

Client Alerts

Update: Personal Loans to Officers and Directors Prohibited and Further News on Section 906 CEO/CFO Certifications

September 10, 2002

Personal Loans Prohibited.

One provision of the Sarbanes-Oxley Act that became immediately 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 renewal or 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. Similarly, travel advances may be considered a loan if not promptly repaid.
- Some cashless exercises of options involving market sales could be considered prohibited personal loans. 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 by the company. However, cashless exercises processed through "captive brokers" designated by the company could be deemed a prohibited arrangement of credit by the company and should be discontinued.
- Housing and relocation assistance may constitute loans or arrangements for the extension of credit that are prohibited under Section 402.
- Plan loans under 401(k) or other retirement plans to officers or directors should be discontinued absent guidance from the SEC, as such loans may be deemed made or arranged by the company.

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

Section 906 CEO/CFO Certifications.

Two practices have developed for filing the CEO and CFO certifications required by Section 906 of Sarbanes-Oxley (this is the certification with criminal penalties for false certification).

- 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

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On **[date]**, **[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 [] for the quarter/year ended **[date]**.

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. However, some officers may prefer to file the certifications as a nonpublic correspondence filing and disclose the filing under Item 9 Form 8-K. We believe that both practices satisfy the requirements of Section 906.

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.