

§ 2550.408b-2

day of the first plan year beginning on or after January 1, 1989.

(Approved by the Office of Management and Budget under control number 1210-0076)

[54 FR 30528, July 20, 1989]

§ 2550.408b-2 General statutory exemption for services or office space.

(a) *In general.* Section 408(b)(2) of the Employee Retirement Income Security Act of 1974 (the Act) exempts from the prohibitions of section 406(a) of the Act payment by a plan to a party in interest, including a fiduciary, for office space or any service (or a combination of services) if:

(1) Such office space or service is necessary for the establishment or operation of the plan;

(2) Such office space or service is furnished under a contract or arrangement which is reasonable; and

(3) No more than reasonable compensation is paid for such office space or service.

However, section 408(b)(2) does not contain an exemption from acts described in section 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account), section 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries) or section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the assets of the plan). Such acts are separate transactions not described in section 408(b)(2). See § 2550.408b-2 (e) and (f) for guidance as to whether transactions relating to the furnishing of office space or services by fiduciaries to plans involve acts described in section 406(b)(1) of the Act. Section 408(b)(2) of the Act does not contain an exemption from other provisions of the Act, such as section 404, or other provisions of law which may impose requirements or restrictions relating to the transactions which are exempt under section 408(b)(2). See, for

example, section 401 of the Internal Revenue Code of 1954. The provisions of section 408(b)(2) of the Act are further limited by section 408(d) of the Act (relating to transactions with owner-employees and related persons).

(b) *Necessary service.* A service is necessary for the establishment or operation of a plan within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(1) if the service is appropriate and helpful to the plan obtaining the service in carrying out the purposes for which the plan is established or maintained. A person providing such a service to a plan (or a person who is a party in interest solely by reason of a relationship to such a service provider described in section 3(14)(F), (G), (H), or (I) of the Act) may furnish goods which are necessary for the establishment or operation of the plan in the course of, and incidental to, the furnishing of such service to the plan.

(c) *Reasonable contract or arrangement.* No contract or arrangement is reasonable within the meaning of section 408(b)(2) of the Act and § 2550.408b-2(a)(2) if it does not permit termination by the plan without penalty to the plan on reasonably short notice under the circumstances to prevent the plan from becoming locked into an arrangement that has become disadvantageous. A long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances is not generally an unreasonable arrangement merely because of its long term. A provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement or lease is not a penalty. For example, a minimal fee in a service contract which is charged to allow recoupment of reasonable start-up costs is not a penalty. Similarly, a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and re-letting of the office space upon early termination of the lease is not a penalty. Such a provision does not reasonably compensate for loss if it provides for payment in excess of actual loss or if it fails to require mitigation of damages.

(d) *Reasonable compensation.* Section 408(b)(2) of the Act and §2550.408b-2(a)(3) permit a plan to pay a party in interest reasonable compensation for the provision of office space or services described in section 408(b)(2). Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services.

(e) *Transactions with fiduciaries—(1) In general.* If the furnishing of office space or a service involves an act described in section 406(b) of the Act (relating to acts involving conflicts of interest by fiduciaries), such an act constitutes a separate transaction which is not exempt under section 408(b)(2) of the Act. The prohibitions of section 406(b) supplement the other prohibitions of section 406(a) of the Act by imposing on parties in interest who are fiduciaries a duty of undivided loyalty to the plans for which they act. These prohibitions are imposed upon fiduciaries to deter them from exercising the authority, control, or responsibility which makes such persons fiduciaries when they have interests which may conflict with the interests of the plans for which they act. In such cases, the fiduciaries have interests in the transactions which may affect the exercise of their best judgment as fiduciaries. Thus, a fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service. Nor may a fiduciary use such authority, control, or responsibility to cause a plan to enter into a transaction involving plan assets whereby such fiduciary (or a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) will receive consideration from a third party in connection with such transaction. A person in which a fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary includes, for example, a person who is a party in interest by reason of a relationship to

such fiduciary described in section 3(14)(E), (F), (G), (H), or (I).

(2) *Transactions not described in section 406(b)(1).* A fiduciary does not engage in an act described in section 406(b)(1) of the Act if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay additional fees for a service furnished by such fiduciary or to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary. This may occur, for example, when one fiduciary is retained on behalf of a plan by a second fiduciary to provide a service for an additional fee. However, because the authority, control or responsibility which makes a person a fiduciary may be exercised "in effect" as well as in form, mere approval of the transaction by a second fiduciary does not mean that the first fiduciary has not used any of the authority, control or responsibility which makes such person a fiduciary to cause the plan to pay the first fiduciary an additional fee for a service. See paragraph (f) of this section.

(3) *Services without compensation.* If a fiduciary provides 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 services 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 section 406(b) of the Act. The allowance of a deduction to an employer under section 162 or 212 of the Code for the expense incurred in furnishing office space or services to a plan established or maintained by such employer does not constitute compensation or other consideration.

(f) *Examples.* The provisions of §2550.408b-2(e) may be illustrated by the following examples.

Example (1). E, an employer whose employees are covered by plan P, is a fiduciary of P. I is a professional investment adviser in which E has no interest which may affect the exercise of E's best judgment as a fiduciary. E causes P to retain I to provide certain kinds of investment advisory services of a type which causes I to be a fiduciary of P

under section 3(21)(A)(ii) of the Act. thereafter, I proposes to perform for additional fees portfolio evaluation services in addition to the services currently provided. The provision of such services is arranged by I and approved on behalf of the plan by E. I has not engaged in an act described in section 406(b)(1) of the Act, because I did not use any of the authority, control or responsibility which makes I a fiduciary (the provision of investment advisory services) to cause the plan to pay I additional fees for the provision of the portfolio evaluation services. E has not engaged in an act which is described in section 406(b)(1). E, as the fiduciary who has the responsibility to be prudent in his selection and retention of I and the other investment advisers of the plan, has an interest in the purchase by the plan of portfolio evaluation services. However, such an interest is not an interest which may affect the exercise of E's best judgment as a fiduciary.

Example (2). D, a trustee of plan P with discretion over the management and disposition of plan assets, relies on the advice of C, a consultant to P, as to the investment of plan assets, thereby making C a fiduciary of the plan. On January 1, 1978, C recommends to D that the plan purchase an insurance policy from U, an insurance company which is not a party in interest with respect to P. C thoroughly explains the reasons for the recommendation and makes a full disclosure concerning the fact that C will receive a commission from U upon the purchase of the policy of P. D considers the recommendation and approves the purchase of the policy by P. C receives a commission. Under such circumstances, C has engaged in an act described in section 406(b)(1) of the Act (as well as sections 406(b)(2) and (3) of the Act) because C is in fact exercising the authority, control or responsibility which makes C a fiduciary to cause the plan to purchase the policy. However, the transaction is exempt from the prohibited transaction provisions of section 406 of the Act, if the requirements of Prohibited Transaction Exemption 77-9 are met.

Example (3). Assume the same facts as in Example (2) except that the nature of C's relationship with the plan is not such that C is a fiduciary of P. The purchase of the insurance policy does not involve an act described in section 406(b)(1) of the Act (or sections 406(b)(2) or (3) of the Act) because such sections only apply to acts by fiduciaries.

Example (4). E, an employer whose employees are covered by plan P, is a fiduciary with respect to P. A, who is not a party in interest with respect to P, persuades E that the plan needs the services of a professional investment adviser and that A should be hired to provide the investment advice. Accordingly, E causes P to hire A to provide investment advice of the type which makes A a fiduciary under §2510.3-21(c)(1)(ii)(B). Prior to

the expiration of A's first contract with P, A persuades E to cause P to renew A's contract with P to provide the same services for additional fees in view of the increased costs in providing such services. During the period of A's second contract, A provides additional investment advice services for which no additional charge is made. Prior to the expiration of A's second contract, A persuades E to cause P to renew his contract for additional fees in view of the additional services A is providing. A has not engaged in an act described in section 406(b)(1) of the Act, because A has not used any of the authority, control or responsibility which makes A a fiduciary (the provision of investment advice) to cause the plan to pay additional fees for A's services.

Example (5). F, a trustee of plan P with discretion over the management and disposition of plan assets, retains C to provide administrative services to P of the type which makes C a fiduciary under section 3(21)(A)(iii). Thereafter, C retains F to provide for additional fees actuarial and various kinds of administrative services in addition to the services F is currently providing to P. Both F and C have engaged in an act described in section 406(b)(1) of the Act. F, regardless of any intent which he may have had at the time he retained C, has engaged in such an act because F has, in effect, exercised the authority, control or responsibility which makes F a fiduciary to cause the plan to pay F additional fees for the services. C, whose continued employment by P depends on F, has also engaged in such an act, because C has an interest in the transaction which might affect the exercise of C's best judgment as a fiduciary. As a result, C has dealt with plan assets in his own interest under section 406(b)(1).

Example (6). F, a fiduciary of plan P with discretionary authority respecting the management of P, retains S, the son of F, to provide for a fee various kinds of administrative services necessary for the operation of the plan. F has engaged in an act described in section 406(b)(1) of the Act because S is a person in whom F has an interest which may affect the exercise of F's best judgment as a fiduciary. Such act is not exempt under section 408(b)(2) of the Act irrespective of whether the provision of the services by S is exempt.

Example (7). T, one of the trustees of plan P, is president of bank B. The bank proposes to provide administrative services to P for a fee. T physically absents himself from all consideration of B's proposal and does not otherwise exercise any of the authority, control or responsibility which makes T a fiduciary to cause the plan to retain B. The other trustees decide to retain B. T has not engaged in an act described in section 406(b)(1) of the Act. Further, the other trustees have not engaged in an act described in

section 406(b)(1) merely because T is on the board of trustees of P. This fact alone would not make them have an interest in the transaction which might affect the exercise of their best judgment as fiduciaries.

[42 FR 32390, June 24, 1977]

§ 2550.408b-3 Loans to Employee Stock Ownership Plans.

(a) *Definitions.* When used in this section, the terms listed below have the following meanings:

(1) *ESOP.* The term *ESOP* refers to an employee stock ownership plan that meets the requirements of section 407(d)(6) of the Employee Retirement Income Security Act of 1974 (the Act) and 29 CFR 2550.407d-6. It is not synonymous with “stock bonus plan.” A stock bonus plan must, however, be an ESOP to engage in an exempt loan. The qualification of an ESOP under section 401 (a) of the Internal Revenue Code (the Code) and 26 CFR 54.4975-11 will not be adversely affected merely because it engages in a non-exempt loan.

(2) *Loan.* The term *loan* refers to a loan made to an ESOP by a party in interest or a loan to an ESOP which is guaranteed by a party in interest. It includes a direct loan of cash, a purchase-money transaction, and an assumption of the obligation of an ESOP. “Guarantee” includes an unsecured guarantee and the use of assets of a party in interest as collateral for a loan, even though the use of assets may not be a guarantee under applicable state law. An amendment of a loan in order to qualify as an exempt loan is not a refinancing of the loan or the making of another loan.

(3) *Exempt loan.* The term *exempt loan* refers to a loan that satisfies the provisions of this section. A “non-exempt loan” is one that fails to satisfy such provisions.

(4) *Publicly traded.* The term *publicly traded* refers to a security that is listed on a national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) or that is quoted on a system sponsored by a national securities association registered under section 15A(b) of the Securities Exchange Act (15 U.S.C. 78o).

(5) *Qualifying employer security.* The term *qualifying employer security* refers

to a security described in 29 CFR 2550.407d-5.

(b) *Statutory exemption—(1) Scope.* Section 408(b)(3) of the Act provides an exemption from the prohibited transaction provisions of sections 406(a) and 406(b)(1) of the Act (relating to fiduciaries dealing with the assets of plans in their own interest or for their own account) and 406(b)(2) of the Act (relating to fiduciaries in their individual or in any other capacity acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries). Section 408(b)(3) does not provide an exemption from the prohibitions of section 406(b)(3) of the Act (relating to fiduciaries receiving consideration for their own personal account from any party dealing with a plan in connection with a transaction involving the income or assets of the plan).

(2) *Special scrutiny of transaction.* The exemption under section 408(b)(3) includes within its scope certain transaction in which the potential for self-dealing by fiduciaries exists and in which the interests of fiduciaries may conflict with the interests of participants. To guard against these potential abuses, the Department of Labor will subject these transactions to special scrutiny to ensure that they are primarily for the benefit of participants and their beneficiaries. Although the transactions need not be arranged and approved by an independent fiduciary, fiduciaries are cautioned to scrupulously exercise their discretion in approving them. For example, fiduciaries should be prepared to demonstrate compliance with the net effect test and the arm’s-length standard under paragraphs (c)(2) and (3) of this section. Also, fiduciaries should determine that the transaction is truly arranged primarily in the interest of participants and their beneficiaries rather than, for example, in the interest of certain selling shareholders.

(c) *Primary benefit requirements—(1) In general.* An exempt loan must be primarily for the benefit of the ESOP participants and their beneficiaries. All the surrounding facts and circumstances, including those described