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November 4, 1975

Dear :

Your letter of August 15, 1975 addressed to the Securities and Exchange Commission, has been forwarded to this office for consideration by
together with a copy of his reply of September 22, 1975.

In your letter, you expressed concern that some attorneys are advising clients who maintain small pension and profit-sharing plans that investment of the assets of such a plan exclusively in shares of a mutual fund might violate the requirement contained in section 404(a)(1)(C) of the Employee Retirement Income Security Act of 1974 (the Act) that a fiduciary of an employee benefit plan discharge his duties with respect to the plan by "diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances, it is clearly prudent not to do so." We assume that by referring to mutual funds in your letter, you are referring to open-end management investment companies registered under the Investment Company Act of 1940.

Section 401(b)(1) of the Act provides that for purposes of Part 4 of Title I of the Act (relating to fiduciary responsiblity), if a plan invests in a security issued by an investment company which is registered under the Investment Company Act of 1940, the assets of such plan are deemed to include such investment company security, but are not, solely by reason of such investment, deemed to include any assets of such investment company.
Thus, when a plan invests in shares of a mutual fund, the mutual fund shares themselves are considered to be assets of the plan, but the securities and any other assets owned by the mutual fund are not considered to be assets of the plan.

However, as pointed out in his letter, the legislative history of the Act indicates that for purposes of determining whether the diversification requirement set forth in section 404(a)(1)(C) of of the Act has been met as regards the investment by a plan exclusively in shares of a mutual fund, the underlying assets of such mutual fund should be taken into consideration. The Conference Report accompanying the Act states:

> The Conferees intend that, in general, whether the plan assets are sufficiently diversified is to be determined by examining the ultimate investment of the plan assets. For example, the conferees understand that for efficiency and economy plans may invest all their assets in a single bank or other pooled investment fund, but that the pooled fund itself could have diversified investments. It is intended that, in this case, the diversification rule is to be applied to the plan by examining the diversification of the investments in the pooled fund. The same is true with respect to investments in a mutual fund. (Joint Explanatory Statement of the Committee of Conference H. Rep. 93-1280, 93d Cong. 2d Sess. (1974), at 305.)

Accordingly, if a plan trustee or other plan fiduciary is considering whether to invest the entire amount of plan assets, or any part thereof, in shares of a mutual fund, such trustees or other fiduciary should examine the securities and other assets held by the mutual fund before such investment is made, review the statement as to the fund's investment policy as contained in the fund's prospectus, and periodically review the fund's investments whenever such information is made available, as long as plan assets are invested in such shares, to determine whether the investment, when considered together with other plan investments, if any, meets the diversification requirement set forth in section 404(a)(1)(C) of the Act.

Such trustees or other fiduciary should also examine the features of such mutual fund in the light of the particular objectives of the plan to determine whether investment of plan assets in shares of the mutual fund meets the other requirements of section 404(a)(1).

Sincerely,