

U.S. DEPARTMENT OF LABOR
LABOR-MANAGEMENT SERVICES ADMINISTRATION
Pension and Welfare Benefit Programs

Washington, D.C. 20216



FEB 23 1979

Mr. Arthur D. Sporn
Barrett, Smith, Schapiro,
Simon and Armstrong
26 Broadway
New York, New York 10004

OPINION 79-11 A

406(b) (1)

408(b) (2)

Dear Mr. Sporn:

This in response to your request for an advisory opinion on behalf of the Irving Trust Company (Bank) regarding the Employee Retirement Income Security Act of 1974 (ERISA).

You represent that the Bank proposes to make a securities lending service available to various employee benefit plans for which it serves either as discretionary or as custodian trustee. The Bank has discussed the proposed service in some detail with the named fiduciaries or sponsors of a number of its employee plan accounts. You request an advisory opinion as to the status of the proposed service under the prohibited transaction rules of ERISA.

Among the details of the proposed service described in your letter are the following: The securities lending program would be offered only to those employee benefit plans whose employers or other sponsors enter with the Bank into an agreement which expressly confirms the Bank's authority to make the loans in question as trustee in managing the plan assets and sets out the terms on which the loans are to be made. The agreement gives the employer (or other sponsor of the plan) the power to direct the trustee at any time to discontinue any or all lending activities in which the plan is then engaged. The Bank, acting as "finder" on behalf of those plans which had executed the requisite authorization, would solicit securities loan requests from borrowing broker-dealers. Loans would be solicited only from those broker-dealer firms which the Bank had investigated and deemed to be sound credit risks, and which in each case had entered with the trustee of the employee benefit trust into a Securities Borrowing Agreement. When a loan is arranged, the lending employee benefit plan would deliver securities to the borrowing broker-dealer against collateral in cash (or the equivalent thereof) at least equal to the market value of the securities loaned. During the term of the loan the Bank would provide a daily monitoring service under which the securities loaned are valued daily and, if the amount of cash collateral already advanced has fallen short of such market value, would notify the borrower and collect the required additional cash collateral from him. During the term of the loan the Bank would invest the cash collateral on behalf of the lending plan in high quality short term money market instruments. During all of this time the lender, though it no longer would hold the physical securities loaned,

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would retain all beneficial rights of ownership therein except the voting rights. Accordingly, the lender would be entitled to all dividend and interest payments accruing on such securities during the term of the loan. The loan would be terminable by the lender at any time upon notice in writing to the borrower; whereupon, the borrower would be obliged to return all securities loaned within five business days of such notice. A broker-dealer to whom a given employee benefit plan had loaned securities would under no circumstances be used to execute portfolio brokerage for that plan at any time while such loan is outstanding. To cover the Bank's expenses in making and servicing the loan arrangements, and to compensate it for these services, the Bank will charge each lender a fee, which will be calculated at a percentage per annum of the average daily value of the collateral held by the lender under the loan. In consideration of this fee the Bank also will undertake to indemnify the lender against any and all loss which it might incur in connection with the loan arrangements, such as might arise from a failure of the borrower to return the borrowed securities, to post additional collateral when due, or to remit dividends or interest payments on the securities while they are out on loan.

ERISA section 406(a)(1)(c) provides, in part, that the furnishing of services between a plan and a party in interest is a prohibited transaction. Under section 3(14)(A), a fiduciary with respect to a plan is a party in interest. However, section 408(b)(2) of ERISA provides an exemption from section 406(a)(1)(c) for a party in interest, including a fiduciary, to perform services for a plan, if several conditions are met. Although this exemption generally permits performance of multiple services for the same plan, it does not exempt an act of fiduciary self-dealing from the prohibition of section 406(b)(1) of ERISA. This section prohibits a plan fiduciary from dealing with the assets of the plan in his own interest or for his own account.

The operation of these statutory provisions is explained in regulations issued by the Department of Labor under section 408(b)(2) of ERISA (29 CFR 2550.408b-2, copy enclosed). Regulation section 2550.408b-2(e) states that no exemption is provided by section 408(b)(2) of ERISA or the regulations promulgated thereunder in the multiple service situation when, for example, a fiduciary exercises the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay a fee for an additional service furnished by such fiduciary (or by a person in which such fiduciary has an interest which may affect the exercise of its best judgment as a fiduciary).

In the situation you describe, the Bank, which is a fiduciary of the plan, would be using its authority, control or responsibility which makes it a fiduciary to cause the plan in effect to pay an additional fee for a

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service performed by the Bank. That is, although there would be initial approval of the arrangement by the sponsoring employer of the plan, the Bank thereafter would have discretion to cause the plan to enter into a series of transactions pursuant to the arrangement, without prior approval by a fiduciary other than the Bank. Further, at least with respect to those plans which the Bank serves as discretionary trustee, we are unable to take the position that the proposed lending arrangement would not contravene section 406(b)(1) of ERISA even if the arrangement were modified to provide prior approval of each loan by a fiduciary other than the Bank. This is because the amount of compensation which the Bank would earn from a particular loan of securities would depend upon how long that loan remains outstanding. Since the Bank would be responsible for determining whether the plan should continue to hold or sell a particular security, the Bank could increase the amount of compensation paid to itself by the plan by causing the plan to continue holding any securities which are on loan. Therefore, if the Bank intends to make the securities lending service available to employee benefit plans which it serves as trustee, arrangements should be made to ensure that any person who receives a fee for the lending of securities is not the fiduciary responsible for decisions with respect to whether a plan should purchase or sell particular securities.*_/

In addition, you might wish to consider the question of whether an arrangement for indemnification between a plan and a party in interest would be an extension of credit between the plan and such party in interest and therefore prohibited under section 406(a)(1)(B) of ERISA. CF. H.R. Rep. No. 93-1280, 93rd Cong., 2d Sess. at 308. This letter should not be construed as indicating any view on the part of the Department with respect to that question.

Section 8 of ERISA Procedure 76-1 states that if a conference has been requested with respect to a request for an advisory opinion and the Department of Labor determines that a conference is necessary or appropriate, the individual or organization or the authorized representative will be notified of the time and place of the conference; a

*_/ As noted above, your letter indicates that a lender of securities would not have voting rights with respect to securities which are on loan. Although this in itself would not necessarily result in a breach of fiduciary responsibility, such a breach might result if the plan trustees do not terminate the loan in time to vote proxies in the event of an occurrence affecting the plan's interest in the security.

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conference will normally be scheduled only when the Department in its sole discretion deems it will be necessary or appropriate in deciding the case. Our analysis of the information submitted leads us to believe that a conference is not necessary or appropriate in deciding this case.

The sections of ERISA discussed above have parallel provisions in section 4975 of the Internal Revenue Code of 1954 (Code). Under Reorganization Plan No. 4 of 1978 (Executive Order 12108, 44 FR 1065) effective December 31, 1978, the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor, and the Secretary of the Treasury shall be bound by the rulings issued by the Secretary of Labor pursuant to such authority. Accordingly, we conclude that the views set forth above apply also under the Code to the extent that such views relate to Code section 4975.

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 thereof relating to the effect of advisory opinions.

Sincerely,

Alan D. Lebowitz
Acting Assistant Administrator
Office of Fiduciary Standards

Enclosures