Springtime brings some good news from the Department of Labor!

On Friday, April 7th, 2006, DOL published in the Federal Register a final amendment to PTE 80-26, the class exemption covering interest-free loans from parties in interest to employee benefit plans. See 71 Fed. Reg. 17917 (Apr. 7, 2006). This exemption provides relief from the provisions of section 406(a)(1)(B) and (D) and 406(b)(2) for a loan by a party in interest (such as the employer or a service provider) to a plan if, among other conditions, no interest or fee is charged.

The final amendment published today is consistent with the 2004 proposed amendment, with one modification.

Under the prior version of PTE 80-26, a distinction was made between loans for "ordinary operating expenses" (including benefit payments), which were permitted to be of unlimited duration, and loans made for a purpose "incidental to the ordinary operation of the plan," the duration of which was limited to 3 days. The final amendment eliminates the duration limitation for "incidental" loans, providing relief for both types of loans regardless of the duration. This is, of course, a welcome change and will increase the opportunities for beneficial no-interest loans to plans. Some possibilities include (if the "lender" is willing to forego interest):

- A "Book up" or "book in" (a service provider advances funds to a new client plan to cover termination charges imposed by prior provider)
- Investment related loans, such as liquidity facilities for Plan investments.
- Overdraft protection provided by a trustee or custodian

While the expansion of the exemption is a positive development, the final exemption includes a significant new condition. PTE 80-26 now requires a written loan agreement (containing all material terms) for any loan with a term of 60 days or longer. Because this new requirement applies to "operating expense" loans (effective April 7, 2006) as well as "incidental loans (effective December 15, 2004), it could have an impact on the "cash flow" practices of plan sponsors and providers. Under the prior version of the amendment, a loan made for operating expenses did not require a written agreement. Plan sponsors might advance expense or benefit payments to a plan, using a quarterly or even annual reconciliation and reimbursement process. Under the new exemption, a practice like this will require a written loan agreement if PTE 80-26 is to be relied upon. In addition, PTE 80-26 has occasionally been used to "solve" inadvertent loans by employers/service providers and plans. Now, if the loan is not discovered within 60 days, the exemption will not be available for this type of "fix."

A second change from the prior version of PTE 80-26 is that relief is not available for loans described in section 408(b)(3) or IRC 4975(d)(3) and the regulations there under. According to DOL, this means that PTE 80-26 is not available for loans to ESOPs to the extent that these loans relate to the acquisition by the ESOPs of employer securities. We will be reviewing the extent to which this condition affects the availability of the exemption for a no-interest liquidity facility provided by an employer or a plan service provider to an employer stock fund characterized as an ESOP. Typically, these funds "borrow" to make redemptions and effect exchanges and not to "acquire" securities.

Lastly, the preamble contains an interesting discussion of the common practice by employers of paying plan expenses and then seeking reimbursement from plan assts. The “written loan agreement” condition in the final exemption seems to have been driven in part by DOL's desire to discourage employers from paying plan expenses from their general assets and then, years after the fact, recharacterizing” these expenses as reimbursable plan expenses.

Note that the exemption is generally effective December 15, 2004, so is available retroactively in some circumstances.