U.S. Department of Labor

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

Reply to the Attention of:
Dan O'Neil
(202)523-8368

OPINION NO. 82-52A
Sec. 406(b)(1), 406(b)(2), 408(b)(2), 408(b)(4), 408(b)(8), 404(a)(1)(B), 3(31)(A), 3(14)(A), 3(14)(B), 3(14)(H)

SEP 28 1982

James R. Hubbard, Esq.
Krehbiel & Hubbard, Inc.
P.O. Box 550
Bellevue, Washington 98009

Re: Identification Number: F-2015A

Dear Mr. Hubbard:

This is in response to your letters of February 13, 1981, June 23, 1981, August 14, 1981, January 14, 1982, March 19, 1982, June 30, 1982, and September 10, 1982, concerning the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

You represent that Krehbiel & Hubbard, Inc., is a registered investment adviser under the Investment Advisers Act of 1940 and currently serves as an "investment manager" (as defined in section 3(38) of ERISA) for several multiemployer employee benefit plans. The Rainier National Bank (the Custodian) maintains custody of the assets of some or all of the plans for which Krehbiel & Hubbard, Inc. serves as investment manager. The outstanding stock of Krehbiel & Hubbard, Inc., is owned equally by James R. Hubbard (Hubbard) and John H. Krehbiel (Krehbiel). You further represent that Krehbiel & Hubbard, Inc. and the Custodian are unrelated entities.

Some of the plans managed by Krehbiel & Hubbard, Inc. desire to commingle portions of their assets in a collective investment program for the purpose of achieving investment economies of scale. The program will take the form of several collective funds organized by Krehbiel & Hubbard Inc. under a single joint master trust. Each collective fund will invest in a specified type of investment and will be designated as follows: "Stock Fund", "Investment Company Fund", "Bond Fund" and "Union Construction Fund." The Internal Revenue Service (IRS) has ruled that the Krehbiel & Hubbard Joint Master Trust (Master Trust) is a group trust of the type described in Revenue Ruling 81-100, 1981-13 I.R.B. 32.

Under the "Joinder Agreement Providing Participation in Joint Master Trust and Custodial Services", the individual plan trustees adopt the K & H Joint Master Trust. Krehbiel & Hubbard, Inc. is engaged as investment manager to the Master Trust and the Custodian is authorized to hold plan assets in one or more collective funds established under the Master Trust. Krehbiel & Hubbard, Inc. may further authorize the Custodian under the Joinder Agreement to temporarily invest excess cash in: (a) the Custodian's Collective Investment Plan for Daily Interest; (b) commercial paper; (c) other short-term securities or (d) savings accounts and certificates of deposit in any bank, including the savings department of the Custodian, provided such savings bear a reasonable rate of interest. This authorization with respect to temporary investments specifically instructs the Custodian to invest Master Trust assets in one of the above described investments pending the receipt of further instructions from Krehbiel & Hubbard, Inc. Under the Master Trust, James Hubbard and John Krehbiel will serve as the initial trustees. The Master Trust authorizes Krehbiel & Hubbard, Inc. to remove and replace the Custodian and the trustees.

You state that the decision to invest in the collective investment program as well as the determination regarding the amount of plan assets which will be allocated to each collective fund are made by the trustees of each plan who are independent of Krehbiel & Hubbard, Inc., and the Custodian.[1] Krehbiel & Hubbard, Inc., does not have the discretionary authority to commit any plan to the program. Section 6.02 of the Master Trust Agreement permits month-end withdrawal of assets from the Master Trust by a plan upon 15 days advance written notice, and cessation of participation upon 30 days written notice (in the case of the Union Construction Fund, payment may be delayed up to 3 years). Section 6.02 further permits Krehbiel & Hubbard, Inc., to terminate participation by a plan in the Master Trust by 90 days advance written notice.

As investment manager for the individual plans, Krehbiel & Hubbard, Inc. receives an annual fee calculated at a rate of from .3 to 1 percent of assets managed, depending on the type of investment program adopted by the plan.[2] No separate investment management fees will be paid directly by the Joint Master Trust. Krehbiel & Hubbard, Inc., intends that clients be permitted to participate in the Master Trust without changing existing fee relationships or the manner of payment of such fees. Charges by the Custodian are in accordance with a published schedule and would include a Set Up and Amendment Fee, an Annual Basic Service Fee, and an Annual Assets Maintenance and Safekeeping Service Fee. No additional charge or management fee is imposed for the temporary investment in the Bank's Collective Investment Plan for Daily Interest

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[1] By letter dated June 30, 1982, you indicate that Krehbiel & Hubbard, Inc. may be given discretionary authority at some future date to allocate plan assets among collective funds. As per your original request, we are not addressing the situation involving the delegation of authority to Krehbiel & Hubbard, Inc. to allocate plan assets.

[2] We note that you made this representation in the course of a telephone conversation with a member of the staff of this Office, along with the representation that the same fee arrangement would apply to the assets managed under the Master Trust. We also note, however, that such fee arrangements are at variance with the "Fee Schedule" described in the copy of the "Advisory Agreement" which accompanied your letter of February 13, 1981.

or other short-term investments. The fees payable to the Custodian are paid by the Master Trust and allocated to the various collective funds. The trustees, Krehbiel and Hubbard, will serve without compensation from the Master Trust. There is no purchase or sale of interests in the Master Trust, nor are any commissions associated with participation in the Master Trust.

You request an advisory opinion that the provision of services in accordance with the arrangement described above by Krehbiel & Hubbard, Inc. Krehbiel, Hubbard and the Custodian does not constitute a prohibited transaction under section 406(a)(1) or 406(b)(1) or (2) of ERISA.

In your letter you indicate that the IRS has determined that the Master Trust is a group trust under the principles of Revenue Ruling 81-100. It is the position of the Department that where an employee benefit plan participates in a group trust of the kind described in Rev. Rul. 81-100, the assets of the plan include an undivided interest in each of the underlying assets of the group trust. See ERISA Opinion 82-31A (July 14, 1982).

Because of their relationship to the Master Trust, Krehbiel, Hubbard, Krehbiel & Hubbard, Inc., and the Custodian are parties in interest with respect to plans that participate in the Master Trust. Krehbiel & Hubbard, Inc., as investment manager of the Master Trust, is a fiduciary with respect to the plans that invest in that entity under section 3(21) of ERISA, and is, therefore, a party in interest with respect to those plans under section 3(14)(A). Krehbiel and Hubbard, as trustees of the Master Trust, are also fiduciaries of, and parties in interest with respect to, the investing plans. Krehbiel and Hubbard are also parties in interest under section 3(14)(H) of ERISA by reason of their other relationship with Krehbiel & Hubbard, Inc. Custodian is party in interest under section 3(14)(B), and may be a fiduciary under section 3(21)(A) of ERISA to the extent it exercises investment discretion over Master Trust assets or has discretionary authority in the administration of Master Trust assets.

In addition, Krehbiel, Hubbard and Krehbiel & Hubbard, Inc. are fiduciaries of, and parties in interest with respect to, individual plans to which they give investment advice or serve as investment manager. See sections 3(14)(A) and 3(21)(A) of ERISA.

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 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 party in interest, of any assets of the plan. Section 406(b)(1) and (2) of ERISA further prohibit 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, or acting in any transaction on behalf of a party or representing a party whose interests are adverse to the interest of the plan or its participants.

Subject to the conditions set forth in section 408(d) of ERISA, section 408(b)(2) of ERISA 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 section 408(b)(2) of ERISA.

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 (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).

Accordingly, the provision of investment management services by Krehbiel & Hubbard, Inc., the provision of trustee services by Krehbiel and Hubbard and the provision of custodial and temporary investment services by the Custodian would be exempt from the prohibitions of section 406(a) of ERISA 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.

Furthermore, the initial appointment of Krehbiel & Hubbard, Inc. as investment manager of the Master Trust and Hubbard and Krehbiel as trustees of the Master Trust by independent plan fiduciaries pursuant to the Joinder Agreement and the adoption of the Master Trust would not cause Hubbard, Krehbiel, and Krehbiel & Hubbard, Inc. to violate sections 406(b)(l) or 406(b)(2) of ERISA as long as those persons exercise none of the authority, control or responsibility that makes them fiduciaries to cause the plan to make such appointments.

Your application indicates that Krehbiel & Hubbard, Inc., when acting in its capacity as investment manager under the collective investment program, cannot exercise authority to require participating plans to pay additional fees or other compensation for those services required to be performed by Krehbiel & Hubbard, Inc., and Krehbiel and Hubbard individually, in accordance with the Joinder Agreement and Master Trust. Therefore, it does not appear that the provision of services in itself by Krehbiel & Hubbard, Inc. and Krehbiel and Hubbard under the collective investment program will result in acts described in section 406(b)(1) of ERISA. However, because a violation of the prohibitions of section 406(b) could occur in the course of the provision of such services, the Department is not prepared to rule that the described arrangement, in operation, would not violate the section.

With respect to the temporary investment of Master Trust assets in the Custodian's Collective Investment Plan for Daily Interest at the direction of Krehbiel & Hubbard, Inc., section 408(b)(8) of ERISA provides, in pertinent part, that section 406(a)(1) of ERISA does not apply to any transaction between a plan and a common or collective trust fund maintained by a bank or trust company supervised by a State or Federal agency, if (a) the transaction is a sale or purchase of an interest in the fund, (b) the bank or trust company receives not more than reasonable compensation, and (c) the transaction is expressly permitted by the instrument under which the plan is maintained or by a fiduciary (other than the bank or trust company, or an affiliate thereof) who has authority to manage and control the assets of the plan. In the absence of regulations, the Department is not prepared at this time to indicate the extent to which section 408(b)(8) applies to prohibitions under section 406(b) of ERISA. See Proposed Class Exemption for Certain Transactions Involving Bank Collective Funds, 44 FR 44290, 44291 n. 3, July 27, 1979. However, since the Custodian cannot exercise authority to cause Master Trust assets to be invested in its Collective Investment Plan or to receive additional fees or other compensation for the provision of services under the Collective Investment Plan, it does not appear that the investment of Master Trust assets in the Custodian's Collective Investment Plan, in itself, would involve the Custodian in acts described in section 406(b)(1) of ERISA.

With respect to the temporary investment of Master Trust assets in deposits of the Custodian at the direction of Krehbiel & Hubbard, Inc., section 408(b)(4) provides that the prohibitions of section 406 shall not apply to the investment of all or a part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if -- (A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or (B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliate thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment.

Section 2550.408b-4(a) of the Department's regulations explains that the exemption provided by section 408(b)(4) of ERISA applies if the bank is a fiduciary or other party in interest which meets the other requirements of that section. Section 2550.408b-4(b)(2) of the regulations requires, for plans covering employees of employers other than the bank or similar financial institution in which plan assets are deposited, that the investment be expressly authorized by a provision of the plan or trust instrument or that the investment be expressly authorized (or made) by a fiduciary of the plan (other than the bank or similar financial institution or any of its affiliates) who has authority to make such investments, or to instruct the trustee or other fiduciary with respect to investments, and who has no interest in the transaction which may affect the exercise of such authorizing fiduciary's best judgment as a fiduciary so as to cause such authorization to constitute an act described in section 406(b) of ERISA. Any authorization to make investments contained in a plan or trust instrument will satisfy the requirement of express authorization for investments made prior to November 1, 1977. Effective November 1, 1977, in the case of a bank or similar financial institution that invests plan assets in deposits in itself or its

affiliates under an authorization contained in a plan or trust instrument, such authorization must name such bank or similar financial institution and must state that such bank or similar financial institution may make investment in deposits which bear a reasonable rate of interest in itself (or in an affiliate).

In addition to the instructions required by Krehbiel & Hubbard, Inc. prior to the Custodian's investment in its own deposits, the Master Trust specifically names the Custodian and authorizes it to temporarily invest Master Trust assets in deposits bearing a reasonable rate of interest in itself. Under the requirements of Revenue Ruling 81-100, the Master Trust must be adopted as a part of each participating employee benefit plan. Accordingly, the investment of Master Trust assets in deposits of the Custodian will be encompassed by the statutory exemption provided by section 408(b)(4) of ERISA if the remaining conditions of the exemption are met.

In your request, you indicate that one of the collective funds will be designated as the "Union Construction Fund". In this regard, we wish to point out that when Krehbiel & Hubbard, Inc. makes investment decisions on behalf of a fund, it must determine, among other things, whether such transactions will be entered into on behalf of the fund solely in the interest of participants and beneficiaries and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man would use in the conduct of an enterprise of a like character and with like aims. In deciding whether and to what extent to invest in a particular investment a fiduciary must consider only factors relating to the interests of plan participants and beneficiaries in their retirement income. Thus, a decision to make an investment may not be influenced, for example, by a desire to stimulate the construction industry and generate employment, unless the investment, when judged solely on the basis of its economic value to the plan, would be equal or superior to alternative investments available to the fund.

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

Sincerely,

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