P/OPINION 77-47

3(14)
406(b)

June 13, 1977

Dear :

This letter will clarify our letter of April 12, 1977.

On October 22, 1976, you filed on behalf of the (named) (Local Union # ) Pension Fund (the Pension Fund) an application for exemption from the prohibitions of section 406 of the Employee Retirement Income Security Act of 1974 (the Act) and from the taxes imposed by section 4975(a) and (b) of the Internal Revenue Code of 1954 (the Code) by reason of section 4975(c)(1) of the Code for a transaction involving the loan of money from the Pension Fund to the (named) Local Union # Journeymen - Apprentice Training Fund (the Training Fund). You submitted additional information in a letter dated April 1, 1977.

The application states that the Training Fund purchased improved property for $275,000 for use as a training facility and executed a mortgage on the property in the amount of $200,000 to the (named) Savings and Loan Association (the Association) to secure a first mortgage loan. The Training Fund proposes to renovate existing buildings and construct a new classroom and meeting room building on this property at an estimated cost, including architect's fees, of $868,000. The Pension Fund proposes to loan to the Training Fund $1,000,000 secured by a construction mortgage on the property, for a period of 25 years at an interest rate of 8.5 percent. The trustees of the Pension Fund will disburse the loan to the Training Fund in installments upon completion of various stages of the construction. The application file states that the trustees of the Pension Fund have tentatively approved the loan. The application file contains a commitment letter from the Association which states that upon completion of construction the land and buildings will be worth approximately 1 million dollars. The Association proposed to loan the Training Fund 75 percent of this appraised value for a term of 10, 15 or 20 years, at an interest rate of 9 percent.

Your letter of April 1, 1977 states that at the present time neither fund provides services to the other, and that Mr. (x), who serves as business manager of the Local Union, Chairman of the Board of trustees of the Pension Fund and trustee of the Training Fund, will abstain from future votes regarding the loan with respect to both funds. Mr. (x) is the only individual who serves as a trustee of both funds.

The application file states that the Pension Fund has assets in excess of 11 million dollars. The Training Fund has an annual income in excess of $220,000 from employer contributions pursuant to a 3-year collective bargaining agreement. Principal and interest on the contemplated construction loan will amount to $8,052.30 a month, or $96,627.60 annually. The Training Fund's anticipated cost of taxes, maintenance, repairs, and salaries for the operation of the training facility is approximately $90,000 annually. It is not clear whether this figure includes payments owed to the Association, the holder of the first mortgage on the real estate. These payments amount to approximately $30,000 annually.

(Confidential, Non-substantive Portion Deleted)

. . . . . .

Section 406(a) of the Act provides, in relevant part, that a fiduciary with respect to a plan shall not cause the plan to engage in a transaction if he knows or should know that the transaction constitutes the direct or indirect lending of money or extension of credit between the plan and a party in interest or the direct or indirect use of plan assets by or for the benefit of a party in interest with respect to the plan. The term "party in interest" is defined in section 3(14) of the Act. Section 406(b)(2) of the Act provides that a fiduciary with respect to a plan shall not in his 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.

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Based on the facts and representations contained in the application file, it does not appear that the Training Fund is a party in interest with respect to the Pension Fund. Accordingly, the loan of money from the Pension Fund to the Training Fund would not be a prohibited transaction under section 406(a) of the Act.

However, the proposed transaction may violate section 406(b)(2) of the Act. Whether a violation of section 406(b)(2) occurs depends upon the facts and circumstances. A violation of section 406(b)(2) will not necessarily occur solely because an individual who is a fiduciary with respect to the plan is also a representative of a party which wishes to encourage in a transaction involving the plan.

If, throughout the negotiation and duration of the proposed transaction, neither Mr. (x) nor any of the other trustees of the Pension Fund or the Training Fund represent interests adverse to those of the respective plans and their respective participants and beneficiaries, then the proposed loan would not be a prohibited transaction under section 406(b)(2) of the Act, and no administrative exemption under section 408(a) of the Act would be necessary. The determination as to whether the proposed transaction violates section 406(b)(2) must be made by plan fiduciaries in light of all the relevant facts and circumstances. Mr. (x)'s decision to abstain from further voting with respect to the proposed loan is merely one factor which should be considered in determining whether the proposed transaction violates section 406(b)(2). Whether Mr. (x) was involved in the deliberations leading up to the decision to approve the loan would be another. If plan fiduciaries determine that the proposed loan would not be a prohibited transaction, they may withdraw their request for an exemption. If the request for an exemption is not withdrawn, the Department will continue to consider the application under section 408(a) of the Act.

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You should note that our response relates only to the application of section 406 of the Act to the proposed transaction. It does not deal with the application of any other provision of the Act, or the provisions of any other statute, to the proposed transaction.

Specifically, our response does not deal with the application of the fiduciary duties set forth in section 404(a)(1) of the Act.

Sincerely,