**U.S. Department of Labor** **Employee Benefits Security Administration**
**Washington, D.C. 20210**

July 26, 2006

2006-06A
PTE 77-3

Mr. F. Jefferson Bragdon
Williams Coulson
15th Floor
Two Chatham Center
Pittsburgh, PA 15219

Re: Company A 401(k) and Profit Sharing Plan (the Plan)
Identification Number C-09259

Dear Mr. Bragdon:

This is in response to your request for an advisory opinion concerning Prohibited Transaction Exemption (PTE) 77-3 (42 FR 18734, April 8, 1977).[1] Specifically, you request an opinion on whether the prohibition on the payment of sales commissions in PTE 77-3 applies to the payment of distribution-related expenses (12b-1 Fees) by a proprietary mutual fund (the Mutual Fund) to an unrelated broker. In particular, the distributor of the Mutual Fund would pay the unrelated broker from Mutual Fund assets received by the distributor under a Rule 12b-1 plan of distribution (the 12b-1 Plan).[2] The distributor would retain no portion of the 12b-1 Fees. Due to your uncertainty about the application of PTE 77-3, you requested that we not identify the relevant parties.

You describe the facts as follows. Company A is the sponsor of the Plan. Company A is an investment adviser to the Z Family of Mutual Funds (the Funds), and one of four employers of employees covered by the Plan. The other employers are Company B, the distributor and principal underwriter of the Funds; Company C, another investment adviser of the Funds; and Company D, which provides other services to the Funds.

The Plan is a defined contribution plan with a section 401(k) cash or deferred feature permitting employee pre-tax deferrals, which allows participants to direct the

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[1]The Department received your submission as a request for an administrative exemption. However, due to the nature of the issue involved, the Department has decided, with your concurrence, to process this submission as an advisory opinion request.

[2]Although you have also requested information concerning excise taxes and the correction of inadvertent prohibited transactions related to the 12b-1 Fees, this opinion letter does not address these issues. The Department believes that the appropriate forum to resolve these matters is the Internal Revenue Service.

investment of their accounts among the Funds. The Plan was established by Company A, effective January 1, 1994. The Plan covers only employees of Companies A, B, C, and D (the Companies). The Plan is intended to comply with section 404(c) of the Employee Retirement Income Security Act of 1974 (the Act or ERISA). As of June 30, 2005, the Plan had total assets of approximately $7 million. As of September 9, 2005, the Plan had 260 participants. The trustee of the Plan is Individual G, a senior executive officer of the Companies.

From the inception of the Plan to September 2005, you explain that participants have directed the investment of their accounts among the Funds. Beginning in 1999, you indicate that some of the Funds, in which participants invested their accounts, adopted 12b-1 Plans in accordance with Rule 12b-1 under the Investment Company Act of 1940 (the '40 Act), 17 CFR §240.12b-1. You further explain that the 12b-1 Plans permit 0.25 percent of the Funds' assets to be used by Company B to pay 12b-1 Fees to promote the sale of shares of the Funds. No 12b-1 Fees have been paid by Company B in connection with the acquisition or sale of shares of the Funds by the Plan.

You state that Company A has entered into an agreement (the Agreement) with Company E, an unrelated party to the Funds and the Companies, to provide administration services for the Plan. In connection therewith, Company A will (a) adopt the approved prototype plan of Company E, (b) appoint Bank F as successor trustee, and (c) transfer the assets of the Plan to Bank F in cash. After the transfer of the Plan assets, you explain that participants will direct the investment of their account balances among investment alternatives consisting of mutual funds that are offered by parties unrelated to the Funds and the Companies, whose net asset values are listed daily in financial and other news publications.

To accommodate a number of participants that want to continue to direct the investment of their account balances in the Funds after the transfer, you state that the Agreement with Company E provides for a self-directed brokerage account (the Self-Directed Brokerage Account) established with Company H, that will permit participants to direct the investment of their account balances in the Funds. The Self-Directed Brokerage Accounts will be available to all participants on an equal basis. A Plan participant that uses the Self-Directed Brokerage Account option will pay a $75 annual fee to the Plan recordkeeper.

You represent that Company B will pay a 12b-1 Fee to Company H, the broker, with respect to amounts invested in the Funds by Plan participants and that Company B will not retain any portion of such fee. You explain that Company H provides brokerage services to the Plan participants and that it is unrelated to the Funds, the Companies, Individual G, and Bank F. You also state that Company H is not a fiduciary, as defined in section 3(21) of the Act, with respect to the Plan, because it does not exercise any discretionary authority or control with respect to management of the Plan or exercise

any authority or control with respect to management or disposition of assets of the Plan, and does not render investment advice with respect to any property of the Plan. You further represent that no fiduciary of the Plan, or affiliate of any fiduciary, will benefit from any part of the 12b-1 Fee.

You represent that the Plan's investment in the Funds has met and will continue to meet the conditions stated in PTE 77-3. Therefore, you explain that the only issue with respect to the continued availability of PTE 77-3 is the possibility that the payment of 12b-1 Fees to Company H may not be permissible under
PTE 77-3.

PTE 77-3 provides relief from the restrictions of sections 406 and 407(a) of the Act and the taxes imposed by section 4975 (a) and (b) of the Internal Revenue Code (the Code), by reason of section 4975(c)(1) of the Code, with respect to the acquisition or sale of shares of an open-end investment company registered under the '40 Act by an employee benefit plan covering only employees of such investment company, employees of the investment adviser or principal underwriter for such investment company, or employees of any affiliated person of such investment adviser or principal underwriter; provided that the conditions of the class exemption are met. Among its requirements, section (c) of PTE 77-3 provides that the plan must not pay a sales commission in connection with such acquisition or sale.

As you have noted, the Department's concern with respect to 12b-1 Fees was expressed in ERISA Advisory Opinion 93-12A (April 27, 1993) in the context of a transaction otherwise covered by PTE 77-4 (42 FR 18732, April 8, 1977). PTE 77-4 permits the purchase or sale by a plan of shares of a registered open-end investment company where an investment adviser to the mutual fund is also a fiduciary with respect to the plan. In ERISA Advisory Opinion 93-12A, a company serving as investment manager or trustee to employee benefit plans invested plan assets in affiliated mutual funds. The company credited the plan for investment advisory fees that the company received from the mutual fund, but did not credit the plan for fees that it received for secondary services provided to that fund. The Department stated that PTE 77-4 would be available if the secondary services were not investment advisory services and the conditions of this class exemption were otherwise met.

The Department also noted in ERISA Advisory Opinion 93-12A that at the time PTE 77-4 was granted, the use of a portion of the assets of a registered investment company to pay distribution-related expenses was not generally permitted by the Securities and Exchange Commission. Accordingly, the Department stated that the payment of 12b-1 Fees was not specifically considered as part of its determination to grant PTE 77-4. In any event, the Department was of the view that the payment of a 12b-1 Fee by a mutual fund to a plan fiduciary or its affiliate could not be "functionally distinguished" in many instances from the payment of a commission by the plan in connection with the

acquisition or sale of shares in a mutual fund. Therefore, the Department 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 was paid to the fiduciary or its affiliate with regard to that portion of the fund's assets attributable to the plan's investment.

In ERISA Advisory Opinion 2002-05A (June 7, 2002) involving "exchange-traded funds," the Department expressed the view that the term "sales commission," as used in section II(a) of PTE 77-4, would not include brokerage commissions paid to a broker in connection with purchases or sales of shares of registered open-end investment companies listed on an exchange if the broker is unaffiliated with the fund, its principal underwriter, investment adviser or any affiliate thereof.

Similarly in the case under consideration, the broker (Company H) is unaffiliated with the Mutual Fund, its principal underwriter/distributor (Company B), any investment advisers (Companies A and C) or any affiliate thereof (Company D), and any other fiduciary of the Plan (Bank F and Company E). In addition, neither the Companies nor their affiliates would receive any part of the 12b-1 Fees, nor would any fiduciary with respect to the Plan or affiliate of such fiduciary receive such fees. Finally, no commissions would be paid from the Plan participants' accounts other than 12b-1 Fees out of Fund assets. Accordingly, it is the Department's view that the term "sales commission," as used in section (c) of PTE 77-3, would not include 12b-1 Fees that are paid to Company H, by Company B, from Mutual Fund assets, where Company H is an unrelated party and Company B keeps no part of the 12b-1 Fees.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and is issued subject to the provisions of that procedure, including section 10, relating to the effect of advisory opinions. This opinion relates only to the specific issue addressed herein and is consistent with ERISA Advisory Opinion 2002-05A.

Sincerely,

Ivan L. Strasfeld
Director
Office of Exemption Determinations