Pension ANALYST

IMPORTANT INFORMATION | New Legislation | September 2002*

The Sarbanes-Oxley Act Affects Retirement Plans

WHO'S AFFECTED The provisions discussed in this publication apply primarily to qualified defined contribution plans sponsored by private employers. The information regarding the increase in criminal penalties under ERISA also applies to qualified defined benefit plans sponsored by private employers. These rules also apply to funded nonqualified plans.

BACKGROUND AND SUMMARY On July 30, 2002, President Bush signed into law the accounting reform legislation known as the "Sarbanes-Oxley Act of 2002" (SOA). While SOA primarily focuses on accounting reform, it also contains provisions affecting retirement plans. SOA requires plan administrators to give participants and beneficiaries 30 days advance notice of blackout periods. Certain exceptions exist that allow the notice to be provided fewer than 30 days before the blackout, but as soon as reasonably possible.

SOA also prohibits directors or executive officers from trading company stock during a blackout period if the individuals acquired that stock in connection with their service or employment as directors or executive officers. This provision only applies to plans that offer employer stock as a form of investment.

In addition, SOA increases criminal penalties for violations under ERISA.

In response to SOA, the Securities and Exchange Commission (SEC) has adopted final rules that require corporate insiders to report certain trading in company stock within two business days.

ACTION AND NEXT STEPS Sponsors of affected plans should review this publication to determine if these provisions apply to their plans and participants. In addition, plan sponsors should review their procedures to ensure they will comply with the notice requirements outlined in the Sarbanes-Oxley Act. We will keep you informed as further guidance is released. If you have questions about how these provisions affect your plan, please contact your Prudential Retirement representative.

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Advance Notice of Blackout Periods

SOA requires plan sponsors to issue a notice to participants and beneficiaries in a defined contribution plan at least 30 days before a blackout period. For purposes of this notice requirement, a "blackout" is defined as a period of more than three consecutive business days during which participants or beneficiaries are temporarily suspended or restricted from directing investments or obtaining loans or distributions from the plan, to the extent these transactions would otherwise be available under the terms of the plan.

The term blackout does not include suspensions, limitations, or restrictions due to Qualified Domestic Relations Orders (QDROs), application of securities laws, or changes in regularly scheduled periods disclosed to participants through plan materials (e.g., quarterly investment direction).

Under certain exceptions, the notice can be provided fewer than 30 days before the blackout, but *as soon as reasonably possibl*e. These situations include:

- If the blackout occurs solely in connection with a merger, acquisition, divestiture, or similar business transaction;
- If a deferral of the blackout period would violate the fiduciary duties outlined in ERISA (based on a reasonable determination made by the fiduciary and documented in writing); or
- If the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the control of the plan administrator (based on a reasonable determination made by the fiduciary and documented in writing).

The notice must be written in a manner that can be understood by the average plan participant, and must include:

- The reasons for the blackout period;
- An identification of the investments and other rights affected;
- The expected beginning date and length of the blackout period;

- A statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to make changes during the blackout; and

- Other matters that the Department of Labor (DOL) may require in upcoming regulations.

The notice must be in writing, but can be provided electronically as long as the notice is reasonably accessible to the participant.

If there is a change in the beginning date or length of the blackout period after the notice is provided, the plan administrator must provide an updated notice as soon as possible. If the plan administrator refuses or fails to provide the notice in a timely manner, the DOL may assess a penalty of up to $100 per day for each participant or beneficiary who did not receive the notice.

The notice requirements are effective for blackouts beginning January 26, 2003, or later.

The DOL is required to provide interim guidance relating to this notice requirement by October 13, 2002. In addition, the DOL is expected to issue further guidance and a sample notice by January 1, 2003. If the guidance is not issued in a timely manner, a "good faith" compliance requirement applies.

Insider Trading Restrictions During Blackout Periods

SOA prohibits any director or executive officer from trading company stock that the individual acquired in connection with his or her service as a member of the Board of Directors or employment as an executive officer (e.g., CEO, CFO) during any blackout period.

The term "blackout" has a different meaning for these purposes than for the advance notice requirement. For purposes of this requirement, the term "blackout" means any period of more than three consecutive business days during which the ability of at least half of the participants or beneficiaries of all the defined contribution plans of the plan sponsor to purchase, sell, acquire, or transfer securities is temporarily suspended. This definition of "blackout period" does not include:

- Regularly scheduled periods during which participants are restricted from trading, as long as the period is: 1) incorporated into the plan document, and 2) timely disclosed to employees before they become participants under the plan or as a subsequent amendment; and

- Suspensions imposed solely in connection with a corporate business merger, acquisition, divestiture, or similar transaction.

This insider trading restriction only applies if the plan affected by the blackout period contains employer securities. If the plan contains employer securities, and the blackout period applies to the stock, the company directors and executive officers are restricted from trading the employer stock held outside the plan during that blackout period.

If this restriction applies, the company must timely notify directors and executive officers, as well as the SEC of the blackout period.

This provision is effective for blackouts beginning January 26, 2003, or later.

Criminal Penalties for ERISA Violations

SOA increases criminal penalties for violations of ERISA. The maximum fine for an individual increases from a maximum of $5,000 to $100,000. The maximum prison term for an individual increases from one to ten years. The maximum fine for a corporation increases from $100,000 to $500,000. This provision is effective immediately.

Prohibition on Personal Loans to Executives

One of the provisions of SOA prohibits personal loans from publicly-traded companies to members of the Board of Directors or executive officers (e.g., CEOs, CFOs). Concern has been expressed this provision of SOA can be interpreted to cover plan loans. The SEC has indicated that it is looking at this issue and the expectation is the SEC will provide relief. However, until the SEC issues guidance, plan sponsors should consult with their counsel on whether to prohibit plan loans to executive officers.

SEC Accelerates Reporting for Certain Transactions

In response to SOA, the SEC has adopted final rules that were effective August 29, 2002. These rules generally require corporate insiders (officers, directors, and principal security holders) to report trading in company stock within two business days.

The SEC has provided an extended reporting deadline for two narrowly defined categories of transactions covering those situations under which the corporate insider does not have control over the date of the transaction. One of those categories covers "discretionary transactions" and affects employee benefit plans, deferred compensation plans or other similar employee benefit plans that offer *publicly-traded* employer stock as an investment alternative. Discretionary transactions can include investment transfers, withdrawals, or certain other distributions affecting the employer stock option. However, a plan sponsor should work with their securities counsel to determine whether a particular transaction is considered discretionary.

The SEC has accelerated the timing for insiders to file SEC Form 4 to within two business days after the "execution date." For reporting purposes, discretionary transactions are deemed to be executed on the earlier of:

- The date the insider is notified of execution by the broker, dealer, or plan administrator executing the transaction; or

- The third business day following the actual execution of the transaction.

In total, the insider must report the transaction to the SEC no later than the end of the fifth business day following the trade.

The broker, dealer, or plan administrator may notify the insider using any means of communication, including oral, paper, or electronic means. Plan sponsors should consult with their securities counsel to carefully review these changes to ensure they comply with the securities law reporting requirements. For assistance in obtaining the information needed for reporting purposes, plan sponsors should contact their Prudential Retirement representative.

Next Steps

Depending on the plan sponsor's decision on handling plan loans to executive officers and directors, the plan sponsor may consider formally amending the plan to prevent those individuals from taking plan loans.

It is not clear whether plan amendments will be required by the advance notice provision. Future guidance may clarify this issue. If plan amendments are required, they must be made by the end of the first plan year beginning after the effective date of the provision. For calendar year plans, any amendments required by the advance notice provision would have to be made by December 31, 2004.

Pension Analyst by Prudential Retirement
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