U.S. Department of Labor

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

Reply to the Attention of:

JAN 4 1984

OPINION NO. 84-04A
Sec. 406(b)(1), 3(21)(A)(ii)

Mr. Paul S. Berger
Mr. K. Peter Schmidt
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Re: Rogers, Casey & Barksdale, Inc.
Identification Number F-2596A

Gentlemen:

This is in response to your letters of February 9, 1983, July 18, 1983 and August 4, 1983, in which you request, on behalf of Rogers, Casey & Barksdale, Inc. (RCB), an advisory opinion under section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code of 1954 (the Code).

You represent that RCB is a registered investment adviser under the Investment Advisers Act of 1940 which provides consulting services and investment management services to clients in connection with investment programs for their employee benefit plans. RCB's consulting services include advice regarding structuring, implementing, monitoring and evaluating the client plan's investment program. The particular services provided to a plan are determined by the plan sponsor or independent fiduciary according to the particular needs of the plan. Some clients retain RCB on an ongoing basis for the entire package of consulting services offered while other clients may engage RCB to perform discrete projects or to perform discrete functions on a continuous basis. RCB's ongoing clients pay RCB on a retainer basis. Other clients engaging RCB's services for specific projects pay hourly rates.

RCB's consulting clients are primarily the corporate and governmental sponsors of tax-exempt employee benefit funds with assets in excess of $100 million.

RCB's consulting services may be grouped in the following functional areas:

--Definition of Policy and Objectives

To assist in the formulation of long-term investment policy and realistic objectives, RCB may be retained to evaluate all aspects of a plan's overall investment situation using a projection model to simulate the plan's future assets and liabilities under varying assumptions. Written policy guidelines with targeted objectives are drafted for consideration by the client.

--Evaluation and Recommendation of Investment Managers

To assist in the implementation of investment policies and objectives, RCB evaluates investment manager possibilities for a plan. The existing client/manager relationship is analyzed, and alternative plans for assigning current plan assets among existing managers are drafted. RCB performs manager searches and evaluates prospective managers against qualitative and quantitative criteria developed by RCB. Final recommendations of investment managers are presented to independent plan fiduciaries for their consideration.

--Monitoring of Policies, Objectives and Investment Management

RCB monitors the investment manager's progress toward meeting objectives. RCB's formal annual review includes an evaluation of the client plan's investment policy and objectives, and recommendations are made for any necessary revisions.

RCB's services in connection with these functions consists solely of advice or recommendations to the plan's independent fiduciaries. It is represented that RCB does not have the authority to implement its advice or recommendations. Final action on such advice is adopted and implemented only pursuant to decision by the independent fiduciaries.

RCB also provides certain investment management services. In 1979, RCB was retained by various clients to conduct a nationwide survey (Sweep Survey) to identify highly capable but lesser known investment management firms. In 1981, RCB organized the Special Equity Group Trust (SEGT), a group trust of the type described in Revenue Ruling 81-100, 1981-1 C.B. 326, for the pooled investment of employee benefit plan assets. Funds in the SEGT are managed in separate investment accounts by entities identified in the Sweep Survey. Participation in the SEGT is limited to 30 plans with a minimum investment of $5 million each. Plans are not permitted to invest more than 10 percent of their assets. Four of the participating plans had engaged RCB on a special project prior to participation in the SEGT, four were engaging RCB on a retainer basis at the time of their participation and another has engaged RCB as a consultant subsequent to participation. RCB's services to the SEGT include: selection and termination of account managers; establishment and termination of investment accounts and designation of account managers; allocation of plan assets among the accounts; and supervision, monitoring,

and periodic reporting of the investment performance of each manager and the trust as a whole. Neither the trustee nor any of the account managers is affiliated with RCB.

RCB is appointed as investment manager pursuant to written agreements with independent fiduciaries of the participating plans. The declaration of trust with respect to SEGT or any other group trust organized by RCB which permits RCB to appoint investment managers will provide (or, if in existence, will be amended to provide) that RCB is a named fiduciary with respect to each plan participating in the group trust. Included in its authority as named fiduciary, RCB holds (or will hold) the power to appoint investment managers for SEGT or other RCB-managed funds. Effective January 1, 1983, RCB receives for its services an annual fee equal to 0.2% of the first $400 million of the market value of the assets comprising SEGT, .15% of the next $400 million, and 0.1% of market value in excess of $800 million. The fees of the account managers and trustee are also based on a percentage of asset value. All such fees are apportioned among plans participating in the SEGT and are paid quarterly from the SEGT or by the plans or other designated persons.

You have asked for an advisory opinion to the effect that it is not a per se violation of section 406(b)(1) of ERISA or section 4975(c)(1)(E) of the Code for RCB to recommend to a plan that the plan invest in SEGT or other RCB-managed funds under circumstances where RCB discloses the nature of its relationship to the managed fund and provides all other relevant information to an independent plan fiduciary who will, on the basis of such information, independently review the proposed transaction and make the investment decision.

Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) effective December 31, 1978, the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code, with certain exceptions not here relevant, has been transferred to the Secretary of Labor. Accordingly, all references to specific sections of ERISA shall also refer to the corresponding sections of the Code.

Section 406(b)(1) of ERISA provides that a fiduciary with respect to a plan shall not deal with the assets of the plan in his own interest or for his own account.

Section 3(21)(A) of ERISA defines the term fiduciary as a person with respect to a plan who (i) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) has any discretionary authority or discretionary responsibility in the administration of such plan. Regulation 29 CFR §2510.3-21(c)(1) states that, as a general matter, a person will be deemed to

be rendering investment advice within the meaning of section 3(21)(A)(ii) if two criteria are met. First, pursuant to regulation section 2510.3-21(c)(1)(i), the person must render advice to the plan with regard to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property. Second, pursuant to regulation section 2510.3-21(c)(1)(ii), a person performing this type of service must either (A) have discretionary authority or control with respect to purchasing or selling securities or other property for the plan, or (B) render such advice on an individualized basis pursuant to a mutual agreement, arrangement or understanding, written or otherwise, with the plan that the plan or a fiduciary with respect to the plan will rely on such advice as a primary basis of investment decisions with regard to plan assets. Although the question of whether an entity is a fiduciary by reason of providing consulting (or any other) services generally depends on the particular facts and circumstances of each case, we are assuming, for purposes of the discussion that follows in the advisory opinion, that the totality of services provided by RCB causes it to be a fiduciary with respect to plans to which it renders consulting services. Thus, we assume that RCB renders investment advice as defined in section 3(21)(A)(ii) of ERISA and regulation 29 CFR 2510.3-21(c) because the consulting services and recommendations it provides to a plan, will in fact be relied upon as a primary basis for either the longer range strategic decisions or the more immediate allocation decisions that are made by the plan, or by the plan's fiduciary.

While section 406(a)(1)(C) of ERISA proscribes the provision of multiple services to a plan by a party in interest, including a fiduciary, and section 406(a)(1)(D) prohibits the use by or for the benefit of, a party in interest, of the assets of a plan, section 408(b)(2) of ERISA provides a statutory exemption from the prohibitions of section 406(a) of ERISA for contracting or making reasonable arrangements 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.[1]

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

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[1] 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. In this regard, you have indicated by way of a footnote in your original submission that any participating plan which was established by an employer that co-sponsored the Sweep Survey, and which invested in the SEGT by November 2, 1981, receives a reduction in the fee payable to RCB of up to the amount paid by such employer for the survey. However, you have not requested an opinion under section 408(b)(2) or any other provision of ERISA with regard to this arrangement, and the Department expresses no opinion thereon.

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 it 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 its best judgment as a fiduciary, a transaction described in section 406(b)(1) 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). Conversely, the regulation explains that a fiduciary does not engage in an act described in section 406(b)(1) if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. This may occur, for example, when one fiduciary is retained on behalf of a plan by a second fiduciary to provide a service for an additional fee. However, because the authority, control or responsibility which makes a person a fiduciary may be exercised "in effect" as well as in form, mere approval of the transaction by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control or responsibility which makes such a person a fiduciary to cause the plan to pay the first fiduciary an additional fee for a service.

Reading regulations 29 CFR §2510.3-21(c) and §2550.408b-2 together, the Department believes as a general matter that, when a person is deemed to be a fiduciary by virtue of rendering investment advice as described in regulation section 2510.3-21(c)(1)(ii)(B), the presence of an unrelated second fiduciary acting on the investment adviser's recommendations on behalf of the plan is not sufficient to insulate the investment adviser from fiduciary liability under section 406(b) of ERISA. Regulation section 2510.3-21(c)(1)(ii)(B) presupposes the existence of a second fiduciary who by agreement or conduct manifests a mutual understanding to rely on the investment adviser's recommendations as a primary basis for the investment of plan assets. In the presence of such an agreement or understanding, the rendering of investment advice involving self-dealing will subject the investment adviser to liability under section 406(b) of ERISA. If, however, the unrelated second fiduciary has not agreed to rely on the investment adviser's recommendations, the investment adviser will not be deemed to be a fiduciary under section 3(21)(A)(ii) because the requirements of regulations section 2510.3-21(c)(1)(ii)(B) will not be met.

In light of this, whether a violation of section 406(b) occurs due to RCB's recommendation to a plan to which it provides consulting services with respect to an investment in an RCB fund will depend on RCB's status as a fiduciary. If, as we have assumed for the purposes of this letter, RCB is a fiduciary as a result of rendering investment advice within the meaning of section

3(21)(A)(ii) of ERISA and regulation 29 CFR §2510.3-21(c)(1)(i) and (ii)(B), the Department would view such a recommendation by RCB as a prohibited transaction under section 406(b)(1). If, on the other hand, the plan fiduciaries to whom RCB provides consulting services have not agreed by written contract or by conduct evidencing a mutual understanding to rely on RCB's recommendations as a primary basis for plan investments, RCB would not be deemed to be a fiduciary under section 3(21)(A)(ii) as a result of providing such services. Under such circumstances, RCB's recommendations would not represent per se violations of the prohibited transaction provisions of section 406(b) of ERISA.[2]

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (issued August 27, 1976). Accordingly, this letter is issued subject to the provisions of the procedure, including section 10 thereof relating to the effect of advisory opinions. This letter relates only to those issues that you specifically raised in your request. Specifically, no opinion has been requested nor is any expressed regarding the propriety or reasonableness of compensation arrangements in connection with the performance of services under the SEGT.

Sincerely,

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

[2] No inference should be drawn from the above discussion as to whether RCB would be considered a fiduciary under section 3(21)(A)(i) or (iii) in its dealings with clients under the particular facts and circumstances, or as to whether section 406(b) would be violated in such circumstances.