

MEMO# 15520

January 7, 2003

DOL ISSUES REQUEST FOR INFORMATION ON AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS

[15520] January 7, 2003 TO: PENSION COMMITTEE No. 1-03 PENSION OPERATIONS ADVISORY COMMITTEE No. 1-03 RE: DOL ISSUES REQUEST FOR INFORMATION ON AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS The Department of Labor has issued a request for information ("RFI") relating to automatic rollovers of certain mandatory distributions to IRAs. As you may recall, section 657 of EGTRRA¹ made a direct rollover to an IRA the default option for involuntary distributions from qualified plans for amounts generally not in excess of \$5,000, but greater than \$1,000. The distributions must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the amount transferred to another vehicle or to receive it directly. The provision becomes effective after the Department issues final regulations under the provision, not later than three years after the date of EGTRRA's enactment. The RFI invites public comment on the Department's implementation of this statutory provision and identifies a number of issues (discussed below) for which it is particularly interested in receiving feedback. Comments in response to the RFI are due by March 10, 2003. We plan to discuss the RFI and the development of the Institute's comment letter at the upcoming Joint Pension and Pension Operations Advisory Committee Meeting on Wednesday, January 22, 2003, in Washington, DC (with video-conferencing participation available in Los Angeles, CA).² To the extent that you have comments or issues you would like to raise concerning the RFI prior to this meeting, please forward them to the undersigned at tkim@ici.org or 202/326-5837. 1 See Institute Memorandum to Pension Members No. 21-01 and Pension Operations Advisory Committee No. 35-01, dated May 31, 2001. Specifically, section 657 of EGTRRA added a new Code section 401(a)(31)(B)(i) to provide that, in the case of a trust that is part of an eligible plan, the trust will not be considered qualified unless the plan of which the trust is a part provides that the plan administrator must transfer a mandatory distribution to an IRA of a designated trustee or issuer, if the distribution is in excess of \$1,000 and the distributee does not elect to have the distribution paid to an eligible retirement plan or receive it directly. Section 657 also added a notice requirement to Code section 401(a)(31)(B)(i) requiring the plan administrator to notify the distributee in writing, either separately or as part of the Code section 402(f) notice, that the participant may transfer the distribution to another IRA. 2 For information about the January 22 Committee meeting, see Institute Memorandum to Pension Members No. 50-02 and Pension Operations Advisory Committee No. 85-02, dated December 24, 2002. 2 Specific Issues The Department is generally seeking to develop safe harbors under which the designation of an

IRA provider to receive the automatic rollover of assets and the initial investment choice of those amounts would be deemed to satisfy the fiduciary requirements of ERISA.³ The RFI specifies 14 areas for which the Department is particularly interested in receiving comments.⁴ Notably, a number of these items relate to fees or costs that may be imposed by IRA providers.

1. Standards for Safe Harbor Entity • What criteria should apply to the Department's determination that an IRA provider qualifies as a safe harbor entity? • Should the standards differ for IRA "accounts" versus "annuities"? • Should IRA providers that are plan service providers receive any special consideration if plan investments can be rolled directly in-kind without transaction fees for liquidating plan investments and purchasing IRA investments?
2. Standards for Safe Harbor Initial Investment • What criteria should apply to the Department's determination that an initial investment qualifies as a safe harbor investment, and should specific investment vehicles be included or excluded from the safe harbor? • If mutual funds are included, should they be limited to passively invested mutual funds such as index funds or include all publicly traded mutual funds? • Should the criteria include specific asset allocation standards?
3. Establishment Costs • What is the range of establishment costs that IRA providers charge for the establishment or set-up of IRAs that would receive an automatic rollover, and how do they vary? • What factors should be considered in determining the reasonableness of these costs imposed by an IRA provider under the safe harbor?

3 As background to the development of these regulations, the RFI discusses the guidance provided in Revenue Ruling 2000-36, in which the IRS approved a plan amendment permitting a direct rollover to an IRA as the default distribution option of involuntary cash-outs for amounts greater than \$1,000, but less than or equal to \$5,000. In the Revenue Ruling, the Department of Labor advised the Treasury Department and the IRS that in the context of such a default direct rollover arrangement, (1) the participant will cease to be covered under the plan where the distribution consists of the entire benefit rights of the participant, and (2) the distributed assets will cease to be plan assets. The Department noted, however, that (1) the selection of an IRA provider and IRA investments would be subject to ERISA's fiduciary standards and prohibited transaction rules, and (2) the plan provisions governing the default direct rollover must be described in the plan's summary plan description. See Institute Memorandum to Pension Members No. 36-00 and Pension Operations Advisory Committee No. 50-00, dated July 18, 2000; 2000-2 C.B. 140.

4 The RFI notes that any safe harbor standards developed by the Department would supplement the existing Treasury regulations setting forth the requirements for IRAs to maintain tax qualification status under the Code.

- 3 • Should regulations clarify that establishment costs are either an expense of the distributing plan or a charge to the IRA funds of the account holder?
4. Termination Costs • What is the range of termination costs that IRA providers charge for the termination or closure of IRAs of the typical size of an automatic rollover, and how do they vary? • What factors should determine the reasonableness of these costs under the safe harbor?
5. Maintenance Fees • What is the range of maintenance and administrative fees that IRA providers charge for IRAs of the typical size of an automatic rollover, and how do they vary? • What factors should determine the reasonableness of these fees under the safe harbor?
6. Investment Fees • What types of fees would be associated with the initial and ongoing investment of the IRA? • What factors should determine the reasonableness of these fees under the safe harbor? • Should the IRA principal be guaranteed with all investment fees, maintenance fees and establishment costs being charged to investment earnings?
7. Surrender Charges • What is the range of surrender charges that investment vehicles for IRAs of the typical size of an automatic rollover are subject to upon surrender or redemption, how do they vary, and what circumstances trigger their imposition? • What factors should determine the reasonableness of these charges under the safe harbor?
8. Transfers within One Year • Do IRA providers refund or waive in whole or in part establishment costs, termination costs,

maintenance fees or surrender charges for IRAs that are withdrawn or directly rolled over within one year of establishment by the account owner? • Should the Department consider refund or waiver features in determining whether an IRA provider or initial investment qualifies for safe harbor treatment? 4 9. Prohibited Transaction Relief • Is there a need for prohibited transaction relief enabling a plan sponsor to select itself or an affiliate as the IRA provider, or to choose an initial investment in which it may have an interest? • If relief is needed, what safeguards should be imposed under such relief? 10. Legal Impediments • What legal impediments are plan administrators likely to encounter in establishing IRAs for automatic rollovers on behalf of separating employees? • What legal impediments are financial institutions likely to encounter in designing and marketing IRAs for automatic rollovers? 11. Disclosure • Should the Department impose any additional disclosure requirements on safe harbor IRA providers? 12. Low-cost IRAs⁵ • Should IRA providers who offer low-cost IRAs for automatic rollover be given special consideration? • What criteria should be used to demonstrate low-cost or the promotion of the preservation of assets for retirement income by IRA providers? • What kinds of low-cost IRA products are available? 13. Current Practices • How many qualified retirement plans currently have mandatory distribution provisions, and what are those provisions? • How many mandatory distributions occur annually, what is the form of distribution, and what are the associated costs? 14. EGTRRA Provisions • What additional administrative costs will compliance with the EGTRRA automatic rollover requirements impose on qualified plans and the assets of plan participants? 5 Section 657(c)(2)(B) of EGTRRA provided that the Treasury and Labor Secretaries may provide, and shall give consideration to, providing special relief with respect to the use of low-cost individual retirement plans for purposes of the automatic rollover rules and for other uses that promote the preservation of assets for retirement income. 5 Finally, the Department requests that the anticipated annual impact of any proposals on small businesses and small plans (i.e., fewer than 100 participants) be addressed in responding to the issues above. Thomas T. Kim Associate Counsel Attachment (in .pdf format)