PLAN DISTRIBUTIONS

EBSA Issues Field Assistance Bulletin 2003-1 On Participant Loan Rules

Many public companies allow participant loans under their 401(k) and other retirement plans. New guidance can help companies avoid ERISA violations when denying such loans to company officers and directors.

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The Sarbanes-Oxley Act of 2002, P.L. 107-204 (the Act), enacted on July 30, 2002, prohibits public companies from making personal loans to their directors or executive officers. Specifically, Section 402 of the Act added new Section 13(k) to the Securities Exchange Act of 1934 (the Exchange Act), making it unlawful for any issuer, directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. The term "issuer," under Section 2 of the Act means an issuer (as defined in Section 3 of the Exchange Act), the securities of which are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn.

The Act does not preclude, however, any home improvement and manufactured home loans (as that term is defined in Section 5 of the Home Owners' Loan Act), consumer credit (as defined in Section 103 of the Truth in Lending Act), any extension of credit under an open-end credit plan (as defined in Section 103 of the Truth in Lending Act), or a charge card (as defined in Section 127(c)(4)(e) of the Truth in Lending Act), or any extension of credit by a broker or dealer registered under Section 15 of the Exchange Act to an employee of that broker or dealer to buy, trade, or carry securities, that is permitted under rules or regulations of the Board of Governors of the Federal Reserve System pursuant to Section 7 of the Exchange Act (other than an extension of credit that would be used to purchase the stock of that issuer), that is (1) made or provided in the ordinary course of the consumer credit business of such issuer; (2) of a type that is generally made available by such issuer to the public; and (3) made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such extensions of credit. The Act also does not apply to any loan made or maintained by an insured depository institution (as defined in Section 3 of the Federal Deposit Insurance Act), if the loan is subject to the insider lending restrictions of Section 22(h) of the Federal Reserve Act.

Any extension of credit maintained by an issuer on July 30, 2002, the Act's enactment date, also is not subject to the Act, provided there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after July 30, 2002.

Many public companies allow participant loans under their 401(k) and other retirement plans. The Act does not specifically address whether plan loans to participants who are directors or executive officers are prohibited. Until the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) issued Field Assistance Bulletin 2003-1 on April 15, 2003, it was widely believed that a public company's plan could not deny loans to employee directors or executive officers without violating the requirement, in Section 408(b)(1) of the Employee Retirement Income Security Act of 1974, as amended (ERISA) and DOL Regulations Section 2550.408b-1, that such loans be made available to all parties in interest who are participants or beneficiaries "on a reasonably equivalent basis."

The specific issue that the EBSA addressed in Field Assistance Bulletin 2003-1 was whether a plan administrator may deny participant loans to directors and executive officers of the plan's sponsoring employer on the basis that such loans *may* violate Section 13(k) of the Exchange Act (as added by Section 402 of the Act) without contravening the requirement of Section 408(b)(1) of ERISA that loans be made available to all participants on a reasonably equivalent basis.

In Field Assistance Bulletin 2003-1, the EBSA briefly summarized Section 13(k) of the Exchange Act (as added by Section 402 of the Act), but noted that it does not have interpretative authority with respect to the Exchange Act. The EBSA then listed the various ERISA provisions that govern participant loans, with respect to which it does have interpretative authority:

- First, Section 404 of ERISA requires, among other things, that fiduciaries of employee benefit plans discharge their duties prudently and solely in the interest of the plan's participants and beneficiaries.

- Second, Section 404(a)(1)(D) of ERISA requires that fiduciaries discharge their duties in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with Title I of ERISA.

- Third, Section 406(a)(1)(B) of ERISA prohibits a fiduciary from causing an employee benefit plan to engage in a loan between the plan and a "party in interest," a term that includes employees, officers, and directors of an employer sponsoring the plan.

- Finally, Section 408(b)(1) of ERISA exempts from the prohibited transactions provisions of Section 406 of ERISA the making of a loan by an employee benefit plan to a party in interest who is a participant or beneficiary of the plan, provided that certain conditions are satisfied. Among other things, Section 408(b)(1)(A) of ERISA and U.S. Department of Labor Regulations Section 2550.408b-1 require that such loans must be made available to all participants and beneficiaries of the plan on a reasonably equivalent basis.

The EBSA also noted that Section 514(d) of ERISA provides that nothing in Title I of ERISA shall be construed to alter, amend, modify, invalidate, impair, or supersede any other federal law.

The EBSA noted that it understood that ERISA practitioners have raised the question whether Section 13(k) of the Exchange Act (as added by Section 402 of the Act) prohibits directors and executive officers of an employer from taking loans from employee pension benefit plans. The EBSA further noted that it had long been the view of the Department of Labor that fiduciaries are responsible for administering their plans to ensure compliance with both ERISA and other applicable federal laws, in recognition of the fact that the other federal laws are not preempted by ERISA. The EBSA declared that, in its view, a decision to disallow a participant loan based on a reasonable question concerning the legality of the loan would not be a failure to provide loans to all participants on a reasonably equivalent basis and would not affect the plan's compliance with Section 408(b)(1) of ERISA or Section 2550.408b-2 of the U.S. Department of Labor Regulations.

The EBSA concluded that given the uncertainty concerning the scope of Section 13(k) of the Exchange Act (as added by Section 402 of the Act), plan fiduciaries of public companies may deny loans to officers and directors (or the equivalent thereof) without violating the fiduciary responsibility rules of Section 404(a)(1) of ERISA or the requirement, in Section 408(b)(1)(A) of ERISA and the regulations issued thereunder, that loans be made available to all participants and beneficiaries on a reasonably equivalent basis. In stating this view, the EBSA took no position on the application of Section 13(k) of the Exchange Act to participant loans, since it lacks interpretative authority with respect to the Exchange Act.

Conclusion

The EBSA's Field Assistance Bulletin 2003-1 provides helpful guidance to ERISA practitioners, public companies, and the administrators of such companies' plans because it resolves the present, apparent conflict between ERISA's requirement that plan loans be made available to all participants on a reasonably equivalent basis and the Exchange Act's requirement that personal loans (which might include plan loans) not be made to participants who also are directors or executive officers. One hopes that the Securities and Exchange Commission (SEC) soon will issue guidance clarifying whether Section 13(k) of the Exchange Act prohibits plan loans to participants who are also directors or executive officers. Many ERISA practitioners believe that the

SEC's guidance ought to state that Section 13(k) of the Exchange Act does not prohibit plan loans to such participants because that would be consistent with their view that the Sarbanes-Oxley Act was never meant to prohibit such loans in the first place. If the SEC does issue guidance to that effect, the EBSA ought to issue further ERISA guidance stating that, in light of the SEC's interpretation of Section 13(k) of the Exchange Act, plan administrators may no longer deny participant loans to directors and executive officers of the plan's sponsoring employer because it would no longer be reasonable for them to conclude that such loans may violate Section 13(k).