

**U.S. Department of Labor**

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



Reply to the Attention of:

OPINION NO. 83-20A  
Sec. 408(c)(2), 406(b)(1), 406(b)(2)

APR 27 1983

Re: Identification Number: F-2528A

Dear Mr.

This is in reply to your letter of October 18, 1982, requesting, on behalf of \_\_\_\_\_ and Investment Management Company ( \_\_\_\_\_ Investment), clarification regarding the application of section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code of 1954 (the Code) to the situation described in your letter.

You represent that \_\_\_\_\_ Investment, a wholly-owned subsidiary of \_\_\_\_\_, is a registered investment adviser under the Investment Advisers Act of 1940. Both \_\_\_\_\_ and \_\_\_\_\_ Investment are participating employers in the \_\_\_\_\_ Salaried Pension Plan, one of 31 defined benefit pension plans maintained by \_\_\_\_\_ and its subsidiaries whose assets make up the master trust (Common Trust) established for the collective investment of the assets of the plans. As of July 31, 1982, the market value of the assets of the Common Trust amounted to \$800 million.

Investment acts as investment manager for approximately \$150 million of the assets of the Common Trust which it manages as a separate and distinct portfolio. The balance of the assets are managed in several separate portfolios by investment managers who are unrelated to \_\_\_\_\_. In addition, it also appears that \_\_\_\_\_ Investment provides investment management services directly to the \_\_\_\_\_ Stock Savings Plan and the \_\_\_\_\_ Foundation, as well as evaluating the performances of the unrelated investment managers and monitoring the overall investment posture of the Common Trust with regard to diversification under section 404(a)(1)(C) of ERISA. \_\_\_\_\_ Investment performs these functions within the parameters of broad policy guidelines established by \_\_\_\_\_ Investment Committee consisting of \_\_\_\_\_ Chairman, Vice President and General Counsel, Executive Vice President and Chief Financial Officer, the Vice President-Human Relations and the Vice President-Investments.

The fees of the unrelated investment managers are paid directly from the Common Trust. The expenses incurred by \_\_\_\_\_ Investment (including the reasonable compensation of its employees) for services performed for the Common Trust, the \_\_\_\_\_ Stock Savings Plan and the \_\_\_\_\_ Foundation are presently paid by \_\_\_\_\_. You represent that Investment can properly identify and segregate all expenses attributable to investment management services performed for the \_\_\_\_\_ Foundation and the \_\_\_\_\_ Stock Savings Plan.

You further represent that both \_\_\_\_\_ and \_\_\_\_\_ Investment are parties in interest and fiduciaries with respect to the Common Trust within the meaning of sections 3(14) and 3(21) of ERISA. The employees of \_\_\_\_\_ Investment are parties in interest with respect to the Common Trust under section 3(14)(B) and (H) of ERISA, and may be fiduciaries of the Common Trust under section 3(21) of ERISA and regulation section 29 CFR 2510.3-21.

\_\_\_\_\_ and \_\_\_\_\_ Investment request clarification from the Department of Labor (the Department) to the effect that the retention of \_\_\_\_\_ Investment as investment manager of the Common Trust and the payment from the Common Trust of the direct expenses of \_\_\_\_\_ Investment allocable to the Common Trust for investment management services performed (which expenses include the reasonable compensation of employees of \_\_\_\_\_ Investment) do not constitute prohibited transactions under section 406 of ERISA.

Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions not here relevant, 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 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 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.

Subject to the limitations of section 408(d) of ERISA, 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 investment management and advisory services by \_\_\_\_\_ Investment to the Common Trust 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 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) states 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 transaction involving the provision of services and would not be exempted 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 Investment to provide investment management and advisory services to the Common Trust without the receipt of compensation other than reimbursement of direct expenses would not, in itself, constitute a violation of ERISA section 406(b). However, because a violation of section 406(b) could occur in the course of the Common Trust fiduciaries' decision to retain Investment 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 Investment, 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 these employees would not receive full time compensation for duties performed for Investment were it not for their investment advisory duties performed in connection with the investment advice Investment renders to the Common Trust and, absent this function, would not be employed.<sup>1</sup>

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 and if it can be properly allocated to the particular services provided. What constitutes a direct expense in a particular case, however, is a factual matter to be resolved taking into account the relevant facts and circumstances. As noted above, the Department ordinarily will not issue an advisory opinion on

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<sup>1</sup> You indicate that compensation paid to employees of performed for the Foundation or the charged to the Common Trust.

Investment for services Stock Savings Plan will not be

such questions.

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

Sincerely,

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