

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210



June 29, 1995

95-17A

Ms. Linda K. Shore
Groom and Nordberg
1701 Pennsylvania Avenue
Suite 1200
Washington, D.C. 20006

Dear Ms. Shore:

This is in response to your request for an advisory opinion on behalf of Banc One Corporation and its affiliates ("Banc One") in connection with Banc One's processing of participant loan applications under a proposed participant loan program (the "Program"). Under the Program participants would access participant loans by the use of credit cards issued by Bank One. Specifically, you inquire as to the fiduciary status under the Employee Retirement Income Security Act of 1974 ("ERISA" or "the Act") of Banc One in connection with Banc One's processing of participant loan applications and administration of the Program.

Your request contains the following facts and representations. Banc One intends to enter into agreements (the "Plan Agreement") with appropriate fiduciaries of individual plans. Such plan fiduciaries (the "Plan Fiduciaries") will be unrelated to Banc One. The Plan Agreement will describe the services to be rendered by Banc One to the plans in connection with the establishment and operation of the Program. The Program will be available only to defined contribution plans (the "Plan" or "Plans") that allocate participant loans to the individual accounts of the borrowers, and that permit participants to direct the investments of their individual accounts.

You represent that the Program will not become effective for a particular Plan until the appropriate Plan Fiduciaries have caused a Uniform Amendment to be adopted amending the Plan and trust documents. The Uniform Amendment will permit participants to elect credit-card-based participant loans under the Program and, at the option of the Plan sponsor, non-credit-card-based installment loans (which may also be administered by Banc One). The Uniform Amendment will authorize the Plan Fiduciaries to establish guidelines (the "Program Guidelines" or "Guidelines") under which each participant's eligibility for a participant loan will be determined.

The Program Guidelines incorporated as part of the Uniform Amendment will also set forth an explicit authorization for the Plan Fiduciary to establish a participant loan program; the procedure for applying for loans; the basis on which loans will be approved or denied; the formula for calculating the "reasonable rate of interest," the types of collateral that may secure the loan; and the events constituting default and the steps that will be taken to preserve plan assets in the event of such default. The specific terms of the documents and instruments comprising the Uniform Amendment, as well as the evaluation and decision making process concerning the appropriateness of its adoption, will be determined solely by the appropriate Plan Fiduciaries.

You represent that Banc One will serve as a subtrustee, in which capacity it will hold the notes evidencing the loans from the Plans to the participants. The terms of Banc One's authority as subtrustee would be set forth in a subtrust agreement (the "Subtrust") executed by Banc One and the Trustee of the Plans. The Subtrust would provide that Banc One would be subject to direction by the trustee or other appropriate fiduciary of the Plans. Banc One may in some instances serve as trustee of a Plan or as a trustee, investment advisor or manager of a collective investment fund or other pooled investment fund in which the Plans invest. In these instances, Banc One will have no

discretionary authority over the decision of the Plan to participate in the Program or over the adoption of the Program Guidelines, nor will Banc One provide investment advice in connection therewith.

You further represent that pursuant to the Uniform Amendment each participant of a Plan who desires to participate in the Program will receive (i) a detailed description of the Program, (ii) a participant loan application ("Participant Application"), (iii) an Investment Direction form and (iv) a Loan Agreement and a Collateral and Security Agreement for the participant's review. Under the Program Guidelines the content of these documents will be subject to the review and approval by the appropriate Plan Fiduciaries. If a participant elects to participate in the Program, they will complete the Participant Application and the Investment Direction form for the amount of the loan desired. You state that under the terms of the Uniform Amendment, each loan will be secured by collateral consisting of not more than 50 percent of the participant's vested, accrued account balance.¹

According to your representations, upon receipt by Banc One of a participant application, Banc One will process the application in accordance with Program Guidelines and will calculate an initial credit line for the participant based on these Guidelines. The Program Guidelines will provide that creditworthiness of the participant will not be considered in determining eligibility for a participant loan, and Banc One will not be authorized to exercise any discretion in applying the Guidelines.

You state that if the Participant Application satisfies these Guidelines, Banc One will enter into an agreement with each participant who elects to participate in the Program (the "Participant Agreement"). At that time, the Plan recordkeeper (which may be Banc One or an unrelated recordkeeper) will establish a participant loan account on behalf of the participant, and Banc One will issue a credit card (the "401(k) card") to the participant and, if requested, to the participant's spouse or child.²

You further state that when a loan is approved, the participant's Investment Direction will authorize the Plan trustee to transfer from such account or accounts designated by the participant an amount equal to the approved credit line to an account established by the Plan for investments intended to provide a high level of current income consistent with the preservation of capital and a high degree of liquidity (the "Cash Account"). The Cash Account may be one already available under the Plan or one established by the appropriate Plan Fiduciaries for purposes of receiving the loan amounts under the Program.³ Under the Program, each participant will be required to maintain an amount equal to their current credit line in the Cash Account at all times. However, a participant may request a reduction or termination of their unused credit lines at any time.

¹ Under the Program the maximum amount of the credit line will be the lesser of \$10,000 or 40 percent of the participant's vested, accrued account balance (the "40 Percent Limit"). However, under the terms of the Program the participant will post 125 percent of his or her credit line, up to a maximum of 50 percent of the participant's vested, accrued account balance, as collateral (the "50 Percent Limit"). You represent that no portion of a participant's vested, accrued account balance that is posted as collateral under the Collateral and the Security Agreement could be used as collateral to secure any other participant loan.

² Spousal consent will not be required under the Participant Agreement and, accordingly, the Program will not be available to plans that are required to obtain spousal consent for participant loans.

³ You represent that where the Cash Account is a mutual fund for which Banc One serves as investment adviser Banc One would receive an advisory fee from a mutual fund to which it provides advisory services, and in which the Cash Account may be held, only to the extent permitted under PTE 77-4, 42 Fed. Reg. 18732 (Apr. 8, 1977) or other applicable exemption.

You represent that pursuant to the Plan Agreement between Banc One and the Plan, Banc One will periodically review outstanding participant loans for compliance with statutory and regulatory requirements and conduct certain collection activities to encourage participants to remit delinquent payments. Banc One will have no discretionary authority over these matters, and its activities will be constrained by the Program Guidelines adopted by the appropriate Plan Fiduciaries. The Program Guidelines will authorize Banc One to take appropriate steps to collect delinquent payments, such as mailing letters to participants notifying them of the consequences of default, telephoning participants whose payments are delinquent to determine the reason for the delinquency, and providing assistance to these participants in addressing the problem. In the event of default, as defined in the Participant Agreement, Banc One will notify the appropriate Plan Fiduciaries of the default but will not be responsible for foreclosing on the collateral under the Plan securing the participant loan.

You further represent that once a 401(k) card is activated, the participant may make purchases from merchants that accept VISA/MasterCard for payment. The participant may also use the 401(k) Card to obtain cash advances from authorized sources. Merchants that accept VISA/MasterCard have agreements with a "Merchant Bank" and/or an agent of a Merchant Bank for processing of VISA/MasterCard transactions. The Merchant Bank is a member of either or both of the VISA or MasterCard associations.

You indicate that daily or periodically, the merchant will deposit with the Merchant Bank or its agent the electronic or paper credit card receipts. The Merchant Bank or agent will credit the merchant's deposit account (i.e., a business checking or cash management account) on the same or a subsequent business day the face amount of the credit card receipts. Pursuant to the agreement established between the merchant and the Merchant Bank or agent, a "Merchant Discount" is assessed by the Merchant Bank or agent based on VISA/MasterCard purchase dollars and transaction volume, and is settled either as part of the daily deposits or as a periodic accounting and reconciliation with the Merchant. Merchant Discounts vary significantly based on various considerations and average between 1.5% to 3.0% of the purchase amount.

According to your representations, the Merchant Bank or agent will electronically forward to the VISA or MasterCard monetary settlement system (clearinghouses maintained by the associations) the purchase transactions. The Merchant Bank or agent will receive monetary credit for the transactions less an interchange amount (the "Interchange Amount"), generally the following business day. The VISA/MasterCard association will then electronically transmit and sell the purchase transactions at face value less the Interchange Amount to Banc One. Banc One will then apply the face value of the transactions to the purchasers' credit card accounts, generally the same day the transactions are received from the association clearinghouse.⁴

You state that on the following business day, Banc One, as agent of the Plan sponsor or other named fiduciary authorized to direct the Plan trustee, will instruct the Plan trustee to remit to Banc One from the participant's account in the Cash Account an amount equal to the total face value amount of the credit card receipts for the participant. By transmitting the amount due to the VISA/MasterCard association before receipt of the similar amount from the trustee, Banc One will, in effect, make an overnight loan of that amount to the Plan. You represent that Banc One will receive no interest as a result of the short term loan and the loan will satisfy the conditions of Prohibited Transaction Class Exemption 80-26, 45 Fed. Reg. 28545 (Apr. 29, 1980).⁵

⁴ Where Banc One is both the issuer of the credit card and the Merchant Bank, the Interchange Amount is calculated and settled within Banc One and the purchase transactions remains within Banc One and is not processed via the VISA/MasterCard settlement system.

⁵ With regard to the requirements of PTE 80-26 see *infra* note 6.

You further state that participants may also access their loan accounts by drawing checks provided to the participants by Banc One. Checks drawn by the participant may be presented for payment to Banc One by the participant, other payee or the payee's bank through established check-clearing procedures. Banc One will instruct the Plan trustee to transfer funds in respect of participant checks in the same manner as credit card receipts. Checks drawn by participants under the Program will not be accepted for repayment of principal or interest due under the Program.

You represent that under certain limited circumstances, a participant may make charges which result in a participant loan exceeding the credit line established under the Program. Most credit card transactions, based on the issuer's instructions, are subject to a preauthorization procedure which will assure that loans do not exceed established limits as a result of such transactions. However, credit card transactions below a certain dollar threshold, certain international transactions, and certain small transactions that the VISA or MasterCard association may authorize as an agent for the Bank need not be preauthorized by the Bank. Provided that the overlimit transaction is within the 50 Percent Limit, and is therefore within the total amount approved in the loan authorization and the Loan Agreement and Investment Direction, the difference between the 40 Percent Limit and the 50 Percent Limit will be treated as an unsecured short-term interest-free loan from Banc One to the Plan which will be repaid within 3 days and is intended to meet the conditions of Prohibited Transaction Class Exemption 80-26.⁶

You indicate that it is anticipated that participants will be notified of transactions in excess of the 40 Percent Limit and will be provided up to three days to repay the overlimit amount without being required to transfer additional funds to the Cash Account to cover the overlimit amount. In the event that the participant does not repay the overlimit amount within the specified period, the Program Guidelines will authorize the transfer of additional assets from the participant's account to the Cash Account, and the overlimit amount will become part of the participant's outstanding loan balance under the Program, subject to the 50 Percent Limit. Because each participant will post a portion of his or her accrued, vested account balance in an amount equal to 125 percent of the approved credit line (subject to the 40 Percent Limit) and the participant's maximum outstanding loan balance under the Program will always be subject to the 50 Percent Limit, you indicate that the participant's outstanding loan balance will remain adequately secured.

In addition, you represent that because Banc One may be unable to identify fraudulent charges under the Program until notified by the participant, Banc One may receive transfers from the Cash Account which includes amounts attributable to fraudulent transactions for which Banc One (and not the Plan) will retain liability. Banc One will immediately correct transfers of these amounts by repaying to the Plan the transferred amount plus interest at least at the rate provided in the Cash Account. You also indicate that under the Program it is possible that a participant could

⁶ PTE 80-26 provides that the restrictions of section 406(a)(1)(B) and (D) and section 406(b)(2) of ERISA and the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code by reason of section 4975(c)(1)(B) and (D) of the Code shall not apply to the lending of money or other extension of credit from a party in interest or disqualified person to an employee benefit plan, nor to the repayment of such loan or other extension of credit in accordance with its terms or written modifications thereof, if, among other things, the proceeds of the loan or extension of credit are used only for (1) the payment of ordinary operating expenses of the plan, including the payment of benefits in accordance with the terms of the plan and periodic premiums under an insurance or annuity contract; or (2) a period of no more than three days, for a purpose incidental to the ordinary operation of the plan. In the Department's view, the loans or extensions of credit described in your submission appear to involve transactions incidental to the ordinary operation of the plan which would come within the scope of PTE 80-26 provided that they are repaid within a three day period and meet the other conditions of the exemption.

engage in a transaction in excess of the 50 Percent Limit, and that under such circumstances any transactions in excess of the 50 Percent limit will be treated as separate loans from Banc One (and not the Plan) to the affected participant.

According to your representations, under the Program, Banc One will calculate the total amount of credit card receipts, finance charges and minimum payment due. Plan charges for principal and interest will accrue from the date of the posting of the transaction. Generally, there will be no "grace period" associated with the 401(k) Card. Banc One will then produce and mail a detailed statement to the participant. The participant will mail the payment to Banc One as agent for the Plans. Upon receipt of the participant's payment, Banc One will verify the amount attributable to repayment of principal and interest owing to the Plan and, on the next business day, remit that amount to the Plan trustee for deposit into the Cash Account. Under the Program Guidelines the loan documentation will provide that, in the event of a payment less than the minimum amount due, the payment will be applied first to overlimit amounts, then to Banc One's fees, and then to repayment of principal and interest. You state that periodically Banc One will transmit to a Plan's recordkeeper a report indicating for each account the principal balance of the loan, interest accrued, and payments made by the participant to the Plan.

You further state that the loans incurred through the use of the credit cards and checks would be repayable in monthly installments. The amount of the required (i.e., minimum) monthly payment would generally vary from month to month, based upon new loan activity and other factors and would be intended to result in the repayment of each loan in substantially level installments within 5 years. Any outstanding fees, overlimit amounts, or delinquent payments would be added to the minimum monthly payment. The outstanding loan balance could always be prepaid, all or in part, at any time without penalty.

According to your representations, in order to ensure that loans under the Program reflect the "prevailing rate" of interest, the 401(k) Card participant loan will carry a variable interest rate that will be applied approximately each month by Banc One in accordance with a predetermined publicly disclosed interest rate that is not subject to Banc One's discretionary control. The interest rate will be the same for all participants in the same Plan, although the administrative fees charged by Banc One to Plan participants that are calculated as a percentage of the outstanding loan balance may be calculated at a lower rate for higher outstanding loan balances. You indicate that the interest rate will be a "reasonable rate of interest" within the meaning of section 408(b)(1) of ERISA and the regulations thereunder because it will represent the rate that a bank in a commercial arms-length transaction would charge on a comparable fully secured loan.

You represent that Banc One may extend credit and services to participants outside of the Program on such terms as Banc One and the participant may agree. Banc One's statements to such participants for credit and services outside of the Program may be combined with statements furnished by Banc One to participants under the Program. However, you indicate that under no circumstances will credit or services furnished to participants outside of the Program be secured by the participant's interests in the Plan. You state that the supplemental line of credit would be independent of the Program and would be provided solely by Banc One through contractual relationships outside of the Plans. Therefore, Plans would not incur any of the credit risk with respect to such supplemental line of credit.

You indicate that Banc One's compensation for its services in connection with the Program will consist of several components which, with one exception, will be payable by the participants individually and not through the Plan. In connection with VISA and MasterCard transactions, except where Banc One is the Merchant Bank or in the case of checks drawn on the credit card credit line, Banc One will purchase transactions from the VISA/MasterCard association at the face value less the Interchange Amount. The Interchange Amount is calculated as a percentage of the total credit card purchases, which varies from approximately 1% to 2% of purchase volume, and is mandated by the VISA and MasterCard associations. Under the Program Banc One will retain the Interchange Amount, subject to

approval of the appropriate Plan Fiduciaries, as part of its compensation for services provided to the Plans.⁷ You represent that the total compensation received by Banc One for its provision of services in connection with the Program will satisfy the requirements of section 408(b)(2) of ERISA.

You ask, based upon the facts provided in your submission and described above, whether Banc One would be considered a fiduciary to the Plans in connection with its processing of participant loan applications and administration of the Program.

Section 3(21) of ERISA provides, in relevant part, that a person, is a fiduciary with respect to a plan to the extent (i) he or she exercise any discretionary authority or control respecting management of the plan or exercises any authority or control respecting management or disposition of its assets, (ii) he or she renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he or she has any discretionary authority or discretionary responsibility in the administration of the plan.

Pursuant to this provision, the Department has indicated that a determination of fiduciary status requires a functional analysis. Consequently, an examination of the types of functions performed, or transactions undertaken, on behalf of a plan must be made to determine whether particular actions are fiduciary in nature and therefore subject to ERISA's fiduciary responsibility provisions. Thus, whether a bank in carrying out various duties for a plan is a "fiduciary" within the meaning of section 3(21)(A) of ERISA is inherently factual and will depend on the specific facts and circumstances involved in each particular case.

With regard to your submission, this functional analysis will be dependent on the particular terms and conditions of the Uniform Amendment and the Program adopted by individual Plans and the specific duties performed by Banc One in connection with the establishment and operation of the Program. Accordingly, we are unable to reach a conclusion that Banc One would not be considered a fiduciary for purposes of Title I of ERISA upon the adoption by a Plan of the proposed Program.⁸ Your submission as outlined above, however, does not on its face lead us to believe that Banc One would be considered a fiduciary to a Plan in connection with its processing of participant loan applications and administration of such loans pursuant to the general terms of the proposed Program.⁹

You have not requested and the Department declines to express an opinion regarding whether the Program, as adopted by any particular plan, would satisfy the conditions of section 408(b)(1) of ERISA. As you know, sections 406(a)(1)(B) and (D) of ERISA prohibit the lending of money or other extension of credit between a plan and a

⁷ You indicate that Plans that adopt the Program will specifically authorize Banc One to retain the Interchange Amount as part of its negotiated compensation for services provided under the Program.

⁸ Similarly, the Department offers no opinion on Banc One's status as a fiduciary with regard to the creation and dissemination to plan participants of information subsequent to enrollment which relates to the ongoing Program.

⁹ We note, however, that Banc One would be a fiduciary to a plan to the extent that it serves as trustee, subtrustee, investment advisor or manager of a collective investment fund in which client plans invest. In this regard, you indicate that Banc One will have no discretionary authority over the decision of the plan to participate in the Program or over the adoption of the guidelines; will not provide investment advice in connection therewith; and, as subtrustee, will be subject to direction by the trustee or other appropriate fiduciary of the plan.

party in interest; or a transfer to or use by or for the benefit of a party in interest any assets of the plan.¹⁰ Section 3(14)(H) of ERISA defines the term "party in interest" to include an employee of an employer any of whose employees are covered by the plan. Therefore, in the absence of a statutory exemption, a loan by a plan to such an employee participant would constitute a prohibited transaction in violation of ERISA.

Section 408(b)(1) of ERISA, however, provides an exemption from the prohibitions of section 406 for loans made by the plan to parties in interest who are participants and beneficiaries of the plan, if the conditions of the exemption are met. Specifically, section 408(b)(1) states that such loans will not be treated as prohibited transactions if they (A) are available to all such participants and beneficiaries on a reasonably equivalent basis, (B) are not made available to highly compensated employees, officers or shareholders in an amount greater than the amount made available to other employees, (C) are made in accordance with specific provisions regarding such loans set forth in the plan, (D) bear a reasonable rate of interest, and (E) are adequately secured. The Department has issued regulations (in 29 C.F.R. 2550.408b-1) which clarify these provisions. Whether a particular loan program satisfies the provisions of Section 408(b)(1) raises questions that are inherently factual in nature. Accordingly, the responsible Plan Fiduciaries must determine, based on all the relevant facts and circumstances, whether the conditions of section 408(b)(1) are met.

With respect to services provided in connection with the Program, section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) any contract or reasonable arrangement with a party in interest, including a fiduciary, for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor. Section 3(14) defines the term "party in interest" to include, among others, a fiduciary or a person who provides services to a plan. Regulations issued by the Department clarify the terms "necessary service" (29 C.F.R. §2550.408b-2(b)), "reasonable contract or arrangement" (29 C.F.R. §225.408b-2(c)), and "reasonable compensation" (29 C.F.R. §§2550.408b-2(d) and 2250.408c-2) as used in section 408(b)(2). The questions of what constitutes a necessary service, a reasonable contract or arrangement and reasonable compensation are inherently factual in nature. The appropriate Plan Fiduciaries must determine, based on all relevant facts and circumstances, whether the conditions of section 408(b)(2) are met. In this regard, the Plan Fiduciaries would have to consider, among other things, the reasonableness of the compensation negotiated and paid by the Plan for specific services in light of any payments made by other parties in connection with the provision of such services.

In addition, ERISA's general standards of fiduciary conduct would apply to the Plan Fiduciaries' decision whether, and to what extent, to adopt the specific terms and conditions of the proposed Program. Section 404 requires, among other things, that a fiduciary discharge his or her duties respecting a plan prudently, and solely in the interest and for the exclusive purpose of providing benefits to the plan participants and beneficiaries. Accordingly, the responsible Plan Fiduciaries must act prudently and solely in the interest of the participants and beneficiaries in deciding whether to enter into the Program as described above, and in negotiating the terms and conditions of the Program. In this regard, it should be emphasized that the purpose of section 408(b)(1) and the regulations thereunder is not to encourage borrowing from retirement plans, but rather to permit it in circumstances that are not likely to diminish the borrower's retirement income or cause loss to the plan. Thus, plan fiduciaries must assess and monitor loan programs, in particular loan programs like the one at issue which are designed to facilitate borrowing, to ensure the programs continue to be in the interest of the participants and beneficiaries of the plan and otherwise in compliance with Title I of ERISA.

¹⁰ Under Presidential Reorganization No. 4 of 1978, 43 Fed. Reg. 47713 (Oct. 17, 1978), the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Internal Revenue Code has been, with certain exceptions not here relevant, transferred to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA refer also to corresponding sections of the Code.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and, accordingly, is issued subject to the provisions of that procedure, including section 10 thereof relating to the effect of advisory opinions. The Department offers no opinion regarding any provision of the Internal Revenue Code under the jurisdiction of the Internal Revenue Service that may be applicable to the arrangements described in your submission.

Sincerely,

ROBERT J. DOYLE
Director of Regulations and Interpretations