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

SEP 25 1989 89-24A

Mr. Richard P. Bogatto
Fulbright & Jaworski
1301 McKinney Avenue
Houston, Texas 77010

Dear Mr. Bogatto:

This responds to your request for an advisory opinion that certain loan transactions will not affect the character of the Quanex Corporation Supplemental Benefit Plan ("Plan") under sections 201(2), 301(a)(3), and 401(a)(1) of the Employee Retirement Income Security Act of 1974 ("ERISA" or the "Act"). Your submission contains the following facts and representations.

Quanex Corporation (hereafter, "the Employer") maintains the Plan as an unfunded, deferred compensation plan for a select group of management and highly compensated employees ("participants"). The deferred compensation is paid upon a participant's retirement, disability, or death. The benefit upon retirement consists of a lump-sum payment that is the actuarial equivalent of a lifetime monthly benefit determined under the Plan's benefit accrual formula.

In connection with the Plan, the Employer has established a "grantor trust" to provide for the payment of benefits to participants should the Employer fail to make such payments. The Employer expects that its contributions to the trust, consisting of insurance policies on the lives of employees and other assets, will approximate the value of benefits accrued under the Plan. The assets held in the trust are subject to the judgment creditors of the Employer and to its general creditors in the event the Employer becomes insolvent. Under the terms of the Plan and trust, the participants receive only the Employer's unsecured promise to pay benefits and have no rights in assets of the trust greater than the rights of unsecured creditors of the Employer. Your submission contains a private letter ruling from the Internal Revenue Service (dated August 26, 1988) in which the Service ruled that the establishment and settlement of the trust, the transfer of any assets to the trust by or on behalf of Quanex and the earnings on those assets will not constitute a taxable event for the employees for whom the trust is maintained.

You represent that, upon receipt of a lump-sum benefit distribution under the Plan and after including the amount in gross income for income tax purposes, some former employee-participants may choose to make a loan to the Employer in the amount of the distribution, less any income tax due or paid. The loans will be evidenced by a note and secured by one or more insurance policies owned by the Employer. The notes will specify interest at a fair market rate

based on the rate the Employer is paying on long-term debt when the loan is made and generally will provide for repayment over a period of 15 years. You state that participants are not legally restricted in any way as to the use of the benefit distributed under the Plan, and any participant who does choose to use the proceeds of his/her distribution to make a loan to the Employer is under no legal obligation to do so. There would be no arrangement or understanding to the effect that participation in the Plan or the making of a benefit distribution from the Plan is conditioned on the participant making a loan to the Employer. Nor would there otherwise be any pressure by the Employer on a participant, either before or after a benefit distribution, to make such a loan. In addition, your submission contains a separate private letter ruling (dated August 29, 1988) on the federal income tax consequences of a lump-sum benefit paid to a participant which is immediately loaned back to the employer, net of any taxes due, when there is no legal or contractual obligation requiring such loan. This ruling states that such a lump-sum benefit is includible in the gross income of the participant for the taxable year in which it was paid.

Sections 201(2), 301(a)(3), and 401(a)(l) of ERISA exempt from the requirements of Parts 2, 3, and 4 of title I of ERISA (pertaining to participation and vesting, funding, and fiduciary responsibility, respectively) plans that are "unfunded and ... maintained by an employer primarily for the purpose at providing deferred compensation for a select group of management or highly compensated employees" (commonly referred to as a "top hat" plan). However, "top hat" plans remain subject to the reporting and disclosure provisions contained in Part 1 of title I of the Act and are also subject to the administrative and enforcement provisions in Part 5 of title I of the Act, including section 502 which permits a participant or beneficiary to bring a civil action to recover benefits due under terms of the plan, section 510 which precludes any person's interference with a plan participant's ERISA rights, and section 511 which makes it unlawful for any person to coercively interfere with a plan participant's exercise of any right to which he is or may become entitled under the plan, title I, section 3001, or the Welfare and Pension Plans Disclosure Act.

According to your representations, the former employee - participants would not be required to enter into the loan transactions at issue pursuant to any legally enforceable contract or agreement. In addition, the loan transactions would not be provided for under any terms of the Plan or trust, and would be made with funds that are entirely within the control of the participant after the Plan has satisfied all of its obligation to the participant. You indicate further that the participant would not in any manner be subject to pressure by the Employer to make a loan.

On the basis of your representations, it is the view of the Department that loans made in the circumstances you have presented would not affect the character of the Plan under sections 201(2), 301(a)(3) and 401(a)(1) of ERISA. However, the Department is also of the view that if, in the operation of the plan, there is any pressure exerted on the participants to loan their distribution back to the employer, such pressure may constitute a violation of the plan

distribution provisions and be actionable under section 502 of the Act as well as section 510 and section 511 of ERISA. We note that you have not asked us to rule, and we provide no opinion in this letter, concerning whether the Plan constitutes a plan described in ERISA sections 201(2), 301(a)(3) and 401(a)(1).

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Section 10 of the procedure explains the effect of advisory opinions.

Sincerely,

Robert J. Doyle
Director of Regulations and Interpretations