

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216



Reply to the Attention of:

OPINION NO. 82-22A
Sec. 408(b)(2), 408(b)(8), 406(b), 3(21)(A)

MAY 12 1982

Mr. Ben E. Benjamin
O'Melveny & Myers
1800 M Street, N.W.
Washington, D.C. 20036

Re: Security Pacific National Bank
Identification Number: F-1850

Dear Mr. Benjamin:

This is in response to your request for an advisory opinion on behalf of Security Pacific National Bank (SPNB) that the provision of services by SPNB and certain of its affiliates would not be prohibited under the general fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 (ERISA) or section 4975 of the Internal Revenue Code of 1954 (the Code).

You represent that SPNB, a wholly-owned subsidiary of Security Pacific Corporation (SPC), desires to establish an individual account program and a common trust fund for the investment in real estate mortgages by employee benefit plans. Security Pacific Investment Managers, Inc. (SPIM), also a wholly-owned subsidiary of SPC, is a registered investment adviser under the Investment Company Act of 1940. Another wholly-owned subsidiary of SPC, Security Pacific Mortgage Corporation (SPMC), is engaged in the business of originating and servicing real estate loans.

The individual account program will be organized under one of three formats. Where SPNB currently serves as trustee to an employee benefit plan, an independent plan fiduciary will execute an authorization agreement to invest in real estate mortgages. SPNB will thereby assume full responsibility for the management of the funds designated for this purpose, including the servicing of mortgages acquired by the trust. Pursuant to the authority conferred upon SPNB under the authorization agreement "to employ such agents including those which may be affiliates of the Trustee, as it may in its sole discretion deem necessary...", SPNB will contract with SPIM to perform a number of functions. First, SPIM will establish the criteria for acceptable mortgage investments. Second, SPIM will monitor adherence to such criteria. In general, these criteria will permit investment only in new mortgages which will be secured by a

first lien on the underlying real property which, in some cases, may be coupled with an equity participation in the property. Except as permitted by applicable law, regulations or administrative exemptions, loans will not be made to any party in interest or disqualified person with respect to the investing plan. Third, pursuant to its agreement with SPNB (Exhibit C to the application), SPIM "shall have complete discretion in the investment and reinvestment of the portfolio including the right to direct the acquisition and disposition of such assets....".

SPIM will in turn delegate to SPMC the responsibility for identifying appropriate mortgages by a mortgage origination and servicing agreement. Pursuant to this agreement with SPMC, SPIM will retain the authority to approve or disapprove all loans recommended by SPMC. If SPIM approves a potential mortgage investment identified by SPMC, SPIM will direct the transfer of funds from the trust to fund the loan. Neither SPNB nor any of its affiliates will advance any amount to fund a mortgage loan that is to be acquired by the trust. All monies will be transferred directly from the trust to or for the benefit of the borrower. All fees paid by the borrower which are normally paid to the mortgage broker at the time of the loan closing will be deposited in the trust, they will not be retained by SPMC. In addition, all interest, principal payments and other payments received by the trust will be invested or reinvested in new mortgages unless the fiduciary who is responsible for the investment of the plan's assets, other than SPNB or any affiliate thereof, directs otherwise.

The authorization agreement establishes the following fee schedule for the operation of the individual account program: (1) a one-time fee at the time each mortgage is acquired either initially or using funds generated by the payment of principal and interest on the loans, and (2) an annual fee for the servicing of the trust which will be calculated at a percentage of assets under management. However, the trustee will not receive any additional fees for the reinvestment of proceeds from the sale of any mortgage held by the trust except in connection with the sale of mortgages directed by an independent plan fiduciary.

Finally, SPNB, SPIM, SPMC and other service providers will be entitled to reasonable reimbursement for out-of-pocket expenses incurred in the performance of their services to the trust. However, an independent plan fiduciary must give prior approval for the provision of additional services by SPNB or any of its affiliates in those situations where additional fees or expenses would be paid.

Where SPNB is not currently the plan trustee, a plan desiring to invest in an individual account program will execute an ancillary trust agreement with SPNB. In all other respects, this arrangement will operate in a manner which is identical to that in which SPNB is already the plan trustee.

Where SPNB will not serve in any trustee capacity to the plan, the independent plan fiduciary will enter into a real estate advisory agreement directly with SPIM. This arrangement will operate in the same manner as previously described except that all fees will be paid from the plan directly to SPIM. Any fees to which SPMC is entitled will be paid solely by SPIM.

The common trust fund will be established to enable employee benefit plans for which SPNB acts as trustee to invest in real estate mortgages on a collective basis. The servicing and fee arrangement for the common trust fund will be similar to the individual account program outlined above with the major exception being that SPNB will perform the investment management services provided by SPIM under the individual account program.

In general, the decision to invest in the individual account program or the common trust fund as well as the determination as to precisely how much of the plan assets shall be made available for investment in this manner, will be made by the fiduciary responsible for investment of the plan's assets.

You request an advisory opinion that the proposed provision of services described above by SPNB or any of its affiliates would not constitute a prohibited transaction under sections 406(a)(1)(C) or 406(b)(1) of ERISA or sections 4975(c)(1)(C) or 4975(c)(1)(E) of the Code.

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

Section 406(a)(1)(A) and (C) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction which the fiduciary knows or should know constitutes a direct or indirect sale or exchange, or leasing, of any property between the plan and a party in interest, or the furnishing of goods, services, or facilities between the plan and a party in interest. In addition, ERISA section 406(a)(1)(D) prohibits a plan fiduciary from causing the plan to engage in a transaction if he knows or should know that the transaction constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. Section 406(b)(1) of ERISA further prohibits a plan fiduciary from dealing with the assets of the plan in his own interest or for his own account.

A "party in interest" is defined in section 3(14) of ERISA to include a fiduciary and a person providing services to a plan. The term "fiduciary" is defined in section 3(21) of ERISA to mean, in pertinent part, a person who exercises any discretionary authority or discretionary control respecting management of the plan or exercises any authority or control respecting management or disposition of its assets.

Based on the facts and representations contained in your application, it appears that SPNB, as investment manager for the common trust fund mortgage investment program, would be a fiduciary with respect to plans investing in that fund. Similarly, under the individual account mortgage investment program, SPNB would be named as a trustee of each plan participating in the program and would, therefore, be a fiduciary with respect to such plans pursuant to section

3(21) of ERISA, and a party in interest with respect to such plans pursuant to section 3(14)(A) of ERISA.

With regard to the status of SPIM under the individual account programs, the agreement between SPNB and SPIM, and that between SPIM and SPMC, indicate that SPIM will actually possess discretionary control and authority over the investment of plan monies in mortgages. As a result, it appears that SPIM would be a fiduciary with respect to plans participating in the individual account program pursuant to section 3(21) of ERISA, and a party in interest with respect to such plans pursuant to section 3(14)(A) of ERISA.

Because SPNB and SPIM would be fiduciaries with respect to plans participating in these programs, and because they also would be parties in interest with respect to such plans, the prohibited transactions provisions of section 406 described above will apply to transactions involving SPNB and its affiliates in the absence of a statutory or administrative exemption. In this regard, we note that 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 408(c)(2) of ERISA provides, in relevant part, that nothing in section 406 shall be construed to prohibit any fiduciary from receiving compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan. Regulations issued by the Department clarify the terms "necessary service" (29 CFR §2550.408b-2(b)), "reasonable contract or arrangement" (29 CFR §2550.408b-2(c)) and "reasonable compensation" (29 CFR §§2550.408b-2(d) and 2550.408c-2) as used in sections 408(b)(2) and 408(c)(2) of ERISA.

The provision of multiple services in connection with the individual account program by SPNB and its affiliates would be exempt from the prohibitions of section 406(a) of ERISA if the conditions of the exemption described in section 408(b)(2) were met. We note, however, that the questions of what constitutes a necessary service, a reasonable contract or arrangement, and reasonable compensation are inherently factual in nature. Section 5.01 of ERISA Advisory Opinion Procedure 76-1 (ERISA Proc. 76-1, 41 FR 36281, August 27, 1976) states that the Department generally will not issue opinions on such questions. The trustees of the Plan or other appropriate plan fiduciaries must determine, based on all the relevant facts and circumstances, whether the conditions of section 408(b)(2) are satisfied.

With respect to the prohibitions in section 406(b), regulation 29 CFR §2550.408b-2(a) indicates that section 408(b)(2) of ERISA does not contain an exemption for an act described in section 406(b) of ERISA (relating to conflicts of interest on the part of fiduciaries) even if such act occurs in connection with a provision of services which is exempt under section 408(b)(2). As explained in regulation 29 CFR §2550.408b-2(e)(1), if a fiduciary uses the authority, control, or responsibility which makes him a fiduciary to cause the plan to enter a transaction involving the provision of services when such fiduciary has an interest in the transaction which may affect

the exercise of his best judgment as a fiduciary, a transaction described in section 406(b) would occur, and that transaction would be deemed to be a separate transaction from the transaction involving the provisions of services and would not be exempted by section 408(b)(2). 29 CFR §2550.408b-2(e)(3) further explains that if a fiduciary provides additional services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly and actually incurred in the performance of such services within the meaning of 29 CFR §2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in section 406(b) of ERISA.

Your application indicates that SPNB, when acting in its capacity as fiduciary to those plans participating in the individual account plan program, can not exercise its authority to require participating plans to pay additional fees or other compensation for those services required to be performed by SPNB and SPIM in accordance with the original customer agreement. Further, SPNB must secure the approval of an independent fiduciary for each participating plan before SPNB and SPIM furnish additional services to such plans, thereby causing such plans to pay fees or other compensation in addition to the compensation negotiated in the original customer agreement. It appears, therefore, that the provision of multiple services by SPNB and SPIM to participating plans will not involve acts described in section 406(b) of ERISA.

However, as noted above, SPIM is a fiduciary by reason of an apparent delegation of investment management discretion from SPNB. Since the selection of a person to manage the investment of plan funds constitutes a dealing with plan assets, if such a delegation is made in a manner which operates in the plan fiduciary's own interest or for its own account, the delegation of investment management authority will be a transaction prohibited under section 406(b)(1) of ERISA.

With respect to the common trust fund, section 408(b)(8) of ERISA provides, in pertinent part, that section 406(a)(1) of ERISA does not apply to any transaction between a plan and a common or collective trust fund maintained by a bank or trust company supervised by a State or Federal agency, if (a) the transaction is a sale or purchase of an interest in the fund, (b) the bank or trust company receives not more than reasonable compensation, and (c) the transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank or trust company, or an affiliate thereof) who has authority to manage and control the assets of the plan. In the absence of regulations, the Department is not prepared at this time to indicate the extent to which section 408(b)(8) applies to prohibitions under section 406(b) of ERISA. See Proposed Class Exemption for Certain Transactions Involving Bank Collective Funds, 44 FR 44290, 44291 n. 3, July 27, 1979. However, in enacting this provision, Congress contemplated that investment management services performed by the pool sponsor would be authorized under this section if the fees for the services were reasonable, as can be seen from the ERISA Conference Report, H.R. Report No. 93-1280, 93d Cong., 2d Sess. (1974), which provides, at p. 316:

To be allowed, no more than reasonable compensation may be paid by the plan in the purchase (or sale) and no more than reasonable compensation may be paid by the plan for investment management by the pooled fund.

Therefore, the provision of investment management services by SPNB and/or its affiliates in connection with the maintenance of a common or collective trust fund would be exempt from the prohibitions of section 406(a)(1) of ERISA if the conditions of section 408(b)(8) are met. With regard to the application of section 406(b)(1) of ERISA to transactions involving the common trust fund, SPNB, as trustee under that program, cannot exercise its authority to require participating plans to pay additional fees or other compensation for those services required to be performed by SPNB in accordance with the original authorization agreement. Further, SPNB must secure the approval of independent plan fiduciaries before SPNB and its affiliates furnish to participating plans additional services which result in additional fees or other payments by such plans. As a result, it does not appear that the provision of services by SPNB under the common trust fund program will result in acts described in section 406(b)(1) of the Act.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and is issued subject to the provisions of the procedure, including section 10, relating to the effect of advisory opinions.

Sincerely,

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards
Pension and Welfare Benefit Programs