

MEMO# 25680

November 30, 2011

DOL Issues Advisory Opinion Regarding Indemnification of a Broker for IRA Account Losses

[25680]

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TO: PENSION MEMBERS No. 63-11

BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 75-11

BROKER/DEALER ADVISORY COMMITTEE No. 80-11 RE: DOL ISSUES ADVISORY OPINION REGARDING INDEMNIFICATION OF A BROKER FOR IRA ACCOUNT LOSSES

The Department of Labor released Advisory Opinion 2011-09A [\[1\]](#) which concludes that it is a prohibited transaction (violating Internal Revenue Code Section 4975(c)(1)(B)) for an IRA owner to enter into an indemnification agreement with a broker as a condition precedent for an IRA to establish a futures trading account with the broker. The requestor of the advisory opinion had been issued a prior advisory opinion wherein the Department expressed its view that it would be a prohibited transaction for an IRA owner to grant to a brokerage firm a security interest in the assets of non-IRA accounts held by the broker as a requirement for establishing an IRA with the broker. [\[2\]](#)

The requestor of the advisory opinion presented a situation where an IRA owner, prior to opening a futures trading account with a broker, may be required to enter into an indemnification agreement securing the broker against certain losses attributable to the IRA's account with the broker. These potential losses would include, but are not limited to, an investment related loss and/or tax the IRA may incur in connection with a futures contract where the amount of the loss and/or tax exceeds the amount of assets held in the IRA. The requester sought an opinion as to whether Prohibited Transaction Exemption ("PTE") 80-26 provided relief from the Code's prohibited transaction provisions under such circumstances.

Code section 4975(c)(1)(B) prohibits the direct or indirect lending of money or other extension of credit between a plan and a disqualified person. [\[3\]](#) PTE 80-26 permits parties in interest with respect to a plan to make certain loans and extensions of credit to such plan. For purposes of PTE 80-26, the term "plan" includes an IRA. Relief is available under PTE 80-26 if the proceeds of the loan or extension of credit are used only (1) for the payment of ordinary operating expenses of the plan, (including the payment of benefits in

accordance with the terms of the plan and periodic premiums under an insurance or annuity contract; or (2) for a purpose incidental to the operation of the plan.

Although PTE 80-26 does not define the terms “ordinary operating expenses” or “incidental to the operation of the plan,” the Department concluded that an excess loss arising from a futures contract entered into by an IRA is neither an “ordinary operating expense” of the IRA [4] nor an expense “incidental to the operation of the plan for purposes of PTE 86-20.

[5] Therefore, the Department concluded that relief under PTE 86-20 is not available with respect to the circumstances described in the request.

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endnotes

[1] A copy of Advisory Opinion 2011-09A is available here:
<http://www.dol.gov/ebsa/regs/aos/ao2011-09a.html>

[2] See Memorandum to Pension Members No. 53-09, Bank Trust and Recordkeeper Advisory Committee No. 51-09, Broker/Dealer Advisory Committee No. 62-09 [23944], dated November 10, 2009.

[3] The Department concluded that the IRA owner was a disqualified person because the IRA was self-directed and thus the owner was a fiduciary within the meaning of Code section 4975(e)(3).

[4] The Department stated that PTE 80-26 and the preamble to the original notice of proposed exemption provided the following examples of “ordinary operating expenses”: plan benefits, insurance premiums, or administration expenses. The Department concluded that these examples are consistent with the plain meaning of “operating expenses,” which is: expenses incurred in the ordinary activities of an entity.

[5] The Department noted that PTE 80-26 and subsequent amendments thereto provided examples of a plan’s use of proceeds for a purpose “incidental to the ordinary operation of the plan” including bank overdrafts, the crediting of dividends or interest, plan liquidity problems, and the transfer of a participant’s account balance from one account to another. The Department’s view is that these examples are consistent with the plain meaning of the term “incidental”, which is “occurring as a minor accompaniment” or “liable to occur in consequence of or in connection with something.”

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