U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

May 22, 1997

97-15A
ERISA SEC. 406(b)(3)

Mark S. Miller
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Dear Mr. Miller:

This is in response to your request for an advisory opinion regarding the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA). In particular, you ask whether the payment of certain fees by a mutual fund in which an employee pension benefit plan has invested to a bank serving as the plan's trustee would violate sections 406(b)(1) and 406(b)(3) of ERISA.

You represent that Frost National Bank (Frost) serves as trustee to various employee pension benefit plans (the Plans). As trustee of the Plans, Frost's duties may include one or more of the following functions, pursuant to instructions from the Plan sponsor or participants: opening and maintaining individual participant accounts; receiving contributions from the Plan sponsor and crediting them to individual participant accounts; investing contributions in shares of a mutual fund and reinvesting dividends and other distributions; redeeming, transferring, or exchanging mutual fund shares; providing or maintaining various administrative forms in making distributions from the Plan to participants or beneficiaries; keeping custody of the Plan's assets; withholding amounts on Plan distributions; making sure all Plan loan payments are collected and properly credited; conducting Plan enrollment meetings; and preparing newsletters and videos relating to the administration of the Plan.

In connection with its Plan-related business, Frost has entered into arrangements with one or more distributors of, or investment advisors to, mutual fund families pursuant to which Frost will make the mutual fund families available for investment by the Plans. Frost will periodically review each such mutual fund family to determine whether to continue the arrangement, and will reserve the right to add or remove mutual fund families that it makes available to the Plans.

As part of Frost's arrangements with the mutual fund families, Frost may provide shareholder services to, and receive fees from, some of the individual mutual funds in which Plan assets are invested. The shareholder services may include, e.g., providing mutual fund recordkeeping and accounting services in connection with the Plans' purchase or sale of shares, processing mutual fund sales and redemption transactions involving the Plans, and providing mutual fund enrollment material (including prospectuses) to Plan participants. The fees paid by the mutual funds to Frost will generally be based on a percentage of Plan assets invested in each mutual fund, and will be paid pursuant to either a distribution plan described in Securities and Exchange Commission (SEC) Rule 12b-1, 17 C.F.R. 270.12b-1 (a 12b-1 plan), or a "subtransfer agency arrangement."

You further represent that, with respect to some of the Plans, Frost will recommend to the Plan fiduciary the advisability of investing in particular mutual funds offered pursuant to Frost's arrangements with the mutual fund

[1] A "subtransfer agency fee" is typically a fee paid for recordkeeping services provided to the mutual fund transfer agent with respect to bank customers.

families. In addition, Frost will monitor the performance of the individual mutual funds selected by the Plan fiduciary and, as it deems appropriate, will make further recommendations regarding additional or substitute mutual funds for the investment of Plan assets.

With respect to other Plans, Frost will not make any recommendations concerning the selection of, or continued investment in, particular mutual funds. Rather, the responsible Plan fiduciary will independently select, from the mutual fund families made available by Frost, particular mutual funds for the investment of Plan assets, or for designation as investment alternatives offered to participants under the Plan.

In both instances, whether or not Frost makes specific investment recommendations, you represent that, before a Plan enters into the arrangement, the terms of Frost's fee arrangements with the mutual fund families will be fully disclosed to the Plans. In addition, Frost's trustee agreement with a Plan will be structured so that any 12b-1 or subtransfer agent fees received by Frost that are attributable to the Plan's investment in a mutual fund will be used to benefit the Plan. Pursuant to the particular agreement with each Plan, Frost will offset such fees, on a dollar-for-dollar basis, against the trustee fee that the Plan is obligated to pay Frost or against the recordkeeping fee that the Plan is obligated to pay to a third-party recordkeeper; or Frost will credit the Plan directly with the fees it receives based on the investment of Plan assets in the mutual fund.[2] The trustee agreement will provide that, to the extent that Frost receives fees from mutual funds in connection with the Plan's investments that are in excess of the fee that the Plan owes to Frost, the Plan will be entitled to the excess amount.

You request an opinion that Frost's receipt of fees from the mutual funds under the circumstances described would not constitute a violation of ERISA section 406(b)(1) or (b)(3).[3] You have asked us to assume for the purpose of your request that the arrangements between Frost and the Plans satisfy the conditions of ERISA section 408(b)(2).[4]

Section 406(b)(1) of ERISA 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)(3) prohibits a fiduciary with respect to a plan from receiving any consideration for his or her personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan.[5]

Under section 3(21)(A) of ERISA, a person is a "fiduciary" with respect to a plan to the extent that the person (i) exercises any discretionary authority or control respecting management of the plan or any authority or control respecting management or disposition of its assets, (ii) renders investment advice for a fee or other compensation,

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[2] We assume for purposes of this opinion that each Plan's governing documents provide that the Plan will pay costs and expenses for trustee services necessary to the operation and administration of the Plan.

[3] For a discussion of related issues involving receipt of fees by a record-keeper offering a program of investment options and services to plans, see also Advisory Opinion 97-16A, May 22, 1997.

[4] We offer no opinion herein as to whether such conditions have been satisfied; nor does this opinion address the application of any other provisions of ERISA.

[5] Under Reorganization Plan No. 4 of 1978, effective December 31, 1978, the authority of the Secretary of the Treasury to issue interpretations regarding section 4975 of the Internal Revenue Code of 1986 (the Code) has been transferred, with certain exceptions not here relevant, to the Secretary of Labor, and the Secretary of the Treasury is bound by interpretations of the Secretary of Labor pursuant to such authority. Therefore, references in this letter to specific sections of ERISA should be read to refer also to the corresponding sections of the Code.

direct or indirect, with respect to any moneys or other property of the plan, or has any authority or responsibility to do so, or (iii) has any discretionary authority or responsibility in the administration of the plan.

Frost, as trustee, is a fiduciary with respect to the Plans under section 3(21)(A) of ERISA. See 29 C.F.R. 2509.75-8, D-3 (the position of trustee of a plan, by its very nature, requires the person who holds it to perform one or more of the functions described in ERISA section 3(21)(A)).[6]

When the Trustee Advises

You have indicated that, with respect to some of the Plans, Frost will advise the Plan fiduciary regarding particular mutual funds in which to invest Plan assets.[7] It also appears from your submission that, under Frost's arrangements with various mutual fund families, Frost may receive fees from some of the mutual funds as a result of a Plan's investment in the mutual funds recommended by Frost. In the view of the Department, advising that plan assets be invested in mutual funds that pay additional fees to the advising fiduciary generally would violate the prohibitions of ERISA section 406(b)(1).

You represent, however, that before entering into an arrangement with a Plan, or recommending any particular mutual fund investments, Frost will disclose to the Plan fiduciary the extent to which it may receive fees from the mutual fund(s). Furthermore, you represent that the trustee agreement between Frost and the Plan will expressly provide that any fees received by Frost as a result of the Plan's investment in such a mutual fund will be used to pay all or a portion of the compensation that the Plan is obligated to pay to Frost, and that the Plan will be entitled to any such fees that exceed the Plan's liability to Frost.[8] To the extent the Plan's legal obligation to Frost is extinguished by the amount of the offset, it is the opinion of the Department that Frost would not be dealing with the assets of the Plan in its own interest or for its own account in violation of section 406(b)(1).

With respect to the prohibition of section 406(b)(3), Frost's contract with a Plan, as described above, will provide that Frost's receipt of fees from one or more mutual funds in connection with the Plan's investment in such funds will be used to reduce the Plan's obligation to Frost, will in no circumstances increase Frost's compensation, and thus will benefit the Plan rather than Frost. Accordingly, it is the opinion of the Department that in these circumstances Frost would not be deemed to receive such payments for its own personal account in violation of section 406(b)(3).

When the Trustee is Directed

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[6] Section 403(a) of ERISA establishes that, in general, a trustee of a plan must have exclusive authority and discretion to manage and control the plan's assets. Under section 403(a)(1), when the plan expressly so provides, the trustee may be subject to the proper directions of a named fiduciary which are made in accordance with the terms of the plan and not contrary to ERISA. Nevertheless, a directed trustee has residual fiduciary responsibility for determining whether a given direction is proper and whether following the direction would result in a violation of ERISA. Accordingly, it is the view of the Department that a directed trustee necessarily will perform fiduciary functions.

[7] We assume for the purposes of your request that Frost will provide investment advice within the meaning of ERISA section 3(21)(A)(ii) and 29 C.F.R. 2510.3-21(c)(1)(i) and (ii)(B) with respect to these Plans.

[8] We express no opinion herein as to the propriety of such a pass-through of fees under Federal securities laws. Questions concerning the application of the Federal securities laws are within the jurisdiction of the SEC.

With respect to Plans for which Frost does not provide any investment advice, it appears that the Plan fiduciary, and in some instances the Plan participants, will select the mutual funds in which to invest Plan assets from among those made available by Frost. Generally speaking, if a trustee acts pursuant to a direction in accordance with section 403(a)(1) or 404(c) of ERISA and does not exercise any authority or control to cause a plan to invest in a mutual fund that pays a fee to the trustee in connection with the plan's investment, the trustee would not be dealing with the assets of the plan for its own interest or for its own account in violation of section 406(b)(1).

Similarly, it is generally the view of the Department that if a trustee acts pursuant to a direction in accordance with section 403(a)(1) or 404(c) of ERISA and does not exercise any authority or control to cause a plan to invest in a mutual fund, the mere receipt by the trustee of a fee or other compensation from the mutual fund in connection with such investment would not in and of itself violate section 406(b)(3). Your submission indicates, however, that Frost reserves the right to add or remove mutual fund families that it makes available to Plans. Under these circumstances, we are unable to conclude that Frost would not exercise any discretionary authority or control to cause the Plans to invest in mutual funds that pay a fee or other compensation to Frost.[9]

However, because Frost's trustee agreements with the Plans are structured so that any 12b-1 or subtransfer agent fees attributable to the Plans' investments in mutual funds are used to benefit the Plans, either as a dollar-for-dollar offset against the fees the Plans would be obligated to pay to Frost for its services or as amounts credited directly to the Plans, it is the view of the Department that Frost would not be dealing with the assets of the Plans in its own interest or for its own account, or receiving payments for its own personal account in violation of section 406(b)(1) or (b)(3).

Finally, it should be noted that ERISA's general standards of fiduciary conduct also would apply to the proposed arrangement. Under section 404(a)(1) of ERISA, the responsible Plan fiduciaries must act prudently and solely in the interest of the Plan participants and beneficiaries both in deciding whether to enter into, or continue, the above-described arrangement and trustee agreement with Frost, and in determining which investment options to utilize or make available to Plan participants or beneficiaries. In this regard, the responsible Plan fiduciaries must assure that the compensation paid directly or indirectly by the Plan to Frost is reasonable, taking into account the trustee services provided to the Plan as well as any other fees or compensation received by Frost in connection with the investment of Plan assets. In this connection, it is the view of the Department that the responsible Plan fiduciaries must obtain sufficient information regarding any fees or other compensation that Frost receives with respect to the Plan's investments in each mutual fund to make an informed decision whether Frost's compensation for services is no more than reasonable. The Plan fiduciaries also must periodically monitor the actions taken by Frost in the performance of its duties, to assure, among other things, that any fee offsets to which the Plan is entitled are correctly calculated and applied.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (41 Fed. Reg. 36281, August 27, 1976). Accordingly, it is issued subject to the provisions of that procedure, including section 10 thereof regarding the effect of advisory opinions.

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[9] See, in this regard, the Department's position as expressed in the preamble to the final regulation regarding participant-directed individual account plans (ERISA section 404(c) plans), 57 Fed. Reg. 46906, 46924 n. 27 (Oct. 13, 1992):

> In this regard [a fiduciary is relieved of responsibility only for the direct and necessary consequences of a participant's exercise of control], the Department points out that the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA 404(c) plan is a fiduciary function which, whether achieved through fiduciary designation or express plan language, is not a direct or necessary result of any participant direction of such plan.

Sincerely,

Bette J. Briggs
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations