U.S. Department of Labor

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

Reply to the Attention of:

OPINION NO. 83-44A
Sec. 406(b)(1), 406(b)(2), 406(b)(3), 408(b)(2)

AUG 24 1983

Mr. Douglas O. Kant
Assistant Counsel
John Hancock Mutual Life Insurance Company
John Hancock Place
P.O. Box 111
Boston, MA 02117

Re: John Hancock Mutual Life Insurance Company Pension Plan (the Plan)
Exemption Application No. D-3998

Dear Mr. Kant:

The Department of Labor (the Department) has reviewed the above referenced application for exemption from the prohibitions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and from the sanctions resulting from the application of section 4975 of the Internal Revenue Code of 1954 (the Code). Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) effective December 31, 1978, the authority of the Secretary of the Treasury to issue rulings and exemptions under section 4975 of the Code, with certain exceptions not here relevant, has been transferred to the Secretary of Labor.

The transaction involves a decision by Plan trustees to select an investment vehicle knowing that such selection would result in the retention of John Hancock Venture Capital Management, Inc. (the Manager), a party in interest, to provide investment and managerial services and the receipt of a management fee by the Manager from John Hancock Mutual Life Insurance Company (John Hancock), the sponsoring employer of the Plan.

The application states that the Plan has been primarily funded through an Immediate Participation Guarantee type of annuity contract (IPG Contract) issued by John Hancock in its capacity as an insurer to John Hancock as the sponsoring employer of the Plan. The Plan participates in the IPG Contract under similar terms and conditions as those covering participation by other contract holders. The IPG Contract permits John Hancock, as employer, to allocate contributions among the investment accounts (including the general account and the several classes of its pooled account) which John Hancock, as insurer, has established or may in the future establish. Investment decisions for the Plan are made by an employee benefit committee (the Committee) comprised of officers and directors of John Hancock.

It was originally contemplated that any venture capital investment to be made by the Plan would be through the creation of a new class of pooled separate account under the existing IPG Contract. However, because of limitations under state law regarding the investments by separate accounts, a limited partnership vehicle was selected as most appropriate for making pooled investments in venture capital. The John Hancock Venture Capital Fund Limited Partnership (the Fund) was formed to enable certain sophisticated investors (such as pension plans or endowment funds) to

make pooled venture capital investments. To accommodate the Plan's investment in the Fund (and other possible investments not permitted under the IPG Contract), the Plan would be amended to authorize the appointment of a trustee to hold such investments. Although the designated trustee would be a bank not affiliated with John Hancock, investments would be made in accordance with instructions provided by the Committee.

The sole general partner of the Fund will be the Manager, an indirect wholly owned subsidiary of John Hancock. The Manager will have full discretionary authority over the management of the Fund. For its services to the Fund, the Manager will receive an annual management fee paid in quarterly installments which, on an annual basis, aggregates to one percent of the capital commitment of the respective limited partners to the Fund. The Manager will not receive an override or performance fee on the capital gains to the Fund. Consequently, the management fee represents the sole source of income to the Manager for performing the management and investment functions incidental to the operation of the Fund.

The exemption application filed on behalf of the Plan has also requested that the Department grant individual exemptive relief to enable the Plan to invest in the Fund. Should the exemption be granted, it is the intention of John Hancock to pay the annual management fee attributable to the Plan's participation in the Fund.[1]

Based on the above representations, it would appear that John Hancock is a party in interest and fiduciary with respect to the Plan within the meaning of section 3(14)(C) and 3(21) of the Act. The Manager is a party in interest under section 3(14)(G) and may also be a fiduciary with respect to the Plan when assets are invested in the Fund, for purposes of this letter, we will assume that the Manager is a fiduciary to the Plan. The exemption has been sought, in part, because the Committee has exercised its fiduciary authority in selecting the Fund as an investment vehicle knowing that such selection resulted in the retention of the Manager to provide investment and managerial services to the Fund. In addition, because the management fee would be paid by John Hancock to the Manager the applicant's request for exemption included relief from section 406(b)(3) of the Act.

Section 406(a)(1)(C) and (D) 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) further prohibits a fiduciary with respect to a plan from dealing with the assets of the plan in his own interest or for his own account. Section 406(b)(2) of the Act 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. Section 406(b)(3) provides that a fiduciary shall not receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

Subject to the limitations of section 408(d) of the Act, section 408(b)(2) exempts from the

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[1] The management fee payable by each partner shall be payable out of and charged against the capital account of each partner. We assume that there will be no recourse against the partnership for non-payment of the manager's fee and that the plan will not be liable either directly or indirectly for the management fee.

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 the Act.

Accordingly, the provision of investment management services by the Manager to the Fund would be exempt from the prohibitions of section 406(a) of the Act 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 section 29 CFR 2550.408b-2(a) states that section 408(b)(2) of the Act does not contain an exemption for an act described in section 406(b) of the Act even if such act occurs in connection with a provision of services which is exempt under section 408(b)(2). As explained in regulation section 29 CFR 2550.408b-2(e)(1), if a fiduciary uses the authority, control or responsibility which makes such person 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 such fiduciary's best judgement 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) of the Act. However, regulation section 29 CFR 2550.408b-2(e)(2) provides that if a fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan 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 judgement as a fiduciary no violation of section 406(b)(1) will occur.

Therefore, the mere selection of the Manager to provide investment management services to the Fund where the payment of compensation for such services is to be made by the sponsor of the plan receiving such services would not, in itself, constitute a violation of section 406(b)(1) of the Act. However, because a violation of section 406(b)(1) could occur in the course of the Committee's deliberations to invest in the Fund and the concomitant retention of the Manager in accordance with the arrangement described above, the Department is unable to rule that the decision, in operation, would, in no case, violate that section.

It is also the Department's view that generally a fiduciary's decision to retain an affiliate service provider whose fees will be paid by the plan sponsor will not involve an adversity of interests as contemplated by section 406(b)(2) of the Act. If, for example under the particular facts and circumstances, a fiduciary of the plan in negotiating a service contract on behalf of the plan, also acts on behalf of a person and causes that person to benefit from such a decision at an expense of any kind to the plan, the decision to retain the service provider would result in a violation of section 406(b)(2) of the Act. Accordingly, the decision to retain the Manager to service the Plan's investment in the Fund would not, in itself, constitute a violation of section 406(b)(2). However, because of the inherently factual nature of the transaction, the Department is unable to rule that the selection, in operation, would, in no case, violate that section.

With regard to the payment of the management fee by John Hancock, the Department is of the opinion that such payment does not constitute a violation of section 406(b)(3) of the Act.

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.

Accordingly, that portion of your exemption application regarding the receipt of management fee compensation by the Manager from John Hancock will be closed by the Department without further action. If you have any questions, please contact Mr. Paul R. Antsen, U.S. Department of Labor, phone number (202) 523-6915.

Sincerely,

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