U.S. Department of Labor

Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210

JAN 9 1986

OPINION NO. 86-02A
Sec. 406(b)(1), (2), (3)
408(b)(2)

Mr. Peter A. Kennedy
Senior Vice President
Associate General Counsel
Shearson Lehman Brothers Inc.
14 Wall Street
New York, NY 10005

Re: Identification Number: F-3200A

Dear Mr. Kennedy:

This is in response to your letter of August 19, 1985 in which you request, on behalf of Shearson/American Express Inc. Retirement Plan (the Plan), the Plan's five individual trustees (the Trustees) and American Express Asset Management Limited (Asset Management), an advisory opinion under section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code of 1954 (the Code).

You represent that the Plan is a defined benefit plan qualified under section 401(a) of the Code which is maintained by Shearson Lehman Brothers Inc. (Shearson) for the benefit of its employees and employees of certain of its subsidiaries who are participating employers under the Plan. The assets of the Plan are held in trust and the Trustees are five individuals, all but one of whom are employees and officers of Shearson. Presently, all of the assets of the Plan are managed by a registered investment adviser which is unrelated to Shearson. The Trustees propose to retain Asset Management as investment manager for a portion of the Plan's assets. You further represent that the Trustees may increase or decrease the portion of the Plan's assets under management by Asset Management.

Shearson is a wholly owned subsidiary of Shearson Lehman Brothers Holdings Inc., which in turn is a subsidiary of American Express Company (American Express). Asset Management is a lower tier subsidiary of American Express.

Asset Management is incorporated in the United Kingdom and is a registered investment adviser under the Investment Advisers Act of 1940. It was formed in 1984 for the purpose of providing international investments for United States public and private pension plans.

You indicate that the investment management fees of Asset Management for services rendered to the Plan will be paid by Shearson and its participating subsidiaries. These fees will be at the same rate charged by Asset Management to unrelated employee benefit plans. You further represent that Asset Management may be terminated as investment manager without penalty upon written notice of no more than sixty days.

You request an advisory opinion that the Trustees may retain Asset Management to manage assets held in trust with respect to the Plan and any plans that Shearson may maintain in the future, and that Asset Management may be paid reasonable compensation by Shearson and its participating subsidiaries for performing such 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 Asset Management is a party in interest with respect to the Plan under section 3(14) of ERISA because more than 50 percent of the equity interest in Asset Management is indirectly owned by American Express, which indirectly owns more than a 50 percent equity interest in Shearson. Furthermore, Asset Management would be a fiduciary under section 3(21) of ERISA upon its appointment as investment manager. Accordingly, the prohibited transaction provisions of section 406 of ERISA would apply to transactions between the Plan and Asset Management in the absence of a statutory or administrative exemption. In addition, each of the Trustees is a fiduciary of the Plan under section 3(21) of ERISA by reason of his or her

discretionary authority in the administration of the Plan and is, therefore, a party in interest with respect to the Plan 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 Asset Management to the Plan 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. Therefore, the Trustees, 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) 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.

If Shearson or one of its participating subsidiaries agrees to pay Asset Management's fees for the provision of investment management services rendered to the Plan and if the Plan is not in any

circumstances obligated to pay such fees,[1] then the mere initial selection by the Trustees of Asset Management would not, in itself, constitute a violation of section 406(b)(1) because none of the Trustees 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 Asset Management for the provision of services. However, because a violation of section 406(b)(1) could occur in the course of the Trustees' deliberations regarding the retention of Asset Management, 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 the Plan pays (directly or indirectly), or obligates itself to pay, any of the fees of Asset Management, then the Trustee’s retention of Asset Management to perform investment management services for the Plan would involve violations of section 406(b)(1). In addition, if a fiduciary of the Plan (or a person subject to the control or direction of a fiduciary), in negotiating the arrangement between the Plan and Asset Management, causes Asset Management to benefit from the 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 by the Trustees of Asset Management 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 or her own personal account from Asset Management, the party dealing with the Plan in connection with a transaction involving the assets of the Plan.

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 provides that the Department generally will not issue an advisory opinion on alternative courses of action or on hypothetical situations.

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 apply in cases involving other types 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).

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[1] We assume that there will be no recourse against the Plan for non-payment of Asset Management's fees and that the Plan will not be liable either directly or indirectly for such management fees.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is issued subject to the provisions of the procedure, including section 10 relating to the affect of advisory opinions. This letter relates only to those issues that you specifically raised in your request. Specifically, no opinion has been requested nor is any expressed regarding the applicability of section 404(b) of ERISA and the regulations promulgated thereunder, relating to the maintenance by a fiduciary of the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States, to your proposed transaction.

Sincerely,

Elliot I. Daniel
Assistant Administrator for Regulations and Interpretations