U.S. Department of Labor

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

Reply to the Attention of:

OPINION NO. 83-61A
Sec. 406(b)(1), 406(b)(2), 406(b)(3), 408(b)(2)

DEC 8 1983

Re: Identification Number: F-2667A

Dear :

This is in response to your letter of May 20, 1983, regarding the prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) as they relate to certain employee pension benefit plans maintained by the subject company (the Company) and members of its controlled group.

The (the Consolidated Plans) are qualified under section 401(a) of the Internal Revenue Code of 1954 (the Code) and are currently commingled for investment purposes. Approximately one-half of the assets are invested in equities which until recently were managed by three registered investment managers unrelated to the Company. The Benefit Plans Investment Committee (the Committee), comprised of executive officers of the Company and a lower tier subsidiary and having responsibility for overall investment philosophy for the Consolidated Plans as well as discretion to select the professional assets managers, recently relieved one of the managers of its duties and has assumed responsibility for that portion of the equity portfolio previously managed by the deposed party.

The committee now desires to engage (Investment Manager), another lower tier subsidiary of the Company, as the third professional investment manager. Investment Manager will be paid at the same rate as it charges other unrelated customers for similar investment managerial services. Heretofore, the Company and members of its controlled group have paid fees directly to the managers for investment services rendered to the Consolidated Plans. In the event fees were not paid directly, these expenses would be paid from the assets of the Consolidated Plans. It is expected that the same arrangement will continue.

You represent that additional employee benefit plans maintained by the Company or members of its controlled group may use the services of Investment Manager. It is also possible that the Committee may increase the portion of the assets of the Consolidated Plans allocated to Investment Manager.

You request an advisory opinion that the Company and other members of its controlled group may from time to time retain Investment Manager to manage assets of certain qualified employee benefit plans which the Company or any member of its controlled group maintains, or in the future may maintain, and that Investment Manager may be paid reasonable compensation, either from the assets of the Company or the assets of the plans, for performing such investment management services without engaging in a prohibited transaction 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) 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 with respect to the plan. Sections 406(b)(1) and (2) of ERISA provide that a fiduciary with respect to a plan shall not (1) deal with the assets of the plan in his or her own interest or for his or her own account, or (2) 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 own personal account from a party dealing with a plan in connection with a transaction involving the assets of the plan.

It appears that Investment Manager is a party in interest with respect to the Consolidated Plans as well as other plans maintained by the Company or members of its controlled group under section 3(14) of ERISA because more than 50 percent of the equity interest in Investment Manager is indirectly owned by the Company. Investment Manager would be a fiduciary under section 3(21) of ERISA upon its appointment as investment manager. Accordingly, the prohibited transactions provisions of section 406 of ERISA described above would apply to transactions between the Consolidated Plans and Investment Manager in the absence of a statutory or administrative exemption. In addition, each member of the Committee is a fiduciary of the Consolidated Plans under section 3(21) of ERISA by reason of his discretionary authority in the administration of the plans and is, therefore, a party in interest with respect to those plans under section 3(14)(A).

Section 408(b)(2) of ERISA exempts from the prohibitions 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 of Labor (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 2550.408b-2(d) and 2550.408c-2) as used in sections 408(b)(2) and 408(c)(2) of ERISA.

The provision of investment management services by Investment Manager to the Consolidated Plans as well as other plans maintained by the Company or members of its controlled group would be exempt from the prohibitions of section 406(a) of ERISA provided the conditions of section 408(b)(2) are met. Whether the conditions are met in each case involves questions which 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 trustees of the plans, or other appropriate plan fiduciaries, must determine, based on all 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 transaction involving the provision of services and would not be exempted by section 408(b)(2) of ERISA.

If the Company or a member of its controlled group agrees to pay Investment Manager's fees for the provision of investment management services, and if none of the Consolidated Plans are in any circumstances obligated to pay such fees (either directly or indirectly), then the mere initial selection of Investment Manager by the Committee would not, in itself, constitute a violation of section 406(b)(1) because none of the members of the Committee would be using any of the authority, responsibility or control that makes him or her a fiduciary to cause a plan to pay an additional fee to Investment Manager for the provision of services. However, because a violation of section 406(b)(1) could occur in the course of the Committee's deliberations regarding the retention of Investment Manager, the Department is unable to rule that the decision would, in no case, violate that section. In addition, 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 ERISA.

We also note, however, that, if any of the Consolidated Plans pays (directly or indirectly), or obligates itself to pay, any of the fees of Investment Manager, then the Committee's retention of Investment Manager to perform fiduciary services for the Consolidated Plans would involve violations of section 406(b)(1).[1] In addition, if a fiduciary of any of the Consolidated Plans (or a person subject to the control or direction of such a fiduciary), in negotiating the arrangement between any of the Consolidated Plans and Investment Manager, also acts on behalf of Investment Manager, and causes Investment Manager to benefit from that arrangement at an expense of any kind to the plan, then that fiduciary would have engaged in a transaction described in section 406(b)(2) of ERISA.

Based on the representations made in your letter, it is our opinion that the mere initial retention of Investment Manager would not involve a violation of section 406(b)(3) of ERISA because no fiduciary would be receiving a fee or other consideration for his own personal account from Investment Manager, the party dealing with the Consolidated Plans (or from any affiliate of Investment Manager) in connection with a transaction involving the assets of those plans.

In your letter, you also requested our opinion regarding certain transactions that might occur from time to time in the future. In this respect, the Department's Advisory Opinion Procedure (ERISA Procedure 76-1; 41 FR 36281, August 27, 1976) provides that the Department generally will not issue an advisory opinion on alternative courses of action or on hypothetical situations. Accordingly, this opinion addresses only the question whether the initial decision to retain Investment Manager is a prohibited transaction.

Finally, we note that the principles discussed in this letter relate only to arrangements involving the provision of services to a plan and different principles may be applicable in cases involving other kinds of arrangements between a plan and a fiduciary of the plan (or a person in whom such a fiduciary has an interest that may affect his best judgment as a fiduciary).

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

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[1] You suggest that the payment of fees to Investment Manager would not involve a violation of section 406(b)(1), regardless of the source of payment of such fees, because the fact that the fee charged will be set in accordance with the competitive pressures of the marketplace precludes the possibility that additional fees will be paid by the Consolidated Plans. In our view, your assertion reflects a misinterpretation of the Department's regulations under section 408(b)(2) of ERISA because the mere fact that a fee for services is competitive does not cause that fee to fail to be an "additional fee" within the meaning of 29 CFR 2550.408b-2(e).

Sincerely,

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