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

October 20, 2011

Mr. Timothy Berry
1812 E. Toledo
Gilbert, AZ 85295

2011-09A
PTE 80-26

Dear Mr. Berry:

This is in response to your request for an advisory opinion from the U.S. Department of Labor (the Department) concerning the applicability of Prohibited Transaction Exemption (PTE) 80-26 to certain transactions involving individual retirement accounts (IRAs) described in section 4975(e)(1) of the Internal Revenue Code of 1986, as amended (the Code).[1] Your request relates, in part, to an Advisory Opinion the Department issued to you on October 27, 2009 (Advisory Opinion 2009-03). That Advisory Opinion concerns whether it would be a prohibited transaction in violation of Code section 4975(c)(1)(B) for an individual to grant a brokerage firm (a Broker) a security interest in the assets of the individual's non-IRA accounts with the Broker as a requirement for the individual's establishment of an IRA with the Broker.[2] As you know, Advisory Opinion 2009-03 sets forth the Department's view that, with respect to the arrangement described above, the grant by an individual to a Broker of a security interest in the individual's non-IRA accounts in order to cover indebtedness of, or arising from, the individual's IRA with the Broker, would be an impermissible "extension of credit," as described in section 4975(c)(1)(B) of the Code.[3]

You state the following in connection with your request. The beneficial owner of an IRA (an IRA Owner) may direct a trust company to open a futures trading account (an Account) with a Broker, for purposes of the IRA Owner thereafter self-directing the investment of assets attributable to the Account. The Broker may seek to require, prior to the establishment of the

---

[1] PTE 80-26 (45 FR 28545 (April 29, 1980), as corrected at 45 FR 35040 (May 23, 1980)) has been amended four times: (65 FR 17540 (April 3, 2000); 67 FR 9483 (March 1, 2002); 67 FR 9485 (March 1, 2002); and 71 FR 17917 (April 7, 2006)). The second amendment (PTE 2002-13) to the class exemption clarifies that for purposes of PTE 80-26 (and certain other class exemptions), the terms "plan" and "employee benefit plan" refer to an employee benefit plan described in ERISA section 3(3) and/or a plan described in section 4975(e)(1) of the Code.

[2] Under Reorganization Plan No. 4 of 1978, effective December 31, 1978, the authority of the Secretary of the Treasury to issue interpretations regarding section 4975 of the Code was transferred, with certain exceptions not here relevant, to the Secretary of Labor. The Secretary of the Treasury is bound by the interpretation of the Secretary of Labor pursuant to such authority.

[3] As noted in Advisory Opinion 2009-03, other prohibited transactions would occur to the extent an individual granted to a Broker a security interest in the assets of the individual's IRA (established with the Broker) for purposes of covering the indebtedness of the individual.

Account, that the IRA Owner effectuate an indemnification agreement (an Indemnification Agreement). An Indemnification Agreement secures a Broker against certain losses attributable to an IRA's Account with the Broker. In this last regard, an IRA may incur an investment-related loss and/or tax in connection with entering into a futures contract, where the amount of such loss and/or tax exceeds the amount of assets held in the IRA (an excess loss). In that instance, it is your understanding that the IRA Owner, pursuant to the terms of an Indemnification Agreement, would be obligated to provide the Broker with cash equal to such excess loss amount.[4]

In your view, an Indemnification Agreement constitutes an impermissible "extension of credit" from an IRA Owner to his or her IRA. As a result, you inquire whether PTE 80-26 provides relief from Code section 4975(c)(1)(B) with respect to such "extension of credit."

Section 4975(c)(1)(B) of the Code prohibits the direct or indirect lending of money or other extension of credit between a "plan" and a "disqualified person." Code section 4975(e)(1) defines the term "plan" to include an IRA described in section 408(a) of the Code. Code section 4975(e)(2) defines the term "disqualified person" to include a "fiduciary" of the plan. Section 4975(e)(3) of the Code defines the term "fiduciary" to include any person who exercises discretionary authority or control respecting management of a plan or exercises any authority or control regarding management or disposition of plan assets.

The arrangement described in your request involves an IRA Owner self-directing investments made by his or her IRA. Pursuant to section 4975(e)(2) of the Code, an IRA Owner who self-directs investments attributable to his or her IRA is a fiduciary and disqualified person with respect the IRA. Accordingly, the IRA Owner is subject to the restrictions imposed by section 4975(c)(1) of the Code.[5]

PTE 80-26 permits parties in interest with respect to employee benefit plans to make certain loans and extensions of credit to such plans.[6] Relief is available under the class exemption for extensions of credit described in Code section 4975(c)(1)(B) to the extent the conditions of the class exemption are met. In the latter regard, the class exemption requires that, among other things, the proceeds of such a loan or extension of credit being used only-

(b)(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

(b)(2) for a purpose incidental to the ordinary operation of the plan.

---

[4] The Department notes that this arrangement may raise tax considerations under the Code.

[5] *See* Advisory Opinion 2009-03.

[6] As noted above, for purposes of PTE 80-26, the terms "plan" and "employee benefit plan" include an IRA described in section 408(a) of the Code. Accordingly, PTE 80-26 permits a disqualified person with respect to an IRA, including a fiduciary, to make certain loans and extensions of credit to the IRA.

With respect to condition (b)(1) of PTE 80-26, the class exemption does not define the term "ordinary operating expenses." However, PTE 80-26 and the preamble to the original notice of proposed exemption for PTE 80-26 provide the following examples of "ordinary operating expenses": plan benefits, insurance premiums, and/or administrative expenses.[7] These examples are consistent with the plain meaning of "operating expenses," which is: expenses incurred in the course of ordinary activities of an entity.[8] It is therefore our view that condition (b)(1) of PTE 80-26 is satisfied only to the extent proceeds from an extension of credit from a party in interest to a plan are used to pay for an expense incurred by the plan in the course of an ordinary activity attributable to the plan.

In your request, as noted above, you state that proceeds from an Indemnification Agreement are used to offset an excess loss, where such loss arose in connection with the investment performance of a futures contract entered into by an IRA. We note that the investment performance of a futures contract entered into by an IRA is independent of, and unrelated to, any activity (ordinary or otherwise) attributable to the operation of the IRA. Therefore, it is our view that an excess loss arising from a futures contract entered into by an IRA is not an "ordinary operating expense" of the IRA for purposes of condition (b)(1) of PTE 80-26.

With respect to condition (b)(2) of PTE 80-26, the class exemption does not define the term "incidental to the ordinary operation of the plan." However, PTE 80-26 and subsequent amendments thereto provide the following examples of a plan's use of proceeds for a purpose "incidental to the ordinary operation of the plan": bank overdrafts;[9] the crediting of dividends or interest;[10] plan liquidity problems;[11] and the transfer of a participant's account balance from one account to another.[12] We note 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."[13]

---

[7] See Notice of Proposed Class Exemption for Interest Free Loans to Employee Benefit Plans (45 FR 8761 at *id.* (February 8, 1980)).

[8] See Black's Law Dictionary, Fifth Edition, which also describes an "operating expense" as "(t)hose expenses required to keep the business running, *e.g.* rent, electricity, heat."

[9] *See* 45 Fr 28545 at *id*.

[10] *Id*.

[11] *See*, generally, 67 FR 9485.

[12] *See* Notice of Proposed Amendment to PTE 80-26 (64 FR 66666, 66667 (November 29, 1999)).

[13] S*ee* Oxford American Dictionary.

As noted above, you state that an Indemnification Agreement is a condition precedent for an IRA to: (1) establish an Account with a Broker; and (2) invest in a futures contract through the Account. In our view, an Indemnification Agreement that is required in order for an IRA to engage in futures trading is not "incidental" within the meaning of condition (b)(2) of PTE 80-26.

In light of the above, it is the view of the Department that relief under PTE 80-26 is not available with respect to the arrangement described in your request.

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.[14]

Sincerely,

Ivan L. Strasfeld
Director,
Office of Exemption Determinations

---

[14] Your request for an Advisory Opinion includes numerous other inquiries which we believe have been addressed by the determination set forth above.