U.S. Department of Labor

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

Reply to the Attention of:

OPINION 80-30A
406

MAY 21 1980

PRO Administrators, Inc.
PRO Services, Inc.
Cannon & Company, Inc.
PRO Funds, Inc.
1107 Bethlehem Pike
Flourtown, PA 19031

Attn: Daniel H. O'Connell

Gentlemen:

This will respond to your letters of September 20, 1977, and February 20, 1978, requesting an advisory opinion concerning the applicability of certain statutory and administrative requirements, discussed below, of the Employee Retirement Income Security Act of 1974 (ERISA).

Based upon your letters and the enclosures submitted therewith, we understand that the facts are as follows.

Cannon & Company, Inc., (Cannon) is engaged in the business of retirement plan consulting and insurance sales. PRO Services, Inc. (Services), a wholly-owned subsidiary of Cannon, is a registered broker/dealer, and serves as investment advisor and underwriter to two "no-load" mutual funds: PRO Fund, Inc. (Pro Fund), and PRO Income Fund, Inc. (collectively, "Funds"). PRO Administrators, Inc. (Administrators), another wholly-owned subsidiary of Cannon, is primarily engaged in the business of providing "ERISA Compliance Services" to Keogh and professional corporation retirement plans of employers who have adopted any one of four prototype defined contribution retirement plans (Plans) sponsored by PRO Fund.

According to the copies of the prototype Plan agreements submitted with your letter, all contributions made by or on behalf of a participant in the Plans are used to purchase, for the individual account of that participant, such investments (within the categories specified in the agreement) as may be directed by the participant. Those categories include investment company shares, insurance contracts and annuity contracts. The assets of each Plan are held in trust by a trustee which, in some cases, is selected by either PRO Fund or Services. In such cases, the

employer executing the Plan agreement delegates to Services the power (1) to select successor trustees; (2) to settle the compensation of the trustee; and (3) to amend, with certain exceptions, the terms of the Plan.

The prototype Plan agreements also state that a signatory employer who does not engage an "independent" firm as "administrator (as defined in Section 3(16)(A) of (ERISA))" shall be the "administrator" of the Plan and shall perform such duties as may be required of that office under ERISA. According to your letters and the terms of a form of agreement, submitted therewith, between Administrators and an electing employer, Administrators offers to perform various specified services and such other services -- as it deems, in its discretion, necessary for the day to day operation of the Plan -- for an annual fee of from $175 to $325 per plan (depending on which Plan is selected), plus $25 per Plan participant. The fee is paid by the employers who elect to have Administrators perform those services.

As of the date of your September 1977 letter, approximately 200 of the approximately 2300 employers using one or more of the Plans have subscribed to this service provided by Administrators.

Persons licensed as registered securities representatives with Services, and as insurance agents with Cannon, explain the investment options and other features of the Plans to Plan participants, and facilitate the processing of the participants' investment instructions to the trustee. Many of those participants instruct the trustee to purchase (1) insurance or annuity products upon which Cannon receives commissions as a general insurance agent, and (2) shares of the Funds. Services receives commissions in connection with purchases for the Plans of mutual fund shares that, unlike the Funds' shares, are sold at a price that includes a sales charge.

You ask that we issue an advisory opinion to the effect that, notwithstanding the affiliations among Cannon, Services and Administrators: (1) Administrators may continue to serve as the "nominal" plan administrator, (despite the limitation on the availability of Prohibited Transaction Exemption 77-9 (PTE 77-9),[1] and (2) Cannon and Services may continue to rely on PTE 77-9 with respect to the classes of transactions described in paragraphs (a), (b), (c), (d) and (f) of Section III of the exemption.[2]

---

[1] 42 FR 32395 (June 24, 1977), amended, 44 FR 1479 (January 5, 1979). PTE 77-9 exempts from the prohibitions of sections 406(a)(1)(A) through (D) and 406(b) of ERISA, and from the taxes imposed by Section 4975 of the Internal Revenue Code of 1954 ("Code"), certain classes of transactions involving the purchase, with plan assets, of insurance or annuity contracts, and securities issued by registered investment companies.

[2] Those paragraphs are:

The availability of the exemptions provided for in PTE 77-9 is subject to conditions set forth in Sections IV and V thereof. Section V(a) contains, among other things, a condition that, with respect to transactions described in paragraphs (a), (b), (c), or (d) of Section III, the insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter not be a plan administrator within the meaning of section 3(16)(A) of ERISA. The terms "insurance agent or broker", "pension consultant", "investment company" and "principal underwriter" are defined, in section VI(b) of PTE 77-9, to mean such persons and any affiliates thereof. An "affiliate" of a person is defined in section VI(c) to include any person controlling, controlled by, or under common control with, such other person.

Although you concede that Administrators is "technically" the plan administrator, as defined in section 3(16) of ERISA, for subscribing Plans, you assert that the purpose of the aforementioned condition V(a) is to prevent a plan administrator having discretionary authority over the investment of plan assets from investing the assets in ways that would result in his receipt of commissions or other compensation. You argue, among other things, that such a situation is not present in your case because Administrators role is essentially clerical and involves no discretionary authority over the investment of Plan assets.

We cannot agree that the term "administrator", as used in section V(a), excludes persons who are without discretionary authority with respect to the investment of plan assets. The preamble to PTE 77-9 (as amended) states, in part:

(a) The receipt, directly or indirectly, by an insurance agent or broker or a pension consultant of a sales commission from an insurance company in connection with the purchase, with plan assets, of an insurance or annuity contract.
(b) The receipt of a sales commission by a principal underwriter for an investment company registered under the Investment Company Act of 1940 (hereinafter referred to as an investment company) in connection with the purchase, with plan assets, of securities issued by an investment company.
(c) The effecting by an insurance agent or broker, pension consultant or investment company principal underwriter of a transaction for the purchase, with plan assets, of an insurance or annuity contract or securities issued by an investment company.
(d) The purchase, with plan assets of an insurance or annuity contract from an insurance company.
(f) The purchase, with plan assets, of securities issued by an investment company from, or the sale of such securities to, an investment company or an investment company principal underwriter, when such investment company, principal underwriter, or the investment company investment advisor is a fiduciary or a service provider (or both) with respect to the plan solely by reason of the sponsorship of a master or prototype plan including the provision in connection therewith of non-discretionary trust or custodial services, of any, with respect to the plan.

> "Another commentator requested that the Agencies amend section V(a) to permit a trustee not having any discretionary authority over the acquisition or disposition of plans assets to avail itself of the relief offered by the exemption. The Agencies believe that such a substantive modification of section V(a) … should be based on a showing, at least, that the present conditions … place an undue burden on common and customary business practices and that … sufficient safeguards would still be present … to protect the interests of plan participants …. The Agencies do not believe that such a showing has been made …."[3]

Thus, an argument similar to the one you advance was specifically considered, but not found persuasive, by the Department and the Internal Revenue Service in the course of the proceeding to amend PTE 77-9. We are of the opinion, therefore, that the interpretation you suggest, of section V(a), is incorrect. It would appear that the appropriate forum for pursuing the result you seek, should you wish to do so, would be an exemption proceeding pursuant to section 408(a) of ERISA. Of course, no assurance can be given of the Department's disposition of such an exemption request.

Administrators is an affiliate of Cannon because it is wholly owned and, therefore, controlled, by Cannon. Administrators is also the administrator of certain Plans. Consequently, the exemption for transactions described in paragraphs III(a) and III(c) of PTE 77-9 is not available to Cannon, as insurance agent or broker (or pension consultant), with regard to: (1) the effecting of a transaction for the purchase, with the assets of those Plans, of an insurance or annuity contract, and (2) the receipt by Cannon of a sales commission from the insurance company in connection therewith. Similarly, the exemption for transactions described in paragraphs III(b) and III(c) of PTE 77-9 is not available to Services, which is under common control with Administrators, with regard to the effecting by Services of a transaction for the purchase, with the assets of those Plans, of securities issued by an investment company, and the receipt of a sales commission by Services in connection therewith.[4]

You state, in your letter, that the transactions described in Paragraph III(d) of PTE 77-9 "directly affect …" Cannon. Paragraph III(d) refers to the purchase, with plan assets, of an insurance or annuity contract from an insurance company. We are unable to express an opinion as to the availability of the exemption with respect to such transactions, because you have not described the relationship (if any), to the Plans or to Cannon, of the insurance companies that may be involved.

---

[3] 44 FR at 1482

[4] It should be noted that the exemption for the transactions discussed above would not be available for such transactions involving a plan if a trustee of that plan were an affiliate of Cannon or Services. See section V(a) of PTE 77-9.

In addition to the aforementioned difficulties that arise in connection with transactions involving those Plans for which Administrators acts as plan administrator, it appears that there are certain other difficulties that may arise in connection with all of the Plans. You indicate that Services sometimes effects purchases, by Plans, of shares of investment companies other than the Funds, and receives part of the applicable sales load as a commission or concession in connection with such purchases. Section IV(a) of PTE 77-9, which contains a condition applicable to all transactions described in section III, provides, in the case of a transaction effected by an investment company principal underwriter, that the transaction be effected "in the ordinary course of its business as such a person [emphasis added]." In the case of the purchase of shares of an investment company for which Services is not a principal underwriter, we are of the opinion that if Services effects such transactions in the ordinary course of its business, it is in the course of its business as a broker/dealer and not as an investment company principal underwriter. In that case, condition IV(a) would not be satisfied and the exemption, therefore, would not be available because, under the circumstances described above, Services is not acting in its capacity as a principal underwriter with respect to sales of shares of investment companies other than the Funds.[5]

Although the persons who act as trustees for the Plans may have no discretion in selecting the investments to be made by various Plans, it appears that they may have discretion in determining the broker, dealer or agent through which such investments will be made. To the extent that they do have such discretion, the trustees would be plan fiduciaries with respect to their exercise of that discretion. Thus, if the Plan participants do not instruct the trustees with respect to such matters but, rather, rely on them as fiduciaries to select appropriate agents for the transactions, a selection by such a trustee of Cannon or Services as agent or broker would, in some circumstances, raise questions under section 406(b)(1) of ERISA.[6] This is because Services (and Cannon, because it controls Services) has the power in such circumstances to replace the Plan trustees and to fix their compensation. As a result, Services and Cannon may be persons in which the trustees have the type of interest that may affect the trustees' best judgement as fiduciaries.[7]

---

[5] Relief for such transactions, however, may be provided in Prohibited Transaction Exemption 75-1 (40 FR 50845, October 31, 1975) and Prohibited Transaction Exemption 79-1 (44 FR 5963; January 30, 1979). In addition, the receipt by Services of commissions with respect to such purchases may be exempted from the restrictions of section 406(a) of ERISA by section 408(b)(2) of ERISA. However, even if the receipt of commissions by Services is exempted by one or more of these exemptions, there may be additional prohibited transactions involved for the reasons discussed in the following paragraphs of the text.

[6] Section 406(b)(1) provides, in part, that a fiduciary with respect to a plan shall not deal with the assets of a plan in his own interest.

[7] See, 29 CFR §2550.408b-2(e) and examples (5) and (6) set forth in paragraph (f) of that regulation.

Any violation of section 406(b)(1) that arises by reason of such exercise of discretion would involve a separate prohibited transaction by the trustee not covered by any of the exemptions in PTE 77-9, and would exist whether or not the underlying transaction were exempt by PTE 77-9 or otherwise. However, the materials you have submitted do not contain sufficient information to enable us to express our opinion with respect to particular transactions.

You also indicate that you intend to comply with conditions set forth in section V of PTE 77-9 by disclosing certain specified information to plan participants. Paragraphs (b), (c), (d) and (e) of section V relate to disclosure to, and approval by, an independent fiduciary in connection with proposed purchases of insurance or annuity contracts, or investment company shares. While we will not express an opinion on the adequacy of the disclosure you do propose to make, it appears to us that your proposed disclosure does not relate to all of the categories of information referred to in the aforementioned provisions of section V. We suggest, therefore, that you consider reviewing your operations with regard to the requirements of section V. However, we are of the opinion that, in the case of a participant who exercises control over the assets of his account in the manner described in section 404(c) of ERISA with respect to a given investment, the provisions of paragraph (b), (c), (d) and (e) of section V of PTE 77-9 may be satisfied with respect to that investment, if they are satisfied in all respects except that the participant is substituted in each case for the independent fiduciary referred to in those provisions.[8]

---

[8] You indicate that the Plans are designed to be "participant directed", within the meaning of section 404(c) of ERISA. Section 404(c) provides, in part, that:

> [i]n the case of a pension plan which provides for individual accounts and permits a participant … to exercise control over assets in his account, if a participant … exercises control over assets in his account (as determine under regulations of the Secretary) --
>
> (1) such participant … shall not be deemed to be a fiduciary by reason of such exercise, and
>
> (2) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participants' … exercise of control.

The Department has not yet promulgated regulations under section 404(c). We do not express any opinion whether the provisions of paragraph (1) and (2) of section 404(c) apply in the case of the Plans. It should be noted, however, that there is no provision of the Code corresponding to section 404(c) that exempts disqualified persons from the imposition of any applicable excise taxes under section 4975 of the Code in connection with prohibited transactions. Under the terms of Reorganization Plan No. 4 of 1978 (43 FR 47713, December 31, 1978), the Internal Revenue Service has sole jurisdiction to grant exemptions from such taxes with respect to transactions that are "exempted by subsection 404(c) from the provisions of Part 4 of … Title I of ERISA."

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,

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