INVESTMENT COMPANY INSTITUTE

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DOL ISSUES ADVISORY OPINION ON DIRECTED TRUSTEE'S RECEIPT OF 12B-1 AND SUBTRANSFER FEES FROM MUTUAL FUNDS OFFERED UNDER PLANS

[16269] July 7, 2003 TO: PENSION MEMBERS No. 30-03 PENSION OPERATIONS ADVISORY COMMITTEE No. 37-03 RE: DOL ISSUES ADVISORY OPINION ON DIRECTED TRUSTEE'S RECEIPT OF 12b-1 AND SUBTRANSFER FEES FROM MUTUAL FUNDS OFFERED UNDER PLANS The Department of Labor has issued Advisory Opinion 2003-09A,1 which addresses whether a trust company's receipt of 12b-1 and subtransfer fees from mutual funds, the investment advisers of which are affiliates of the trust company, for services relating to plan investments in mutual funds, would violate ERISA's prohibited transaction rules. Based on the facts represented, the advisory opinion concludes that the receipt of such fees by the trust company would not violate the prohibited transaction rules of ERISA sections 406(b)(1) or 406(b)(3)2 where the decision to invest in the mutual funds offered under the plan is made by a plan fiduciary who is independent of the trust company (and its affiliates) or by plan participants. Under the facts set forth in the advisory opinion, ABN AMRO Trust Services Company ("Trust Company") provides directed trustee and non-fiduciary services to participant-directed and other defined contribution plans through bundled services arrangements.3 An affiliate of the Trust Company serves as the investment adviser to mutual funds, one or more of which are made available under the Trust Company's client plans. 1 Advisory Opinion 2003-09A, which is attached, is also available at: http://www.dol.gov/ebsa/regs/aos/ao2003- 09a.html. 2 Section 406(b)(1) of ERISA prohibits a fiduciary with respect to a plan from dealing with the assets of the plan in its own interest or for its own account. Section 406(b)(3) prohibits a fiduciary from receiving any consideration for its own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan. Section 406(b)(2), which is not addressed in this advisory opinion, prohibits a fiduciary, in an individual or other capacity, from acting in any transaction involving the plan on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries. 3 Plan services provided as part of the bundled services arrangement include custodial trustee services, participant- level recordkeeping, participant communications and education, voice response system availability, plan documentation services, summary plan description and annual report services, tax compliance assistance, administrative assistance in processing plan distributions and loans, and a "facility" for plan investment options. 2 As a directed trustee, the Trust Company takes direction from plan fiduciaries regarding their selection of plan investment options — with respect to both "proprietary" and "nonproprietary" funds. As a condition of engagement, however, at least one

proprietary fund must be offered as an investment option under the bundled services arrangement. The terms of the arrangement provide that the Trust Company will not be able to assert any influence with respect to the selection of the other investment options or the particular proprietary fund(s) in which plans will invest. The Trust Company, if requested, will provide a list of investment funds for plans to consider. As part of its proposal to potential clients, the Trust Company discloses, with regard to each proprietary fund offered: (1) the total number of actively-managed mutual funds in the same category as the proprietary fund (based on fund classifications by third-party firms); (2) the investment advisory fee, 12b-1 fee (if any) and other fees paid by the proprietary fund, as well as the aggregate fees paid by the proprietary fund; and (3) the same fee information described above with respect to the highest-fee, lowest-fee and average-fee fund in the same category as the proprietary fund. Under the arrangement, the plan's choice of investment vehicles affects the cost of engaging the Trust Company. For example, the plan services offered by the Trust Company would cost less if the plan fiduciary selects three proprietary funds as part of the plan menu, rather than one or two proprietary funds. Where a plan fiduciary decides to remove a proprietary fund as an investment option, the Trust Company would invite the plan fiduciary to consider one or more other proprietary funds to replace non-proprietary investment options. If the plan fiduciary chooses not to select another proprietary fund, the Trust Company would continue to provide plan services under the bundled services arrangement. If, however, the Trust Company determines that the bundled services arrangement is no longer profitable, the Trust Company could withdraw or make an offer to the plan fiduciaries to renegotiate the plan service fees. Either party also may terminate the arrangement without cause upon at least thirty days' advance written notice. In concluding that the Trust Company's arrangement does not violate ERISA sections 406(b)(1) or 406(b)(3), the Department analogized the arrangement to that in Advisory Opinion 97-16A (the "Aetna letter").4 That advisory opinion provided that a person would not be exercising discretionary authority or control over the management of a plan or its assets solely as a result of deleting or substituting a fund from a program of investment options and services offered to the plan, provided that an appropriate plan fiduciary makes the decision to accept or reject the change. The plan fiduciary, however, must be provided advance notice of the change, including disclosure of recordkeeping fee information, and must be afforded a reasonable amount of time to accept or reject the change.5 4 See Institute Memorandum to Pension Members No. 21-97, dated May 28, 1997. See also Institute Memorandum to Pension Members No. 37-97, dated August 26, 1997 (DOL letter providing further clarification concerning its May 1997 advisory opinions on bundled services arrangements). 5 The Department distinguished the Trust Company's arrangement from that in Advisory Opinion 97-15A (the "Frost letter"). See Institute Memorandum to Pension Members No. 21-97, dated May 28, 1997. There, the trustee had reserved the right to add or remove mutual fund families that it made available to plans. The trustee also had agreed to apply any fees it received from the mutual fund to the benefit of plans. Here, once a plan enters into a bundled services arrangement with the Trust Company, the plan fiduciary has the authority to decide investment fund selections and any modifications to the plan's investment menu. 3 As in the Aetna letter, the Department observed that the plan sponsor or other fiduciary independent of the Trust Company maintains complete control of the selection of funds in which the plan will invest. The Trust Company has no role in the selection of investment options beyond requiring, "as a condition of initial engagement" of the Trust Company as a bundled provider, at least one proprietary fund to be offered by the plan. Moreover, when a plan engages the Trust Company to provide bundled plan services, a plan fiduciary independent of the Trust Company or its affiliates selects the plan's investment options. The advisory opinion, however, cautions that if the Trust Company were to provide "investment advice" as defined in 29 C.F.R. section 2510.3-21(c), the Trust Company would violate ERISA section 406(b)(1) in causing the plan to invest in a proprietary fund (or any mutual fund that pays a fee to the Trust Company or its affiliates). In addition, under ERISA's general standards of fiduciary conduct, plan fiduciaries must act prudently and solely in the interests of plan participants and beneficiaries in both deciding whether to enter into or continue an arrangement with the Trust Company, as well as in determining the plan's investment options. Finally, plan fiduciaries must ensure that plan assets (1) do not inure to the benefit of the employer, and (2) are held for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.6 Thomas T. Kim Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 16269, or call the ICI Library at (202) 326-8304 and request the attachment for memo 16269. Attachment (in .pdf format) 6 With respect to situations where the Trust Company serves as a plan fiduciary with authority to select investments, including proprietary funds, the advisory opinion notes that the Trust Company relies on Prohibited Transaction Class Exemption (PTE) 77-4. In this regard, the Department states that in Advisory Opinions 93-12A and 93-13A, "it was unable to conclude that PTE 77-4 would be available for plan purchases and sales of mutual fund shares if a 12b- 1 fee is paid to the fiduciary or its affiliate with regard to that portion of the mutual fund's assets attributable to the plan's investment."