

MEMO# 18052

September 29, 2004

DOL ISSUES FINAL REGULATIONS ON AUTOMATIC IRA ROLLOVERS

[18052] September 29, 2004 TO: PENSION MEMBERS No. 49-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 64-04 TRANSFER AGENT ADVISORY COMMITTEE No. 74-04 RE: DOL ISSUES FINAL REGULATIONS ON AUTOMATIC IRA ROLLOVERS The Department of Labor issued final safe harbor regulations and a prohibited transaction exemption implementing the automatic IRA rollover provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).¹ We are pleased to inform you that, as the Institute suggested,² the Department has eliminated the requirement (contained in the proposed regulations) that would have restricted fees and expenses chargeable to an automatic rollover IRA to the income earned by the IRA. The Department also clarified the effect of the statutory relief provided in ERISA section 404(c)(3) in a manner consistent with the Institute's recommendations. Overview Under section 657 of EGTRRA,³ qualified plans must establish a default mechanism under which amounts subject to the provision are automatically rolled over to an IRA designated by the plan administrator, unless the participant affirmatively elects otherwise. The Department's final regulations establish a safe harbor under which a fiduciary will be deemed to have satisfied its fiduciary responsibilities in connection with automatic rollovers to IRAs, provided that a number of conditions are satisfied. Notably, compliance with the safe harbor is not intended to represent the exclusive means by which a fiduciary may satisfy its duties under ERISA. 1 The final safe harbor regulations are available at: <http://www.dol.gov/ebsa/regs/fedreg/final/2004021591.pdf>. The final prohibited transaction exemption is available at: <http://www.dol.gov/ebsa/regs/fedreg/notices/2004021592.pdf>. 2 See Institute Memorandum (#17344) to Pension Members No. 24-04 and Pension Operations Advisory Committee No. 29-04, dated April 2, 2004; see also Institute Memorandum (#15741) to Pension Members No. 12-03 and Pension Operations Advisory Committee No. 15-03, dated March 12, 2003. 3 See Institute Memorandum (#13566) to Pension Members No. 21-01 and Pension Operations Advisory Committee No. 35-01, dated May 31, 2001. 2 Conditions Under The Safe Harbor • Fees and Expenses. As noted above, the final regulations do not contain the rule in the proposed regulations that would have limited the fees on an automatic rollover IRA to the income earned by the IRA. Consistent with the Institute's recommendation, the final regulations retain a comparability standard as the only fee standard. Specifically, fees and expenses attendant to an IRA, including its investments, may not exceed the fees and expenses charged by the IRA provider for comparable IRAs established outside of the automatic rollover process. • Agreements With IRA Providers. The final regulations contain a new provision that requires a written agreement between the plan fiduciary and the IRA provider. The written agreement must address, among other things, the investment product into which the rolled-over funds will be invested, the fees and expenses attendant to the IRA, and the right of the participant to enforce the terms of the agreement against

the IRA provider. The Department states that a plan fiduciary may rely on the commitments of the IRA provider set forth in the agreement and would not be required to monitor the provider's compliance with the terms of the agreement following a rollover into an IRA. • Investment Products. As in the proposed regulations, the rolled-over funds must be invested in a product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity. For these purposes, the investment product must seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the IRA. In addition, the investment product selected must be offered by a state or federally regulated financial institution, which must be (1) an investment company registered under the Investment Company Act of 1940, (2) a bank or savings association, (3) a credit union, or (4) an insurance company. • Rollover Amounts Less Than \$1,000. Unlike the proposed regulations, the final rules extend safe harbor relief to mandatory distributions of \$1,000 or less. The final regulations retain the requirement that the present value of the nonforfeitable accrued benefits as determined under Code section 411(a)(11) may not exceed the maximum amount under Code section 401(a)(31)(B). • Definition of "Individual Retirement Plan." As in the proposed regulations, the final regulations require that mandatory distributions be directed to an "individual retirement plan" within the meaning of Code section 7701(a)(37). This provision defines the term to mean an individual retirement account under Code section 408(a) or an individual retirement annuity under Code section 408(b). The Department also clarified that the safe harbor does not limit the number of IRA providers that an employer may designate as recipients of automatic rollovers. • Notice to Participants. The final regulations, like the proposed rules, require participants to be furnished with a summary plan description (SPD) or summary of material modifications (SMM) that describes the plan's automatic rollover provisions. This description must include (1) an explanation that the mandatory distribution will be invested in an investment product designed to preserve principal and provide a 3 reasonable rate of return and liquidity, (2) a statement on how fees and expenses attendant to the IRA will be allocated (i.e., the extent to which the plan or plan sponsor will bear any costs relating to the IRA), (3) the name, address and phone number of a plan contact, (4) the IRA provider, and (5) the fees and expenses attendant to the IRA. ERISA Section 404(c)(3) As suggested by the Institute, the Department addressed the relationship between the statutory relief provided in ERISA section 404(c)(3) (as added by EGTRRA) and the Department's safe harbor relief provided under ERISA section 404(a). Specifically, the Department confirmed that its safe harbor regulations constitute the guidance referred to in ERISA section 404(c)(3).⁴ Moreover, the Department clarified that the plan fiduciary's responsibilities with respect to automatic rollovers ends when the rollover assets are placed with the IRA provider pursuant to an agreement that satisfies the safe harbor's conditions. Beneficiary Designations Consistent with the Institute's recommendations, the Department clarified that a beneficiary designation under the distributing plan would cease to control a distribution of the rolled-over funds from an IRA upon the death of the IRA owner. In the Department's view, the rollover distribution of an entire plan benefit into an IRA ends the individual's status as a plan participant, and the distributed assets cease to be plan assets under Title I of ERISA. The Department further clarified that nothing in its regulations precludes an IRA provider from applying its own default beneficiary rules until the IRA owner makes an affirmative designation under the terms of the IRA. Anticipated Code Guidance The preamble states that the Treasury Department and the IRS have informed the Department that guidance under the Internal Revenue Code on the application of the automatic rollover rules is anticipated prior to the effective date of the Department's final regulations. The Institute had requested guidance under the Code in response to the Department's 2003 request for information on automatic rollovers.⁵ Prohibited Transaction Class Exemption In

addition to the safe harbor regulations, the Department issued its final class prohibited transaction exemption on the automatic rollover rules. The exemption permits a plan fiduciary that is also an IRA provider to establish automatic rollover IRAs for its own 4 ERISA section 404(c)(3) provides plan fiduciaries with statutory relief under ERISA section 404(c) for automatic rollovers “upon (A) the earlier of (i) a rollover of all or a portion of the amount to another individual retirement account or annuity; or (ii) one year after the transfer is made; or (B) a transfer that is made in a manner consistent with guidance provided by the Secretary.” The Department’s safe harbor regulations were issued under section 657(c)(2) of EGTRRA; that provision directed the Department to prescribe safe harbor guidance under which the designation of institutions and investment of funds would be deemed to satisfy the fiduciary requirements of ERISA section 404(a). 5 See Institute Memorandum (#15741) to Pension Members No. 12-03 and Pension Operations Advisory Committee No. 15-03, dated March 12, 2003. 4 employees. The conditions in the final class exemption largely reflect the conditions set forth in the final safe harbor regulations. One significant difference, however, is that the class exemption retains the rule that limits fees and expenses (other than establishment fees) to the income earned by the IRA. The Department noted that the removal of this requirement would increase the potential for self-dealing. Effective Date The final regulations apply to any rollover of a mandatory distribution made on or after March 28, 2005. Thomas T. Kim Associate Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 18052, or call the ICI Library at (202) 326-8304 and request the attachments for memo 18052.