U.S. Department of Labor

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

Reply to the Attention of:

OPINION NO. 83-52A
Sec. 406(b)(1), 406(b)(2), 408(b)(2)

OCT 5 1983

Thomas F. Finch, Esquire
McDermott, Will & Emery
111 West Monroe Street
Chicago, Illinois 60603

Identification Number: F-1484

Dear Mr. Finch:

This is in response to your letters of February 20 and November 21, 1980, January 28, 1982, and March 14, 1983, and your telephone conversations with Messrs. Rudy Nuissl and C.E. Beaver of this office, in which you requested an advisory opinion as to the application of the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to an arrangement involving the furnishing of investment management services to a master trust comprised of the assets of plans maintained by Lumbermens Mutual Casualty Company (LMC) and certain of its affiliated corporations.

You represent that LMC is the parent corporation of a group of affiliated corporations. LMC owns approximately 54 percent of the outstanding stock of Kemper Corporation. Kemper Corporation owns 100 percent of the outstanding stock of Economy Fire and Casualty Company (Economy), Iowa Kemper Insurance Company (Iowa Kemper), National Automobile and Casualty Insurance Co. (National Auto), National Loss Control Service Corporation (NATLSCO) and Kemper Financial Services, Inc. (KFS). With the exception of LMC, all of the above companies file a consolidated Federal income tax return.

LMC, Economy, Iowa Kemper, National Auto and NATLSCO each maintain a separate savings and profit sharing plan for its own employees, (the Plans). Each of the aforementioned sponsoring employers established a trust fund for its own plan with a non-affiliated bank. Furthermore, LMC, Economy and Iowa Kemper appointed KFS, a registered investment advisor under the Investment Advisers Act of 1940, to serve as investment manager for its respective plan. In selecting KFS as investment manager, each sponsoring employer has satisfied itself that KFS is well qualified to furnish these investment management services to each of the Plans. In the spring of 1982, the five trusts established to fund the Plans were consolidated into a single master trust for the collective investment of the assets of the Plans. KFS now serves as investment manager to The Kemper Companies Master Trust. (the Master Trust) KFS' fees for the provision of investment management services both under the prior arrangement and currently are paid by the sponsoring employer of each plan.[1] You represent that no consideration passes from the Plans to KFS and that the payment of fees by the employers has no material effect upon contributions to the Plans. The appointment of KFS as investment manager may be terminated by either party at any time by written notice.

[1] By letter dated March 14, 1983, you indicated that the sponsoring employers and not the Plans, pay KFS for the provision of investment management services. We note, however, that the Master Trust agreement accompanying your submission indicates certain circumstances under which such expenses may be charged directly to the Master Trust. You have not asked, and we are not addressing, the situation involving the direct payment of fees by the Master Trust to KFS for services rendered.

In effect, you request an advisory opinion that the provision of investment management services by KFS to the Master Trust does not constitute a prohibited transaction under section 406 of ERISA.

Section 406(a)(1)(C) and (D) of ERISA prohibit a fiduciary with respect to a plan from causing a plan to engage in a transaction which the fiduciary knows or should know constitutes a direct or indirect furnishing of goods, services, or facilities between a plan and a party in interest; or transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. Section 406(b)(1) and (b)(2) further prohibit a fiduciary from dealing with the assets of the plan in his or her own interest or for his or her own account or representing a party whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.

LMC, Economy, Iowa Kemper, National Auto and NATLSCO are fiduciaries under ERISA section 3(21)(A) by reason of the sponsoring employers' discretionary authority in the administration of their respective plans and are, therefore, parties in interest with respect to such plans under section 3(14)(A) of ERISA. KFS is a party in interest under section 3(14) of ERISA because of its relationship to LMC and a fiduciary under section 3(21) as investment manager to the Master Trust. Accordingly, the prohibited transactions provisions of section 406 of ERISA would apply to transactions involving KFS in the absence of a statutory or administrative exemption.

Subject to the conditions set forth in section 408(d) of ERISA, section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) the payment by a plan to a party in interest, including a fiduciary, for services (or a combination of services) if: (1) the service is necessary for the establishment or operation of the plan; (2) the service is furnished under a contract or arrangement which is reasonable; and (3) no more than reasonable compensation is paid for the service. 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 2550.408c-2) as used in section 408(b)(2) of ERISA.

Accordingly, the provision of investment management services by KFS to the Master Trust would be exempt from the prohibitions of section 406(a) of ERISA if the conditions of section 408(b)(2) are met. We note, however, that the question 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 appropriate plan fiduciaries must determine, based on all of 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) states that section 408(b)(2) of ERISA does not contain an exemption for an act described in section 406(b) of ERISA 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 or her a fiduciary to cause the plan to enter into a transaction involving the provision of services when such fiduciary has an interest in the transaction which may affect the exercise of his or her best judgement as a fiduciary, a transaction described in section 406(b) of ERISA would occur, and that transaction would be deemed to be a separate transaction from the transaction involving the provision of services and would not be exempted by section 408(b)(2) of ERISA.

The mere selection of KFS to provide investment management services to the Master Trust does not, in itself, constitute a violation of ERISA section 406(b)(1). However, because a violation of section 406(b)(1) could occur in the course of the employers' decision to retain KFS as investment manager, the Department is unable to rule that the decision, in operation, would never violate that section.

It is the Department's view that generally a fiduciary's decision to retain a service provider whose fees will be paid by the plan sponsor will not involve an adversity of interests as contemplated by section 406(b)(2) of ERISA. However, if, for example, under the particular facts and circumstances, a fiduciary of the plan in negotiating a service contract on behalf of the plan also acts on behalf of a person and causes that person to benefit from such a decision at an expense of any kind to the plan, the decision to retain the service provider would result in a violation of section 406(b)(2) of ERISA. Accordingly, the employers' decision to retain KFS to provide investment management services would not, in itself, constitute a violation of section 406(b)(2).

This letter is an advisory opinion under ERISA Proc. 76-1. Section 10 of the procedure explains the effect of advisory opinions.

Sincerely,

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