U.S. Department of Labor

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

September 26, 1997

97-23A
ERISA SEC. 408(b)(2)

Mr. Robert D. Alin, Esq.
Senior Vice President
Financial Institutions Retirement Fund
108 Corporate Park Drive
White Plains, NY 10604

Dear Mr. Alin:

This is in response to your request for an advisory opinion regarding the application of the prohibited transaction provisions of section 406 of the Employee Retirement Income Security Act of 1974 (ERISA or the Act) and section 4975 of the Internal Revenue Code of 1986 (the Code) to certain proposed transactions by the Financial Institutions Retirement Fund ("the Pension Plan" or "the Plan").[1]

You describe the Pension Plan as a multiple employer defined benefit pension plan whose participating employers include the twelve Federal Home Loan Banks, hundreds of individual thrift institutions and various companies which directly service the thrift industry. You state that the Plan is an employee pension benefit plan within the meaning of section 3(2) of ERISA and meets the requirements for tax qualification under section 401(a) of the Code. You further represent that the Plan is a single plan under section 413(c) of the Code and regulations thereunder, because all plan assets are available to pay all benefits.[2] The Board of Directors of the Pension Plan is the principal named fiduciary for the Plan. The Board has fifteen members, one of whom is the president and administrator of the Plan, six of whom are presidents of Federal Home Loan Banks, and eight of whom are the presidents or chief executive officers of other Plan employers.

The Pension Plan proposes to establish and operate a for-profit plan-owned entity, Pentegra, that will provide administrative services to employers and plans, some of which have prior relationships to the Plan, and some of which do not. The Pension Plan will create Pentegra as a wholly-owned subsidiary of the Plan by making an initial capital contribution to Pentegra of approximately $400,000 in exchange for 100% of the outstanding stock of Pentegra. An independent financial advisor will determine the fair market value of the Pentegra stock at the time the transaction is consummated and at the end of each plan year. Initially no more than .5% of the Plan's assets will be invested in Pentegra. The Board of Directors of Pentegra will have five members: the president of the Plan, a current member of the Plan Board, and three representatives of Plan employers who are not members of the Plan Board.

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[1] Under Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47713 (Oct. 17, 1978), the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code, with certain exceptions not here relevant, has been transferred to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA should be read to refer also to corresponding sections of the Code.

[2] The Pension Plan has been held to be one plan by the Tenth Circuit in RTC v. Financial Institutions Retirement Fund, 71 F.3d 1553 (10th Cir. 1995), and the Second Circuit has treated it as such in a recent decision. Financial Institutions Retirement Fund v. OTS, 964 F.2d 142 (2d Cir. 1992). In light of this past treatment of the Pension Plan, and because you have represented that it is a single plan under Title I of ERISA, we assume, without deciding, that the Pension Plan is a single plan for purposes of this advisory opinion.

The Plan will provide Pentegra with personnel, office space and equipment at rates to be calculated by the Plan Board in consultation with an independent financial advisor.[3] Pentegra will provide various employee benefit plan services to plan sponsors and to plans.[4] Pentegra will not provide services to the Pension Plan, which will continue to be administered through its own staff.

The Pension Plan has received an individual exemption from sections 406(a) and 406(b)(1) and (2) of ERISA to permit Pentegra to provide services, under the conditions specified, to plans and their sponsoring employers where such employers also participate in the Pension Plan. PTE 95-31, 60 Fed. Reg. 18619 (April 12, 1995) (Application No. D-09469, et al.). That exemption, however, addresses only the role of Pension Plan fiduciaries in connection with Pentegra's provision of services to other plans and employers.[5] You have requested an opinion regarding two other areas of concern: (1) transactions between the Plan and Pentegra; and (2) possible fiduciary violations by employers who retain Pentegra to provide services to their plans.

1. Transactions between the Pension Plan and Pentegra. First, you ask whether Pentegra would be a party in interest to the Plan under section 3(14) of ERISA, and whether transactions between the Plan and Pentegra, both in the establishment and operation of Pentegra, would be prohibited by ERISA. Assuming the plan makes the only capital contribution to Pentegra and obtains 100% of the outstanding shares of stock, Pentegra would not be a party in interest with respect to the Plan. Although, pursuant to ERISA section 3(14)(G), plan fiduciaries would hold all the value of Pentegra stock, they would hold such shares on behalf of the plan, not on behalf of themselves or of a third party. As explained below, it is the opinion of the Department that, under the circumstances described, such transactions would not be prohibited because, under the terms of the "plan assets/plan investments" regulation (29 C.F.R. 2510.3-101), they would be treated as "intra-plan" transactions rather than transactions between a plan and a party in interest.

As applicable here, the plan assets regulation provides that, when a plan or a related group of plans owns all of the outstanding equity interests (other than director's qualifying shares) in an entity, the plan's assets include those equity interests and all of the underlying assets of the entity. 29 C.F.R. 2510.3-101(h)(3). As explained in the preamble to the final plan assets regulation, this provision reflects the Department's conclusion that, when a plan is

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[3] See Exemption Application No. D-9469, et al., Letter dated July 8, 1993 from Robert D. Alin; 60 Fed. Reg. 5700 (Jan. 30, 1995) (notice of proposed exemptions).

[4] Those services will include: (a) preparation of plan documents and summary plan descriptions; (b) procurement of favorable determination letters with respect to the tax qualification of the plans from the Internal Revenue Service; (c) maintenance of books of account for plans and each participant, disclosing, among other things, accrued benefits and account balances; (d) performance of plan administration functions involving preparation of employee statements, calculation and payment of benefits, preparation of investment performance data, top-heavy testing, and administration of plan participant loans and hardship withdrawals; (e) performance of functions necessary for maintaining compliance with applicable provisions of the Code such as, the special nondiscrimination testing, testing for compliance with the annual limitations on contributions and benefits, and testing for compliance with minimum coverage and participation requirements; (f) assistance in preparation of annual reports and participant benefit statements as required by the Act and Code; and (g) provision of consulting services to its clients, including employers participating in the Pension Plan, with respect to tax-qualified retirement plans. See 60 Fed. Reg. at 5702.

[5] We note that section 408(b)(2) of ERISA provides conditional exemptive relief to fiduciaries for contracting or arranging for services on behalf of a plan from a party in interest to the plan. It does not, however, provide relief for the provision of services by a plan to a party in interest.

the sole owner of an entity, there is no meaningful difference between the assets of the entity and the assets of the plan. See 51 Fed. Reg. 41262, 41276 (Nov. 13, 1986).

In this case, because the Pension Plan will establish and own 100% of the equity interests in Pentegra, the underlying assets of Pentegra will be assets of the Plan. Therefore, transactions between Pentegra and the Plan, including the initial capitalization of Pentegra by the Plan and the transfer of property or services between the Plan and Pentegra, would be considered intra-plan transactions, rather than transactions between the Plan and a party in interest.

2. Retention of Pentegra as Service Provider to Other Plans. Next, you request an opinion that the retention of Pentegra by employers who participate in the Pension Plan ("participating employers") to provide services to such employers or to their plans (other than the Plan) would be exempt from the prohibitions of section 406(a) of ERISA pursuant to section 408(b)(2), and would not be prohibited under ERISA section 406(b). You also ask for confirmation that the retention of Pentegra by employers with no preexisting relationship with the Plan to provide services to such employers or their plans would be exempt from the prohibitions of section 406(a) of ERISA by reason of section 408(b)(2), and that such employers would not violate section 406(b) by retaining Pentegra.

a. Section 406(a). Section 406(a)(1)(C) of ERISA provides that a fiduciary with respect to a 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. Section 406(a)(1)(D) prohibits the transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. Section 3(14) of ERISA defines the term "party in interest" to include, among others, a plan fiduciary, a person providing services to a plan, and an employer any of whose employees are covered by the plan (ERISA sections 3(14)(A), (B), and (C), respectively).

Section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) contracting or making reasonable arrangements with a party in interest 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. Regulations issued by the Department clarify the terms used in section 408(b)(2). See 29 C.F.R. 2550.408b-2.

By providing administrative services to plans other then the Plan, Pentegra would become a party in interest with respect to those plans under ERISA section 3(14)(B), whether or not the employers sponsoring those plans also participate in the Pension Plan. Absent a statutory or administrative exemption, fiduciaries of a plan would violate ERISA section 406(a)(1)(C) by obtaining services from a party in interest, and would violate ERISA section 406(a)(1)(D) by using plan assets to pay for those services.

In the opinion of the Department, the statutory exemption in section 408(b)(2) is available for services purchased by a plan from another plan, or from an entity whose assets are considered plan assets by reason of a plan's ownership of all of the outstanding equity interests in the entity, provided the conditions of the exemption are otherwise met. In other words, if the provision of services by a plan-owned entity to another plan meets the conditions of ERISA section 408(b)(2), the receipt of such services would not cause a prohibited transaction by the fiduciaries of the plan receiving the services.[6] Accordingly, the receipt of services from Pentegra by plans of either participating or non-

[6] As the Department explained in the preamble to PTE 76-1, 41 Fed. Reg. 12740 (March 26, 1976):

> On many occasions, office space and administrative services are furnished to a [collectively-bargained] multiple employer plan by a participating employee organization, employer, or employer association, or by another multiple employer plan which is a party in interest or disqualified person with respect to the plan.

participating employers would be exempt from the prohibitions of ERISA section 406(a) if the conditions of section 408(b)(2) are met.

b. Section 406(b). 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)(2) provides that a fiduciary with respect to a plan shall not 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) prohibits a fiduciary with respect to a plan from receiving any consideration for his or her own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan.

The Department's regulations provide that section 408(b)(2) of ERISA does not extend to acts described in section 406(b), even if they occur in connection with a provision of services which that section exempts from the prohibitions of section 406(a). 29 C.F.R. 2550.408b-2(a). As explained in regulation section 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 his or her best judgment as a fiduciary, a transaction described in section 406(b) of ERISA would occur. This transaction is deemed to be a separate transaction that is not exempted by section 408(b)(2) of ERISA. Therefore, section 408(b)(2) will not exempt the fiduciaries of Pentegra's customer plans from possible violations of section 406(b) of ERISA.

In general, whether a violation of section 406(b) occurs in the course of a fiduciary's selection of Pentegra to provide services to the plan is an inherently factual matter. If the employer that selects Pentegra to provide services to its plan(s) does not participate in the Pension Plan, the mere selection of Pentegra would not appear to implicate section 406(b) of the Act. In contrast, if the employer that selects Pentegra as a service provider to its plan(s) also participates in the Pension Plan, there is a greater potential for the types of conflicts of interest that sections 406(b)(1) and (2) are designed to prevent. Under these circumstances, the fiduciaries of plans making the decision may have an interest in purchasing services from Pentegra that could affect their best judgment as fiduciaries of the purchasing plans to the extent that Pentegra's financial success may reduce the need for employer contributions to the Pension Plan.

With respect to section 406(b)(1), the Department's regulations at 29 C.F.R. 2550.408b-2(e) explain that a fiduciary does not engage in an act described in section 406(b)(1) if the fiduciary does not use the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in whom such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. Nor does the provision of services by a fiduciary, or a person in whom such fiduciary has an interest, in and of itself, violate section 406(b)(1) if such services are provided 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).

> The furnishing of office space or administrative services to a plan by such parties in interest ... will generally be exempt from the prohibited transaction provisions of section 406(a) of the Act ... if the conditions of section 408(b)(2) of the Act ... are met.

The same principles apply here, where the plan receiving the services is a single employer plan rather than a collectively-bargained multiple employer plan.

Accordingly, if, as you suggest, the employer who sponsors a plan that purchases services from Pentegra agrees to pay Pentegra's fees for the provision of such services, and if the plan is not in any circumstances obligated to pay such fees, then the mere selection of Pentegra would not, in itself, constitute a violation of section 406(b)(1) because the employer or other fiduciary would not 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 Pentegra for the provision of services. See 29 C.F.R. 2550.408b-2(e)(2). In this regard, we assume that there would be no recourse against the plan for non-payment of Pentegra's fees and that the plan would not be liable either directly or indirectly for such fees.

On the other hand, if such a plan pays or obligates itself to pay any of the fees of Pentegra (directly or indirectly), then the employer's (or other fiduciary's) retention of Pentegra may violate section 406(b)(1). In addition, because a violation of section 406(b) could always occur in the course of the fiduciary's deliberations regarding the retention of Pentegra, even if the employer pays all fees, the Department is unable to rule that the decision would in no case violate that section.

A violation of section 406(b)(2) would occur if the same fiduciary acts on both sides of a transaction involving the retention of Pentegra as a service provider. To avoid this problem, you have represented that, where a participating employer that seeks to retain Pentegra is also represented on the Board of Directors of either the Pension Plan or Pentegra, such an employer would take the following steps to avoid acting on behalf of both its plan and Pentegra or the Pension Plan. First, the employer would recuse itself from all consideration by either the Board of Directors of the Pension Plan or the Board of Directors of Pentegra of any transaction between Pentegra and the employer or its plan. Second, the plan's decision to purchase services from Pentegra would be made by an individual other than the Pension Plan Board or Pentegra Board member. See Exemption Application No. D-9469, Letter dated December 6, 1995 from Robert D. Alin. In these circumstances, the participating employer would not violate section 406(b)(2) if it removes itself as described, and does not otherwise exercise, with respect to these transactions, any of the authority, control, or responsibility which makes it a fiduciary. See A.O. 86-11A (Feb. 27, 1986); and 29 C.F.R. 2550.408b-2(e).

As a general matter, the Department wishes to emphasize that, because the assets of Pentegra will be considered Pension Plan assets under regulation section 2510.3-101, the provision of services to Pentegra by other parties will result in party in interest relationships between the Pension Plan and those parties. Similarly, where Pentegra provides services to a plan and would, therefore, be a party in interest to the plan pursuant to section 3(14)(B) of ERISA, the Pension Plan would also be a party in interest to such plan. Non-exempt prohibited transactions under section 406 of ERISA may therefore occur as a result of the activities of Pentegra or of the Plan if statutory or administrative exemptions are unavailable or are not complied with.

Finally, the Department emphasizes that the general standards of fiduciary conduct contained in ERISA sections 403 and 404 would apply to all of the transactions discussed herein. Accordingly, the respective fiduciaries of the individual plans and the Pension Plan (and Pentegra) must act prudently and solely in the interests of the participants and beneficiaries of the plans on whose behalf they are acting when causing the individual plans, the Pension Plan or Pentegra to enter into the transactions discussed herein.

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 effect of advisory opinions.

Sincerely,

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