U.S. Department of Labor Office of Pension and Welfare Benefit Programs
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85-15A
Sec. 408(b)(2), 406(b)(1)

Mr. David J. Dorne
Seltzer, Caplan, Wilkins & McMahon
3003-3043 Fourth Avenue
Post Office Box X 33999
San Diego, CA 92103

Re: San Diego Trust & Savings Bank (the Bank)
Identification Number F-2972A

Dear Mr. Dorne:

This is in response to your request for an advisory opinion on behalf of the Bank 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 the Bank has recently established an in-house discount brokerage division to effect securities transactions for its customers at fees that are substantially lower than the fees charged by the major stock brokerage houses. The fees set by the Bank are published and adjusted regularly to remain competitive with other discount brokers.

The Bank also serves as the trustee of numerous qualified defined benefit plans, defined contribution plans, retirement plans for self-employed individuals, and individual retirement accounts (the Plans). Each Plan contains provisions that permit participants to direct the investment of their own account or to appoint an investment manager independent of the Bank to direct the investment of all or specified portions of the trust fund.

At the present time, the Bank allows Plans that are invested at the discretion of a participant or an independent investment manager (collectively, account managers) to use its in-house brokerage service to effect securities transactions when expressly directed by the participant or the investment manager. However, for such services the Bank charges only the approximate cost to the Bank of the services rather than the discount brokerage fee charged to other non-trust customers. The Bank desires to change its practice and to charge such Plans the same discount brokerage fee charged to other non-trust customers.

The Bank contemplates distributing a circular that informs such account managers of the Bank's in-house discount brokerage service and contains the current fee schedule. The account managers would be allowed to make any of the following requests:

(a) that the Bank use its in-house brokerage service for all securities transactions, unless the account manager requests otherwise. In this regard the Bank would have standing authorization to effect securities transactions subject to immediate cancellation by an account manager;

(b) that the Bank use another specified broker for all securities transactions unless the account manager requests otherwise; or

(c) that the Bank request direction as to which brokerage service to use at the time of each securities transaction.

If the account manager wished to use the Bank's in-house discount brokerage service for some or all securities transactions, the manager would establish a brokerage account with the Bank. Such account would be subject to cancellation at any time. In all cases, the individual Plan participant or investment manager would have complete discretion for investment decisions and in deciding whether to use the Bank or any other broker for securities execution. All account managers will be informed in writing of any increase in the brokerage fees charged by the Bank no less than 30 days before the effective date of the increase and that any standing authorization to use the Bank's in-house brokerage services is subject to immediate termination by the managers without penalty. The use of the in-house brokerage service and receipt of compensation by the Bank in connection with the execution of securities transactions would have no bearing on the fees that the Bank charges as trustee. Under no circumstances would the Bank use the in-house brokerage services for Plan accounts with respect to which the Bank has investment discretion.

You have asked for an advisory opinion that it is not a prohibited transaction under section 406 of ERISA and section 4975 of the Code for the Bank to provide in-house discount brokerage services to plans for which the Bank acts as trustee but has no investment discretion.

Under Presidential Reorganization No. 4 of 1978, effective December 31, 1978, the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been, with certain exceptions not here relevant, transferred 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)(C) and (D) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction, if he or she knows or should know that the transaction

constitutes a direct or indirect furnishing of goods, services, or facilities between the 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) of ERISA further prohibits a fiduciary with respect to a plan from dealing with the assets of the plan in his or her own interest or for his or her own account.

Section 3(14) of ERISA defines the term "party in interest" to include a fiduciary and a person providing services to such plan.

Subject to the limitations of section 408(d), section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) contracting (or making reasonable arrangements) for services (or a combination of services) with a party in interest, including a fiduciary, 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 brokerage services by the Bank would be exempt from the prohibitions of section 406(a) of ERISA if the conditions of section 408(b)(2) are met. Whether the conditions are met in each case involves questions which 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 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) even if such act occurs in connection with a provision of services which is exempt under section 408(b)(2). As explained in 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 judgment 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 one involving the provision of services and would not be exempted by section 408(b)(2).

Based on your representations, it appears that under alternative (b) or (c) discussed above, each use of the Bank's in-house discount brokerage is specifically authorized in advance by the account manager. Thus, in the Department's view, the selection of the Bank to provide brokerage

services under such circumstances would not constitute a violation of section 406(b)(1) of ERISA.

With respect to alternative (a), although the account manager makes each investment decision with respect to the plan, the use of the Bank's in-house brokerage is based on a standing authorization. Further, it appears that the bank may unilaterally modify the fees charged for discount brokerage services. This authority to unilaterally change the fees charged to the Plan could involve the exercise of fiduciary discretion to cause the plan to pay an additional fee. However, you also represent that all directed account managers will be informed in writing of any increase in the fees charged for brokerage services no less than 30 days before the effective date of the increase and that any standing authorization to use discount brokerage services is subject to immediate termination by the directed account managers without penalty. In the circumstances you describe, it appears that the Bank would not be exercising any of the authority, control or responsibility that makes it a fiduciary to cause the plan to pay an additional fee. Thus, the use of the Bank's in-house brokerage services in those circumstances would not violate section 406(b)(1) of the Act.

The Department notes that it is expressing no opinion regarding whether the transactions contemplated satisfy the general fiduciary responsibility provisions of section 404(a) of ERISA. The analysis in your letter deals only with sections 406 and 408 of ERISA and related regulations. Accordingly, this opinion reflects only our analysis of those sections as applied to the facts you describe. The opinion does not address the implications of any other sections of ERISA, including section 404(c), relating to participant-directed individual account plans.

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

Sincerely,

Elliot I. Daniel
Acting Assistant Administrator for Regulations and Interpretations