U.S. Department of Labor Pension and Welfare Benefits Administration
Washington, D.C. 20210

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89-11A
Sec. 407

Mr. Leon E. Irish, Esq.
Jones, Day, Reavis & Pogue
1450 G Street, N.W.
Washington, D.C. 20005-2008

Re: Identification No. F-4273A

Dear Mr. Irish:

This is in response to your letters of February 28, April 28, and June 28, 1989, in which you request an advisory opinion regarding the application of section 9345(a)(3) of the Omnibus Budget Reconciliation Act of 1987 (OBRA 87) (the grandfather provision) to the proposed merger of seven pension plans which make up a "floor-offset arrangement" (the Arrangement) which was established prior to December 18, 1987.

You represent that the Arrangement was established several years prior to December 18, 1987 by Manufacturing Company (the Company) and have been maintained by the Company continuously since its establishment. The Arrangement consists of six defined benefit plans (DB Plans), each covering a different group of employees, and a single stock bonus plan covering all participants in the DB Plans. The stock bonus plan is invested entirely in common stock of the Company. The annuity values of accounts in the stock bonus plan serve as offsets with respect to the benefits provided under the DB plans. The six DB plans serve as floor plans, providing a minimum level of retirement benefits for participants.

You further represent that, in order to simplify its administrative burdens and to establish uniformity, the Company proposes to amend the six DB plans to bring each up to the benefit level of the best plan for all future accruals, and then to merge the six DB plans into one DB plan. There would be no decrease in benefits provided to any participant in any DB plan as a result of these amendments.

You also represent that the plan sponsor proposes to amend the stock bonus plan to satisfy the requirements for an employee stock ownership plan (ESOP) under section 4975(e)(7) of the

Internal Revenue Code of 1986, as amended (the Code).[1] The purpose of this amendment would be to enable the company to take advantage of the benefits available to ESOPS under the interest exclusion rules of section 133 of the Code.[2]

Finally, you represent that the offset plan, after amendment to become an ESOP, will not be leveraged and will operate in exactly the same manner as the existing stock bonus plan. Similar amounts of stock will be contributed each year and allocated to participants' accounts, which, in turn, offset the DB Plan in precisely the same way as before. Thus you indicate that the amendments will not alter the substantive nature of the floor-offset arrangement or affect the benefits provided.

You have requested an advisory opinion that: (1) the amendment and merger of the six DB plans into one DB plan, and (2) the amendment of the stock bonus plan, under the circumstances described above, would not render the grandfather provision of section 9345(a)(3) of OBRA 87, inapplicable to the Arrangement.

Section 406(a)(1)(E) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect acquisition on behalf of the plan of any employer security or employer real property in violation of section 407(a). Section 406(a)(2) of ERISA provides that no fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that the holding of such security or real property violates section 407(a).

Section 407(a) provides, in part, that (1) a plan may not acquire or hold any employer security which is not a qualifying employer security, and (2) a plan may not acquire any qualifying employer security if immediately after such acquisition the aggregate fair market value of employer securities held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

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[1] You further represent that the stock bonus plan and the DB Plans will be amended to comply with the Tax Reform Act of 1986 and subsequent legislation.

[2] The Tax Reform Act of 1936 amended section 133 of the Code to enable plans funded with employer stock to take advantage of the interest exclusion rules that reduce borrowing costs for ESOPs. Under so-called "immediate allocation" loan provisions of section 133(b)(2)(B) of the Code, for example, if a bank makes a loan to a corporation and within 30 days the corporation transfers employer securities to an ESOP in an amount equal to the amount of the loan and such securities are allocated to participants' accounts within one year of the date of such loan, the bank can exclude from gross income 50 percent of the interest income received under the loan. For purposes of section 133 of the Code, an ESOP has the meaning given to such term by section 4795(e)(7) of the Code.

Section 407(b)(1) of ERISA, however, provides, in part, that the 10 percent limitation of section 407(a) shall not apply to the acquisition or holding of qualifying employer securities by an eligible individual account plan.

Section 407(d)(3)(A) of ERISA defines "eligible individual account plan" to include an individual account plan which is (i) a profit-sharing, stock bonus, thrift or savings plan (ii) an employee stock ownership plan, or (iii) a money purchase plan which was in existence on the date of enactment of ERISA and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in section 408 of the Code. Section 407(d)(3)(B) provides that notwithstanding subparagraph (A), a plan shall be treated as an eligible individual account plan with respect to the acquisition or holding of qualifying employer real property or qualifying employer securities only if such plan explicitly provides for acquisition and holding of qualifying employer securities or qualifying employer real property (as the case may be). Section 407(d)(3)(C) of ERISA, as added by section 9345 (a)(1) of OBRA 87, provides that the term "eligible individual account plan" does not include any individual account plan the benefits of which are taken into account in determining the benefits payable to a participant under any defined benefit plan.

Section 407(d)(9) of ERISA, as added by section 9345(a)(2) of OBRA 87, provides that for purposes of section 407, an arrangement which consists of a defined benefit plan and an individual account plan shall be treated as one plan if the benefits of such arrangement are taken into account in determining the benefits payable under such defined benefit plan.

Section 9345(a)(3) of OBRA 87 provides that sections 407(d)(3)(C) and 407(d)(9) shall apply with respect to arrangements established after December 17, 1987. Thus, sections 407(d)(3)(C) and 407(d)(9) of ERISA do not apply to floor offset arrangements established on or before December 17, 1987.

On the basis of the facts and representations contained in your submissions, it is the opinion of the Department that the merger of the DB Plans, which were part of a floor-offset arrangement that was established on or before December 17, 1987, into a single DB plan with a benefit level equal to the highest benefit level offered by any of the DB Plans, would not render the grandfather provision contained in section 9345(a)(3) of OBRA 87 inapplicable to the Arrangement.

With regard to your second question, you represent that the amendments to the stock bonus plan would be made solely to comply with the formal requirements of section 4975(e)(7) of the Code in order to take advantage of the interest exclusion provisions in section 133 of the Code, and that the ESOP will not be leveraged and will operate in exactly the same manner as the stock bonus plan. Accordingly, it is the further opinion of the Department that the amendment of the

stock bonus plan to comply with section 4975(E)(7) of the Code would not render the grandfather provision contained in section 9345(a)(3) of OBRA 87 inapplicable to the Arrangement.

Because your submission deals only with issues arising under section 407(d)(3) and (9) of ERISA, this letter deals only with those issues and does not address the implications of any other sections of ERISA. Specifically, you have not requested and consequently the Department is not offering an opinion regarding the merger of the DB Plans. This letter is an advisory opinion under ERISA Procedure 76-1. Section 10 of the Procedure explains the effect of an advisory opinion.

Sincerely,

Robert J. Doyle
Director of Regulations and Interpretations