INVESTMENT COMPANY INSTITUTE

**MEMO# 18649**

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# DOL ISSUES PROPOSED ORPHAN PLAN GUIDANCE; CONFERENCE CALL SCHEDULED FOR MARCH 24

[18649] March 11, 2005 TO: PENSION COMMITTEE No. 10-05 PENSION OPERATIONS ADVISORY COMMITTEE No. 10-05 RE: DOL ISSUES PROPOSED ORPHAN PLAN GUIDANCE; CONFERENCE CALL SCHEDULED FOR MARCH 24 The Department of Labor issued proposed regulations and a prohibited transaction class exemption that address "abandoned" or "orphan" individual account plans.1 As you know, the Institute called for the issuance of regulatory guidance that would facilitate participants' ability to obtain their benefits under orphan plans.2 The proposed regulations reflect the Institute's recommendations in a number of respects. In particular, the proposed regulations would establish a voluntary program by which certain plan service providers can make distributions to abandoned plan participants. The proposed regulations also define when a plan becomes orphaned and provide some liability relief to parties that take steps to assist plan participants. In addition, the proposed regulations clarify a number of tax-qualification issues raised by orphan plans. This memorandum summarizes both the proposed regulations and proposed exemption. A conference call has been scheduled for Thursday, March 24, 2005, at 2:00 p.m. Eastern to develop the Institute's comments on the proposed rules. If you would like to participate in this call, please respond to Brenda Turner by Wednesday, March 23 via the attached response form or by email (to bturner@ici.org). To participate in this call, dial 888-913-9967 and enter passcode 62768. Comments on the proposed regulations and proposed prohibited transaction exemption must be submitted to the Department by May 9, 2005. 1 The proposed regulations are available at: http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/05-4464.pdf. The proposed class exemption is available at: http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/05-4465.pdf. The Department's fact sheet describing the guidance is available at: http://www.dol.gov/ebsa/newsroom/fsabandonedindaccplan.html. 2 See, e.g., Institute Memorandum (#14947) to Pension Committee No. 27-02 and Pension Operations Advisory Committee No. 47-02, dated July 22, 2002 (Institute Testimony before the ERISA Advisory Council on orphan plans). 2 PROPOSED REGULATIONS The proposed regulations establish (1) standards to determine when a plan may be considered abandoned and deemed terminated, (2) procedures for winding up the affairs of the plan and distributing benefits to participants and beneficiaries, and (3) guidance on who may initiate and carry out the winding-up process. Qualified Termination Administrator Only a qualified termination administrator ("QTA") may determine whether a plan is abandoned and perform related activities to wind up an abandoned plan. The proposed regulations define a QTA as a party who (1) is eligible to serve as a trustee or issuer of an individual retirement plan, within the

meaning of Code section 7701(a)(37), and (2) holds the assets of the plan considered abandoned. The Department requests specific comments on whether, and how, the definition of a QTA may be expanded to include other parties. Finding of Abandonment A QTA may determine that an individual account plan is abandoned when (1) either (a) no contributions or distributions have been made for at least 12 consecutive months or (b) other facts and circumstances (such as a bankruptcy filing) known to the QTA suggest that the plan sponsor has abandoned the plan, and (2) following reasonable efforts to locate or communicate with the plan sponsor, the QTA determines that the plan sponsor (a) no longer exists, (b) cannot be located, or (c) is unable to maintain the plan. The proposed regulations provide guidance on steps deemed to constitute reasonable efforts to locate or communicate with a plan sponsor. Deemed Terminations Following a QTA's finding that a plan has been abandoned, the plan would be deemed to be terminated on the 90th day following the date on which the QTA provides notice to the Department of Labor of the plan's abandoned status and the QTA's election to serve in that capacity. The 90-day period is intended to provide the Department with an opportunity to review the determination and object to the termination. A QTA's notice to the Department would include (1) information about the QTA and its contact information, (2) the QTA's steps to locate or communicate with the plan sponsor, (3) a statement that the QTA elects to terminate and wind up the plan, and (4) an itemized estimate of any expenses the QTA expects to pay (including itself) as part of the termination process. The submission also would include information about the plan and plan sponsor. The proposed regulations provide a model notice for this purpose. Winding Up Plan Affairs Updating Records. The proposed regulations establish guidelines on how QTAs may wind up the affairs of abandoned plans. Among others things, a QTA would undertake reasonable and diligent efforts to locate and update plan records necessary to determine participant benefits, calculate the benefits payable to each participant based on such plan records, and engage service providers as necessary to wind up plan affairs. Notably, the 3 Department states that a QTA would not have failed to act reasonably and diligently merely because it determines in good faith that updating the records is either impossible or involves significant cost to the plan in relation to the total assets of the plan. Payment of Reasonable Expenses. The proposed regulations would permit QTAs to pay, from plan assets, the reasonable expenses of carrying out the QTA's responsibilities. An expense would be reasonable if: (1) the expense is for services necessary to wind up plan affairs and distribute benefits to the plan's participants and beneficiaries, (2) the expense is consistent with industry rates for the services, based on the QTA's experience, (3) the expense is not in excess of rates charged by the QTA (or affiliate) to other customers for comparable services, if the QTA (or affiliate) provides comparable services to other customers, and (4) the payment of the expense would not constitute a prohibited transaction or is otherwise exempt by virtue of an individual or class exemption under the prohibited transaction rules. As discussed below, the Department has issued a proposed prohibited transaction class exemption under which QTAs and their affiliates can be reimbursed or compensated for services performed pursuant to the regulations. Notice to Participants. As part of winding up plan affairs, a QTA must notify each plan participant and beneficiary regarding the termination of the plan. The notice must include (1) a statement that the plan has been terminated, (2) a statement of the participant or beneficiary's account balance and distribution options available under the plan, (3) a request for the participant or beneficiary to make an election regarding the form of distribution, (4) a statement explaining that in the event the participant or beneficiary fails to make an election, the account balance will be rolled over to an individual retirement plan (e.g., an IRA) or another account and invested in an investment product designed to preserve principal that provides a reasonable rate of return,3 and (5) the name, address and phone number of a person to contact with questions or to request additional information. The proposed regulations provide a model participant notice. Under the proposed regulations, the QTA would send the notice to the participant's last known address. If the notice is returned as undeliverable, the QTA, consistent with the duties of a fiduciary under ERISA section 404(a)(1), could take steps to locate and notify the missing participant or beneficiary pursuant to the Department's Field Assistance Bulletin No. 2004-02 on missing participants.4 Final Notification to the Department. Once all benefits have been distributed to participants and beneficiaries, the QTA would provide a final notice to the Department. The notice, among other things, would provide that (1) the plan has been terminated and all assets held by the QTA have been distributed based on the best available information, (2) plan expenses were paid out of plan assets in accordance with applicable federal law, and (3) in cases where the QTA paid itself 20 percent or more than it had estimated, an explanation of the overrun. The proposed regulations contain a model final notice. 3 See discussion below on the proposed fiduciary safe harbor for rollovers to IRAs. 4 See Institute Memorandum (#18065) to Pension Members No. 50-04 and Pension Operations Advisory Committee No. 66-04, dated October 4, 2004. 4 Plan Amendments The proposed regulations provide that the terms of the plan would, for purposes of Title I of ERISA, be deemed amended to the extent necessary to allow the QTA to wind up the plan in accordance with the regulations. QTA's Limited Liability Where a QTA carries out its responsibilities with regard to winding up the affairs of the plan, the QTA would be deemed to satisfy any responsibilities it may have under ERISA section 404(a) with respect to such activity, except for selecting and monitoring service providers. With respect to its selection and monitoring duties, if the QTA selects and monitors service providers consistent with the prudence requirements in "part 4 of ERISA," the QTA would not be held liable for the acts or omissions of the service providers with respect to which the QTA does not have knowledge. Internal Revenue Service The proposed regulations clarify a number of tax issues relating to abandoned plans. Specifically, the IRS has advised the Department of Labor that, provided the QTA satisfies three conditions, the IRS will not challenge the qualified status of any plan terminated under these regulations or take any adverse action against, or seek to assess or impose any penalty on, the QTA, the plan, or any participant or beneficiary of the plan as a result of such termination, including the distribution of the plan's assets. The conditions are as follows. First, the QTA should reasonably determine whether, and to what extent, the survivor annuity requirements of Code section 401(a)(11) and 417 apply to any benefit payable under the plan. Second, each participant and beneficiary must have a nonforfeitable right to the benefit as of the deemed termination date, subject to income, expenses, gains, and losses between that date and the distribution date. Lastly, participants and beneficiaries must receive notification of their rights under Code section 402(f). Proposed Safe Harbor for Rollovers from Terminated Plans As part of the abandoned plans guidance, the Department is proposing a fiduciary safe harbor for QTAs that roll over distributions pursuant to the proposed regulations. Where the conditions of the safe harbor are met, a QTA would be deemed to have satisfied the requirements of section 404(a) with respect to both the selection of an individual retirement plan provider and the investment of the distributed funds. The safe harbor would be limited to plans that are intended to be tax qualified under Code section 401(a). The proposed safe harbor is modeled on the Department's fiduciary safe harbor for automatic rollovers of mandatory distributions under Code section 401(a)(31)(B).5 Thus, for example, the rolled-over funds must be invested in an investment product that seeks to maintain a stable dollar value equal to the amount invested in the product in order to qualify under the proposed safe harbor. 5 See Institute Memorandum (#18052) to Pension Members No. 49-04, Pension Operations Advisory Committee No. 64-04 and Transfer Agent Advisory Committee No. 74-04, dated September 29, 2004. 5 Annual Reporting Rules The proposed regulations provide special reporting rules relating to abandoned plan filings. Specifically, a QTA would file a special terminal report for abandoned plans with the Department within 2 months after the end of the month in which the QTA completes the tasks set forth in the proposed regulations. The report would contain information such as the total assets of the plan as of the deemed termination date, the total termination expenses paid by the plan, and total distributions made. Effective Date The regulations are proposed to be effective 60 days after the final rules are published in the Federal Register. The Department invites comments on whether the final regulations should be effective earlier or later than the proposed date. PROPOSED PROHIBITED TRANSACTION EXEMPTION DOL also has proposed prohibited transaction relief for QTAs in connection with the termination of abandoned individual account plans. The proposed exemption would allow a QTA to use its authority to (1) select itself or an affiliate to provide services to the plan, and (2) receive fees for the services performed as a QTA. The exemptive relief would be conditioned upon the QTA's satisfaction of the proposed regulations' requirements, and provision, in a timely manner, of any other reasonably available information requested by the Department. The fees also would have to be consistent with industry rates for similar services, based on the experience of the QTA, and not in excess of rates charged by the QTA for the same or similar services provided to customers that are not terminated plans (if applicable). In addition, the proposed exemption would provide relief for transactions relating to rollovers from abandoned plans to IRAs. Specifically, a QTA could (1) designate itself or an affiliate as provider of an individual retirement plan or other account for the rollover of the account balance of the participant or beneficiary who does not provide direction as to the disposition of such assets, (2) make the initial investment of the account balance of the participant or beneficiary in the QTA's or its affiliate's proprietary investment product, (3) receive fees in connection with the establishment or maintenance of the individual retirement plan or other account, and (4) pay itself or an affiliate investment fees as a result of the investment in the proprietary investment product. To obtain prohibited transaction relief for these rollover-related transactions, the QTA must (1) meet the conditions of the proposed QTA regulations, (2) include a statement about the rollover in the regulation's prescribed notice to participants and beneficiaries, (3) establish and maintain the account for the exclusive benefit of the holder, spouse and beneficiaries, (4) align the terms of the account, including fees and expenses, with those applicable to comparable accounts established for other purposes, (5) invest the account in an "Eligible Investment Product," (6) provide investment returns no less favorable than those of comparable accounts, (7) refrain from charging a sales commission, and (8) allow transfers to other QTA-provided investments without penalty, or to other investments at other financial institutions. 6 Eligible Investment Product would be defined as an investment designed to preserve principal and provide a reasonable rate of return, consistent with liquidity, and would include a money market fund. In addition, account fees and expenses could not exceed those charged by the QTA for comparable accounts, could be charged only against income earned (with the exception of establishment charges), and could not be in excess of reasonable compensation within the meaning of Code section 4975(d)(2). Recordkeeping requirements, including a six-year retention period, would apply to the exemption. Thomas T. Kim Associate Counsel Attachment (in .pdf format)

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