

# Department of Labor (DOL)

## Exemption for Uninvested IRA Balances

Federal Register / Vol. 71, No. 53 / Pages 14005-14008

### Department of Labor

Employee Benefits Security Administration

[Prohibited Transaction Exemption 2006-01; Exemption Application No. D-11216 et al.]

**Grant of Individual Exemptions; Edward D. Jones & Co., L.P. (the Applicant)**

**Agency:** Employee Benefits Security Administration, Labor.

**Action:** Grant of individual exemptions.

**Summary:** This document contains exemptions issued by the Department of Labor (the Department) from certain of the prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (the Act) and/or the Internal Revenue Code of 1986 (the Code).

A notice was published in the **Federal Register** of the pendency before the Department of a proposal to grant such exemption. The notice set forth a summary of facts and representations contained in the application for exemption and referred interested persons to the application for a complete statement of the facts and representations. The application has been available for public inspection at the Department in Washington, DC. The notice also invited interested persons to submit comments on the requested exemption to the Department. In addition the notice stated that any interested person might submit a written request that a public hearing be held (where appropriate). The applicant has represented that it has complied with the requirements of the notification to interested persons. No requests for a hearing were received by the Department. Public comments were received by the Department as described in the granted exemption.

The notice of proposed exemption was issued and the exemption is being granted solely by the Department because, effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), transferred the authority of the Secretary of the Treasury to issue exemptions of the type proposed to the Secretary of Labor.

### Statutory Findings

In accordance with section 408(a) of the Act and/or section 4975(c)(2) of the Code and the procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, 32847, August 10, 1990) and based upon the entire record, the Department makes the following findings:

- (a) The exemption is administratively feasible;
- (b) The exemption is in the interests of the plan and its participants and beneficiaries; and
- (c) The exemption is protective of the rights of the participants and beneficiaries of the plan.

**Edward D. Jones & Co., L.P. (the Applicant) Located in St. Louis, Missouri [Prohibited Transaction Exemption No. 2006-01; Application No. D-11216]**

### Exemption

The restrictions of sections 406(a)(1)(A) through (D) of the Act and the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (D) of the Code, shall not apply to the extension of credit to the Applicant, by certain IRAs whose assets are held in custodian accounts by the Applicant, a party in interest and a disqualified person with respect to the IRAs, in connection with the Applicant's use of uninvested IRA cash balances (Free Credit Balance(s)) in such accounts. This exemption is conditioned upon the adherence to the material facts and representations described herein and upon the satisfaction of the following requirements:

- (a) Neither the Applicant nor any affiliate has any discretionary authority or control with respect to the investment of the cash balances of the IRA that are held in the Free Credit Balance or provides investment advice (within the meaning of 29 CFR 2510.3-21(c)) with respect to those assets;
- (b) Edward Jones credits the IRA with monthly interest on its Free Credit Balance at an annual rate no less than the bank national index rate for interest checking, as reported in the Bank Rate Monitor. This rate will be subject to a minimum rate level of 10 basis points (0.10%);
- (c) The interest rate will be no less than the rate paid by Edward Jones on non-IRA Free Credit Balances;
- (d) The IRA independent fiduciary has the ability to withdraw the Free Credit Balance at any time without restriction;
- (e) The Applicant provides in writing, to the IRA independent fiduciary, prior to any transfer of the IRA's available cash into a Free Credit Balance account, an explanation (i) that funds invested in a Free Credit Balance are not segregated and may be used in the operation of the business of the Applicant; (ii) of the method to be used for crediting interest to the Free Credit Balance; and (iii) that the funds are payable to the IRA on demand;
- (f) On the basis of the information disclosed pursuant to paragraph (e) above, the IRA independent fiduciary approves the transfer of the IRA's available cash into a Free Credit Balance account. If the disclosure includes a specified date before which the independent fiduciary must object to the transfer of the IRA's existing cash balances into a Free Credit Balance account, failure of the IRA independent fiduciary to object to the transfer by that date will be deemed an approval by the IRA independent fiduciary of the transfer to and

holding of the IRA's available cash in the Free Credit Balance account.

The Applicant provides, with or as part of the customer's statement of account, no less frequently than once every three months, notification that the IRA independent fiduciary may, at any time and without penalty, direct the Applicant in writing to withdraw the IRA's available cash from the Free Credit Balance account. Failure of the IRA independent fiduciary to provide such written direction will be deemed an approval by the IRA independent fiduciary of the transfer to and holding of the IRA's available cash in the Free Credit Balance account; and

(g) The Applicant periodically provides a written statement subsequent to the proposed transaction informing the IRA independent fiduciary that (i) such funds are not segregated and may be used in the operation of the business of such broker or dealer, and (ii) such funds are payable on demand.

For a more complete statement of the facts and representations supporting the Department's decision to grant this exemption, refer to the Notice of Proposed Exemption (the Notice) published on June 29, 2005 at 70 FR 37437.

## Written Comments

The Department received 107 written comments from interested persons in response to the Notice. The Department forwarded copies of the comments to the Applicant and requested that the Applicant address in writing the various concerns raised by the commentators. Many of the comments fell into broad categories to which the Applicant responded collectively. Where a single commentator raised a unique issue, such issue was responded to individually. The comments and the Applicant's responses are summarized below.

Four commenters favored granting the exemption, and one expressed no objection. Six posed questions regarding the exemption without taking a position. The remaining 96 commenters objected to granting the exemption. Of those, 22 did not describe the reasons for their objections, leaving 74 that made substantive comments on the proposed exemption.

The principal objection to the exemption (reflected in 36 of the comments) was that transferring IRA cash to Free Credit Balances in place of the currently-used money market fund would negatively affect the annual rate of return earned by the IRAs, providing a lower checking account interest rate instead of a money market rate. While the money market rates were low at one time, the commentators pointed out that money market rates have risen to a level that is considerably higher than the 10 basis points described as the current rate in the Notice. Related to this concern was the view that the Applicant should not impose a \$3/month low balance fee on the Retirement Shares class of its money market fund, with some pointing out that the Applicant already charges an IRA custody fee. (One commenter, by contrast, saw the Notice as unnecessary because the Applicant already has the option to impose a minimum account balance requirement, which the person thought would encourage IRA

contributions – like some others, apparently viewing the low balance fee as being imposed on IRAs themselves rather than limited to the money market fund.)

The Applicant represents that these comments reflect a misunderstanding of the context in which the Free Credit Balance arrangement is to be made available. The large number of small accounts in the Retirement Shares class has resulted in increased administrative expense to the money market fund, depressing investment return. The Applicant has determined to impose a minimum balance fee on the Retirement Shares, as is already the case for the other class of fund shares, to discourage small accounts and thereby restore returns to the level of other money market funds. However, it was concerned that this would leave IRAs without a convenient investment for their available cash generated through interest and dividends. It therefore postponed imposing the minimum balance fee until it could make FreeCredit Balances available to the IRAs.

Several of these commenters, along with two others, noted that the minimum balance fee would represent additional income to the Applicant, to which they objected, and some added that this additional income was unnecessary since the Applicant already charges an IRA custody fee. The Applicant represents that three points are relevant here. First, the Applicant does not retain the entire low balance fee; it is in part retained by the money market fund. Second, it is contemplated that only a minimal number of customers would pay the fee instead of moving their balance to the cash interest option. Third, as an offset to any fees that the Applicant might collect, if the fund has fewer accounts as a result of the minimum balance fee—as would likely be the case—the Applicant's income would decrease, as the fund would pay to the Applicant lower transfer and dividend disbursing agent fees (which are based on the number of shareholder accounts). For these reasons, the Applicant represents that the minimum balance fee is not expected to increase the Applicant's bottom line, as one commenter suggested, or otherwise benefit the Applicant at the fund's expense, as several others alleged.

The other principal objection, reflected in 17 of the comments, was that the change to using Free Credit Balances of the broker-dealer as the IRAs' cash vehicle would place the IRAs' assets at higher risk, because the money would no longer be "protected" or safe and/or would be used for the Applicant's general business operations. The Applicant's response states that several of the commentators do not appear to understand the nature of the current cash vehicle. While a money market fund attempts to maintain stability of principal, its assets are not insured, either by the Federal Deposit Insurance Corporation (as one commenter believed) or otherwise, and its investments are subject to risk of loss. As stated in the fund prospectus, the fund shares are not guaranteed or insured by any bank, the U.S. government or any government agency. The Applicant represents that in fact, the Free Credit Balances would be subject to reduced risk in this regard, assuming that they are intended for the purpose of purchasing securities (as would normally be the case for an IRA account), because they would be covered by SIPC insurance. SIPC insurance would protect the IRA holders against

loss in the event the Applicant was to file for bankruptcy (a concern expressed in at least four of the comments). In addition, Free Credit Balances are subject to reserve requirements. These provide further protection to customers against a broker-dealer's misuse of the funds or insolvency by requiring the broker-dealer to deposit the amount of its liabilities to customers in excess of amounts owed to it by customers in a specially designated bank account. The effect of the reserve requirements is to restrict the use of the money to the financing of the broker-dealer's customer-related business, not permitting the money to be used beyond that for the broker-dealer's general business operations.

The Applicant represents that some of these comments reflected misperceptions about the nature of the Free Credit Balances. Two commenters assumed that the cash placed in the Free Credit Balances would no longer be part of their IRAs. One was concerned that the cash would therefore be at increased risk because it would lose the protection that IRA funds have from creditors in the event of his personal bankruptcy. The Applicant represents that that is not the case. The money in the Free Credit Balances would still be part of the IRAs, and as such would be protected from bankruptcy and exempt from income tax to the same extent as any other assets of the IRAs.

Several of these commenters were concerned that the cash in the Free Credit Balances would not be immediately available on demand, or otherwise that the change would mean that they would lose control over their funds. The Applicant represents, by law, Free Credit Balances are liabilities of the broker-dealer subject to immediate cash payment to customers on demand. These liabilities are backed by special reserve requirements, which further assure that the cash will be available as needed. Therefore, the IRA holders will continue to control these funds, having the ability to withdraw the cash on demand and to use it to purchase other investments of their choosing.

Similarly, there were comments about the benefits that the Applicant would receive as a result of the change in the cash sweep vehicle, reflected in several of the comments concerned about greater risk and reduced return. Four commenters specifically objected to letting the Applicant keep the interest spread from taking in IRA funds and investing those funds at a higher rate. The Applicant represents that it is true that, in the ordinary conduct of its business, the Applicant is permitted to use customer Free Credit Balances for the purpose of making customer loans, and that these loans would be at a higher interest rate than the Applicant would pay on the Free Credit Balances. Importantly, however, the IRAs would still be receiving market interest rates for small balance demand accounts—at the same or higher rate that the Applicant pays to non-IRA Free Credit Balances—so that they will be treated in a fair and reasonable manner. Furthermore, the Applicant represents that the Applicant will be sacrificing other fees on the money market fund assets as a result of the reduction in the number of shareholder accounts, so that any additional income it may earn may not result in additional profit. One of these commenters added that offering a money market fund, even if not profitable, should be a cost of doing business. However, the Applicant

represents that the issue is not one of profitability – it is whether the money market fund is able to achieve market returns for its investors.

Six commenters expressed a preference to continue to place their cash in the money market fund. The Applicant represents that under the terms of the Notice as it would be implemented by the Applicant, they will be able to do so. A current IRA customer will be notified of the Applicant's intention to transfer the IRA's cash to a Free Credit Balance at least 30 days in advance of the effective date of such a change, and will have the ability to request to continue to use the money market fund. New customers will be able to make this request when they enter into the IRA account agreement. Furthermore, customers will be able at any time to request not to have their cash placed in Free Credit Balances. Therefore, IRA holders will not be forced to use Free Credit Balances as their cash sweep vehicle if they object to doing so.

Eight commenters said that there would be no advantage to the IRA holders from switching to Free Credit Balances. However, the Applicant represents that once the minimum balance fee is imposed on the Retirement Shares, the income on the Free Credit Balances would exceed the income in the money market fund for amounts in the Retirement Shares below the minimum balance. For such accounts, there will be an advantage to switching over to Free Credit Balances.

Two commenters appeared to view the Notice as imposing additional burdens specifically on small IRAs, indicating that it would be unfair for that reason. The Applicant represents that these commenters should understand that the minimum balance fee will be imposed on small investments in the Retirement Shares, without regard to the overall size of the IRAs.

One commenter complained that the Notice would permit the Applicant to "arbitrarily" transfer IRA cash balances into Free Credit Balances, with the investor only finding out after the fact. The Applicant represents under the approval requirements under condition (f) above, the Applicant could make the transfer only after advance notice to the IRA holder.

Two commenters complained that making the change to Free Credit Balances would not be consistent with their existing agreements with the Applicant. The Applicant represents that there is nothing in the Applicant's standard form of IRA agreement that would prohibit the use of Free Credit Balances as an IRA's cash sweep vehicle. Furthermore, the change would be disclosed to the IRA holders, and they would have the opportunity to object to the change.

Five commenters indicated that they prefer to permit their cash to accumulate to a certain level, such as \$5,000, before investing it, and that the lower interest rate paid by the Free Credit Balances would pressure them to monitor their accounts more closely and either take more frequent distributions or make more frequent investments. If they are forced to make more frequent investments, they said, they would have to pay higher commissions to the Applicant. The Applicant represents that the majority of the Applicant's IRA customers find it prudent to invest

cash as it becomes available, as evidenced by the large number of zero-balance accounts in the Retirement share class of the money market fund. Should a customer wish to accumulate cash as described, the accumulation could take place in a Free Credit Balance until the amount reaches the level at which the money market low-balance fee is avoided, and then the cash could be transferred without any commission charge to the money market fund and credited to the customer's account on the next business day. This would not create undue pressure to monitor one's account.

One commenter objected for the reason that there are no alternative ways of handling any funds not immediately invested. The Applicant represents that the Retirement Shares of the money market fund would still be available if the IRA holder decides not to use a Free Credit Balance.

Another commenter did not think there was a problem because interest rates would rise. The Applicant represents that while the problem with low returns on the Retirement Shares is not as serious as it was in 2003 when the Applicant filed its exemption application, due to rising interest rates, there still is an issue of administrative fees for carrying small accounts decreasing returns for the Retirement Shares as compared to the Investment Shares. Furthermore, the problem may recur in the future should interest rates again fall. The Applicant believes it is in the interest of all of its customers to find a more efficient way to handle cash so that those who seek large cash investments can earn competitive rates in the money market fund, while those who keep very small cash amounts can make use of Free Credits Balances as their cash sweep vehicles.

Some of the commenters complained about having lost money from their investments with the Applicant (and in one case, also A.G. Edwards). The Applicant represents that these comments are not relevant to this Notice proceeding.

Four of the commenters requested a hearing, but did not specify any particular issues to be addressed at such a hearing. The Applicant represents that as the issues described above either represent a misunderstanding of the transaction or can be addressed by opting out of use of the Free Credit Balance as the cash sweep vehicle for a particular IRA, there is no need for a hearing. The Department concurs.

The Department also received a written comment submitted by the Applicant. This comment sought changes to a condition in the Notice, which is discussed below. The Applicant seeks changes to condition (f) of the Notice. Condition (f) of the Notice reads as follows:

The IRA independent fiduciary approves the transfer of the IRA's available cash into a Free Credit Balance account no less frequently than once every three months, or once every month if there is account activity for the particular month other than the crediting of interest, together with or as a part of the customer's statement of account;

The Applicant raises two issues regarding condition (f). First, the condition does not adequately address the initial approval by the IRA independent fiduciary of the use of free credit balances.

Second, it does not permit the approval to take the form of "negative consent."

The Department concurs with the Applicant and has modified condition (f) of the Notice to read as follows:

On the basis of the information disclosed pursuant to paragraph (e) above, the IRA independent fiduciary approves the transfer of the IRA's available cash into a Free Credit Balance account. If the disclosure includes a specified date before which the independent fiduciary must object to the transfer of the IRA's existing cash balances into a Free Credit Balance account, failure of the IRA independent fiduciary to object to the transfer by that date will be deemed an approval by the IRA independent fiduciary of the transfer to and holding of the IRA's available cash in the Free Credit Balance account.

The Applicant provides, with or as part of the customer's statement of account, no less frequently than once every three months, notification that the IRA independent fiduciary may, at any time and without penalty, direct the Applicant in writing to withdraw the IRA's available cash from the Free Credit Balance account. Failure of the IRA independent fiduciary to provide such written direction will be deemed an approval by the IRA independent fiduciary of the transfer to and holding of the IRA's available cash in the Free Credit Balance account. The Department has considered the entire record and has determined to grant the exemption with the revisions noted herein.

**For Further Information Contact:** Khalif I. Ford of the Department, telephone (202) 693-8540. (This is not a toll-free number.)