that defined benefit plans continue to be a viable retirement plan option. ▲

Brian H. Graff, Esq., is Executive Director of ASPA. Before joining ASPA, Brian was legislation counsel to the US Congress Joint Committee on Taxation.

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Employer/Employee Obligations

the employee's military service ends in order to gain USERRA's benefits. If the military service is 1 to 30 days, the person must report to his or her employer by the beginning of the first regularly scheduled workday that would fall eight hours after the end of the last calendar day of service. If the military service is 31 to 180 days, the employee must apply for reemployment no later than 14 days after completion of a person's service. If the military service is 181 or more days, an application for reemployment must be submitted no later than 90 days after completion of the person's military service.

What Leave Policies Apply?

For an employee using military leave, an employer must apply its most favorable leave-of-absence policies applicable to non-military leaves. For example, if employees on educational or training leaves of absences are entitled to maintain benefits during the leave, but are not allowed to do so on an unpaid leave of absence for personal reasons, the employer must allow an employee on military leave to maintain benefits.

Employees on military leave are entitled to use accrued vacation, annual, or other leave with pay to apply to the military leave. The employer is required to honor such a request. However, the employer may not force employees on military leave to use paid vacation leave.

To What Position Is the Reemployed Employee Entitled?

Employees who return to the employer after the military leave generally must be promptly reemployed in the job the person would have held had the person remained continuously employed, so long as the person is qualified for the job or can become qualified after reasonable efforts by the employer to qualify the person. If the person is not qualified to perform the duties of the position the person would have had after reasonable efforts have been undertaken by the employer to qualify the person, the employee must be reemployed in the position that the person was employed when the employee left for service.

USERRA incorporates and reflects the escalator principle that has been a key concept in federal veterans' reemployment legislation. The escalator principle generally requires that each returning service member step back onto the seniority escalator at the point the person would have occupied if the person had remained continuously employed.

Reemployment of a person is excused if an employer's circumstances have changed so much that the reemployment of the person would be impossible or unreasonable. A reduction-in-force that would have included the person is an example of an acceptable reason.

Employers also are excused from making an effort to qualify or accommodate returning service members with service-connected disabilities when doing so would cause "undue hardship" for the employer.

What Retirement Benefits Does the Returning Veteran Receive?

If a serviceman or woman returns to his or her job on a timely basis under USERRA and if the employer has a retirement plan [such as a 401(k) or pension plan], there are numerous benefits:

- The military leave of absence is not treated as a "break in service."
- Vesting and eligibility service credit must be given for the period of absence.
- The employee must be provided an allocation of any employer profit sharing, pension, or other amounts (but not including earnings or allocations of forfeitures) that were contributed during the employee's absence.

  The amount that would have been allocated for the employee if he or she had not been absent must be provided.

  The compensation that is used (presuming compensation is used in the plan benefit or allocation formula) is the compensation that the employee would have earned if he or she were actively employed. If that cannot be determined, the plan must use the average rate of the employee's pay for the 12 months before the employee left for uniformed service.
- The employee must be allowed to make up pre-tax deferrals or after-tax employee contributions that he or she could have made. The employee must also be credited with any related employer matching contribution. He or she has up to three times the period of leave, to a maximum of five years after his or her return, to make up the contributions.
- For defined benefit plans, benefit accruals must be provided as if there were no absence.

What Health Benefits Does the Serviceman or Woman Receive?

If an employee goes on military leave, he or she must have the right to continue health care benefits. This right to coverage during military leave is similar to COBRA, but technically is not the same thing as COBRA. As an example of the difference between USERRA and COBRA, under USERRA there are no multiple "qualifying events" that could

entitle an employee on military leave to coverage beyond an 18-month period.

The employee (and his or her dependents) has the right to 18 months of coverage from the day he or she goes on military leave or, if less, for a period that ends the day after the date the person fails to apply or return to a position of employment, as required under USERRA, when the military service ends.

If a military leave is under 31 days, the employee on leave must return to work at the beginning of the next pay period in order to be reinstated to employment. Under that circumstance, most employers may not be likely to regard the employee as having terminated employment. Under some health plans, health plan coverage in such circumstances likely would not have terminated.

The 18-month period may be cut off if the employee informs the employer that he or she does not intend to return to work after the leave.

The employer may charge the employee for the health coverage. The method of charging the employee on military leave is similar to that under COBRA. If the military leave is under 31 days, the employee may be required to pay only the employee's usual share for such coverage. For coverage that extends beyond the 30 days, the employer may charge up to 102% of the full premium for the elected coverage.

The employee must be entitled to recommence coverage upon return to work without regard to any waiting periods or exclusions. This requirement applies even if the employee did not elect continuation of coverage during the leave. This rule also applies to any beneficiary who is covered as the employee's dependent. However, this rule does not apply with respect to an illness or injury that the Secretary of Veterans Affairs determines to be service-related. ▲

Editor's Note: The author has made available a detailed summary of issues related to USERRA. Login at **https://router.aspa.org** and you can find the summary under Members Only>Newsletter.

Jeffery Mandell is an attorney, founder, and president of The ERISA Law Group, PA. Since 1982, he has concentrated his practice solely in retirement plans, welfare plans, and other ERISA and deferred compensation matters. Jeffery is a nationally recognized practitioner, speaker, and author on ERISA topics, and has been voted by his peers to be listed in the Best Lawyers in America *since 1995. He is an Adjunct Professor at the University of Idaho College of Law (and formerly was an Adjunct Professor at the University of Wisconsin Law School). Panel Publishers published his textbook regarding ERISA plan administrative and legal matters in 1998. Jeffery is the founder of Employee Benefit Publications and Seminars.*

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Highlights of the 2001 Annual Conference

Your 2001 Space Odyssey spaceman, the affable George Taylor, MSPA, opens the Conference with some fun.

Another packed crowd of Annual Conference attendees listens intently to a Conference session. Joan Gucciardi, MSPA, CPC, explains the design of cross-tested plans under the new regulations.

Brennan Haggett, son of Government Affairs Manager, Jolynne Flores, leads the opening general session audience in the Pledge of Allegiance.

Senator Max Baucus (D-Mont.), Chairman, Senate Finance Committee, talks with Brian Graff, Esq., during a reception for the Senator.

ASPA Annual Conference Co-Chair, Maureen Thomas, CPC, addresses the crowd. Jane Osa, MSPA, served with Maureen as Conference Co-Chair. Many thanks for a job well done!

Ruth Frew, FSPA, CPC, accepts her honor as ASPA's 2001 Harry T. Eidson Founders Award recipient from Past President, Karen Jordan, CPC, QPA.

A group of more than 150 participants proudly represent ASPA at the 2001 Visit to Capitol Hill.

The ASPA staff, minus Brian, Geoff, Marc, and Dee. Thanks for the great work! Love you, Jane.

all photos ©2001 Bill Petros

President George Taylor, MSPA, is recognized for his leadership by President-Elect, Craig Hoffman, APM.

2001 ASPA ANNUAL CONFERENCE

ASPA Past President, Edward Burrows, MSPA, a.k.a. Professor Burrows, speaking at yet another ASPA conference.

An inquisitive ASPA crowd visits the Exhibit Hall and finds just what they're looking for from a selection of more than 50 vendors.

2002 ASPA President, Craig Hoffman, APM, addresses the attendees.

ASPA member Jim Nolan and staff member Jolynne Flores burn up the dance floor during the Conference Gala.

President George Taylor, MSPA, and Executive Director Brian Graff, Esq., update the attendees on the intricacies of EGTRRA.

Sal Tripodi, APM, accepts the 2001 Educator's Award from Education and Examination Chair, Gwen O'Connell, CPC, QPA.

Join us in 2002!

Annual Conference
October 27 - 30
Washington Hilton

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Participant Loans

funding. [*See*, IRS Q&A From 2000 ASPA Annual Conference, Q&A-5]

So, what is the solution? One idea is for the plan to restrict loans to something less than fifty percent of the vested interest, thereby creating a buffer for account decreases. However, that buffer (whatever it is) can be insufficient if an unfortunate employee authorizes a loan on the day before a significant stock market drop. Alternatively, the plan representative can inform the employee when the loan is authorized that there may be some modicum of taxable income related to the loan if the stock market goes down. However, the problem is not just that the employee will have some taxable income. The plan administrator must also keep proper records of these minor deemed distributions, file Forms 1099R, and properly account for distributions made to the employee in the future when the loan has been repaid (since repaid funds become nontaxable basis when they are distributed at a later time).

The only solution that really makes sense is for the IRS to issue a regulation to provide that the maximum loan is determined on the date the loan is requested, so long as the loan is effected within a reasonable time. Then, the value of the account can be reasonably determined when the loan is authorized by the participant, and such value will control what portion of the loan (if any) is taxable at its inception.

An enthusiastic student of Title I might point out that it is a violation of the Department of Labor's (DOL) rules for the vested interest to act as security to the extent that the loan exceeds fifty percent of the participant's vested interest. [Labor Reg. §2550.408b-1(f)(2)] The response to that is: The DOL needs to update its rules, too. It is reasonable for the rules for vested interest to be applied at the time the loan is requested, as well.

And What About Interest Rates?

While we are complaining about regulations being out of date with actual practice, the DOL's regulations require that the interest rate charged for participant loans be commensurate to the prevailing rate charged by a person who is in the business of lending money for a comparable loan. [Labor Reg. §2550.408b-1(e)] When DOL's regulations were issued, the DOL specifically declined to provide a "safe harbor" to practitioners equal to the prime rate plus some range of percentages. [*See*, Preamble to DOL Regulations, 54 FR 30520 (7/20/89), Discussion, §E]

In practice, it is very common, if not universal, for the plan's loan interest rate to be stated as the prime rate on a given date plus some percentage (usually 1 or 2 percent). Since the prime rate is generally a lending measurement by financial institutions, and since most participant loans are secured loans with identical security (*i.e.*, the participant's vested interest), why is the DOL so compelled not to grant practitioners and sponsors a break on the loan interest rate? Is there ever going to be a time when the prime rate plus 1 percent is not within the range of prevailing rates?

Whose Idea Was This Deemed Distribution Business?

Anyone who has accounted for a deemed distribution in a plan knows what a headache it is that the IRS wants the participant to pay taxes before the plan permits a bona fide distribution.

If the deemed distribution happens when a real distribution is permitted, the loan can actually offset the participant's account. At that time, the participant's account is permanently decreased by the loan distribution, and the loan is taken off the books. [Prop. Treas. Reg. §1.72(p)-1; Q&A-13] If, on the other hand, the plan is a pension or 401(k) plan (or a profit sharing plan that does not permit in-service distributions, even for loan offsets), no offset of the account is permitted when the deemed distribution occurs. The result is that there is a distribution for one purpose and not for another. As if that were not problematic enough, there are the bizarre rules regarding interest accrual. Under IRS regulations, the deemed distributed loan continues to accrue interest for purposes of: (a) determining the maximum amount that may be borrowed in the future; (b) determining whether the loan is really paid off on the plan's books, or (c) determining the balance of participants' accounts in the unlikely event that the loan is not a self-directed investment of the borrower's account. However, the participant is not taxed on the interest that accrues and is unpaid on the loan after it is deemed distributed, even when the loan offset ultimately occurs. [Prop. Treas. Reg. §1.72(p)-1; Q&A-19] Therefore, the loan offset on the plan's books is different than the amount shown on the Form 1099R to the participant. These rules result in an accounting version of three-dimensional chess, with the loan and the participant's account having different values for different purposes. As if that were not enough, Form 5500 instructions require most deemed distributions to be removed from the plan balance sheet, even if the plan was not permitted to actually offset the loan. [*See*, Instructions to Form 5500, Schedule H, item 1(c)(8)] Is it any wonder that practitioners are so completely confounded by these rules?

Furthermore, the deemed distribution rules often discourage an employee from repaying a problematic loan. There is really little incentive to do so. Sure, the amount that was taxable income as a deemed distribution becomes a nontaxable basis once it is repaid. Sure, the repaid amounts are allowed to grow with tax-deferred earnings, but the plan does not really charge the participant interest on a self-directed participant loan if it is not repaid. As a result, the participant is left in a position analogous to someone who is considering making after-tax contributions to a qualified plan. If tax sheltered growth is that valuable to the individual, he or she repays the loan. Otherwise, he or she does not. Those who choose not to are likely to be nonhighly compensated employees.

The IRS addressed this dilemma to some extent in its new proposed regulations by making loans harder to take for participants who have defaulted on a previous loan. In particular, these proposed regulations provide that an individual who has had a prior default and who has not repaid the loan must meet two requirements to obtain a new nontaxable loan. First, the defaulted loan will be considered an outstanding loan for purposes of the Section 72(p) loan limitations. Second, the participant must either agree to repay the new loan through payroll deduction or provide security, in addition to his or her vested interest, for the loan. If any action is subsequently taken that causes the second requirement to be negated (such as a revocation by the participant of the agreement to permit loan repayments by payroll deduction), the new loan is deemed distributed. [Prop. Treas. Reg. §1.72(p)-1; Q&A-19]

What else can be done to make the process more palatable? It would be nice if plans were permitted to offset all loans once they are deemed distributed. However, this would violate the limitations on distributions from pension and 401(k) plans (and is presumably unacceptable to Treasury). That leads to the conclusion that the solution is in the hands of the plan sponsor and administrator. It is best to require that all loans be directed investments of the participant's account, and that they always be repaid by automatic payroll deduction. With these constraints, a loan cannot default before termination of employment (which is a distributable event) unless the employee is on leave of absence and not on the payroll of the employer. Even then, the Code permits a suspension of loan payments without default for up to one year for leaves of absence without pay. In addition, a participant's default does not adversely affect other participants, which limits the fiduciary breach issues arising out of the defaulted loan.

Loan Refinancing and Extensions

The most recent proposed loan regulations finally address what happens if a participant wants to refinance his or her loan. [Prop. Treas. Reg. §1.72(p)-1; Q&A-20] The new rules permit a participant to replace an existing loan with a new loan without

causing a deemed distribution, but only if certain conditions are met.

If the new loan extends the original repayment date, the regulations treat both the old loan and the new loan as in existence on the date the new loan is taken. Both loan amounts are used to determine whether the amount of the loan exceeds the 50% of vested interest or $50,000 limitation. For example, suppose a participant's vested interest is $20,000, and he has an outstanding loan with the highest outstanding balance of $8,000 during the prior 12 months and a current balance of $7,000. He wants to refinance the loan, borrow another $3,000, and extend the term for another 3 years. In that case, the new $10,000 loan (which replaces the old loan and has the new financed amount) plus the current outstanding balance of the old loan are compared to the loan limitation to determine if it meets the Section 72(p) rules. In our example, the total of $17,000 is greater than 50% of the participant's vested interest ($10,000), so the proposed loan violates Section 72(p). For purposes of the maximum dollar limitation, the $17,000 combined amount would be compared to $49,000 ($50,000 reduced by the excess of the highest outstanding balance during the prior 12 months, over the current balance of the old loan).

But the regulations giveth at the same time that they taketh away. If, on the other hand, the new loan provides for "stepped" repayment, the violation of Section 72(p) may be avoided. Under this structure, the remaining balance of the original loan continues to be repaid over its initial term. The newly financed amount can be repaid over a new 5-year period. The loan document for the refinanced loan must require a loan payment for the remaining term of the original loan equal to the original repayment amount plus the loan payment on the newly financed additional amount. At the end of the original loan period, the portion of the loan payment attributable to the first loan amount drops off and only the repayment of the newly financed portion remains. In other words, it is like two loans wrapped into one.

Going back to our example: suppose that the payment on the original loan (which had a remaining balance of $7,000) was $300 per month, which would repay the loan in two years. The payment for the additional $3,000 with a repayment over three years is $90. For the two remaining years of the original loan, the loan payment under the refinanced loan will be $390, the total of the old and new portions of the loan. After the second year, the original loan is repaid, and the payment amount reduces to $90 for the final year of the loan.

What's the value of doing this? If this structure is followed, the new loan and the old loan are considered to be one, and the amount compared to the loan limitation is the principal amount of the new loan only. In the example, the new consolidated loan ($10,000) is equal to the Section 72(p) loan limitation of $10,000, and there is no violation.

Furthermore, if the applicable interest rate has decreased since the time that the original loan was issued and the time of refinancing, the new, lower interest rate may be applied to the refinanced part of the loan. [Prop. Treas. Reg. §1.72(p)-1; Q&A-20(b), Example (2)] Presumably, if the interest rates had increased between the original loan initiation and refinancing, the higher rate should be applied to the old loan amount. However, this undesirable result could be avoided by not consolidating the loans, and merely taking a new loan for the additional amount.

If you stop to look at this, it makes sense and does permit participants to take out new amounts as their vested interests grow (which may or may not be a good thing, depending on your point of view). The problem is that the computer systems of many fundholders and TPAs cannot accommodate the structure. As a result, although the IRS has sanctioned these refinancing loans, most plan sponsors have not been able to institute them in their plans. The solution to date has been to permit participants to have two or more loans outstanding simultaneously (increasing the administrative costs for the loan program), or to prohibit refinancings, notwithstanding the new regulations.

One more thing about the new proposed regulations: they provide that no more than two loans may be made to participants in a calendar year. Additional loans are deemed distributions. Therefore, an individual is effectively prohibited from financing his quarterly loan payments on one loan with new loans from the plan. [Prop. Treas. Reg. §1.72(p)-1; Q&A-20(b), Example (3)]

Asset Acquisitions and Outstanding Participant Loans

One of the most significant challenges plan sponsors encounter occurs when a company's assets are sold and the employees go to work for the buyer. If the employees have loans outstanding in the seller's plan, the repayment of the loans becomes a significant challenge. This problem was particularly acute when the same desk rule applied to 401(k) plans. We thank Congress for EGTRRA's repeal of that rule. Nonetheless, the problem persists even when distributions are possible, because participants often do not want to be taxed prematurely on these loans. Unless they can repay the loans (not incidentally, at a time when their employer is going through changes and their jobs may be in limbo), the premature tax will ensue.

There are only four ways (that I can think of, anyway) that the loans can get repaid to the plan without causing

a distributable event, and none is very satisfactory.

1. *Distribute benefits to the participants soon after the asset sale. Borrowing participants can roll over their loans to the buyer's plan*. This solution, so sensible on paper, is so unworkable in reality. First, it is a rare buyer that will permit the rollover of loans to its plan at all. It is also an administrative hassle, increases plan costs, and often wreaks havoc on the buyer's payroll system. Second, even if the buyer wants to accept rollovers, prudent buyers often want the seller's plan to have a favorable determination letter before it will do so. In today's remedial amendment period, that takes time – more time than is permitted under Code Section 72(p)'s grace period rules. So, the participants' loans will default and become deemed distributions before the buyer's plan will accept rollovers.
2. *The seller's plan continues to accept loan payments from the participants by check.* Virtually no one wants to use this approach, particularly if the seller is going out of business and is keeping the plan open just until it gets a favorable determination letter on the plan termination. The fundholder of the seller's plan does not want to be in the position of accepting checks from all the participants, and will want the seller to collect the funds and transmit them. The seller may have neither the desire nor the remaining staff necessary to administer a loan-repayment-by-check program.
3. *The buyer collects loan payments by payroll deduction and then transmits them to the seller's plan.* I have seen this approach used twice, and it pleasantly surprised me both times. Both situations involved a buyer that initiated a new "mirror" plan for the acquired employees and used the same fundholder as was previously retained for the seller's plan. The buyer was already making transmissions to the fundholder every payroll and could simply code repayments of the seller's plan loans separately from its own repayments. The fundholder could then identify what should go into the seller's plan and helped accommodate the solution. In a situation in which the seller's plan is housed with a different fundholder/recordkeeper with whom the buyer has no relationship, it is less likely that this solution would work.
4. *The buyer makes corporate "bridge" loans to participants to enable them to repay participant loans, and rolls over the full account to the buyer's plan, and retakes the participant loan at that point*. Option 4 is an undesirable solution (no surprise here!). The buyer would not want to loan corporate money to new employees, particularly when it realizes that the employee cannot secure the loan with his or her rollover account. Nothing would stop the participant from taking the bridge loan, rolling the funds into either the buyer's plan or an IRA, and then refusing to take a participant or other loan to repay the bridge loan from the company.

What is the real solution? It would be nice if the IRS would permit a suspension of loan payments after an asset transaction while the plan timely seeks a determination letter to satisfy the recipient plan's sponsor, if distributions or rollovers are made within a reasonable time after the letter is received. On the other hand, how would the payments on the loan be calculated once the suspension period is over? If the "leave of absence" rules are followed, the participant would be given a choice between (a) repaying the loan at the old repayment amount, with a balloon payment due at the end of the normal loan term; or (b) reamortizing the loan over its remaining term. Would the complexity cause the buyer to decline the administrative hassle and refuse to accept rollovers of the loans? One must also consider again whether fundholders' computer systems could accommodate these once-suspended loans.

Perhaps the solution is to better educate participants at the front end about what happens to their loans if they terminate employment, either voluntarily or as part of a company buyout. Participants are not likely to mold their borrowing behavior to events that they do not expect to occur. On the other hand, they will not be so surprised if the unexpected comes to pass.

Conclusion

We have come a long way since 1982 with regard to participant loans, and the journey has generally been difficult. It would be helpful to all if the government would consider today's daily valuation environment when it issues regulations. It would also be helpful if fundholder/recordkeeper systems had more flexibility than they often do. It would be nice if participants would stop raiding their accounts before retirement. It would be best if the rules and the realities fit together better than they do. ▲

Ilene Ferenczy, JD, CPC, APA, consults with the law firm of Powell, Goldstein, Frazer & Murphy LLP in Atlanta on a wide range of employee benefits issues, particularly those relating to qualified plans and mergers and acquisitions. A member of the employee benefits community since 1977, Ilene was a third party administrator before becoming an attorney. Ilene is the author of Employee Benefits in Mergers and Acquisitions, *a Panel Publishers' publication.*

The Look-in-the-Mirror Test

by Jim Lewis

Many professions today require their members to look in the mirror and ask themselves, "Do I know what I'm doing here?" or "Am I qualified to do this?" We certainly expect our doctors or lawyers to ask themselves these questions before they meet us in the operating room or in court.

For actuaries, the look-in-the-mirror test can be found in Precept 2 of the Code of Professional Conduct for Actuaries: "An actuary shall perform actuarial services only when the actuary is qualified to do so on the basis of basic and continuing education and experience and only when the actuary satisfies applicable qualification standards."

When members of the American Academy's Committee on Qualifications were asked what questions they asked themselves for the look-in-the-mirror test, they provided several useful perspectives to ponder:

- Do I really know what I am doing on this assignment?
- On a scale of 1-10, how well qualified am I?
- Do I have adequate basic education, experience, and continuing education to do this project well?
- Would my grandmother, my mother, my father, or my teenager think that I know what I am doing?
- Would a judge or opposing attorney accept my professional actuarial credentials in court?
- Will my peer review agree that I am qualified?
- Do I take this question seriously?
- Are my continuing education records up-to-date and presentable for review, if necessary?

There are a number of things that can cause you problems if you're not careful, and some of them have serious consequences. Actuaries should strive to avoid taking chances with their qualifications.

Need to review? Qualification standards are available online at **www.actuary.org/standard.htm** or can be obtained in booklet form by contacting the Academy's legal assistant, Rita Winkel (202-223-8196, **winkel@actuary.org**). ▲

Jim Lewis, FSA, MAAA, is the vice chairperson of the Academy's Committee on Qualifications.

ASPA would like to offer special thanks to the American Academy of Actuaries for allowing us to reprint the above article, which was previously featured in the Academy's *Actuarial Update* July 2001 newsletter.

ASPA's Non-Actuaries Should Also Perform the Look-in-the-Mirror Test

by Anna Delaney, CPC

The look-in-the-mirror test for ASPA Members is found in Precept 3 of the ASPA Code of Professional Conduct: "An ASPA member shall render opinions or advice, or perform professional services only when qualified to do so based on education, training or experience."

ASPA's actuarial and non-actuarial members alike will serve the public interest by taking a long look in the mirror before agreeing to take on an assignment. Non-actuarial ASPA members should consider the same types of questions as those supplied above by the Academy's Committee on Qualifications.

ASPA members can obtain more information on ASPA's guidelines regarding qualifications by contacting the ASPA Professional Conduct Committee at **bgraff@aspa.org**. ▲

Welcome New Members

Welcome and congratulations to ASPA's new members and recent designees.

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PIX Digest

The Pension Information eXchange (PIX) is an online service for pension practitioners. ASPA has co-sponsored the PIX Pension Forum for many years. For more information about PIX, call (805) 683-4334.

EGTRRA Cutbacks

EGTRRA did not provide for 411(d)(6) anti-cutback relief. This thread discusses the timing of amendments necessary for EGTRRA to avoid potential cutbacks. This is especially significant for plans that allocate employer contribution without any sort of "last day" or minimum hours requirement.

A PIX user posted a question about amending plans to increase the compensation and 415 limits for EGTRRA. The user rightly noted that IRS Revenue Ruling 2001-51 states that these changes are not merely cost-of-living increases, but will require a plan amendment. Under current IRS thinking, if a participant has satisfied the criteria necessary to share in the contribution allocation, then any amendment that could adversely affect a participant's share of an employer contribution is a potential prohibited cutback, even if the overall plan contribution is discretionary.

In the situation where a plan is amended to reflect the increase in compensation to $200,000 and the increase in the 415 limit to $40,000, it is possible that for a given level of employer contribution, certain participants would now receive less contribution than under the terms of the plan prior to the EGTRRA amendments. So, notwithstanding IRS guidance that permits EGTRRA amendments to be adopted by the end of the plan year in which they are implemented, the IRS is clear that this does not waive the anti-cutback issues.

The thread also discussed what other issues might cause a cutback to arise or otherwise lead to a need to do an EGTRRA amendment sooner rather than later. Some of the items identified were:

1. 415 limits and 401(a)(17) as discussed above
2. If a plan was top-heavy under the old rules but not the new rules, the need to amend for the new top-heavy/key employee determinations prior to employees accruing a top-heavy minimum benefit
3. A defined benefit plan with 415 incorporated by reference not wanting benefits to pop-up unexpectedly.

Some practitioners who sponsor prototypes may adopt certain EGTRRA amendments at the sponsor level by the end of 2001, rather than try to deal with all of their individual employers in such a short time period. It is not clear how this might work with prototype plans that have subsequently been amended in a way to make them individually designed plans.

It was also noted in another thread that the timing of these EGTRRA amendments and the GUST restatement is unfortunate. Many, if not most, firms have not yet started the GUST restatement process. So if the EGTRRA amendments are done first, they will have to be done again as part of the GUST process, as the initial amendments would be superseded by the GUST restatement.

The conclusion of the various discussions was that there may be some arguments made as to which of these changes may or may not create a cutback. There may be later IRS guidance, but as things appear right now, the best thing to do is amend plans prior to the time the participants accrue a benefit in the 2002 plan year. For plans with no "last day" or hours requirement, the amendment should be done by the last day of the 2001 plan year.

These threads will be included in our ongoing archive of EGTRRA messages; however, you may download this discussion in the file egtrcut2.fsg.

To Reduce Or Supplement, That Is The Question

In addition to EGTRRA changes, other PIX users are discussing plan document options in anticipation of the GUST plan restatements. This thread discusses the use of forfeitures in profit sharing and 401(k) plans.

The thread starts with a question regarding a 401(k) plan where forfeitures reduce contributions. The user notes that despite instructions, when clients remit their 401(k) matching contributions, they frequently do not incorporate the forfeiture properly. This user was wondering if, since forfeitures reduce employer contributions, it would be feasible to simply return the forfeitures to the employer.

Other PIX users quickly agreed that the forfeitures should not be returned to the employer, but the discussion quickly turned to whether or not forfeitures should reduce or supplement contributions.

It was pointed out that having the forfeitures reduce the contribution makes little sense when the amount of contribution is discretionary. While that is true, there are other considerations. First, the employer may have a fixed contribution formula (especially in the case of matching contributions) and does not want to provide more than the formula. Additionally, many plan documents have provisions for allocating forfeitures separately from contributions. This could lead to an inadvertent operational error or an undesirable allocation result if the forfeiture allocation language is not followed or is not the same as the contribution language.

It was noted that with the pre-EGTRRA 404 limit of 15%, having forfeitures reduce the contribution could lower the amount of contribution below the maximum. Now with the new EGTRRA 25% limit, the new $200,000 compensation limit, and deferrals no longer counting toward the 404 limit, this issue should not be a significant problem going forward.

To read the entire thread, download forfred2.fsg.

EGTRRA Archive

At the ASPA conference, PIX users were able to pick up a diskette with an archive of some 600 messages to date dealing with EGTRRA. This file is available on PIX via the internet. To get it, start your browser and go to **ftp://pixpc.com/pub**. Download the file EGTRRA.EXE to a folder where you can find it. After saving, find the file in Explorer and double click on it. Extract the files to your WODWin 4 directory. (For most users, this is C:\ProgramFiles\WODWin.) Run WODWin. Pull down the File Utilities menu and select Copy Message File to WOD Folder. You will see a directory of files. Select EGTRRA.MDB. You will be asked what name to give the resulting file. I suggest "EGTRRA Archive." You will then be able to read this file as any other PIX message file. ▲

New Year – New Look – New Name!
The ASPA Journal

As 2002 approaches, ASPA's newsletter is getting a facelift and a new name! Beginning with the January/February 2002 issue, the ASPA newsletter will be titled *The ASPA Journal.* Our membership has grown tremendously and so has our breadth of topics. We are not just about "pensions," and our membership has expanded to include retirement plan professionals in addition to "actuaries." Thus, the new name – *The ASPA Journal* – better reflects the changes ASPA is experiencing. The new name emphasizes the fact that the purpose of our newsletter, as it always has been, is to keep you informed about ASPA's activities as an organization and to bring you articles covering a wide variety of industry-related topics that appeal to our broad base of members.

Many of you responded to our newsletter survey several months ago, letting us know what was important to you and what type of articles you would like to see in the future. Responses indicated that your primary interests were to see topics concerning detailed explanations of rules and regulations, plan designs and examples, and legal and fiduciary issues. Topics of secondary interest included participant and client communication, operational procedures, technology, and sales and marketing strategies. We will continue to look for timely topics and new authors to keep you up-to-date in these areas of interest.

Due to our large membership and budget constraints, most of our bimonthly newsletters are sent bulk mail. In an effort to get you information faster, ASPA will send an e-mail each time a new issue has been posted on the website. All members who have included their e-mail address in their membership information will receive this notification, which will contain the direct URL that you can click on to view the latest issue. For those of you who have never visited the newsletter portion of the website, you will find that you can also access articles from previous issues with an index sorted by title or by author.

As we go through the year, we may tweak the look and feel of the newsletter and try some new things. You may see some advertising, you may see some different types of articles, and you may see a different style of layout. Please let us know what you think, and please send us any ideas or suggestions you have on how we can continue to improve *your* newsletter. Feel free to send your comments to **theaspajournal@aspa.org**.

EDUCATION

C-3, C-4, A-4 exams
December 5

QKA online kit now available www.aspa.org

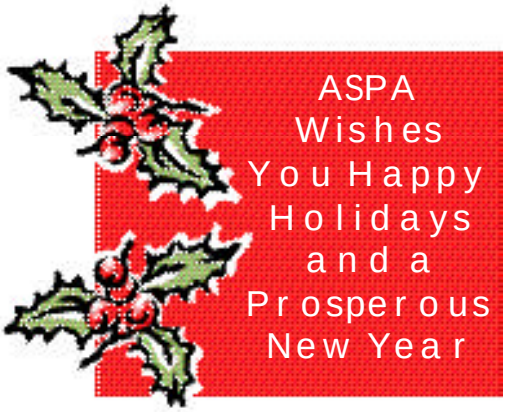
CONFERENCES

Los Angeles Benefits Conference
January 31 - February 1
Register online at www.aspa.org

401(k) Sales Summit
Scottsdale, AZ
Feb 28 - Mar 2, 2002

MEMBERSHIP

Be sure to submit your 2002 ASPA dues payment by January 2, 2002.



2001 Calendar of Events

		ASPA CE Credit
December 5	C-3, C-4, and A-4 exams	*
December 5	Webcast – Deduction Issues After EGTRRA	2
December 31	Deadline for 2001 edition exams for PA-1 (A&B)	**
December 31	Deadline for 2001 edition exam for Daily Valuation	***

2002 Calendar of Events

January 2	ASPA dues postmark deadline	
Jan 31 - Feb 1	Los Angeles Benefits Conference, Universal City, CA	16
Feb 28 - Mar 2	401(k) Sales Summit, Scottsdale, AZ	14
March 31	Early registration deadline for spring exams	
April 26	Registration deadline for spring weekend courses	
April 30	Final registration deadline for spring exams	
May 1 - May 31	C-1, C-2(DB), C-2(DC) spring exam window	*
May 2 - 3	Great Lakes TE/GE, Chicago, IL	16
May 4 - 5	C-1, C-2(DB), C-2(DC), C-3, and C-4 weekend courses, Chicago, IL	15
May 4 - 7	Business Leadership Conference, Lake Tahoe, NV	20
May 17	Postponement deadline for spring exams	
May 22	C-3 and C-4 exams	*
May 30	Northeast Key Conference, Natick, MA	8
May 31	Northeast Key Conference, White Plains, NY	8
July 27 - 31	Summer Conference, San Diego, CA	20
September 30	Early registration deadline for fall exams	
October 27 - 30	Annual Conference, Washington, DC	20
October 31	Final registration deadline for fall exams	
November 1	Registration deadline for fall weekend courses	
November 1 - 30	C-1, C-2(DB), C-2(DC) fall exam window	*

* Exam candidates earn 20 hours of ASPA continuing education credit for passing exams, 15 hours of credit for failing an exam with a score of 5 or 6, and no credit for failing with a score lower than 5.

** PA-1A and B exams earn five hours of ASPA continuing education credits each for passing grades.

*** Daily Valuation exams earn 10 hours of ASPA continuing education credits each for passing grade.