U.S. Department of Labor **Employee Benefits Security Administration**
Washington, D.C. 20210

March 25, 2005

2005-04A
ERISA SEC.
406(b)

Ms. Norma M. Sharara
Buchanan Ingersoll, PC
1776 K Street, NW
Suite 800
Washington, DC 20006-2365

Dear Ms. Sharara:

This is in response to your request for guidance under the Employee Retirement Income Security Act of 1974 (ERISA). In particular, you request an advisory opinion that the proposed investment of assets of an employee retirement plan (the Plan) in a mutual fund (the Fund) will not constitute a *per se* prohibited transaction under section 406 of ERISA.[1] The Plan is sponsored by a foundation (the Foundation) and the Fund is a registered open-ended investment company that is advised and distributed by an investment advisor (the Advisor).

You represent that the Foundation is a tax-exempt organization described in Code section 501(c)(3). The Foundation was organized under Ohio law as a non-profit corporation, and its principal place of business is currently located in New York City. The Foundation has functioned as a private foundation whose principal purpose is to support other operating charitable organizations. It is exempt from federal income taxation and has been classified by the Internal Revenue Service (IRS) as a private foundation under Code section 509. As of December 31, 2002, the Foundation had approximately $305,000,000 in assets. The Foundation, in keeping with the wishes of its founder is time-limited, and expects to disburse substantially all of its assets by 2010.

Because the Foundation expects to bring its operations to a close by 2010, the level of grant-making will accelerate significantly in the coming years. Prior to 2002, the Foundation did not have any paid staff. The Foundation hired nine individuals in 2002 essentially to prepare for and carry out the increased grant-making activities that the Foundation expects to occur between 2002 and 2010 as the Foundation winds down its activities and operations. The Plan was established in 2002 on behalf of these nine employees.

[1] 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 Internal Revenue Code (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 should be taken as referring also to the corresponding sections of the Code.

The Foundation is governed by a three-person board of trustees (the Board), none of whom are currently employees of the Foundation or participants in the Plan. One trustee also serves as the chief executive officer of the Foundation, and will soon become an employee of the Foundation. Another trustee serves as a vice-president of the Foundation.

The Plan is a defined contribution plan covering nine participants and is intended to qualify under Code section 401(a). As of December 31, 2002, the Plan had net assets of $163,652. Investment decisions for the plan are made by the Foundation. The Foundation is also the plan administrator and named fiduciary of the Plan. The Board, as the decision-maker for the Foundation, carries out the Foundation's fiduciary responsibilities on behalf of the Plan. The Board also serves as the Plan's trustee, in which capacity it is subject to direction by the Foundation. The Board has determined to allocate the Plan's investments equally between equity and interest-bearing securities.

The Fund invests primarily in common stocks and is managed using a "value" strategy. The Fund has consistently outperformed its benchmark, the S&P 500 Index, over the last 10 years. A trustee and member of the Board is the President and Chief Executive Officer of the Advisor. He also holds a 22.9% ownership interest in the Advisor. Neither the Foundation nor any of the other trustees holds any ownership interest in, or has any other relationship with, the Advisor. The Board proposes to invest up to 25% of the Plan's assets in the Fund. The remaining allocation to equity securities will be invested in other mutual funds that are unrelated to the Advisor. The Board has determined that this allocation would be consistent with the Plan's investment policy.

This trustee is also one of three Advisor portfolio managers charged with day-to-day management of the Fund's assets. The Fund pays the Advisor an annual investment advisory fee of 1% of the Fund's net asset value, reduced by certain expenses that the Advisor reimburses to the Fund. The Fund's independent Board of Directors is responsible for approving the investment advisory agreement between the Fund and the Advisor. The Fund imposes no sales charges, exchange fees, or redemption fees.

You represent that the trustee's compensation for his services on behalf of the Advisor is not affected by the total amount of assets under management by the Fund. As of December 31, 2002, the Fund held net assets of approximately $3.9 billion.

You request an opinion that the Plan's investment of up to 25% of its assets in the Fund will not result in a prohibited transaction under section 406 of ERISA.

Section 3(21) of ERISA provides that a person is a fiduciary with respect to a plan to the extent he exercises any discretionary authority or control respecting the management of the plan or the management or disposition of the assets of the plan. A plan's

administrator and named fiduciary by virtue of having those positions, must have or exercise discretionary authority or control respecting the management of the plan or the management or disposition of its assets.[2] The Foundation is the Plan's administrator and named fiduciary. The Board exercises the Foundation's fiduciary responsibilities on behalf of the plan. Accordingly, all trustees and members of the Board are fiduciaries with respect to the Plan.

Section 406(b)(1) of ERISA prohibits a fiduciary from dealing with the assets of the plan in his own interest or for his own account. Section 406(b)(2) of ERISA prohibits a fiduciary with respect to a plan from acting 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 of its participants and beneficiaries.

The Department has explained in regulation 29 CFR §2550.408b-2(e) that the prohibitions of section 406(b) are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility that makes them fiduciaries when they have interests that may conflict with the interests of the plans for which they act. Thus, a fiduciary may not use the authority, control, or responsibility that makes him a fiduciary to cause a plan to pay an additional fee to such fiduciary, or to a person in which he has an interest that may affect the exercise of his best judgment as a fiduciary, to provide a service. However, regulation 29 CFR §2550.408b-2(e)(2) provides that a fiduciary does not engage in an act described in section 406(b)(1) of ERISA if the fiduciary does not use any of the authority, control, or responsibility that makes him 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 which the fiduciary has an interest that may affect the exercise of his judgment as a fiduciary.

One member of the Board and trustee of the Plan is a significant owner and the President and Chief Executive Officer of the Advisor, the investment advisor for the Fund. In addition, he is one of the portfolio managers of the Fund, involved in the day-to-day operation of the Fund. It is the opinion of the Department that based on these factors, taken together, this trustee has an interest in the Fund that may affect his best judgment as a fiduciary of the Plan regarding the decision whether to invest Plan assets in the Fund. Accordingly, if that trustee uses any of the authority, control, or responsibility that makes him a fiduciary to cause the Plan to invest in the Fund, the trustee will engage in a violation of section 406(b)(1) and 406(b)(2).

The Department has stated in other situations involving a fiduciary who has this type of conflict of interest that the fiduciary can avoid engaging in a transaction described in section 406(b)(1) and 406(b)(2) of ERISA by removing himself from all consideration of the transaction in question, and not exercising any of the authority, control, or

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[2] See, Interpretive Bulletin 75-8, D-3 (29 CFR 2509.75-8, D-3)

discretion that makes him a fiduciary to cause the plan to enter into the transaction, as long as there is no arrangement, agreement, or understanding regarding the proposed transaction.[3] We note, however, that if a fiduciary has or obtains material information, including information regarding plan investments, that would be necessary in order for other plan fiduciaries to make an appropriate and prudent decision with respect to the purchase, holding, or disposition of a particular investment, we believe the fiduciary's duties under section 404 of ERISA would require informing the deciding fiduciaries of that information.[4]

ERISA's general standards of fiduciary conduct also would apply to the proposed investment. Under section 404(a)(1), the responsible Plan fiduciaries must act prudently and solely in the interest of the Plan participants and beneficiaries in deciding whether to make an investment of Plan assets in the Fund.

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

Sincerely,

Louis Campagna
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

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[3] See, Advisory Opinion 99-09A (May 21, 1999) and Advisory Opinion 79-72A (October 10, 1979)
[4] We offer no opinion on the impact that insider-trading rules under the Federal securities laws may have on the dissemination of such information to other fiduciaries. Such rules are under the jurisdiction of the Securities and Exchange Commission.