SEYFARTH SHAW
MANAGEMENT ALERT

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What To Do About Plan Loans And SOX?

The Sarbanes-Oxley Act of 2002 (SOX), enacted last year in response to well-publicized corporate scandals such as Enron and WorldCom, prohibits "personal loans" by public companies to directors and executive officers. This provision of the law has raised a number of troubling issues, including whether SOX prohibits executive officers from borrowing from their accounts in their company's 401(k) or other tax-qualified retirement plan.

The prohibition on personal loans to executive officers is part of the Securities Exchange Act of 1934 (1934 Act), and violations are subject to the general civil and criminal penalties of the 1934 Act which, for a willful violation, can be as much as a $5,000,000 fine and 20 years imprisonment (or a $25,000,000 fine for a corporation). The prohibition does not apply to loans outstanding on the effective date of SOX (July 30, 2002) unless there is a material change to the terms of the loan.

Most plan participants consider plan loans as borrowing from themselves. Nevertheless, the law prohibits loans that are "arranged by" the company, and it is at least arguable that plan loans are "arranged by" the plan sponsor. The Securities and Exchange Commission (SEC), which has jurisdiction over SOX, has not issued any guidance on this issue, and even last week in a meeting with ABA members, has refused to take a position. This leaves plans and officers of publicly-held companies in a quandary.

Until recently, plan sponsors/employers have been in a particularly difficult position because Department of Labor (DOL) regulations specify that a plan which offers participant loans, must make them available to all employees participating in the plan. Accordingly, by banning plan loans to officers to comply with SOX, a company could have arguably run afoul of the DOL regulations.

The DOL recently resolved this dilemma by ruling that a plan could disallow loans to executive officers until the legal status of such loans is resolved. In Field Directive Bulletin 2003-1, the DOL reasoned that ERISA only requires that loans be available to all employees on a "reasonably equivalent basis," and that denying loans to executive officers until the proper interpretation of SOX is resolved may be a "reasonable" restriction in light of the uncertain legality of the loans.

The DOL was careful not to express any opinion as to whether plan loans to executive officers are illegal under SOX, because this is within the exclusive jurisdiction of the SEC. The SEC's refusal to speak on this issue has encouraged a conservative approach. Until now, many public companies informally asked officers to avoid new plan loans or implemented informal suspensions. Others have taken no position.

Although the consensus is that plan loans should not be prohibited by SOX, and in any event should not be considered a willful (*i.e.* criminal violation), the matter is not entirely free from doubt, especially in light of the SEC's reluctance to give guidance. The DOL guidance allows public companies that choose to follow a conservative approach to formally suspend plan loans to executive officers pending resolution of the issue. Plan documents should be considered. If the plan document provides that all participants have the right to borrow against their account, then any exception for executive officers should be made a part of the terms of the plan, even if the excep-

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tion is only a suspension until the legal issue is resolved. Plan fiduciaries have a responsibility under ERISA to administer a plan in accordance with its terms. Note that the plan's loan provisions may be reflected in the plan document, plan loan policy and procedures, or other plan documentation.

In addition to plan loans, a number of other common compensation and benefits practices of public companies are also called into question by the loan prohibition of SOX, including split-dollar life insurance policies, cashless stock option exercises, and various types of advances, such as relocation expenses, travel expenses, indemnification, etc. No new guidance has been issued on these subjects.

If you have any questions about the potential application of the SOX to your company's 401(k) plan or other compensation or benefits practices, please contact the Seyfarth Shaw employee benefits group attorney with whom you work or any employee benefits group attorney listed on the website at www.seyfarth.com.

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