

U.S. Department of Labor

Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210



DEC 17 1985

85-43A
Sec.

R. Gregory Barton
Vanguard Fiduciary Trust Company
Vanguard Financial Center
Valley Forge, Pennsylvania 19482

Re: Vanguard Fiduciary Trust Company (the Trust Company)
Identification Number F-2974A

Dear Mr. Barton:

This is in response to your letter of September 17, 1984 in which you request an advisory opinion concerning the application of section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code to certain collective investment fund arrangements the Trust Company will enter into with investment advisers registered under the Investment Advisers Act of 1940.

You represent that the Trust Company is a wholly owned subsidiary of the Vanguard Group, a business corporation which in turn is wholly owned by 16 publicly held investment companies. Miller, Anderson and Sherrerd (MAS) is an investment adviser registered under the Investment Advisers Act of 1940 and serves as investment manager (as defined by section 3(38) of ERISA) for several employee benefit plans. MAS and the Trust Company are not in any way affiliated. MAS charges an annual fee for its investment advisory services calculated as a percentage of plan assets managed. MAS and the Trust Company propose to enter into an Agreement of Trust establishing the Miller, Anderson and Sherrerd Fixed Income Trust (the MAS Trust). The MAS Trust is intended to qualify under Revenue Ruling 81-100, 1981-13 I.R.B. 32, as a tax-exempt "group trust" investing primarily in fixed income securities, with participation limited to employee benefit plans.

The Trust Company will serve as trustee under the MAS Trust and will perform certain custodial, valuation, record keeping and recording services. The Trust Company will receive an annual fee for its trustee and administrative services calculated as a percentage of the MAS Trust's assets. All fees will be apportioned among the plans participating in the MAS Trust and will be paid quarterly from the MAS Trust. MAS will provide investment advisory services to the MAS Trust by directing the Trust Company as to all investments and reinvestments.

MAS will not receive any fees for its investment advisory services to the MAS Trust to the extent the MAS Trust's assets are attributable to employee plans for which MAS is already serving as investment manager. As a result, you represent there will not be any additional investment advisory fees paid by such plans directly or indirectly to MAS.

MAS will furnish plans for which it serves as investment manager a detailed description of the MAS Trust. This description will set forth the reasons why MAS considers the MAS Trust to be an appropriate investment for the plan and any additional fees the plan will incur by transferring assets to the MAS Trust. It is anticipated that there will not be any net increase in fees paid by the plan when plan assets are transferred to the MAS Trust rather than individually managed by MAS. The pooling of assets in the MAS Trust is expected to result in savings in administrative costs and other transactional expenses that will exceed the trustee's fees paid by the MAS Trust to the Trust Company.

MAS will exercise its fiduciary discretion to cause plans for which it serves as investment manager to invest in the MAS Trust. MAS wishes to commingle a portion of the employee benefit plan assets it manages for purposes of achieving greater diversification and investment economies of scale. As a condition of participating in the MAS Trust, a fiduciary for each plan who is independent of MAS and the Trust Company must authorize the transfer of plan assets to the MAS Trust. In this connection, you explain that such approval would relate solely to the fees to be incurred by the plan and would not relate to any other aspect of the investment. You represent that in the future other collective fund arrangements between the Trust Company and other investment managers to plans may be entered into on terms substantially identical to those relating to the MAS Trust.

You request an advisory opinion that the provision of services in accordance with the arrangement described above to the MAS Trust by the Trust Company and MAS does not constitute a prohibited transaction under ERISA sections 406(a) and 406(b)(1). You also request an advisory opinion that the transfer of a plan's assets to the MAS Trust in the manner described will not constitute a prohibited transaction under ERISA section 406(b)(1). Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) the authority to issue rulings under section 4975 of the Code has been transferred, with certain exceptions, to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA refer also to corresponding sections of the Code.

In general, it is the position of the Department that where an employee benefit plan participates in a group trust of the kind described in Rev. Rule 81-100, the assets of the plan include an undivided interest in each of the underlying assets of the group trust. See ERISA Opinion 82-52A, September 28, 1982. Because of the services provided to the MAS Trust by the Trust Company and MAS, they are parties in interest with respect to plans which participate in the

MAS Trust under ERISA section 3(14)(B). MAS, as investment adviser to the MAS Trust, and the Trust Company as trustee, are fiduciaries and parties in interest with respect to those plans under ERISA section 3(21) and 3(14)(A). In addition, MAS is a fiduciary and party in interest with respect to the individual plans for which MAS serves as investment manager.

ERISA section 406(a)(1)(C) and (D) 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 furnishing of goods, services or facilities between the plan and a party in interest or the transfer to, or use by or for the benefit of a party in interest, of any assets of the plan. ERISA section 406(b)(1) further prohibits a fiduciary with respect to a plan from dealing with the assets of a plan in his or her own interest or for his or her own account.

Subject to the conditions set forth in ERISA section 408(d), ERISA section 408(b)(2) exempts from the prohibitions of section 406(a) the payment by a plan to a party in interest, including a fiduciary, for a service (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 ERISA section 408(b)(2).

Accordingly, the provision of investment advisory services by MAS and the provision of trustee services by the Trust Company to the MAS Trust would be exempt from the prohibitions of ERISA section 406(a) 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.

With respect to the prohibitions in section 406(b), regulation 29 CFR 2550.408b-2(a) indicates that ERISA section 408(b)(2) does not contain an exemption for an act described in ERISA section 406(b) (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 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.

Your letter of February 26, 1985 states that MAS, acting in its capacity as investment manager to the plans, will cause the plans to invest in the MAS Trust.¹ Your submission also explains that it is anticipated that MAS will not receive any additional fees as a result of a plan's investment in the MAS Trust. Moreover, you state that the Trust Company is unaffiliated with MAS, is not involved in any decision to invest plan assets in the MAS Trust, and otherwise does not have the authority under the arrangement to increase its fee.

In the circumstances you describe, it appears that MAS would not be exercising any of the authority, control or responsibility that makes it a fiduciary to cause a plan to pay an additional fee in connection with the collective investment arrangement. Thus, the investment of plans assets in the MAS Trust and the provision of services under that collective investment arrangement by MAS would not, in and of themselves, involve acts described in section 406(b)(1) of ERISA. Also, to the extent that the Trust Company does not exercise its authority as a fiduciary to cause participating plans to pay to itself (or to a person in whom it has an interest which might affect the exercise of its best judgment as a fiduciary) any additional fees in connection with the performance of services under the arrangement you describe, the provision of services in question would not, in itself, result in violations of ERISA section 406(b)(1). However, because a violation of the prohibitions of section 406(b) could occur in the course of the provision of services by MAS or the Trust Company, the Department is not prepared to rule that the described arrangement, in operation, would not violate section 406(b)(1).²

¹ In your opinion request, you did not ask whether the acquisition of an interest in the MAS Trust would itself involve violations of section 406(a) of ERISA and we have not addressed that issue. In this respect, however, ERISA section 408(b)(8) provides an exemption from the restrictions of section 406(a) for the acquisition of an interest in a common or collective trust fund maintained by a party in interest which is a bank or trust company provided certain conditions are met. The Department is not prepared to state that the exemption under section 408(b)(8) provides relief under ERISA section 406(b). See, Proposed Class Exemption For Certain Transactions Involving Bank Collective Funds, 44 FR 44290, 44291 n.3, July 27, 1979.

² We are assuming that no additional fees will be charged plans under the described arrangement in the event of the withdrawal of a plan's interest in the MAS Trust. Further, we express no opinion herein regarding the prohibited transaction implications of investments in the MAS Trust by plans for which MAS does not serve as investment manager.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and is issued subject to the provisions of that procedure, including section 10, relating to the effect of advisory opinions. We note that pursuant to section 5 of ERISA Procedure 76-1 this advisory opinion relates solely to the arrangement described involving MAS, the Trust Company and the MAS Trust.

Sincerely,

Elliot I. Daniel
Assistant Administrator for Regulations and Interpretations