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LEGAL ALERT



## Legal Alert: Plan Loans under Truth-In-Lending Act

3/6/2009

The federal Truth in Lending Act ("TILA"), and the Federal Reserve Board's Regulation Z implementing TILA, are applicable to most employee benefit plans that have plan loan provisions, such as a "typical" 401(k) plan or 403(b) plan. This is because Regulation Z covers any entity or individual that offers credit under the following conditions: (1) the credit is offered or extended to a "consumer"; (2) the credit is primarily for personal, family, or household purposes; (3) the credit carries a finance charge, or is payable in more than four installments, pursuant to the terms of a written agreement; and (4) the entity or individual makes more than 25 loans – including both new loans and refinancing of old loans – during the year, or made more than 25 such loans during the preceding year. The first three conditions will always be met by a plan loan program, so it becomes a question of whether the plan makes, or has made, more than 25 loans per year. Three-participant plans need read no further, but if you are over, or near, the 25-loan threshold, you should read on. The purpose of TILA was to require creditors to disclose their credit terms in a uniform manner that would enable consumers to easily compare terms available to them, so as to avoid the uninformed use of credit, and to protect consumers against inaccurate, unfair or fraudulent credit billing and credit card practices. These requirements have been effective, in one form or another, since 1968, and, although both TILA and Regulation Z have changed over the years, employee benefit plans that have sufficient loan activity have had to comply with these consumer-lending protections. In 2007, the Federal Reserve Board proposed substantial amendments to Regulation Z which included, among many other things, an exemption for plan loans from the conditions of TILA. The main reason given for that proposed exemption was that plan loans come from, and repayments are reinvested in, the borrower's own plan account (an observation that is not always accurate). There is also no third-party creditor in the transaction imposing finance charges on the borrower, which results in a much lower cost of credit (i.e., the borrower is paying interest to him- or herself). Finally, the Board noted that there is already sufficient regulation by the Department of Labor requiring disclosure of fees and expenses to borrowers. When one commenter on the proposal noted that many covered plans – including governmental plans – were in fact not subject to Department of Labor oversight under ERISA, the Board responded that it ". . . believes that the exemption for the plans specified in new § 226.3(g) [*i.e.*, 401(a) plans, 403(b) plans and governmental 457(b) plans] is appropriate even for those plans to which ERISA disclosure requirements do not apply." As a result, for those of you who enjoy receiving advance notice, effective July 1, 2010, loans made to participants from most employer-sponsored retirement plans (whether or not subject to ERISA) will be exempt from the TILA and Regulation Z requirements. The final amended Regulation Z exempts extensions of credit to participants in

employer-sponsored retirement plans qualified under Section 401(a) of the Internal Revenue Code ("Code"), tax-sheltered annuities under Section 403(b) of the Code, or eligible governmental deferred compensation plans under Section 457(b) of the Code, provided only that ". . .the extension of credit is comprised of fully vested funds from such participant's account and is made in compliance with the Internal Revenue Code." This exemption leaves open the question of whether a "non-allocated" loan (i.e., where the loan is held as an asset of the plan as a whole, rather than as an asset of the borrower's account, such as by assigning all plan loans to an unallocated "loan fund") should remain subject to TILA. As written, the exemption will apply, since the loan is funded from the participant's vested account balance, and it complies with the applicable Code requirements. However, two of the Board's stated reasons for creating the exemption, i.e., that loan payments are reinvested in the borrower's account, and that the interest on the loan is repaid to the borrower's account, do not apply to such a loan.

The Board will have more than twelve months in which to fine-tune this exemption, if it determines that changes are necessary.

The final regulation is available at:

<http://edocket.access.gpo.gov/2009/pdf/E8-31185.pdf>. The plan loan exemption is discussed starting at page 5262, and the actual exemption appears at page 5399 as §226.3(g). If you have any questions regarding plan loans or the new TILA exemption, you can contact the author of this Alert, Jeffrey Ashendorf, 212-453-5926, [jashendorf@fordharrison.com](mailto:jashendorf@fordharrison.com), or any member of Ford & Harrison's Employee Benefits practice group.