U.S. Department of Labor

Pension and Welfare Benefits Administration
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ERISA SEC. 408(b)(3)

Ms. Roberta Casper Watson
Trenam, Simmons, Kemker, Scharf,
Barkin, Frye & O'Neill
Attorneys at Law
2700 Barnett Plaza
101 East Kennedy Blvd.
P. O. Box 1102
Tampa, FL 33601-1102

Dear Ms. Watson:

This is in response to your letter requesting an advisory opinion regarding whether proceeds received from the sale of stock acquired with a loan which is exempt under section 408(b)(3) may be used to repay the loan if there is no formal pledge of the stock as security for the loan. In effect, you inquire whether Department of Labor Regulation 29 C.F.R. 2550.408b-3(e) would preclude repayment using such proceeds.

You represent that in late 1987 an employee stock ownership plan (the ESOP) executed a promissory note which was guaranteed by its corporate sponsor. The ESOP subsequently acquired corporate stock at an average purchase price of . The stock was not formally pledged as security for the loan. In April, 1989 there was an unsolicited offer to purchase all the shares of the sponsor. After consideration by a "Special Independent Committee" of the sponsor's board of directors, the sponsor agreed to accept an offer of . In connection with the offer, shares held in the ESOP's suspense account were tendered.

The tender offer was issued pursuant to agreements which further contemplated a merger of the purchaser into the sponsor. Under the merger agreement, all other shares held by the ESOP will be exchanged for cash. Upon consummation of these agreements, the suspense account will contain approximately in cash, with a balance remaining on the loan. It is the desire of the Trustee and the Company that the cash held in the suspense account be used to prepay the loan in full and that the balance of the suspense account be allocated to participants' accounts.

Section 406(a)(1)(B) of ERISA prohibits the lending of money or other extension of credit, including a guarantee of a loan,[1] between a plan and a party in interest. An employer that sponsors a plan is a party in interest with respect to the plan, under section 3(14)(C) of ERISA. Therefore, a sponsor's guarantee of a loan to a plan would be prohibited in the absence of a statutory or administrative exemption.

Section 408(b)(3) of ERISA provides a conditional exemption for loans to employee stock ownership plans. Regulation section 2550.408b-3(e) interprets this exemption and provides, in part, that:

> No person entitled to payment under the exempt loan shall have any right to assets of the ESOP other than:

[1] See Conference Report accompanying ERISA, H.R. Rep. No. 1280, 93rd Cong., 2d Sess. 308 (1974).

> (1) Collateral given for the loan;
> (2) Contributions (other than contributions of employer securities) that are made under an ESOP to meet its obligations under the loan; and
> (3) Earnings attributable to such collateral and the investment of such contributions.

It is the view of the Department of Labor that while 2550.408b-3(e) precludes recourse to other than the above-enumerated assets of the ESOP by persons entitled to repayment of a loan that is exempt under ERISA section 408(b)(3), it does not serve to limit the use of other assets by the fiduciary of an employee stock ownership plan to repay an exempt loan. Accordingly, the loan to the ESOP would not fail to be exempt solely because the appropriate plan fiduciary used assets of the ESOP other than those enumerated in 2550.408b-3(e) to repay the loan.

However, any such action would be subject to the general fiduciary rules of ERISA. In this regard the appropriate plan fiduciary should consider the application of ERISA sections 403, 404, and 406. Section 403(c)(1) of ERISA provides, in part, that:

> [T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(A) provides, in part, that:

> [A] fiduciary shall discharge his [or her] duties solely in the interest of the participants and their beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan.

ERISA section 404(a)(1)(B) provides, in part, that a fiduciary shall discharge his or her duties:

> [W]ith the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

ERISA section 406(a)(1)(D) provides that, except as provided in section 408, a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan.

The appropriate plan fiduciary must consider the application of these provisions to the facts and circumstances of this case. In particular, the fiduciary must ascertain under the above-described circumstances whether the lender has recourse to employer securities in the suspense account (or proceeds received from the sale of such securities) in the event of default -- i.e., whether the securities serve as collateral for the loan.[2] In the absence of such a determination, repayment by the plan of the balance remaining on the loan would appear to violate ERISA sections 403(c)(1), 404(a)(1)(A), 404(a)(1)(B) and 406(a)(1)(D) because, assuming the loan complied with the terms of 29 C.F.R. 2550.408b-3, the lender would have no right to employer securities held in the suspense account and the plan would have no legal obligation to repay the loan with the proceeds from the sale of the securities.

[2] Notwithstanding collateralization of the loan by the unallocated employer securities in the suspense account, other fiduciary duties under Title I of ERISA may be implicated when considering the sale of such securities to service the exempt loan debt.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is subject to the provisions of the Procedure including section 10 thereof relating to the effect of advisory opinions.

Sincerely,

ROBERT J. DOYLE
Director of Regulations and Interpretations