U.S. Department of Labor

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

October 24, 1997

97-25A
ERISA SEC. 407(d)(5), 407(f)(1)

Mr. Larry E. Shapiro
McDermott, Will & Emery
1200 Eighteenth Street, N.W.
Washington, D.C. 20036

Dear Mr. Shapiro:

This is in response to your request for an information letter concerning the definition of "qualifying employer security" in sections 407(d)(5) and 407(f)(1) of the Employee Retirement Income Security Act of 1974 (ERISA). Your request concerns the application of ERISA section 407(f)(1), which contains certain ownership limits on the acquisition of qualifying employer securities in non-eligible individual account plans, to the redemption or conversion of preferred shares. Specifically, you ask whether a redemption or conversion of the same class of publicly-traded preferred stock that is held by a defined benefit plan by holders other than the plan would trigger the application of the ownership limits in section 407(f)(1) of ERISA.

You represent that it is often the case that preferred stock is convertible to common stock and/or subject to periodic redemption. For many publicly-held companies, redemption may be done by a lottery which affects all shareholders, making it impossible for any holder of such stock, including, but not limited to the plan, to control whether the stock will or will not be redeemed. Further, because preferred stock generally carries a considerably larger dividend than the common stock of the same company, the holder of the convertible preferred stock will want to hold the preferred stock until the convertible feature is about to expire, or, if earlier, the holder wants to sell the stock.

You state that if a trustee of a qualified defined benefit plan acquires convertible preferred stock of a publicly-held company subject to redemption by a lottery at stated intervals or at will, the trustee will not have unfettered control over the ongoing percentage of outstanding convertible preferred stock held by the plan. This is because the percentage of such stock held by the plan could be altered by a lottery redemption or conversion of such stock into common stock by holders other than the plan.

Pursuant to ERISA Procedure 76-1 (41 Fed. Reg. 36218, August 27, 1976), and in the interest of sound administration of ERISA, the Department has determined that it is appropriate to respond to your request in the form of an advisory opinion, the effect of which is described in section 10 of ERISA Procedure 76-1.

Section 407(a)(1) of ERISA provides, in part, that a plan may not acquire or hold any employer security which is not a qualifying employer security. Section 407(d)(5) of ERISA provides, in part, that the term "qualifying employer security" includes an employer security which is stock. The Omnibus Budget Reconciliation Act of 1987 amended section 407(d)(5) of ERISA to provide that, after December 17, 1987, in the case of a plan other than an eligible individual account plan, stock shall be considered a qualifying employer security only if the percentage ownership tests set forth in section 407(f)(1) are satisfied.

Section 407(f)(1) of ERISA provides that stock satisfies the requirements of the paragraph if, immediately following the acquisition of such stock: (A) no more than 25 percent of the aggregate amount of stock of the same class issued and outstanding at the time of acquisition is held by the plan; and (B) at least 50 percent of the same class of stock issued and outstanding is held by persons independent of the issuer.

The primary purposes of the ownership limits in ERISA section 407(f)(1) are to assure a measurable public market for employer stock and that the required arms-length determination of the value upon purchase or receipt of the stock by the plan reflects competitive market forces. See H.R. Rep. No. 100-391(I), 100th Cong., 1st Sess (1987) 115-116. In light of these concerns, it is the opinion of the Department that the ownership limits set forth in section 407(f)(1) must be tested any time there is a direct or indirect acquisition of such stock by a plan that is subject to the limits. Whether there is a direct or indirect acquisition of stock by the plan is a factual determination which can only be made in light of all the facts and circumstances surrounding a particular transaction.[1] Your letter, however, does not describe any facts and circumstances to suggest that there would necessarily be an acquisition by a plan when holders other than the plan convert or redeem by lottery preferred stock of a publicly-held company.

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,

Bette J. Briggs
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

[1] The Department's regulation 29 C.F.R. 2550.407a-2(b), which applies for purposes of section 407(a) of ERISA, and 2550.408e(b), which addresses the statutory exemption for the acquisition or sale by a plan of qualifying employer securities, similarly provide that an "acquisition" of employer securities shall include, but not be limited to, an acquisition by purchase, by the exchange of plan assets, by the exercise of warrants or rights, by the conversion of a security, by default of a loan where the qualifying employer security or qualifying employer real property was security for the loan, or in connection with the contribution of such securities or real property to the plan. However, an acquisition shall not be deemed to have occurred if a plan acquires the security as a result of a stock dividend or stock split.