

## Publications

# DOL Guidance on Plan Loans After Sarbanes-Oxley

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## SERVICES

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) prohibits a public company from extending credit, or arranging for an extension of credit, to a director or an executive officer of the company. The Department of Labor (DOL) recently issued guidance that assures plan sponsors that they will not violate the ERISA rules for plan loan programs by applying the Sarbanes-Oxley restriction, the scope of which remains unclear.

Sarbanes-Oxley Loan Prohibition – Sarbanes-Oxley added a new §13(k) to the Securities Exchange Act of 1934 (Exchange Act) that made it unlawful, effective July 30, 2002, for a public company:

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 [company].

Sarbanes-Oxley did not define the term “personal loan,” nor what it meant “to extend, maintain or arrange for the extension of credit.” Because the provision was added to the legislation as a floor amendment late in the process, there is no committee or conference report language that describes the intended scope of the key terms of the provision. The Securities and Exchange Commission (SEC), which has authority to interpret the Exchange Act, to date has issued no guidance on the loan prohibition and none is apparently planned.

The broad wording of the loan provision, the limited list of exceptions given in the statute, and the lack of any legislative history or SEC guidance to date, have raised concerns that many types of broadly available, routine transactions, including loans from qualified plans, may be prohibited as to executive officers and directors.

- For the reasons listed below, it was hoped that the SEC would issue some interpretive relief for loans from 401(k) and other qualified plans:
- the participant – and not the company – generally bears the loss if a plan loan is not repaid,
- ERISA §408(b)(1) generally requires that, to be exempt from ERISA's prohibited transaction rules, plan loans be available to all participants and beneficiaries on a

reasonably equivalent basis; thus, there could be prohibited transaction issues under ERISA §406 if plan loans were not available to executive officer participants,

- while Senators have written to the SEC (or been quoted in the media) stating that certain types of arrangements were intended to be covered by the loan prohibition, none have indicated that plan loans were to be affected,
- under the tax laws, plan loans may not exceed \$50,000, and the SEC has provided exemptions or lesser requirements in the compensation area for small loans, and
- under the tax laws, plan loans must be offered on a basis that does not discriminate in favor of highly compensated employees, and the SEC has provided exemptions or lesser requirements in the compensation area for broadly-based plans.

However, as noted above, the SEC has not issued any guidance on the issue to date, and it does not appear that it will issue any exemptions from the loan prohibition any time soon.

**Dilemma for Plan Sponsors** – The Sarbanes-Oxley loan prohibition has placed public companies in a difficult position. If a company allows its executive officers and directors to receive loans from its 401(k) or other qualified plans, it risks a possible violation of the Exchange Act and substantial penalties. If a company prohibits such individuals from receiving loans and the relevant plan documents do not provide for such a prohibition, it faces two issues under ERISA:

- it raises the prohibited transaction issue under ERISA §§406 and 408 noted above, and
- a violation of ERISA §404(a)(1)(D), which requires a fiduciary to administer a plan in accordance with the relevant plan documents.

In addition, the IRS position is that any violation of a retirement plans terms may result in disqualification of the plan.

**DOL Guidance** – On April 15, the DOL issued guidance for public companies on this issue in the form of Field Assistance Bulletin 2003-1. The guidance, though in the form of a memo to DOL field representatives and not, technically, legal authority, nevertheless sets out the DOL's position on the ERISA issues.

The DOL first makes clear that it has no authority to interpret the loan prohibition under the Exchange Act, and therefore, it takes no position as to whether plan loans are permissible under the provision. The DOL also notes that §514 of ERISA generally provides that other Federal laws are not preempted by ERISA, and in light of that provision, plan administrators must assure compliance with both ERISA and other applicable Federal laws. Given the uncertainty on the scope of the loan prohibition, the DOL concludes that fiduciaries for plans sponsored by public companies may deny plan loans to executive officers and directors without violating ERISA §404 or losing the prohibited transaction exemption under ERISA §408. A company which decides to deny plan loans to these individuals would need to ensure that its third party administrator or whoever approves such loans has an updated list of the company's executive officers and directors.

**Conclusions** – The DOL's Field Assistance Bulletin provides no guidance on whether plan loans to executive officers and directors are permissible under the new Exchange Act provision. However, the Bulletin should relieve the fear of a DOL action against a plan fiduciary who chooses to prohibit such loans, or the imposition by the IRS of a prohibited transaction excise tax under IRC §4975. Further, a court would likely give substantial weight to the DOL's views on this issue if a participant were to challenge such a prohibition as a violation of ERISA. However, absent some guidance from the IRS, the issue of the tax qualification of the relevant plan would remain (unless the plan is amended to reflect the limitation).