U.S. Department of Labor

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

August 28, 1997

97-19A
ERISA SEC. 406(b)(3), 408(c)(2)

Stephen M. Saxon
Groom & Nordberg
1701 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Dear Mr. Saxon:

This is in response to your request for an advisory opinion regarding the "direct expenses" provisions contained in Department of Labor (the Department) regulation section 2550.408b-2(e)(3) and the prohibitions of section 406(b)(3) of the Employee Retirement Income Security Act (ERISA). In particular, you ask whether a company providing services to its own pension plan may receive fees from certain mutual funds which the company has selected as investment options for participants in the plan as "reimbursement" for "direct expenses" incurred in providing services to the plan.

Your request contains the following facts and representations. Aetna Services, Inc. (Aetna), a Connecticut corporation, is a holding corporation whose subsidiaries include financial institutions. A wholly-owned indirect subsidiary of Aetna, Aetna Life Insurance and Annuity Company (ALIAC), advises certain investment companies registered under the Investment Company Act of 1940 (mutual funds) and provides recordkeeping and other administrative services to employee benefit plans, including the Aetna Services, Inc. Incentive Savings Plan (the Plan), a participant-directed defined contribution plan sponsored by and covering employees of Aetna and its subsidiaries. The Plan's governing documents permit the Plan to pay costs and expenses for services necessary to the operation and administration of the Plan. Aetna is the Plan administrator. The Plan's trustee is a bank that is unrelated to Aetna.

Aetna selects the investment options that are made available to the Plan's participants. The investment options that are currently available to Plan participants include mutual funds that are advised by ALIAC and mutual funds that are not advised by ALIAC and are otherwise unrelated to Aetna. Aetna, through its wholly-owned subsidiary, ALIAC receives from the unrelated mutual funds (or their advisers or distributors) fees for providing certain shareholder services (including, e.g., maintaining shareholder ownership records for each fund on a client-by-client basis, providing prospectuses and other shareholder information materials to client investors, and handling of proxy voting materials) to the unrelated mutual funds in connection with investments by client plans.[1] The fees for these services are generally based on a percentage of plan assets invested in each mutual fund, and are paid either pursuant to a distribution plan described in Securities and Exchange Commission Rule 12b-1, or as administrative expenses paid in lieu of the mutual fund's transfer agency or other administrative fees.

Aetna wishes to receive fees from the unrelated mutual funds in return for providing shareholder services in connection with elections by Plan participants to invest in the mutual funds. Aetna wishes to receive such fees on the same terms and in the same amounts as the fees it receives for other client investments in such mutual funds. Aetna

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[1] You have assumed, and the Department agrees, that the receipt of fees by ALIAC, a wholly-owned subsidiary of Aetna, is imputed to Aetna. Accordingly, the discussion in this letter is limited to Aetna.

has proposed to begin accepting the fees payable to it by the unrelated mutual funds in connection with Plan investments as reimbursement of the expenses it incurs in providing recordkeeping and other administrative services to the Plan, which amounts would otherwise be paid to Aetna directly from the Plan's assets in accordance with the terms of the Plan.

You represent that Aetna has developed methods for determining the dollar amount of its reasonable direct expenses incurred in the provision of services to the Plan within the meaning of regulation 29 C.F.R. 2550.408c-2(b)(3). In this regard, Aetna represents that it will seek reimbursement solely for expenses that Aetna would not incur but for its provision of services to the Plan, e.g., salary and benefits paid to certain employees who are engaged full-time to provide administrative services to the Plan, and whose position would be terminated if Aetna should cease providing services to the Plan, charges for telephone services dedicated to answering participant inquiries and taking participant investment directions, and the cost of office supplies, including paper stocks for printing participant information materials, used in connection with the provision of services to the Plan. Aetna anticipates that the aggregate of fees that it would receive from unrelated mutual funds in connection with elections by Plan participants to invest in unrelated funds will not exceed its reasonable direct expenses determined as described above.

If the fees received from the mutual funds exceed Aetna's reasonable direct expenses, you represent that Aetna would take one of three courses of action. Aetna may decide to provide additional services to the Plan, either itself or through an unrelated third party. These services would be paid for with the fees in excess of Aetna's direct expenses. If Aetna determines that providing additional services to the Plan is not necessary and appropriate, it will then consider whether applicable law (including the Internal Revenue Code and Federal securities laws) would permit the payment of such excess fees into the Plan, and whether doing so would be administratively feasible. If Aetna determines that paying the excess fees into the Plan is not appropriate (for legal or administrative reasons), Aetna will waive the excess fees by requesting that the unrelated funds not pay these amounts.

You represent that Aetna is a fiduciary with respect to the Plan under ERISA section 3(21)(A) by reason of its discretionary authority in the administration of the Plan, including its selection of the Plan investment options, and thus is a party in interest with respect to the Plan under section 3(14)(A) of ERISA.

You request an opinion that, under the circumstances described, receipt by Aetna of mutual fund fees may be construed as reimbursement for its direct expenses incurred in providing services to a plan within the meaning of Department regulation 29 C.F.R. 2550.408b-2(e)(3), and thus would not violate ERISA section 406(b)(3).[2]

Section 406(b)(3) of ERISA prohibits a fiduciary from receiving a fee or other consideration for his or her own personal account from a party dealing with a plan in connection with a transaction involving the assets of the plan.

Section 408(c)(2) of ERISA provides, in relevant part, that nothing in section 406 shall be construed to prohibit any fiduciary from receiving compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his or her duties with respect to a plan.

Regulation 29 C.F.R. 2550.408b-2(a) indicates that ERISA section 408(b)(2) does not contain an exemption for an act described in section 406(b) even if such act occurs in connection with a provision of services which is exempt

[2] You have not requested an opinion, and the Department expresses no view, as to whether contracting or making arrangements for the provision of services by Aetna to the Plan is exempt from the prohibitions of ERISA section 406(a) by reason of the exemption provided by section 408(b)(2). Similarly, you have not requested an opinion, and the Department expresses no view, concerning Aetna's activity with respect to client plans that are not the Plan that is the subject of this advisory opinion.

under section 408(b)(2). As explained in regulation section 2550.408b-2(e)(1), if a fiduciary uses the authority, control, or responsibility that makes him or her 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 ERISA 406(b) would occur, and that transaction would be deemed to be a separate transaction from the one involving the provision of services and would not be exempt by section 408(b)(2).

Regulation section 2550.408b-2(e)(3) provides that if a fiduciary furnishes services 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 service within the meaning of § 2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in ERISA section 406(b).[3] The term "reimbursement" is not defined in the regulation. In the view of the Department, although the payment of fees by an unrelated mutual fund may not be intended by the mutual fund to reimburse Aetna for its direct expenses incurred in providing services to the Plan, to the extent that the Plan and Aetna have expressly agreed to and do in fact use such payments to reduce or eliminate the Plan's liability for Aetna's documented direct expenses incurred in providing services to the Plan, such payments may be considered "reimbursement" within the meaning of regulation section 2550.408b-2(e)(3).

You represent that any fees earned by Aetna in excess of what is required to reimburse it for its direct expenses will be applied to the provision of additional services to the Plan, passed through to the Plan, or waived by Aetna. Accordingly, it is the opinion of the Department that if Aetna credits all payments received from the unrelated mutual funds in connection with investments directed by Plan participants exactly against its "direct expenses" incurred in providing services to the Plan, for which the Plan would otherwise be liable, and provided that Aetna receives no compensation or other consideration for such services, Aetna would not violate ERISA section 406(b)(3). We caution, however, that retention of any payments from the mutual funds in which Plan participants elect to invest that exceed Aetna's "direct expenses" would constitute a prohibited receipt of consideration for Aetna's personal account under ERISA section 406(b)(3).

Finally, it should be noted that ERISA's general standards of fiduciary conduct also would apply to the proposed arrangement, including any determinations by Aetna concerning the disposition of any excess fees. Accordingly, under sections 403(c)(1) and 404(a)(1) of ERISA, the responsible Plan fiduciaries must act prudently and solely in the interest of the Plan participants and beneficiaries with respect to the decision to enter into, or to continue, the above-described arrangement with Aetna. In this regard, the responsible Plan fiduciaries must assure that any compensation retained by Aetna in connection with the investment of Plan assets constitutes no more than reasonable direct expenses, taking into account the services provided to the Plan.

This opinion does not address the effect of Federal securities laws on the proposed arrangements. Such questions are within the jurisdiction of the Securities and Exchange Commission.

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

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[3] Regulation section 2550.408c-2(b)(3) provides that an expense is not a "direct expense" to the extent that it would have been sustained had the service not been provided or if it represents an allocable portion of overhead costs. You have not requested an opinion as to whether the expenses for which Aetna proposes to be reimbursed are "direct expenses" within the meaning of regulation section 2550.408c-2(b)(3). See, in this regard, Advisory Opinion 88-03A (Feb. 29, 1988).

Sincerely,

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