U.S. Department of Labor Pension and Welfare Benefits Administration
Washington, D.C. 20210

88-03A
Sec. 406(b), 408(b)(2), 408(c)(2), 404(a)(1)(B)

Re: [ ] Corporation
Identification Number: F-3673A

Dear :

This is in response to your letter of May 29, 1987, in which you request an advisory opinion that the retention by the [ ] Corporation Master Retirement Trust A and the [ ] Corporation Master Retirement Trust B (collectively, the Master Trusts) of [ ] Corporation ([ ]) to provide investment-related services to the Master Trusts and the payment by the Master Trusts of the direct expenses of [ ] allocable to performing such services (which expenses include the reasonable compensation of employees of [ ]) do not constitute prohibited transactions under section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code of 1986 (the Code).

You represent that the Master Trusts hold the plan assets of 98 pension benefit plans, established and maintained by [ ] and certain of its subsidiaries and affiliates for the benefit of their eligible salaried and hourly employees. The plans participate in the Master Trusts through Participating Trusts. Each of such participating plans meets the requirements for qualification under section 401(a) of the Code.

Since the inception of the Master Trusts in 1977, and for many preceding years, [ ] has provided investment services for the plan assets of the employee benefit plans of [ ] and its subsidiaries and affiliates. The Pension Fund Trust and Investment Committee (the Committee) has general responsibility for the management of the plan assets held under the Master Trusts. Most of the actual investments of the Master Trusts are managed by approximately 22 investment managers, within the meaning of section 3(38) of ERISA, selected and monitored by [ ] on behalf of the Committee, with responsibility for various equity, bond, real estate and international investment portfolios. The Master Trusts also invest in other specialized investments and guaranteed insurance contracts selected and evaluated by [ ] on behalf of the Committee.

All trustees' and investment managers' fees, and the fees of the consulting actuaries for the participating plans, are paid directly from the plan assets held under the Master Trusts. The actual cash expenditures incurred by [ ] for salaries and fringe benefits of its employees which are attributable solely to providing certain specified services as plan administrator of the

Retirement Plan for Salaried Employees of [ ] Corporation are, effective January 1, 1985, reimbursed from the assets of that plan held under the Master Trusts.[1] The other expenses incurred by [ ] (including the reasonable compensation of its employees) for services provided by [ ] to the plans participating in the Master Trusts were paid by [ ] through December 31, l986.

You further represent that, effective January 1, 1987, [ ] notified the Committee that [ ] would discontinue providing certain specified investment services without charge to the Master Trusts. However, [ ] proposed to provide such services to the Master Trusts for a charge consisting of (1) its actual cash expenditures for salaries and fringe benefits of its employees which are attributable solely to providing such services to the Master Trusts, and (2) certain other expenses incurred directly in connection with providing such services to the Master Trusts. [ ] management informed the Committee that it had determined to sever the employees engaged in providing such services unless their salary and fringe benefit costs, and other costs incurred directly in connection with providing such services, could be reimbursed from the plan assets held under the Master Trusts.

With the advice of counsel, the Committee accepted [ ] proposal on March 19, 1987, subject to any necessary government approval. Both the Committee and [ ] have the right to terminate the arrangement at any time, for any reason, without any additional charge, upon 60 days advance written notice. The Committee will periodically monitor and evaluate [ ] as the provider of investment services to the Master Trusts and will seek additional advice from independent advisers as the Committee determines is appropriate. In addition, [ ] has informed the Committee that it will limit its charges for investment services provided by [ ] employees to the Master Trusts during 1987 to a maximum of $217,000 for compensation of such employees and $20,000 for other costs incurred directly in connection with providing such services, even if actual costs exceed those amounts, unless [ ] should become aware of any unanticipated circumstances which would materially increase the expected total cost of providing such services to the Master Trusts. In such circumstances, the Committee, after being advised by [ ] of an increased estimated annual cost to the Master Trusts, may decide to pay the additional amount or make other arrangements independent of [ ] for necessary investment services.

You represent that the employees with respect to whom [ ] would be reimbursed its salary and fringe benefit costs are, in each instance, clerical and administrative personnel who have no power to make any decisions as to plan policy, practices or procedures, but who make recommendations to the Committee for decisions and perform purely ministerial functions within

[1] In this regard, see Advisory Opinion 86-1 (January 2, 1986) regarding the application of section 406 of ERISA to the retention of [ ] to provide services as plan administrator and the reimbursement of [ ] therefor.

a framework of policies, rules, practices and procedures established by the Committee with respect to plan investments.

The employees with respect to whom [ ] would be reimbursed its salary and fringe benefit costs will maintain daily records of all hours actually worked on providing investment services to the Master Trusts and the number of hours worked on other assignments. Under the proposed arrangement, charges to the Master Trusts would be that percent of [ ] salary and fringe benefit costs for each such employee that the employee's hours worked on investment services matters bears to the employee's total hours worked. The method of recording hours worked and the allocation would be subject to periodic verification and audit by [ ] internal auditors and to annual audit by Arthur Andersen & Co., [ ] outside auditor. Charges for other expenses incurred directly in connection with providing investment services to the Master Trusts would be limited to those directly and fully attributable to providing such services, such as business travel expenses, and would also be subject to periodic verification and audit by [ ] internal and outside auditors. No overhead costs, such as rent, office space or telephone expenses, would be charged to the Master Trusts.

To the extent the work time of the employees with respect to whom [ ] would be reimbursed its salary and fringe benefits costs is not devoted to providing investment services to the Master Trusts, such employees' work time is devoted to providing investment services for other employee benefit and similar plans of [ ] and its subsidiaries and affiliates (e.g., selecting and monitoring investment managers and guaranteed insurance contracts under other [ ] pension and welfare benefit plans). In this regard, the Master Trusts' independent consulting actuary confirms that over 90 percent of the total work time of such employees is devoted to providing investment services to the Master Trusts. The expenses incurred by [ ] (including the reasonable compensation of its employees) for investment services provided to such other plans are presently, and will continue to be, paid by [ ].

You further represent that [ ] can properly identify and segregate all direct expenses for investment services provided to the Master Trusts and to such other employee benefit plans.

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, and the Secretary of the Treasury is bound by the interpretations of the Secretary of Labor pursuant to such authority. Therefore, the references in this letter to specific sections of ERISA refer also to the corresponding sections of the Code.

You state that [ ] is a party in interest within the meaning of section 3(14) of ERISA with respect to plans participating in the Master Trusts. The employees of [ ] are parties in interest

with respect to such plans within the meaning of section 3(14)(B) and (H) of ERISA. In addition, each member of the Committee is a fiduciary of such plans under section 3(21) of ERISA by reason of his or her discretionary authority respecting plan investment management and is, therefore, a party in interest with respect to such plans under section 3(14)(A) of ERISA. No charge will be made to the Master Trusts for the salary and fringe benefit costs of the Committee members. You further represent that the employees with respect to whom [ ] would be reimbursed its salary and fringe benefit costs are not fiduciaries with respect to such plans.

Section 406(a)(1)(C) and (D) of ERISA provides, in pertinent part, that a fiduciary with respect to an employee benefit plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect furnishing of goods, services or facilities between the plan and a party in interest with respect to the plan 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 406(b)(2) of ERISA provides that a fiduciary shall not in his or her individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries. Section 406(b)(3) of ERISA prohibits a fiduciary from receiving a fee or other consideration for his or her own personal account from a party dealing with a plan in connection with a transaction involving the assets of the plan.

Subject to the limitations of section 408(d) of ERISA, section 408(b)(2) exempts from the prohibition 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 or her duties with respect to 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 §§2250.408b-2(d) and 2550.408c-2) as used in sections 408(b)(2) and 408(c)(2) of ERISA.

Accordingly, the provision of investment services by [ ] to the Master Trusts 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 of Labor (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) indicates 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 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 exempt by section 408(b)(2) of ERISA. However, regulation section 29 CFR §2550.408b-2(e)(3) provides that if a fiduciary furnishes 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.

The mere selection of [ ] to provide investment services to the Master Trusts without the receipt of compensation other than the reimbursement of direct expenses would not, in itself, constitute a violation of section 406(b). However, because a violation of section 406(b) could occur in the course of the Committee's decision to retain [ ] in accordance with the proposed arrangement described above, the Department is unable to rule that the decision, in operation, would, in no case, violate that section.

With regard to whether "direct expenses" includes the compensation paid to employees of [ ], 29 CFR §2550.408c-2(b)(3) provides that an expense is not a direct expense to the extent it would have been sustained had the service not been provided or if it represents an allocable portion of overhead costs. You represent that each of the employees with respect to whom [ ] would be reimbursed its salary and fringe benefit costs would not receive full-time compensation for duties performed for [ ] were it not for their duties performed in connection with the investment services [ ] provides to the Master Trusts, and, absent this function, would not be employed by [ ].[2]

[2] The Department previously addressed a similar situation in Advisory Opinion 83-20A (April 27, 1983). In that situation, a wholly-owned subsidiary provided investment management services to a sponsoring employer. Both of the entities were participating employers in a defined benefit pension plan maintained by the sponsoring company and its subsidiaries whose assets made up a common master trust. The expenses incurred by the wholly-owned subsidiary (including the reasonable compensation of its full time employees) for services performed for the

In the Department's view, compensation paid by a service provider to its employees may be a properly reimbursable expense under 29 CFR §2550.408c-2(b)(3) if the expense would not, in fact, have been sustained had the services not been provided, if it can be properly allocated to the particular services provided and the expense does not represent an allocable portion of overhead costs. What constitutes a direct expense in a particular case, however, is a factual matter which can only be resolved by taking into account the relevant facts and circumstances. As noted above, however, the Department ordinarily will not issue an advisory opinion on such questions. To reiterate, the Department notes that an expense would not be properly reimbursable to the extent it was incurred in connection with a service that was not otherwise exempt under section 408(b)(2) of ERISA. Thus, the Committee, in its fiduciary capacity, and not [ ], as plan sponsor, must review each service to be provided by [ ] to determine whether such service is a "necessary service" for which reimbursement is lawful.

We wish to point out that ERISA's general standards of fiduciary conduct would apply to the proposed arrangement. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties with respect to a plan solely in interest of the participants and beneficiaries, and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the Committee must act "prudently" and "solely in the interest" of the participants and beneficiaries of the plans participating in the Master Trusts when causing the Master Trusts to enter into the proposed arrangement. If the decision by the Committee to retain [ ] to provide the investment services specified in the proposed arrangement and to reimburse [ ] for the services in accordance with the proposed arrangement is not "prudent" and "solely in the interest" of the Master Trusts' participants and beneficiaries, the Committee would be liable for any loss resulting from such breach of fiduciary responsibility, even though the retention and reimbursement of [ ] may not constitute a prohibited transaction.

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

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common trust were paid by the sponsoring employer. In that opinion, the Department stated that compensation paid by a service provider to its employees may be a properly reimbursable expense under 29 CFR §2550.408c-2(b)(3) if the expense would not, in fact, have been sustained had the services not been provided and if it can be properly allocated to the particular services provided. See also Advisory Opinion 86-1.

Sincerely,

Robert J. Doyle
Acting Associate Director for Regulations and Interpretations