

Client Alerts

Personal Loans to Officers and Directors Prohibited, Further News on Section 906 CEO/CFO Certifications, and Accelerated Filing Under Section 16

August 9, 2002

Personal Loans Prohibited. One provision of the Sarbanes-Oxley Act that has already become effective is the prohibition on new personal loans by companies to directors or executive officers. Effective July 30, 2002, Section 402 of the Act made it unlawful for any public company, directly or indirectly, to make or renew any personal loans to, or to arrange for the extension of credit to, its directors or executive officers. Also unlawful is any material modification to existing personal loans. Thus, personal loans by issuers to their officers and directors that were already in place on July 30, 2002 must be repaid as they mature, but do not need to be repaid prior to their stated maturity.

Some potential pitfalls:

- Split dollar life insurance may be treated as a loan to the executive officer or director of the insurance premium, and these arrangements appear to be prohibited by Section 402.
- Allowing executive officers and directors to make personal charges on company credit cards now appears to be questionable, especially if the company pays the charges and the insider does not settle the balance for a period of time.
- Some cashless exercises of options involving market sales could be considered prohibited personal loans. However, if the company receives the cash exercise price on the same day that the shares are issued, the cashless exercise should not be considered a loan or extension of credit.
- Housing and relocation assistance may constitute loans or arrangements for the extension of credit that are prohibited under Section 402.

Section 402 is subject to SEC interpretation and possible rule making. [Return to Index](#)

Section 906 CEO/CFO Certifications.

Two practices appear to be developing for filing the CEO and CFO certifications required by Section 906 of Sarbanes-Oxley (this is the certification required for all Form 10-Q filings now being made and for future periodic reports that contain financial statements).

- The first practice, used in most Form 10-Qs filed to date, is to include the certifications as exhibits to the Form 10-Q.
- The second approach (recommended by some groups within the securities bar) is a two-step process:
 - File the certifications by EDGAR as a nonpublic correspondence filing to "accompany" the Form 10-Q filing, as required by Section 906.
 - Promptly after the Form 10-Q filing, file a Form 8-K, using Item 9 (Regulation FD Disclosure) to disclose that the certifications have been made.

Under this two-step approach, the certifications are not deemed to be "filed" with the SEC for purposes of any liability under the Securities Exchange Act of 1934 and Securities Act of 1933, but still "accompany" the filing as required by Section 906 and are publicly disclosed as required by Regulation FD.

Example of Item 9 disclosure on Form 8-K:

Item 9. Regulation FD Disclosure

On August , 2002, [Company Name] submitted to the Securities and Exchange Commission the certification by its chief executive officer and chief financial officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Company's report on Form 10-Q for the quarter ended June 30, 2002.

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Our view continues to be that most companies will prefer to file the certifications as exhibits, in part to reassure investors that the Section 906 certifications have been made in the required form. We do not believe that filing the certifications as a nonpublic correspondence filing offers protection from a violation of Section 906, which is a criminal statute, or from disclosure violations under the Exchange Act or the Securities Act, and could appear evasive in the event of any later investigation or securities proceeding. However, some officers may prefer to file the certifications as a nonpublic correspondence filing, and this practice could become more prevalent as the filing deadline approaches and therefore could become more acceptable to investors. We believe that both practices satisfy the requirements of Section 906. [Return to Index](#)

Accelerated Filing under Section 16.

As most of our clients are aware, the Sarbanes-Oxley Act shortened the time period for filing Form 4s (the form that reports transactions by insiders in company stock). The SEC will issue final rules on this by August 29, 2002. Most (if not all) Form 4 transactions on and after August 29 will need to be reported to the SEC within two business days of the trade date (and before the settlement date). As a practical matter, most officers and directors will need to file their Form 4s electronically by EDGAR in order to comply with this extremely short timing. In preparation for accelerated filing, we recommend that companies apply now for CIK and CCC numbers for all of their Section 16 reporting persons.

- Until further rule-making by the SEC, expected before August 29, 2002, insiders should report under the current rules and may use existing exemptions.
- EDGAR filing of Form 4s will be required before July 30, 2003.

For more information on the topics in this E-Alert, please contact your attorney at Andrews & Kurth L.L.P. A&K Attorney Search In This Alert Personal Loans Prohibited Section 906 CEO/CFO Certifications Accelerated Filing under Section 16.

This E-Alert is intended to be only a general discussion and summary of the matters discussed, based on laws and regulations and practices currently in effect. For more information on the topics in this E-Alert, please contact your attorney at Andrews & Kurth L.L.P.